



REPUBLIC OF CROATIA



2010 PRE-ACCESSION ECONOMIC PROGRAMME

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1 OVERALL ECONOMIC POLICY FRAMEWORK AND OBJECTIVES

Economic policy framework and objectives of the Republic of Croatia are defined in strategic documents of the Government of the Republic of Croatia, namely the Government Programmes Strategy 2011 - 2013, the Economic and Fiscal Policy Guidelines 2011 – 2013 and the Pre-Accession Economic Programme (PEP). The process of preparation of these documents has been achieved through consultations of the Government of the Republic of Croatia with the relevant economic and social partners. In addition to the abovementioned documents, the backbone of economic policy is the Economic Recovery Program from April 2010 that includes both short-term, as well as medium-term and long-term measures for the recovery of the Croatian economy.

The main objective of the Economic Recovery Programme is the economic recovery and creating a competitive economy to achieve a high standard and life quality. Determinants of this Programme, as well as global and domestic economic moment have significant implications on the expected movement of economic policy in the period to which the Pre-Accession Economic Programme refers.

Specifically, the worldwide economic crisis has made significant impacts on macroeconomic trends in Croatia, leading to a fall of economic activity over the past two years. The period of economic crisis had, as expected, a lot of challenges, focusing on the overall economic and especially fiscal policy. However, appropriate measures and activities covered by the Economic Recovery Programme alleviated the possible stronger negative impacts of the crisis on the Croatian economy, and thus on public finances in Croatia. However, the strength of actual negative impacts of the global crisis on economic developments in Croatia presents us with the need for further efforts in achieving, first the economic recovery, and then a future acceleration of economic growth. In this sense, it is encouraging that as a result of a combination of measures taken in this direction, and influences of the recovery of the European economy, the Croatian economy, towards the end of 2010, has returned to the growth path as a first sign of economic recovery.

In these conditions, the fundamental objective of economic policy remains the maintenance of the macroeconomic stability and creation of conditions for recovery and sustainable economic growth. In the period until 2013 gradual acceleration of economic activity is planned. The projections of economic growth that are contained in the Pre-Accession Programme 2011 - 2013 are realistic, but also conservative. The reality of growth projections for that period lies in fact of the strength of global economic shocks that occurred in the last two years, and negative trends that the same have caused in the domestic economy. Trends in economic activity in Croatia in the coming period will be determined by the effects of described negative movements, strength and speed of implementation of structural reforms, but also with the world and specially European economic environment. In this sense, the implementation of measures of economic recovery, by the determined plan, with the absence of the additional external negative economic developments, will result in growth rates over the medium term that can be significantly above the levels estimated in accordance with this document. Conservatism contained in the projections of economic growth for the mentioned three year period directly translates to more conservative view on public finances. Terms of possible improved macroeconomic trends in relation to the central projection and adopted legal guidelines of the Fiscal Responsibility Act aimed at strengthening fiscal discipline, place fiscal policy on solid fundamentals of returning trend of prompt fiscal consolidation and reduction of budget deficits.

In this context, it should be taken into account and other aspects that can accelerate economic recovery and thus economic growth can be more pronounced. This certainly includes the fact that the completion of negotiations on Croatian accession to the European Union is expected by the mid-2011, and the very fact of accession to the European Union which will have positive implications on overall economic policy and give additional impulse to the Croatian economy. In addition, key measures of the Economic Recovery Programme related to the revival of the Croatian economy by creating a supportive entrepreneurial environment that will attract significant investments, strengthening of fiscal discipline, with the reform of public administration and efficient management of state assets and public enterprises and reform of the social security system, will provide significant boost to the economy as a whole. In particular, a new investment cycle supported by the measures of the Croatian Government and the acceleration of the privatization process should be also noted, which will make the private sector the main generator of economic growth and ensure the Croatian capital market a new stimulus to development. The state can not replace private initiative and responsibility, but it will create the foundations for the stimulating business environment.

In this regard, this year's PEP reflects the established fundamental objective of economic policy and elaborates in detail the macroeconomic trends and projections, future direction of fiscal policy, as well as key structural reforms to be implemented in the period 2011-2013.

2 MACROECONOMIC DEVELOPMENTS

2.1 CURRENT MACROECONOMIC DEVELOPMENTS

Real gross domestic product (GDP) declined by 5.8% in 2009. Looking at the expenditure side of GDP, almost all categories declined in real terms on a year-on-year basis. The largest decline in real terms was seen in goods and services imports which fell by 20.7% compared to 2008 and in goods and services exports which fell by 16.2%. Gross fixed capital formation fell by 11.8% and personal consumption by 8.5% in real terms in 2009. Government consumption was the only component which rose year-on-year in 2009 (0.2%). Looking at contributions to year-on-year real GDP growth in 2009, the contribution of personal consumption was -5.3 percentage points, the contribution of gross fixed capital formation was -3.4 percentage points, while the contribution of changes in inventories (which include statistical discrepancy) was -1.2 percentage points. The contribution of government consumption was neutral (0.0 percentage points). The contribution of goods and services exports to real GDP growth was -7.3 percentage points, however, owing to a bigger positive contribution of goods and services imports of 12.0 percentage points, the contribution of net exports was positive and stood at 4.7 percentage points.

The comparison between real GDP growth in 2009 and that projected under the previous year's PEP shows that the fall was 0.1 percentage points smaller than projected. The outturns of individual categories on the expenditure side also show smaller departures. The real fall in personal consumption was equal to while real growth in government consumption was 0.8 percentage points smaller than that projected. The real fall in gross fixed capital formation was 0.5 percentage points higher than that projected while the real fall in goods and services imports and exports was smaller than that projected. The real fall in goods and services exports was 1.4 percentage points smaller than that projected and the real fall in goods and services imports was 1.2 percentage points smaller than that projected.

In the first half of 2010, real GDP fell by 2.5% year-on-year, as a result of a 2.5% fall in the first and the second quarter. First third quarter estimates point to a real GDP growth of 0.2% and first estimates for the first three quarters point to a real fall of 1.6% year-on-year. On the expenditure side, gross fixed capital formation was the category which fell the most in the first half of 2010 compared to the same period 2009. They fell by 13.6% in real terms (real fall of 13.9% in the first and 13.4% in the second quarter). They were followed by goods and services imports which fell by 4.5% in real terms (-4.8% in the first and -4.2% in the second quarter), personal consumption which fell by 3.3% in real terms (-4.1% in the first and -2.5% in the second quarter) and government consumption which fell by 1.5% in real terms (-1.1% in the first and -1.8% in the second quarter). With a 5.5% year-on-year growth in real terms, goods and services exports were the only category which grew year-on-year in real terms in the first half of 2010 (3.6% in the first and 7.0% in the second quarter). As regards contribution to real GDP change, the largest negative contribution in the first half of 2010 of -3.8 percentage points came from gross fixed capital formation, followed by personal consumption (-2.0 percentage points), changes in inventories (-0.4 percentage points) and government consumption (-0.3 percentage points). By contrast, a positive contribution of 4.1 percentage points came from net exports as a result of positive contribution of goods and services exports of 1.9 percentage points and a positive contribution of goods and services imports of 2.2 percentage points.

Industrial production fell by 0.5% in the first, 3.3% in the second and rose by 0.1% in the third quarter of 2010, on a year-on-year basis. It declined 6.0% year-on-year in October, and 1.8% year-on-year in the first ten months of 2010. Broken down by activities, the largest contribution to the decline in industrial production in the first ten months came from manufacturing, i.e. manufacture of other non-metallic mineral products, manufacture of fabricated metal products, except machinery and equipment, manufacture of other transport equipment and manufacture of beverages.

Retail trade turnover fell in real terms year-on-year by 6.4% in the first quarter, 4.4% in the second quarter and rose by 1.7% in the third quarter of 2010. In October it rose by 0.3% in real terms. In the first ten months of 2010, retail trade turnover declined nominally by 1.9% and by 2.4% in real terms. Looking at the nominal retail trade turnover by branches, the most significant contribution to year-on-year decline in trade in the first ten months of 2010 came from textiles, clothing, footwear and leather goods and motor vehicles.

The number of tourist overnight stays increased by 2.6% year-on-year in the first ten months of 2010. In the first and the second quarter of 2009, the number of tourist overnight stays declined by 3.5% year-on-year, while the third quarter witnessed a 4.5% growth compared to the same period 2009. The number of tourist overnight stays increased by 0.2% year-on-year in October. According to balance of payments data, tourism revenues amounted to EUR 1.8 billion in the first half of 2010, a decrease of 4.9% compared to the same period of 2009.

The labour market in 2010 was characterised by further unfavourable developments as seen in the rising number of unemployed persons and a fall in the number of employed persons on a year-on-year basis. The average number of unemployed persons rose by 40,246 or 15.4% in the first eleven months of 2010, compared to the same period 2009. Preliminary data provided by the Central Bureau of Statistics (hereinafter: CBS) indicate that the average number of employed persons declined by 82,219 or 5.5% in the first ten months of 2010 on a year-on-year basis. Administrative unemployment stood at average 17.4% in the first ten months, increasing by 2.7 percentage points compared to the same period 2009. The Labour Force Survey data available for the first two quarters of 2010 also point to growing unemployment. The average Labour Force Survey unemployment rate stood at 11.8% in the first half of 2010, which is an increase of 2.7 percentage points compared to the same period 2009.

Such economic developments had an impact on development in wages, with nominal gross wages falling year-on-year in the first nine months. The average gross wage fell in nominal and real terms year-on-year in the first nine months of 2010, compared to the same period 2009 when they grew in nominal and real terms. The average nominal gross wage declined by 0.7% year-on-year in the first nine months of 2010, while the average real gross wage fell 1.6% on a year-on-year basis. Net wages fell slightly nominally on a year-on-year basis in the first half of the year, but recovered in the second part of the year as a result of income tax changes. The average net wage remained the same in nominal terms in the first nine months of 2010 and fell by 0.8% in real terms, compared to the same period 2009.

Following inflation deceleration to 2.4% in 2009, the year 2010 witnessed further alleviation of inflationary pressures. In the first ten months of 2010, inflation stood at 0.9%, and in October 2009, the annual consumer price index grew by 1.4%. On a year-on-year level, the largest contribution to price growth in October came from the prices of fuels and lubricants for personal vehicles and gas prices. By contrast, the prices of clothing and footwear made the largest contribution in terms of mitigating year-on-year prices growth in October. Core inflation fell by 1.0% on an annual level in

the first ten months of 2010, and by 0.7% in October. The industrial producer price index increased by 4.2% year-on-year in the first eleven months of 2010.

The average nominal exchange rate of the kuna against the euro in 2009 was HRK 7.34/EUR, depreciating by 1.6% compared to 2008. In the first ten months of 2010, the average nominal exchange rate of the kuna against the euro stood at HRK 7.27/EUR, appreciating by 1.1% compared to the same period 2009. In the first nine months of 2010, the real effective exchange rate of the kuna depreciated by 0.3%, deflated by consumer prices, or appreciated by 1.1% deflated by producer prices on a year-on-year basis. The nominal effective exchange rate of the kuna appreciated by 0.3% in the first nine months of 2010 compared to the same period 2009.

The year 2010 saw a small recovery in money (M1) which rose by 5.4% on average in the first ten months of the year compared to the same period 2009. Towards the end of October, money (M1) rose by 13.5% year-on-year, with the largest contribution to its increase coming from an increase in demand deposits. Total deposits with banks (demand deposits included) rose by 5.8% year-on-year during the same period. The most significant contribution to their increase came from foreign currency deposits which rose by 9.8%, in contrast with kuna savings and time deposits which fell steadily throughout the year on a year-on-year basis and whose fall amounted to 16.5% at the end of October. Such developments were the result of a substitution of a part of household kuna deposits by foreign currency deposits driven by the spillover of the financial crisis to the domestic market. At the end of October 2010, total liquid assets (M4) rose by 5.1% compared to the end of the same month 2009.

Total bank loans stood at HRK 265.4 billion at the end of October 2010. The year-on-year growth in total loans stood at 5.7% in October 2010. Kuna loans rose by HRK 8.9 billion and foreign currency loans rose by HRK 4.2 billion in the first ten months of the year. In the first ten months of 2010, household loans rose by HRK 1.8 billion, loans to corporates rose by HRK 6.7 billion while loans to the central government rose by HRK 3.5 billion. Household loans rose by 2.2% year-on-year in October, while those to corporates rose by 9.2% year-on-year. The year-on-year growth of housing loans, which account for 44.4% of total household loans amounted to 6.5%. Bank loans to the central government rose by 4.5% year-on-year in October 2010.

Current account deficit fell from 9.2% of GDP in 2008 to 5.5% of GDP in 2009. Such developments can largely be attributed to a year-on-year decline in the goods account deficit of 31.6%. The surplus in the services account fell by 18.4% compared to 2008. The fall in the surplus in the services account was largely due to a fall in tourism revenues which amounted to EUR 6.4 billion in 2009, falling on a year-on-year basis by 14.5%. The increase in the current account deficit in 2009 was also due to an increase in the income account deficit of 14.6%, while the surplus in the current transfers account fell by a small 3.2%. The coverage of goods and services imports by goods and services exports stood at 90.4% in 2009, increasing by 6.6 percentage points compared to 2008. The current account deficit in 2009 was largely financed by other investments, which recorded a net inflow of EUR 2.8 billion, a 7.7% decline compared to 2008. Net foreign direct investments stood at EUR 1.2 billion in 2009, a decline of 62.6% compared to 2008. The account of portfolio investment witnessed a net inflow of EUR 186 million in 2009. Net errors and omissions stood at EUR -828 million in 2009, while international reserves rose by EUR 896 million. The comparison between the projected current account deficit to GDP ratio under the previous year's PEP and the outturn in 2009 points to a lower deficit outturn of 0.2 percentage points of GDP.

In the first six months of 2010, the current account deficit stood at EUR 1.7 billion, declining year-on-year by EUR 1.1 billion or 38.8%. Such developments can be attributed to a year-on-year decline in the goods account deficit of EUR 894 million, a decline in the services account surplus of EUR 2 million, increased income account deficit of EUR 133 million and increased current transfers account surplus of EUR 38 million. Goods and services imports to goods and services exports coverage stood at 84.4% in the first two quarters. Developments in the financial account were characterised by a net inflow from other investment of EUR 562 million in the first six months, a decline of 70.9% compared to the same period 2009. Direct investment account recorded a net inflow of EUR 436 million, a 50.9% decrease compared to the first six months of 2009. The portfolio investment account recorded a net outflow of EUR 647 million in the first two quarters. Net errors and omissions were around EUR 1 billion, while international reserves fell by EUR 396 million in the first six months of 2010.

Goods exports rose year-on-year by 15.9%, while goods imports declined by 3.8% in the first ten months of 2010. If the category of other transport equipment is excluded from goods exports and imports, goods exports rose by 10.4% and imports fell by 3.3% in the first ten months of 2010. Goods imports to goods exports coverage ratio was 59.0% in the first ten months of 2010, an increase of 10.1 percentage points compared to the same period 2009. Looking at trade in goods by activities, the largest contribution to increased exports in the first ten months of 2010 came from manufacture of other transport equipment (year-on-year growth of 66.6%), manufacture of coke and refined petroleum products (36.6%), manufacture of chemicals and chemical products (40.6%) and waste collection, treatment and disposal activities, materials recovery (83.8%). The categories which made the largest contribution to a fall in goods imports in the first ten months of 2010 were manufacture of machinery and equipment (year-on-year decline of 24.1%), manufacture of motor vehicles, trailers and semi-trailers (-21.6%), electricity, gas, steam and air conditioning supply (-34.4%) and manufacture of other transport equipment (-23.8%).

Looking at the structure of goods exports by countries, Italy (18.9%), Bosnia and Herzegovina (11.4%), Germany (10.5%), Slovenia (7.7%) and Austria (5.3%) accounted for the largest share of the total Croatian goods exports in the first ten months of 2010. Goods exports to all these countries rose compared to the first ten months of 2009. Goods exports to Slovenia rose the most (21.6%), and were followed by Austria (15.1%), Italy (11.9%), Germany (9.4%) and Bosnia and Herzegovina (0.7%). Looking at trade in goods expressed in American dollars, goods exports grew by 12.7% year-on-year in the first ten months of 2010, while goods imports declined by 6.6%.

2.2 MID-TERM MACROECONOMIC PROGRAMME

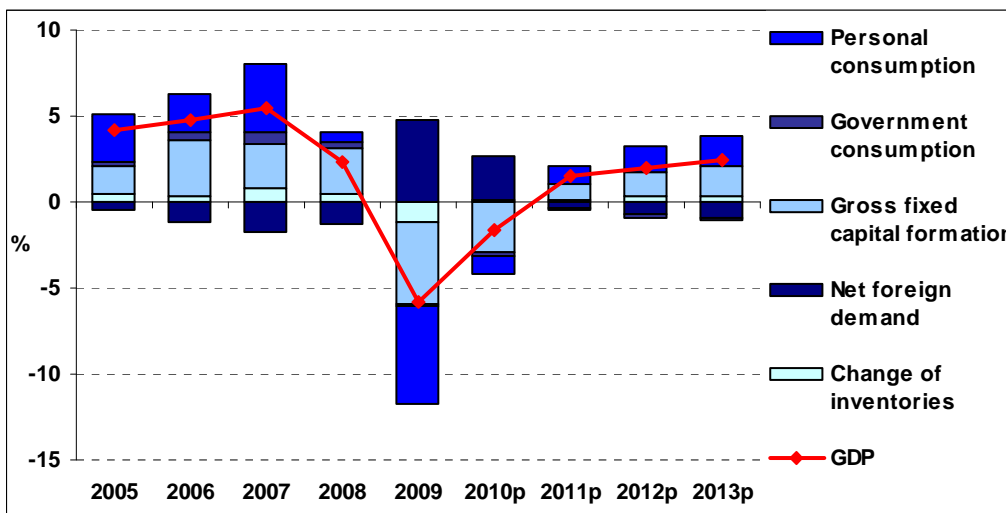
Macroeconomic projections are based on released GDP and balance of payments data for the first half of the year and other high-frequency indicators of economic activity available for the first ten months of 2010 i.e. data released until 15th of December 2010. In this programme, we use the same basic characteristics of the combination of macroeconomic policies as we used previously since they proved adequate under extremely unfavourable circumstances and, while taking into account the existing limitations, helped achieve the basic objective of maintaining macroeconomic stability. The potential of fiscal policy measures in addressing real economic contraction is limited due to the existing external imbalances. Against such a backdrop, further fiscal consolidation is an imperative necessary to ensure that foreign liabilities are regularly met and that long-term negative impacts on economic growth are prevented. Monetary policy will continue to be based on maintaining the stability of the exchange rate of the kuna against the euro while simultaneously ensuring adequate level of liquidity necessary for economic activity recovery. The realisation of such fiscal and

monetary policy measures will ensure that macroeconomic stability is maintained while at the same time ensuring economic activity recovery at rates which are sustainable over a long term.

2.2.1 Real Sector

Following a real fall of 5.8% in 2009, in 2010 GDP is expected to fall by 1.6% in real terms. The effect of further correction of domestic aggregate demand on GDP will be more pronounced than the effect of foreign demand recovery. However, looking at the developments in high-frequency indicators available so far, economic developments in the international environment, as well as relevant macroeconomic projections of economic growth in the world, most notably in the European Union, it seems likely that recession in Croatia hit its bottom in the first half of 2010. Therefore, following a further sharp fall in all GDP components, except goods and services exports, in the first half of the year, we expect to see a slowdown in negative economic developments and a beginning of economic recovery until the end of the current year. Accordingly, the estimated GDP fall for the entire 2010 stands at 1.6%. Projections for 2011 point to moderate recovery of Croatian economy and real GDP growth of 1.5%. In 2012, we expect to see a real GDP growth of 2.0% and its acceleration to 2.5% in 2013.

Figure 1: Contribution of Aggregate Demand Categories (in percentage points) to Real GDP Growth



Source: CBS, MF

Looking at GDP components on the expenditure side, in 2010 we expect to see a real decline in personal consumption of 1.9% and its significant contribution to a decline in economic activity. Despite a further sharp fall in personal consumption at the beginning of the year, the relevant high-frequency indicators show that recovery in personal consumption is already underway. Until end-2010, we expect to see a somewhat higher level of consumer optimism compared to the crisis period, particularly in view of the boost generated by the repealed special tax on salaries, pensions, and other receipts and legislative changes in the area of income tax. Generally, the real decline in personal consumption in 2010 will go hand in hand with the decline in household disposable income much more than in 2009. The most significant contribution to year-on-year fall in personal consumption in 2010 will come from its main component, the real wage bill, whose fall will accelerate additionally compared to the previous year. Employment fall in 2010 will be much more

pronounced than in 2009, while net wages will see a real fall similar to that in 2009, taking into account the effects of the special tax on salaries, pensions, and other receipts.

It should be noted that on an annual level we expect to see a bigger fall in gross wages than in net wages given the increase in the share of net wages in gross wages towards the end of the year, as a result of the mentioned legislative changes. The negative contribution to personal consumption in 2010, though in a much smaller absolute amount compared to the previous year, will also come from a real decline in consumer loans granted to households as a result of a smaller demand for loans on the one hand and smaller risk appetite on the other, as well as from the effect of increased repayments of the existing consumer loans granted to households. As shown by data on lending interest rates of banks in 2010 available so far, it is evident that average interest rates on consumer loans to households held steady at their 2009 levels or have even increased. Note should also be taken of the fact that unfavourable developments in the capital market coupled with surplus supply over demand in the real estate market, led to a fall in the value of total household assets. Government consumption is expected to decline by 1.0% in real terms in 2010 and thus make a small negative contribution to GDP change.

The most significant contribution to economic activity fall in 2010 will come from gross fixed capital formation whose real year-on-year fall is estimated at -11.7%. In the conditions of foreign demand recovery and further contraction in domestic demand, investments which fell sharply in real terms in 2009, slumped even further in the first half of 2010. However, despite persistently negative developments in business sector liquidity and solvency indicators and uncertainty as regards the speed of recovery, towards the end of the year we expect to see a partial recovery in business optimism and a slight heightening of investment activity and a slowdown in the fall of aggregate investments on a year-on-year level.

It should be noted here that the mentioned beginning of investment activity heightening will relate primarily to the equipment category which accounted for approximately 36% of realised gross investments in 2009, of which a little less than 70% was imported equipment. By contrast, the construction sector, the main generator of investment activity in the previous years, recorded extremely negative developments in 2010 so that the dynamics and the intensity of recovery in construction works which accounted for approximately 56% of the realised gross investments in 2009 is uncertain. Due to a fast growth in construction activity at the time of emergence of the economic crisis, longer-term nature of construction projects and connection to government investment cycle, the adjustment of the construction sector to the worsened conditions was slower so that high-frequency indicators in the construction sector only started falling significantly at the end of 2009, to accelerate sharply in 2010. Factors that should also be taken into account are a persistent gap between supply and demand for housing, with a slower fall in real estate prices than initially thought and persistently high interest rates on housing loans.

Further uncertainty as regards the growth dynamics of the largest world economies and fiscal difficulties encountered by some EU Member States only add to the insecurity on the foreign financial markets and make consolidation of global financial systems more difficult, thus limiting the possibility for direct corporate borrowing abroad and putting upward pressure on the price of capital. In addition, real interest rates of domestic banks on corporate loans have so far not come sufficiently close to a level that would provide a serious boost to investment activity. It is also necessary to mention the effort that the Government has made by incentive programs through the HBOR with the aim to encourage financing of companies. Note should also be taken of the fact that, despite acceleration in real growth in corporate loans granted by domestic banks that has taken place in 2010 so far, it is difficult, even over a short term, to give a general assessment of the

developments in financing conditions and capital availability, given that global financial markets, as well as the domestic market, and investors' risk appetite are characterised by large volatility and high degree of uncertainty. In 2010, we do not expect to see any significant inventory renewal on the part of the corporates either. We only project a small increase in the share of inventories in GDP (to 2.1%).

As regards net exports, in 2010 we expect to see its significant positive contribution to economic activity, though smaller than that in 2009. Namely, as a result of a further fall in domestic demand, we expect that goods and services imports will fall by 1.9% in real terms, though in the light of the previously described macroeconomic developments, in the second half of 2010 imports will begin to grow on a year-on-year basis after falling steadily for one year and a half. As a result of the described decline in investment demand, the imports of capital goods are expected to fall significantly in 2010. A decline in personal consumption will result in a negative or negligible real contribution of the imports of household consumption-related goods such as consumer goods and food products while small demand for cars will lead to a significant fall in imports of transport equipment. As a result of total economic activity weakening, no significant positive real contribution to goods and services imports is also expected to come from other categories under the Classification by Broad Economic Categories. The projected goods and services exports growth of 4.2% in 2010 is based on the expected further recovery in foreign demand until the end of the year. Taking into account the envisaged further recovery in economic activity of major Croatian export partners and the data released so far on goods exports, we expect to see a sharp increase in goods exports. As regards services exports, favourable developments in volume indicators in tourism and the expected stagnation in average tourist consumption relative to the previous year, point to a small increase in services exports.

The fall in the economic activity in 2010 will also be accompanied by negative developments in the labour market whose intensity, however, are expected to subside towards the end of the year. The Labour Force Survey employment rate will fall by 3.9% in 2010, while the Labour Force Survey unemployment rate is estimated at 12.0%. More than a twice faster fall in the Labour Force Survey employment rate than GDP fall in 2010 will result in the growth of average labour productivity of 2.4%. Looking at both crisis years, the year 2009 and the year 2010, it can be claimed that developments in wages were characterised by moderate rigidity and that employment was characterised by a much bigger adjustment to negative changes in macroeconomic conditions. Following two years of strong growth, as a result of increased average labour productivity and a simultaneous fall in gross wages, in 2010 we expect to see a fall in unit labour costs.

In 2011 and subsequent years, we expect to see a real growth in all components of GDP on the expenditure side except government consumption. In 2011, we expect to see recovery in personal consumption and its growth of 1.8% and further acceleration to 2.5% in 2012 and 2.8% in 2013. It should be noted here that over a medium term contributions to real growth in personal consumption by all its components, though positive, will be smaller compared to the period preceding the crisis. Firstly, in the forthcoming period we expect to see a higher level of consumer optimism, though it should be stressed that, although the marginal propensity to consume will rise during that period, it will not reach levels recorded in the preceding years. Secondly, in 2012 we also expect to see a moderate contribution to personal consumption growth to come from a real net wage bill that will be somewhat smaller than in 2011 owing to the previously mentioned legislative changes regarding wages in 2010 but that will rise again in 2013. However, assuming that over a medium term, the growth in real gross wages will not exceed labour productivity, the expected postponed and slower employment recovery also means a slower dynamics of household disposable income compared to the years preceding the economic crisis.

In the forthcoming years, we also expect to see a positive contribution to personal consumption growth from real growth in consumer loans to households, though on a much smaller scale than in the period up to 2008, both as a result of factors on loan demand and supply side, so that we will see much smaller contributions to personal consumption growth from this source. Certain positive impacts on personal consumption in the forthcoming years are also expected to come from an increase in the value of household financial assets and a small decrease in lending interest rates of banks compared to the crisis period, as well as from positive psychological effects of pending accession to EU membership. The projection of government consumption points to a small real decline until the end of the projection period. In 2011, government consumption is expected to fall by 0.5% and in 2012 and 2013 by a somewhat larger 1.2% and 0.9%, respectively.

Over a medium term, private sector investment consumption is expected to become again an important generator of economic growth. But, assuming that foreign capital inflows will not be as ample as in the pre-2008 period, business sector financing will rely primarily on the domestic financial system. Given the shallow and underdeveloped financial market and the still limited potential of other credit institutions, this will mainly involve domestic banks. Although over a medium term credit activities of banks will be slower than in the period preceding the crisis, it is expected that, unlike previous years when bank loans were channelled mainly to personal consumption and goods and services imports financing, in the forthcoming years we will see an increase in domestic financing of the corporate sector while equilibrium interest rates of that segment of the financial market will enable a more development-oriented allocation of funds, all under the assumption of global financial system stability.

Also, partly as a positive externality of economic crisis but also as a consequence of the approaching accession to the EU, a certain favourable structural transformation of the economy in the crisis years and structural reforms implemented or pending implementation by the Government of the Republic of Croatia are expected to enhance overall economic efficacy. Accordingly, in 2011 we expect to see a growth in gross fixed capital formation of 3.0%, mainly relating to equipment renewal on the part of the private corporate sector, with the presence of the base effect and still no significant contribution of investment in construction. The growth of gross fixed capital formation will accelerate to 4.4% in 2012 and 5.8% in 2013. The process of corporate sector inventory renewal will, in accordance with what has been stated so far, stretch over the entire projection period, and will reach its peak intensity in its last two years. Inventories in 2011 will thus reach the level of 2.2% of real GDP and 2.5% and 2.8% in 2012 and 2013, respectively.

Provided further stabilisation of economic conditions in the country and further economic growth of major economic partners are achieved, we expect that the contribution of net exports to economic growth will again be negative in 2011, reaching -0.9 percentage points in absolute terms until 2013. In other words, towards the end of the projection horizon, we expect to see a more pronounced acceleration of goods and services imports than exports. However, it should be noted that the negative contribution of net exports that is expected to take place towards the end of the observed period is still lower compared to that in the years preceding the year 2008. In 2011, we expect to see a real growth in goods and services exports of 4.4% and a real growth in goods and services imports of 4.7%. The real growth in goods and services exports will accelerate to 4.8% in 2012 and to 5.9% in 2013, while the real growth of imports will accelerate to 5.6% in 2012 and 6.8% in 2013.

In 2011, we expect to see an increase in the Labour Force Survey employment of 0.6% and a decrease in the Labour Force Survey unemployment rate to 11.7%. In 2012, employment will grow by 1.3% and the Labour Force Survey unemployment rate will fall to 10.8%. At the end of the

projection period, we expect to see a further growth in employment of 1.3% while the Labour Force Survey unemployment rate will fall to 10.0%. The growth of average labour productivity will decelerate to somewhat below one percent in 2011 and 2012 to exceed one percent in 2013. In accordance with the developments in gross wages and average labour productivity, after decreasing in 2010, unit labour costs will see only a negligible growth in 2011. In the last two years of the projection period, the growth of unit labour costs will accelerate again although it will again remain significantly lower than that in 2008 and 2009.

2.2.2 Inflation

The average annual rate of inflation in 2009 was 2.4%, a 0.1 percentage points below the rate projected under the previous Pre-accession Economic Programme (2010-2012). This was the result of a much sharper than expected fall in the prices of individual products in December 2009 (most notably meat, clothing and footwear and cars) compared to the previous month.

Table 1: Index of Consumer Prices (average year on year change)

	2009	2010p	2011p	2012p	2013p
CPI, PEP 2010 - 2012	2.5	2.7	3.0	3.0	
CPI, PEP 2011 - 2013	2.4	1.1	2.2	2.5	2.5

Source: CBS, MF

The annual rate of inflation of consumer prices fell from 1.9% in December 2009 to 1.4% in October 2010, mainly as a result of a deceleration of year on year change in price of services. Additionally, annual growth in prices of processed food decelerated and intensified decrease in prices of industrial products (excluding food and energy) on annual level. Domestic factors which contributed to inflation slowdown included a fall in personal consumption as a result of a steady fall in household disposable income and consumer pessimism. Moreover, the decline in labour unit costs on an annual level, as a result of adjustments on the labour market (a larger fall in employment than in manufacturing and a fall in compensations of employees on an annual level) suggests a fall in domestic inflationary cost pressures in the economy. The effect of the base period also had a favourable impact on the fall in the annual rate of inflation in the first ten months of 2010, given that the effect of a significant growth in administered prices and excise duties on tobacco products in the same period of year 2009 had vanished. On the other hand, the contribution of energy prices to the total yearly inflation increased during the observed period which was a result of increase in crude oil prices in the world markets. Furthermore, the contribution of unprocessed food products increased which was partially a result of unfavourable base period effect, i.e. the result of the fact that decline in the prices of vegetables during the summer months was smaller than in the same period of 2009. Additionally, the prices of fruit recorded an increase during the summer months of 2010 instead of usual seasonal decline. Similar developments of vegetable and fruit prices were also realized in Eurozone, which is attributed to the unfavourable weather conditions.

Imported inflationary pressures increased in the first ten months of 2010 as a result of an increase in the price of energy and other raw materials (most notably food raw materials, textile fibers, ferrous metals and iron ores) on the world market and marked depreciation of the euro against the American dollar. However, against the backdrop of fallen demand, a large number of producers did not transfer the increased costs of energy and other raw materials to the consumer, but have instead

partly reduced their profit margins. This can be seen in the relatively low annual rates of change in producer prices of durable and non-durable consumer goods which in October 2010 stood at 0.4% and -0.1%, respectively. It should be stressed, however, that import pressures began to show in the developments in producer prices of food products whose annual rate of change accelerated from -1.8% in June to 3.9% in October 2010, and in the developments in some food products from the consumer price index (such as oil, sugar, confectionery and coffee) in the second part of 2010. The increase in the prices of textile fibers on the world market led to an increase in domestic producer prices of textile intermediate products, whose annual growth rate stood at approximately 8% in October 2010.

As regards inflation estimates for the entire 2010, the average annual rate of inflation might fall from 2.4% recorded in 2009, to 1.1% in 2010, and that mainly as a result of a fall in the average annual rate of change in the prices of food and a slowdown in the growth rate of consumer price index, excluding food and energy. The estimation is based on the fall in domestic personal consumption, reduced domestic cost pressures and low domestic and foreign inflation of producer prices for personal consumption. It has been estimated that in the conditions of poor demand, producers and traders will largely refrain from transferring the increase in the cost of energy and other raw materials to end-users so the mentioned import pressures might only start affecting consumer price inflation in 2011. However, the average annual rate of change in the consumer price index energy price is expected to increase in 2010 compared to 2009, due to increased prices of crude oil on the world market, depreciation of the exchange rate of the kuna against the American dollar and increased price of gas.

The estimated average annual rate of inflation in 2010 will be 1.6 percentage points lower than that forecast under the previous PEP. The main reason for this lies in a much sharper fall in consumer prices in the last quarter of 2009 and particularly in December which resulted in a much smaller effect of inflation transmission from 2009 to 2010.

In 2011, we expect that the rate of inflation will accelerate to 2.2%¹, though it will still remain low, given low inflationary pressures expected as a result of recovery in domestic demand, while we expect to see a fall in domestic cost pressures, since no significant increase in unit costs is expected in 2011. Imported inflationary pressures due to increased prices of oil and other raw materials on the world market are expected to be smaller than those in 2010. Inflationary pressures in 2011 might come from companies' efforts to transfer, in the conditions of mildly growing demand, some of the increase in the price of energy and other raw materials (particularly food and textile) to end-users and to restore profit margins to their previous levels.

In 2012 and 2013, inflation is expected to rise slightly to 2.5% and remain stable and low. Among domestic factors that might drive this increase in inflation is the expected growth in domestic demand. Global economic recovery might also cause increased imported inflationary pressures as a result of an increase in the prices of raw materials and finished products on the world market.

Among the risks which could have impact on significant increase in overall prices in 2011, the risk of more pronounced spillover of food raw materials price increases in the world market² to the domestic food products than projected should be pointed out. Unfavourable weather conditions might cause a marked growth in the prices of domestic agricultural products. Also, one of the risks

¹ The 2010 inflation transmission might reach 0.7 percentage points (an increase of 1.0 percentage points compared to the previous year).

² Which was due to unfavourable weather conditions, such as drought and fires in Russia this summer and in some other major wheat exporters such as Ukraine and North America.

to the realisation of inflation forecast is the chance of a larger than projected increase in the prices of oil and other raw materials on the world market, should the global economic recovery be better than expected. In addition, a more pronounced depreciation of the exchange rate of the kuna against the American dollar might lead to higher inflationary pressures. An additional factor that might lead to a higher than expected increase in the annual rate of inflation lies in a possible increase in the price of electricity, gas and heating in 2011. By contrast, one of the main downside risks to inflation forecast lies in weaker domestic demand recovery in 2011.

2.2.3 Monetary and Exchange Rate Policies

The Croatian National Bank (CNB) pursues its main objective, price stability, by maintaining the stability of the exchange rate of the kuna against the euro as the main nominal anchor of the monetary policy. The selection of such an exchange rate policy reflects the conditions in which the central bank operates, most notably a high degree of euorisation of the domestic financial system and the open character of the Croatian economy. In such conditions, the developments in the nominal exchange rate of the domestic currency strongly influence the developments in domestic prices, inflationary expectations, financial stability of the banking system and overall economic activity.

In the first nine months of 2010, foreign capital inflows were again one of the key factors that determined monetary policy, though these inflows were much lower compared to the period preceding the global financial crisis. In the first five months of 2010, supply and demand on the foreign exchange market were relatively balanced, while June 2010 saw an increase in appreciation pressures driven by seasonal inflows of foreign currency from tourism revenues, expectations of market participants regarding foreign and domestic government borrowing (with a foreign currency clause) and smaller corporate demand for foreign currency due to a contraction in the foreign trade deficit. At three foreign exchange interventions, conducted in June and July 2010, the CNB purchased EUR 363.7 million, thus halting the strengthening of the exchange rate of the kuna. After these interventions, the exchange rate of the kuna against the euro stabilised and began depreciating slightly in the second half of the quarter. The CNB conducted two foreign exchange interventions in November, selling EUR 350.1 million to the banks. Looking at the first ten months of 2010, the nominal exchange rate of the kuna against the euro depreciated year-on-year by 1.1%. The international reserves of the CNB rose by 6.8% in the first ten months of 2010, reaching EUR 11.1 billion at the end of October. The growth in international reserves received an additional boost from foreign currency government deposits placed temporarily with the CNB, raised through a government bond issue abroad.

In 2010, the central bank continued to act towards maintaining high kuna liquidity of the monetary system with a view to improving financing conditions on the domestic market and encouraging recovery in the credit activities of banks that will focus on domestic economy. High kuna liquidity which was generated by means of foreign exchange auctions with the banks and direct transactions with the central government in the last quarter of 2009, did not change much in 2010. The average liquidity surplus (overnight deposits with the CNB included) in the first nine months of 2010 stood at HRK 4.3 billion. The policy of maintaining a high level of liquidity has so far no negative effects on developments in the exchange rate of the kuna against the euro, and at the same time it contributed to interest rates fall and stabilisation in money market interest rates and a fall in short-term interest rates on corporate kuna loans. Therefore, in the forthcoming period, the CNB will continue to support good liquidity to boost credit activities of banks, particularly those geared towards the corporate sector. It should be emphasized though, that central bank will maintain

favourable liquidity just to the extent allowed by the market conditions and foreign exchange rate developments, i.e. to the extent which will not jeopardize exchange rate stability, the key anchor of the financial and overall economic system stability.

The central bank also used other measures to revive credit activities of banks in 2010. At the beginning of February 2010, the CNB issued a decision on the reduction of the reserve requirements rate from 14% to 13%, thus releasing funds earmarked, together with bank funds, for loan financing within the framework of a programme of incentives of the Government and the Croatian Bank for Reconstruction and Development (HBOR). The cut in the reserve requirements rate also meant reduced regulatory costs of funding sources for banks which also contributes towards increasing the banks' credit potential and reducing interest rates.

More favourable monetary environment notwithstanding, further negative trends in the real sector of the economy still prevent any sizeable recovery in credit activities. In the first ten months of 2010, we saw only a moderate year-on-year growth in bank placements to the private sector, most notably the corporate sector, while household lending did not start recording positive year-on-year growth rates until the second half of the year. The growth in corporate placements might be associated with a gradual fall in lending interest rates, a cessation in this sector's foreign borrowing and, partly with the realisation of loans granted under government incentives in co-operation with HBOR, which amounted to HRK 1.6 billion. Following a sharp increase in the first half of 2010, banks' net placements to the government fell in July owing to inflows from bond issues on the domestic and foreign market. In line with a small growth in loans, monetary aggregates also grew moderately in the first ten months of 2010 (money, M1, rose by 7.4% and total liquid assets M4 by 4.2%) and similar developments are expected in the forthcoming period.

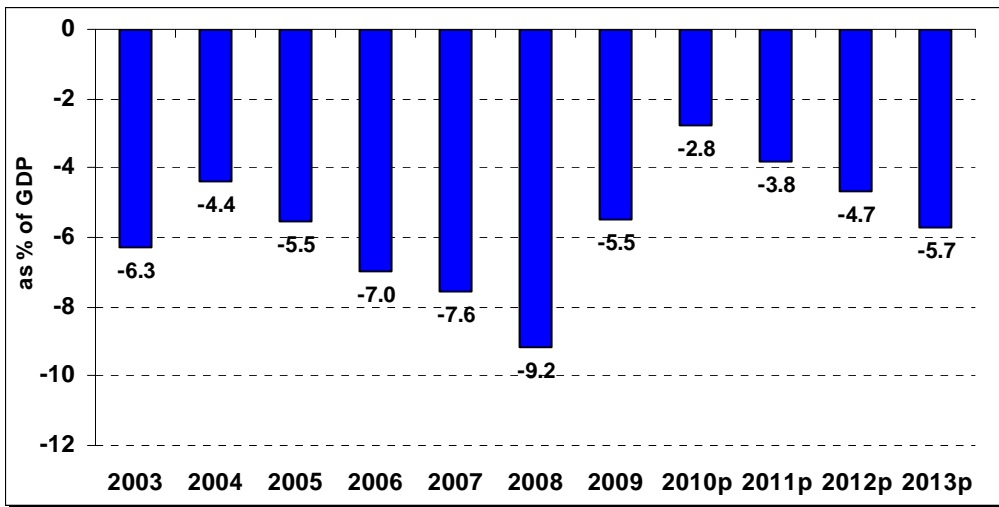
Unfavourable macroeconomic developments also had an impact on the quality of credit portfolios of banks which continued to worsen steadily in 2010. The share of irrecoverable loans rose from 7.8% at the end of 2009 to 9.5% at the end of the first half of 2010. Increased loss provisions led to a fall in bank returns, but did not undermine banking system stability. Its ability to withstand shocks is also due to a relatively high banking system capitalisation which stood at 19.0% at the end of June 2010, much above the prescribed level³.

2.2.4 External Sector

The last quarter of 2009 was marked by a further reduction in the current transactions deficit, with current account deficit falling by almost one half in 2009 compared to the year before and stood at 5.5% of GDP or only a little below the value projected under the previous PEP (5.7%). This contraction was entirely due to a marked fall in the volume of foreign trade, particularly on the side of the imports, which, owing to their much higher value resulted in a one third smaller deficit in the trade in goods. At the same time, developments in other sub-accounts were unfavourable, as seen in the services account surplus fall owing to lower tourism revenues, widening in the factor income account deficit, mainly attributable to a sharper fall in revenues than expenditures, particularly those based on interest expenses, and a small fall in the positive current transfers account balance.

³ Since March 2010, the minimum capital adequacy ratio has been raised from 10% to 12%, thus offsetting the effect of lenient calculation of risk exposure in the context of application of Basel II standards which also entered into force in March.

Figure 2: Current Account Balance



Source: CNB, MF

The negative trends started subsiding in individual areas towards the end of 2009 and in early 2010, with goods exports starting recording growth in the first quarter of 2010. At the same time, imports continued to contract steadily, though at a slower rate, and the negative trends were halted by mid-year. Further contraction in the trade in goods deficit thus determined again developments in the current account deficit, which fell by 38.8% in the first half of 2010. A lower negative balance was also seen in the income account as a result of smaller expenditures, mainly due to a fall in interest expenses of the domestic sector associated with lower interest rates on the world market. Balances in the services and current transfers accounts were similar to those in the previous year.

The main determinant of developments in the current account in the remaining part of 2010 will be trade in goods. Preliminary data on the developments in trade in goods in the first ten months of 2010 point to its further recovery and further dynamic growth in exports and acceleration in imports growth until the end of 2010. Exports of oil and petroleum products is expected to, particularly owing to developments in the third quarter of 2010, grow by over one quarter on an annual level. Much slower but stable growth should be seen in the exports of other goods, with total exports increasing by 11.6% in 2010 relative to the previous year. By contrast, a reverse in the trend of imports did not take place until mid-2010 so further strengthening of imports is expected to take place in the second half of the year. However, imports are expected to hold steady on overall 2010 level, as a result of negative developments at the beginning of the year. As a result of such developments in imports and exports, the trade deficit might fall by one tenth compared to the previous year and stand at EUR 6.6 billion. Developments in the current account in 2011 will also mainly be determined by trade in goods that might be characterised by growing dynamics in imports and stable exports growth. This could lead to the widening of the deficit by one tenth in which case it would reach its 2009 level. The trade in oil and petroleum products could have a significant impact on its widening and so could, though on a much smaller scale, a smaller net export of ships. In the forthcoming years we expect to see similar developments, though with a somewhat faster growth in imports than exports and a consequential further widening of the trade deficit.

The balance of services account in 2010 will record only mild increase, as a result of decrease in negative balance of other services and increase in net revenues of transportation services. In the same time, mainly as a result of developments in the third quarter, tourism revenues could record

mild drop in 2010 as a whole. With the expected strengthening of economic recovery in major tourist-generating markets, in 2011 we expect to see an increase in the number of tourist arrivals and recovery in their consumption which dropped considerably in the previous two years. Therefore, following stagnation in tourism revenues in 2010, in 2011 we expect to see a small recovery in tourism revenues and a continuation of this trend in the remaining part of the projected period.

As regards developments in the income account, the deficit in 2010 might be lower by some EUR 0.2 billion than in 2009, largely as a result of a lower deficit arising from debt and equity investment. Opposite developments might take place in 2011, where we expect that deficit growth might be driven by developments in income from investment. With gradual improvement in companies' business performance, we expect to see a noticeable increase in expenditures from direct equity investment, most notably retained earnings of foreign-owned domestic companies. However, a small increase in revenues that might be spurred by recovery in bank and central bank income from foreign asset investment, might offset to an extent total deficit widening. Further widening of the income account deficit until 2013 will largely be driven, in addition to a steady increase in expenditures based on equity investment, by growing net interest expenses resulting from the accumulated debt.

As regards the current transfers account, in 2010 we expect to see a small increase in the positive balance which has not been revised significantly compared to projections under the previous PEP. This increase relative to 2009 should be the result of an increase in government revenues, which already took place in the first half of 2010. As regards developments in the remaining part of the projection period, we expect to see a somewhat faster growth in net revenues in the light of the process of accession to the European Union and the associated transfers to the domestic sectors.

Accordingly, the expectations regarding current account deficit for the entire 2010 point to a much narrower deficit than that in 2009. From 5.5% of GDP in 2009, it might fall by almost three percentage points to 2.8% of the projected GDP in 2010. With recovery in economic activity and domestic demand, in the forthcoming years we expect to see again a further widening of the imbalance in foreign trade in goods and consequently in the overall current account. We expect that the relative indicator of deficit will reach 3.8% of GDP in 2011 and over 5% of GDP until 2013.

The described projection of the current account deficit in 2010 has been revised downwards from 6.0% of GDP to 2.8% of GDP, relative to the previous PEP, suggesting its large contraction, in contrast with its previously expected widening. This is the result of a fall in the economic activity in 2010 and a large contraction in domestic demand, in contrast with the expected small economic recovery envisaged under the previous PEP (0.5%). Deficit projections for the forthcoming years have also been revised downwards, in line of the latest estimate of current year developments.

Foreign capital inflows, changes in international reserves excluded, were very small (EUR 0.3 billion) in the first half of 2010 and mainly involved foreign direct investment and withdrawal of cash and deposits of banks. The decline in foreign debt liabilities that took place during the same period, cross-currency changes and differences in coverage excluded, corresponded to changes in external debt. In the second part of 2010, in the light of smaller current account deficit financing needs and the persistent insecurity on the financial markets, we might see relatively modest net capital inflows. With an increase in the current account deficit in 2011, we expect to see a somewhat greater need for foreign financing, however, foreign capital inflow in the private non-financial sector might remain relatively small.

Foreign direct investment in Croatia might amount to approximately EUR 1.5 billion in 2010, a level similar to that in 2009, round-trip investments excluded⁴. The largest direct equity investments will be seen in trade, tourism and construction as well as in other activities in projects already underway. The amount of retained earnings could exceed somewhat that achieved in 2009 provided a significant fall in losses incurred in individual activities, most notably oil industry and leasing companies business is achieved. However, a fall in banking profits might offset some of the recovery in these activities. Borrowing from ownership related companies, which also constitutes direct investments, will probably remain as modest as in the first half of 2010. Investor interest might remain relatively small next year so we expect to see only a slight increase in foreign direct investment compared to 2010, and similarly small but steady growth is also expected in the periods after that.

In addition to inflows from equity investments, debt liabilities might also continue to grow relatively modestly because, slow economic recovery notwithstanding, we do not expect to see any significant increase in foreign borrowing. In the first seven months of 2010, the amount of foreign liabilities paid by domestic sectors exceeded the amount of new borrowing. Nevertheless, foreign debt stock increased slightly due to cross-currency changes. Of the domestic sectors, only the government sector borrowed more heavily. Although we expect that the negative effects of cross-currency changes will wear off somewhat in the remaining part of the year, the projection envisages an increase in the debt stock, due to the expected further borrowing of the central government and the banks and a very small increase in corporate debt. In general, the total debt stock in 2010 might increase by EUR 2.3 billion and reach EUR 45.4 billion at the end of the year, with the relative indicator of foreign debt rising to 100.6% of the estimated GDP (up from 94.9% in 2009). Very small economic recovery expected in 2011 will probably not prompt a new cycle of large foreign borrowing, with debt growth possibly taking place in banks, in line with heightened credit activity and in the central government, due to increased need for budget deficit financing. The expectations are that the gross external debt will grow only slightly in the forthcoming years, and that we might see, in the light of growth in the nominal amount of gross domestic product, a stabilisation in the gross external debt to GDP ratio at levels of about 100%.

The December 2009 Regulation on amendments to the Foreign Exchange Act provided for the postponement of full liberalisation of the capital account, i.e. liberalisation of deposit transactions of residents abroad and granting of short-term financial loans to non-residents. In this context, it should be noted that full liberalisation of granting short-term financial loans to non-residents entered into force on 1 July 2010 and full liberalisation of deposit transactions of residents abroad will enter into force on 1 January 2011.

⁴ Total foreign direct investments in 2009 stood at EUR 2.1bn, of which EUR 0.7bn went to round-trip investments (an increase in direct debt investments in Croatia and direct equity investments abroad). In the first half of 2010, a share of these investments (EUR 0.4bn) was transformed into equity capital which resulted in a simultaneous decline in direct debt and an increase in direct equity investment, with no impact on total foreign direct investments in the RC. It is estimated that until the end of the year, additional EUR 0.9bn in round-trip debt investments will be transformed into equity capital, which will also lead to an increase in direct equity investment and a similar decline in direct debt investments.

3 PUBLIC FINANCES

3.1 GENERAL GOVERNMENT BALANCE AND DEBT

3.1.1 Fiscal Policy and Medium-Term Objectives

In the forthcoming mid-term period, the key objective of the Government of the Republic of Croatia will lie in the preservation of macroeconomic stability and in the creation of conditions for recovery and stable economic growth. Fiscal policy will be directed towards consolidation of public finances, and the Fiscal Responsibility Act⁵ adopted by the Parliament on 23 November 2010 will play a crucial role in this context. The Act came into force on 1 January 2011.

A significant contribution to the achievement of fiscal policy objectives will be provided by structural reforms, described in more detail later in this document.

In this context, fiscal policy will act towards fulfilment of the twelve general objectives laid down in the Strategy of Government Programmes for the 2011-2013 period:

- *macroeconomic and economic stability* – this objective will be achieved through efficient management of public finances and further improvement of budget processes, strengthening of the internal financial controls systems in the public sector, further development of macroeconomic statistics, fair and effective revenue collection and capacity strengthening for the use of European Union funds;
- *optimum environment for the development of a competitive economy* – this objective will be achieved by means of a more effective use of national resources through increased competitiveness and a sustainable energy system, implementation of the measures for strengthening the competitiveness of economic entities, including restructuring and development of individual industrial branches, incentives for the development of the small economy, incentives for economic development on the islands and in the coastal region and inspection supervision of the work of economic inspectors in the areas of catering, tourism and trade, strengthening the development, competitiveness and flexibility of the labour market and improving the protection of economic interests and safety of consumers;
- *strengthening of the state of law and the rule of law* – this objective will be achieved through further implementation of the reform of the judiciary that is aimed at creating the preconditions for independence, unbiasedness and professionalism of the judiciary, speeding up of court proceedings and judicial authorities network rationalisation, improving the protection of human rights and freedoms, as well as prison system improvement, combating of corruption and organised crime, rationalisation of the system of government administration and reform of the system of local and regional self-government and the development of an efficient system of civil service human resources management and development;
- *promoting knowledge, excellence and culture* – this objective will be achieved through the development of an economical and effective network of educational institutions, the establishment of the system of quality assurance on all educational levels and the development of the system of sports and sports activities, the establishment of an IT society, the development of cultural and artistic activities and further protection and maintenance of cultural heritage;

⁵ Official Gazette 139/10

- *uniform regional development* – this objective will be achieved through the promotion of development of counties and statistical regions and sustainable development of less developed regions, the development of borderline areas and strengthening of cross-border co-operation, forest management, sustainable development of water management and transport system development;
- *strengthening of social justice* – to achieve this objective, further measures will be taken that are aimed at improving the quality of life of vulnerable groups, expanding the network of services to new communities and users, improving the quality of services and service providers, local employment regarding the provision of social services, and encouraging and promoting volunteer work, social empowerment of the family, children and the young, protection of the dignity of Croatian war veterans and encouraging the development of a sustainable system of pension insurance against the backdrop of ageing population;
- *positioning of the Republic of Croatia as one of the leading European tourist destinations* – this objective will be achieved by encouraging sustainable use of natural, cultural and historical resources, tourist sector development by encouraging the development of small and medium-sized entrepreneurship in tourism, investments in human resources training in tourism, creating the conditions for a pleasant and safe stay of tourists and encouraging the development of tourism in touristically underdeveloped areas and efficient promotion of Croatian tourist products and services;
- *more competitive agricultural, food industry and fisheries sector* – this objective will be achieved through further adjustment of the system of aid to agricultural production and fisheries with that in the European Union, improvement of market mechanisms for the sale of agricultural, food and fisheries products, protection of the health of humans, animals and plants, protection of consumers' interests and rural development;
- *further strengthening of the international status of the Republic of Croatia* – in the previous years, Croatia's international position strengthened in all areas of foreign policy and in 2009 and 2010, further progress was made in negotiations on accession to the European Union, which have now entered a final phase. In the transitional period until full accession, the provision of information to the Croatian public about the European Union and the integration process will be of extreme importance and so will the establishment of a credible Croatian version of the *acquis communautaire* and translations for the purposes of the process of accession;
- *improving the police and armed forces in the service to citizens* – this objective will be achieved through improved prevention of punishable behaviour and improved detection and prevention of crime, enhanced road and state border safety, progress in administrative affairs and inspection supervision, development of an integrated system of protection and rescue, and maintenance of international defence and police co-operation;
- *health protection, maintenance and improvement* – this objective will be achieved through reorganisation and improvement of emergency medical aid, improvement of public health network, development and standardisation of health care infrastructure, informatisation of the health care system, supervision of the legality of work of health care institutions and health care workers and promotion of healthy lifestyles;
- *environmental protection and spatial development* – this objective will be achieved through efficient environmental management, activities towards improvement of the cadastre and designated use of space, implementation of measures directed at improving the situation in the field of housing, municipal management and construction.

3.1.2 Actual Balances and Medium-Term Perspectives

Recent Movements in the Consolidated General Government Budget

Unfavourable economic developments present in the RC in 2009 and 2010 had a sizeable effect on public finances. A fall in the economic activity had a direct impact on budget revenues as the most direct channel of transmission of unfavourable economic developments to public finances. Such developments on the revenue side of the general budget, combined with reductions on the side of sources of financing, had significant implications on developments in total general government budget expenditures. In the conditions characterised by reductions on the side of sources of financing and developments in the prices of new sources of financing, the expenditure side of the general budget underwent a significant process of adjustment in line with fiscal possibilities, while taking into account the structure of the expenditure side and, under the given circumstances, making sure that realistic needs of all levels of the general budget are met to the maximum extent possible. In this context, it should be noted that three budget revisions, revisions of financial plans of extra-budgetary users and changes in the projections of local and regional self-government units were made in 2009. The measures taken in 2009 involved both the revenue and the expenditure side. On the revenue side, especially important was the increase in the general value added tax rate of 1 percentage point (from 22% to 23%) and the introduction of a special tax on salaries, pensions and other receivables as a tax form with a limited duration. Moreover, the Special tax on salaries, pensions and other receivables was abolished in two phases during 2010. This tax form was introduced in mid-2009 with limited lifespan, not later than by the end of 2010. In April 2010, the Croatian Parliament adopted an Act abolishing the payment of the special tax on salaries, pensions and other receivables at a rate of 2% on receipts ranging from HRK 3,000 to HRK 6,000 from July 1st 2010, and at a rate of 4% on net payments exceeding HRK 6,000 from November 1st 2010.

On the expenditure side, the measures taken were aimed at ensuring the maximum possible savings through cuts in expenses associated with implementation of different programmes and by rechanneling some of these funds to anti-recession measures financing, most notably the maintenance of the standard of living of the most vulnerable groups of society. Support was also provided for job preservation to employers who were forced to scale down their economic activities on account of economic and financial crisis and were faced with the risk of surplus workforce. Salaries of government officials were also cut by reducing the basis for the calculation of salaries by further 5% relative to the April 2009 basis. Pensions regulated by the Act on the Rights and Obligations of Representatives in the Croatian Parliament were also cut by 10%. The execution in 2009 points to an outturn in line with the last July 2009 amendments to the annual plan. As a result of such developments in general budget revenues and expenditures, net lending/borrowing stood at -4.1% of GDP in 2009, which is an increase in the negative balance relative to the previous 2008 of 2.7 percentage points.

Table 2: Revenue, Expenditure and Net Lending/Borrowing of the Consolidated General Government 2006-2009

% BDP-a	2006	2007	2008	2009
Net lending/borrowing	-3.0	-2.5	-1.4	-4.1
Total revenue	39.6	40.7	39.8	38.7
Total expenditure	42.6	43.2	41.2	42.8

Source: MF

Negative economic developments continued into 2010. Despite certain difficulties in the financial market at the beginning of 2010, overall system liquidity was much higher than in 2009. Nevertheless, a certain amount of caution that was still present among the main participants in the financial market in early 2010, prompted direct Government involvement in the search of possibilities for encouraging business sector financing through developed financing models both for the purpose of strengthening current business operations and for the purpose of launching new investment initiatives. In this context, the Government, in co-operation with the Croatian National Bank, has developed and launched financing models aimed at initiating credit and investment activities with lower financing cost. These models include a system of co-financing in the framework of new credit lines focused mainly on the working capital of entities hit by the negative impacts of the financial and economic crisis and a system of government participation in the share of the risks involved in new bank lending through guarantees directed towards new investment projects. In April 2010, the Government adopted a comprehensive Economic Recovery Programme that is aimed at creating the conditions for overcoming the crisis and laying the foundations for future robust economic growth and development. The Economic Recovery Programme consists of some one hundred priority reform measures, mostly of short-term and medium-term nature, largely relating to the areas of public administration, fiscal policy, domestic economy revival, the labour market, the system of social security, education, science, etc. Further unfavourable economic developments in 2010, coupled with a number of legislative changes whose impact was seen on the revenue side, resulted in lower than expected budget revenues relative to those initially planned for 2010, an issue addressed in government budget revision for that year. In accordance with the provisions of the Economic Recovery Programme, the Government introduced changes in income taxation, simplifying it by reducing the number of tax rates and repealing tax reliefs. Changes were also made to tax brackets ranges of the taxable basis which are now subject to new income tax rates. The change in the taxable basis tax bracket and the change in income tax rates applicable to the new tax brackets, led to a reduction in income tax burden of natural persons which gives additional boost to consumption. More specifically, the previous tax rate was cut from 15% to 12%, while the 35% and 45% tax rates were repealed and replaced by a new 40% tax rate. The cut in the former tax rate to 12% is particularly important for lower income individuals as it raises their income. These changes in the system of income taxation led to an increase in net receipts of some 1.5 million citizens. By repealing tax reliefs which amounted to HRK 12,000 annually, and which were accessible to a lesser extent by socially vulnerable groups of the society, the Government achieved a higher level of social sensitivity while at the same time achieving administrative simplification of the system of income taxation in the country and efficiency growth.

Macroeconomic developments and developments in budget revenues in 2010 suggested poorer outturn than that originally planned. The correction of macroeconomic and fiscal planned values was made towards the end of August in the framework of government budget revision and revision of financial plans and projections of other levels of the general government. On general government level, these changes involved a reduction in the revenue plan on an annual level of 1.7% of GDP while the expenditure side of the general government budget increased by 0.1% of GDP. The greatest changes in the plan for 2010 in terms of the amount were those on the budgetary central government level, as the largest component of the general government budget. The revenue plan of the budgetary central government was reduced by HRK 4.5 billion or 1.4% of GDP, while total expenditure was increased by HRK 900 million or 0.3% of GDP. The increase in budgetary central government expenditure in 2010 is associated with the need to ensure additional funds on an annual level for individual expenditure categories such as pensions, natural disasters, unemployment benefits, etc. while at the same time further rationalisation of other expenditure categories was made in an extent that will largely offset the increase in the mentioned expenditure categories.

In the light of the changes on the revenue and expenditure side, the new level of net lending/borrowing stands at -5.2% of GDP.

The changes in the 2010 budget were largely driven by macroeconomic developments affecting the revenue side and further rationalisation on the expenditure side. Changes in the 2010 budget also represent a basis for the 2011 budget. Namely, in the adoption of the 2010 budget revision, the Croatian Parliament issued a Conclusion that provides that the level of expenditures determined under the 2010 budget revision also represents the ceiling for expenditures in the following two years, i.e. the years 2011 and 2012.

In November 2010, the Government of the Republic of Croatia proposed and the Croatian Parliament adopted the 2011 budget with projections for 2012 and 2013 which was drawn up in line with the restrictions regarding the maximum level of expenditures defined under the previously mentioned Conclusion of the Croatian Parliament. In addition to the 2011 budget and projections for 2012 and 2013, the Croatian Parliament also adopted in November 2010 the Fiscal Responsibility Act. This Act lays down fiscal rules aimed at implementation of fiscal consolidation in the forthcoming period and elaborates and/or strengthens, i.e. introduces individual provisions for the achievement of a higher level of fiscal responsibility. According to the mentioned fiscal rules, total general budget expenditure expressed by the share in the estimated gross domestic product will be decreasing annually by at least 1 percentage point, whereas this reduction is carried out up to the moment when primary fiscal balance of the general budget in nominal terms will be zero or positive. After that, the goal is to achieve a cyclically adjusted primary fiscal balance of the general budget at zero or positive level during the cycle in order to achieve stabilization and reduction of public debt in gross domestic product.

Medium-Term Fiscal Projections

Consolidated General Government Revenue

The consolidated general government revenue plan for 2011 and projections for the 2012-2013 period are based on macroeconomic assumptions for the 2011-2013 period and the expected budget revenues in 2010, and take into account the estimated effects of EU accession and full EU membership of the Republic of Croatia as well as changes in the tax legislation. The changes to the Income Tax Act, implemented in mid-2010, introduced changes in income tax rates and tax brackets for the application of tax rates with a view to simplifying the system of income taxation and reducing the tax burden for the majority of Croatian citizens. The annual impact of this change, as seen in reduced revenues on this basis, is estimated to stand at around 0.3% of GDP. Legislative changes were also made in the area of excise duties. Under a Government Regulation, the rate of the proportional excise duty on cigarettes was raised as of 1 October 2010 from 30% to 35% of the retail price for the purpose of gradually achieving the minimum conditions and the amount of excise duty on cigarettes prescribed by EU directives. Under Government Regulation, the amount of excise duty on unleaded motor gasoline for use as fuel in motor vehicles was also raised as of 1 September 2010 from HRK 2,850/1,000 per litre to HRK 3,100/1,000 l, which is an increase of HRK 0.25 l, or the same amount as the amount for which excise duty decreased at the time of strong pressures on the prices of petroleum products in 2007. In addition to these changes that will affect developments in total general budget revenues over a medium-term, note should be taken of the fact that projections for the observed period also take into account the effects of full EU membership of the Republic of Croatia, both on the revenue and expenditure side.

In light of the above-mentioned, total consolidated general government budget revenues in 2011 are planned to stand at 36.5% of GDP, which is a decrease of 1.4 percentage points of GDP relative to 2010. It should be stressed that such developments in the share of revenues in GDP are due to the repealed Special Tax on Salaries, Pensions and Other Receivables in 2010.

The consolidated general government revenues as a share of GDP will stand at 37.0% of GDP and 36.8% of GDP in 2012 and 2013, respectively.

The most significant budget revenue, VAT revenue, are planned to stand at 11.6% of GDP in 2011 and until end-2013 it is estimated to grow by 0.3 percentage points of GDP and stand at 11.9% of GDP. Such developments can be attributed to the expected acceleration in economic growth towards the end of the observed period, while the projections for this revenue are based on the expected developments in personal consumption.

Unlike VAT, the share of revenues in GDP from profit tax, customs and excise duties is expected to decline over a medium-term. Revenues from profit tax have been planned based on altered macroeconomic conditions, a decrease in the expected corporate profit and their time-related impact on developments in revenues from profit tax. The projected revenues from profit tax range between 1.7% of GDP in 2011 and 1.6% of GDP in 2013. Special taxes and excise duties will also see a gradual decrease in their share in GDP; from 3.4% in 2011 to 3.2% in 2013. In the projection of revenues from excise duties, we took into account economic growth rates, the previous developments trend in these revenues, and changes in the legislative framework regulating excise duties on tobacco and tobacco products and excise duties on petroleum products. The projected revenues from customs fees and duties suggest a steady share in GDP of 0.5% during the projection period. Revenues from income tax have been planned based on the expected developments in gross wages and total employment, taking account of the legislative changes in tax rates and tax brackets. The share of revenues from income tax in GDP stands at 2.6% of GDP throughout the entire medium-term period.

Revenues from social contributions have been planned in line with the expectations on the labour market, i.e. in accordance with developments in gross wages and employment. These revenues are closely related to economic activity both in the period in which they are collected and in the previous periods given the time dynamics of the effect of overall economic activity on the labour market. Revenues from social contributions are planned to have a steady share in GDP of 11.6% over a medium-term period.

Property revenue includes revenues from the profit of enterprises and financial organisations, revenues from dividends, concessions, property leases, interests and other property revenues. Over a medium-term, these revenues are planned at an average level of 0.9% of GDP.

Consolidated General Government Expenditure

Consolidated general government expenditure over the next three-year period will be determined by key objectives and measures laid down in the Strategy of Government Programmes. Developments in expenditure during this period will also be determined by the Economic Recovery Programme. The implementation of structural reform measures envisaged under this Programme will also influence developments in individual expenditure categories in the forthcoming period. The reduction in the share of total expenditure in gross domestic product in the period immediately following the crisis and in the years to follow is also determined by the provisions of the Fiscal Responsibility Act which is determined by the Economic Recovery Programme and the Conclusion of the Croatian Parliament aimed at restricting the level of total expenditure of the budgetary central government and extra-budgetary users. Therefore, the consolidated general government expenditure will see a steady fall in their share in GDP over the next three-year period and thus

contribute to the achievement and subsequently to the maintenance of such fiscal positions that will ultimately reinforce long-term sustainability of public finances. It should be noted in particular that expenditure will continue to be aimed at the fulfilment of the broadest social needs through continued investment in the development of entrepreneurship, uniform regional development, promotion of knowledge and excellence and protection of the socially most vulnerable categories. At the same time, continuous activities and projects will be carried out related to adjustment of the RC in the process of EU accession, in particular those relating to the accelerated accommodation of returnees and refugees, alignment of the agricultural system to EU rules, establishment and management of the Schengen system, judiciary reform, administrative capacity building, construction and equipment of border crossings, adjustment to the European system of statistics, etc. The meeting of these needs on the one hand, while at the same time ensuring continuous contribution of the expenditure side to the implementation of fiscal consolidation, on the other hand, depend on the implementation of structural reforms in line with the strategic orientation. Consequently, total consolidated general government expenditure is estimated to range between 41.9% of GDP in 2011 and 39% of GDP in 2013.

The most significant group of general government budget expenditure in terms of the amount involved are social benefits which will see a steady decline in their share in GDP over the next three-year period. Their share in GDP is thus planned to fall from 13.5% in 2011 to 12.5% in 2013. The developments in these expenses are largely determined by developments in the major categories of social benefits, most notably expense for pensions and health care. Outlays in the health sector are influenced by further implementation of the health care reform, particularly in primary and secondary health care, which is aimed at sustainability of financial stability in health care system. The main determinants of expense for pensions in the forthcoming period will be developments in the number of pension users, developments in expense aimed at eliminating the differences between the pensions of the so-called "old" and "new" pensioners and the absence of pension indexation in 2011. Social benefits as the expenditure category also include 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 in public and state administration, with the average share of 25% in total expenditures, makes up the second largest expenditure item of the general government budget. In the next three years, developments in this expense will largely be determined by developments in the number of civil and public servants. Some of the effects of reduction in the number of public and civil servants by some 5% as envisaged under the provisions of the Economic Recovery Programme are expected to be seen during the observed period. During this period, we expect to see the share of this expense in GDP to fall steadily from 10.5% in 2011 to 9.6% in 2013. Over the next three year period, this expense will also be determined by outlays for the envisaged 0.5% salaries growth for past labour, 2.2% salaries growth in education and science in accordance with the 2006 Agreement on Supplements to Salaries in the Science and Education Sector and additional strengthening of the administrative capacity in the process of preparation of the Republic of Croatia for EU membership.

Expense for intermediary consumption which relate mostly to expense for goods and services earmarked for compensation of employees, material, energy and services are expected to average at some 3% of GDP over a mid-term period. Their dynamics will largely be determined by activities and projects financed under EU pre-accession and accession assistance programmes. In 2011, this expense will also include different expense of one-off nature such as population census, parliamentary elections, referendum on EU accession and expense for the military.

The share of expense for subsidies will continue to decrease from 2.2% of GDP in 2011 to 2.0% of GDP in 2013 primarily as a result of a decrease in subsidies in railway and air traffic.

The expense for property income in the forthcoming period will be determined by developments in interest expense. Under the influence of developments in the financial markets and fiscal developments in the conditions of economic crisis, we expect to see a steady nominal increase in interest expense. The share of expense for property income over the next three-year period will stand at 2.2% of GDP.

Other current transfers, which comprise current grants and current donations are projected at 1.3% of GDP in 2011, and 2.2% of GDP in 2012 and 2013. The reason for the increase in the share of this expense in GDP in 2012 lies in planned contributions of the Republic of Croatia to the EU budget of around 1.0% of GDP. Capital transfers, which include capital grants and capital donations are expected to maintain an average level of 1.6% of GDP in the observed medium-term period.

Expense for gross fixed capital formation comprises net expense for the acquisition of fixed assets, strategic inventories and valuables. This expense is planned to range from 1.9% of GDP in 2011 to 1.5% in 2013, and will largely be determined by activities associated with capital investments in health care, social welfare, science, education, judiciary, road infrastructure, water management, etc.

Table 3: Revenue, Expenditure and Net Lending/Borrowing of the General Government 2009-2013

ESA 95	% of GDP	2009	2010p	2011p	2012p	2013p
TR	Total revenue	38.5	37.8	36.3	36.8	36.6
	<i>Main components of total revenue:</i>					
P.11	Market output	3.2	3.2	3.1	3.0	2.9
D.211	Value-added tax	11.1	11.5	11.6	11.8	11.9
D.61R	Social contributions, receivable	12.2	12.0	11.8	11.8	11.8
	Current taxes on income, wealth etc., receivable					
D.5R		6.5	5.5	4.5	4.4	4.5
D.51A	- of which: personal income tax	0.0	0.0	0.0	0.0	0.0
D.51B	corporate income tax	0.0	0.0	0.0	0.0	0.0
D.212	Taxes and duties on imports excluding VAT	0.5	0.5	0.5	0.5	0.5
	Taxes on products, except VAT and import taxes					
D.214		3.8	4.1	3.9	3.8	3.7
D.214a	- of which: excises	0.0	0.0	0.0	0.0	0.0
D.4R	Property income, receivable	0.8	0.4	0.4	0.3	0.2
TE	Total expenditure	42.6	43.0	41.9	40.7	39.0
	<i>Main components of total expenditure:</i>					
P.2	Intermediate consumption	4.8	4.8	4.8	4.4	4.1
D1.P	Compensation of employees	10.6	10.8	10.5	10.0	9.6
D.3P	Subsidies, payable	2.4	2.3	2.2	2.1	2.0
D.4P	Property income, payable	1.7	1.9	2.2	2.2	2.2
	Social benefits other than social transfers in kind, payable					
D.62P		13.6	14.0	13.5	13.0	12.5
D.631	Social transfers in kind	3.3	3.6	3.3	3.2	3.0
D.7P	Other current transfers, payable	1.4	1.5	1.3	2.2	2.2
D.9P	Capital transfers, payable	1.9	1.8	1.7	1.5	1.6
P.5	Gross capital formation	1.8	1.8	1.9	1.7	1.5
B.9	Net lending/net borrowing	-4.1	-5.2	-5.6	-3.9	-2.4

Source: MF

Net Lending/Borrowing

The financial and economic crisis, the effects of which are still present, left a great mark on public finances. The revenue side of the budget was substantially influenced by a fall in the economic activity in 2009 and 2010. Such developments, coupled with unfavourable financial developments, also led to a significant fall in the level of expenditures. However, given the magnitude of revenue adjustment to changes in macroeconomic developments and the actual capacity for full absorption of such developments on the expenditure side, the total general government budget deficit increased during this period. Thus, after a steady decline in the total general government budget deficit in the period before the crisis to the level of –1.4% of GDP in 2008, in 2009 net lending/borrowing stood at –4.1% of GDP. With further unfavourable developments in 2010, the total deficit is projected to stand at –5.2% of GDP. Over a medium-term decline in the general budget deficit to –2.4% of GDP in 2013 is expected. However, it should be noted that in 2011 we expect to see an increase in the negative balance of the general budget compared to 2010 and that its projections for that year stand at 5.6% of GDP. This is largely attributable to one-off effects of changes in income taxation in 2010 and the effects of the repealed 2009 Special Tax on Salaries, Pensions and Other Receivables in 2010. Net lending/borrowing in 2012 is estimated to stand at –3.9% of GDP. The largest contribution to the planned decline in the negative fiscal balance is expected to come from the expenditure side, supported by the implementation of structural reforms, whose year-on-year increase for the observed period averages below 1%.

Table 4: Revenue, Expenditure and Net Lending/Borrowing of the General Government 2009-2013 According to Government Level

ESA 95	% of GDP	2009	2010p	2011p	2012p	2013p
Budgetary central government - unconsolidated						
TR	Total revenue	33.1	32.8	31.6	32.2	32.0
TE	Total expenditure	36.8	37.6	36.5	35.7	34.0
B.9	Net lending/net borrowing	-3.7	-4.8	-4.9	-3.5	-2.0
Extrabudgetary users - unconsolidated						
TR	Total revenue	1.7	1.6	1.5	1.5	1.4
TE	Total expenditure	1.8	1.8	1.9	1.6	1.5
B.9	Net lending/net borrowing	-0.1	-0.2	-0.4	-0.2	-0.2
Local government - unconsolidated						
TR	Total revenue	4.8	4.4	4.3	4.2	4.2
TE	Total expenditure	5.1	4.6	4.5	4.4	4.4
B.9	Net lending/net borrowing	-0.3	-0.2	-0.3	-0.3	-0.2
Consolidated general government						
TR	Total revenue	38.5	37.8	36.3	36.8	36.6
TE	Total expenditure	42.6	43.0	41.9	40.7	39.0
B.9	Net lending/net borrowing	-4.1	-5.2	-5.6	-3.9	-2.4

Source: MF

Financing of the General Government Budget

Developments in total needs for financing over a medium-term will be determined by developments in the fiscal balance, expected developments in financial assets and liabilities maturing during that period. The total financing needs during the observed period will be determined predominantly by developments in the fiscal balance. Towards the end of the observed period the developments in the fiscal balance will see a steady decline in their contribution to total financing needs as the negative fiscal balance improves. The liabilities maturing in the forthcoming period stand at similar nominal levels in the first two years of the medium-term period, but will see a nominal increase in 2013.

Two domestic bonds will mature during the observed period; a EUR 500 million bond maturing in 2012 and a HRK 4 billion bond maturing in 2013 while one foreign bond, worth EUR 750 million

will mature in 2011. On the loan side, the biggest maturities during the observed period relate to maturing syndicated loans issued on the domestic financial market. The syndicated loans maturing during the observed period stand at EUR 1.385 billion nominally with the most of this amount or some EUR 1 billion maturing in 2013.

Table 5: Overview of bonds maturing in the period 2011 – 2013

Bond	Date of issue	Amount (in million)	Interest rate	Date of maturity
DOMESTIC BONDS				
Series 03 D-12	23.5.2002.	500 EUR	6,88%	23.5.2012.
Series 11 D-13	11.7.2006.	4.000 HRK	4,50%	11.7.2013.
FOREIGN BONDS				
Euro - EUR III 2011	06.03.2001.	750 EUR	6,75%	14.03.2011.

Source: MF

The total financing needs over a medium-term will be met on the domestic and foreign financial markets. The basic objective of borrowing and public debt management is to ensure budget needs financing at the lowest possible medium-term and long-term financing costs and to maintain acceptable level of risk.

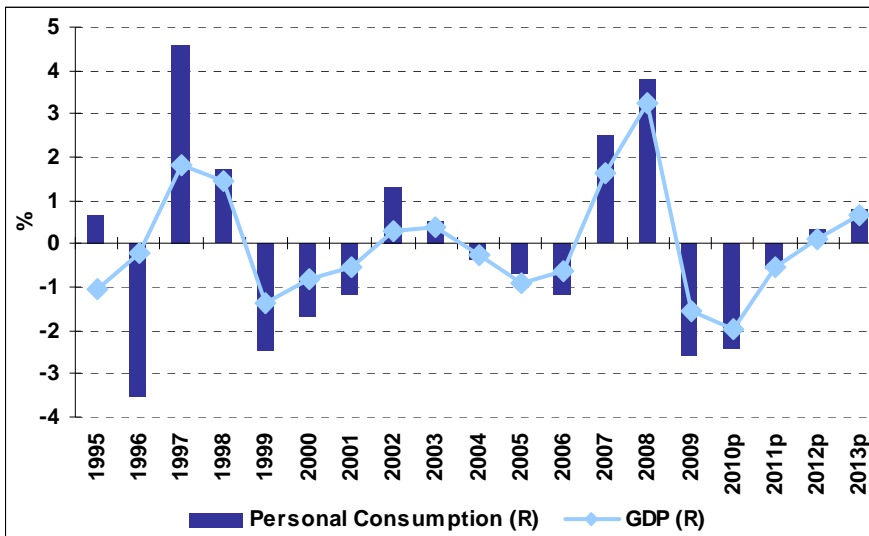
3.1.3 Estimate of the Cyclically Adjusted Primary Deficit

The 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 deficit was calculated as the difference between the primary and the cyclical deficit.

The calculation of the cyclically adjusted deficit was based on the method of the European Central Bank⁶. Personal income tax, profit tax, value added tax, excise duties and social contributions were observed as cyclically sensitive components on the revenue side, whereas, on the expenditure side, unemployment benefits were observed. The 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 $\lambda=300$.

⁶ Bouthevillain et al., (2001), „Cyclically Adjusted Budget Balances: An Alternative Approach“, European Central Bank Working Paper Series, No. 77.

Figure 3: Deviations of GDP and Personal Consumption from their Trend Values



Source: MF

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

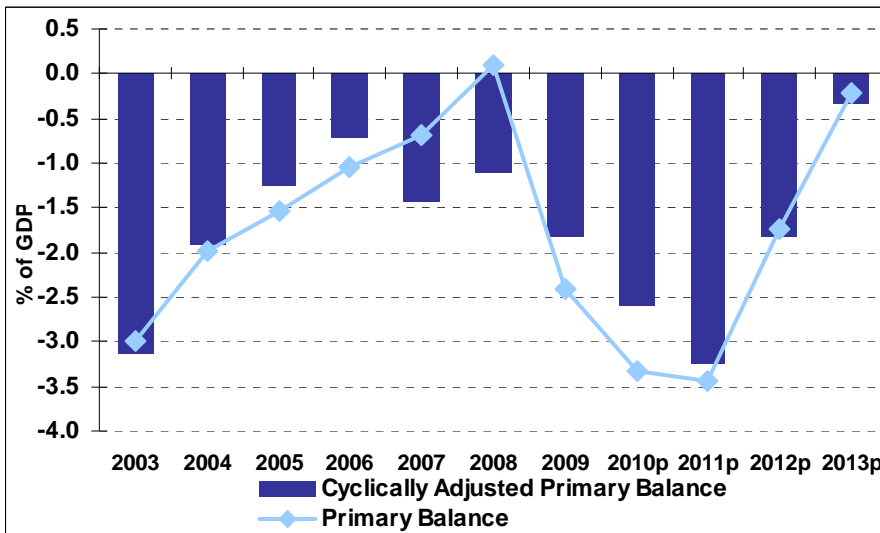
$$\Delta \ln X_t^i = \alpha + \beta(\ln X_{t-1}^i - \gamma \ln V_{t-1}^i + \phi + \delta + \dots) + \delta_1 \Delta \ln V_t^i + \delta_2 \Delta \ln V_{t-1}^i + A + \zeta,$$

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 base in the same and the preceding period.

As the model with the deviation correction is an integral part of the presented equation, the test 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.

The cyclical component of the chosen revenue and expenditure budget categories is calculated as a product of estimated elasticity and deviation of 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. The structural budget balance is the difference between the actual budget balance and the cyclical balance. The primary deficit of the consolidated general government is used for the calculation of structural budget balance, as the expenses for interest are not solely the result of current fiscal policy.

Figure 4: Primary Balance and Cyclically Adjusted Primary Balance

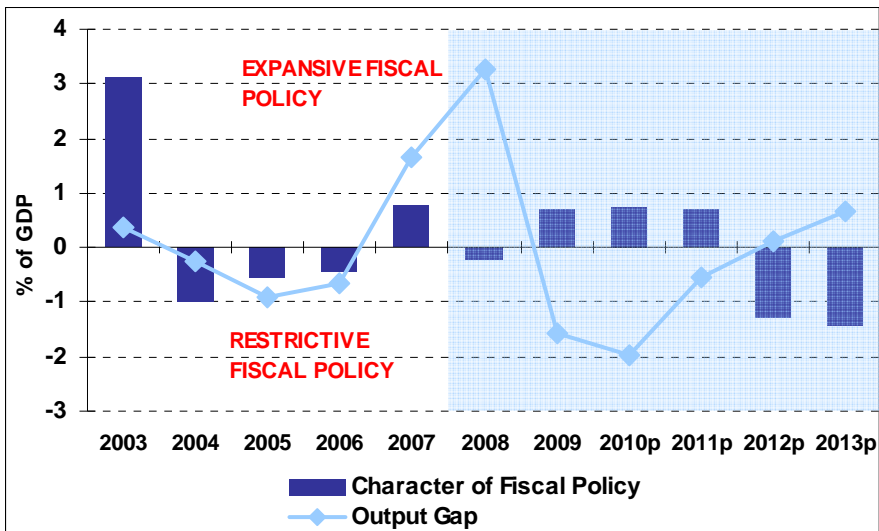


Source: MF

The 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 analysed period. Pro-cyclical fiscal policy is characterised 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 characterised by expansive fiscal policy in the period of underemployment and restrictive fiscal policy in the period of overheating of the economy. Restrictive fiscal policy in a year is defined as a reduction and expansive fiscal policy as an increase of the cyclically adjusted primary fiscal deficit relative to the previous year.

The ratio between expansivity or restrictivity of fiscal policy and the output gap in some of the years during the 2003 to 2009 period indicates the pro-cyclical character of the fiscal policy in the period 2003-2007 and its anti-cyclical character in 2008 and 2009. Based on projections for 2010 and 2011, the output gap is expected to be negative with anti-cyclical character of the fiscal policy, and the anti-cyclical character of the fiscal policy is also projected for 2012 and 2013, with a small positive output gap.

Figure 5: Character of Fiscal Policy



Source: MF

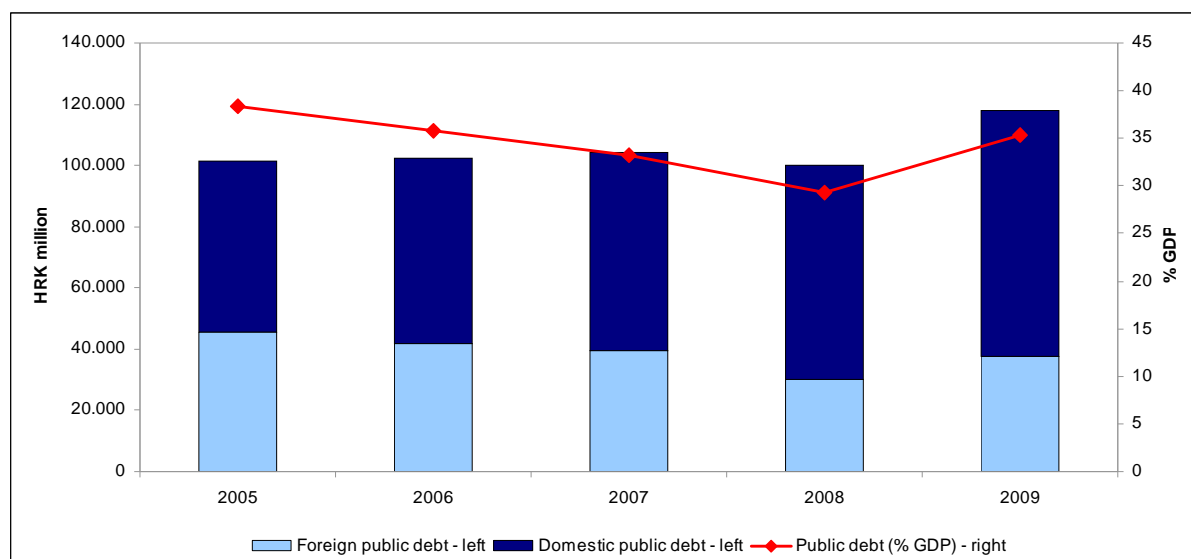
Note: Shaded areas represent periods of anti-cyclical fiscal policy

3.1.4 Debt Levels and Developments

The process of fiscal consolidation which started in 2004 resulted in positive effects on public debt to GDP ratio which declined by 9.1 percentage points towards the end of 2008 compared to the end of 2005 and stood at 29.3% of GDP. However, as the effects of the global economic and financial crisis began to be felt in Croatian economy in early 2009, budget revenues declined, deficit widened and GDP fell, resulting in an increase in the nominal amount of public debt and its share in GDP. Thus, at the end of 2009, total public debt reached HRK 117.8 billion, or 35.4% of GDP.

In the previous period, financing relied mainly on domestic sources. As a result, the domestic component of public debt rose from 55.3% in 2005 to 68.2% of the total public debt stock in 2009. During the same period, the foreign component of public debt fell from 44.7% to 31.8% of the total public debt stock.

Figure 6: Public Debt 2005-2009



Source: MF

The bulk of the public debt was associated with borrowing based on securities, followed by loans and T-bills issues. Looking by levels of government authority, the central government accounted for 93.6%, or the largest share of public debt towards the end of 2009. Extra-budgetary users accounted for 4.7% and local government units for 1.8% of the public debt. With central government borrowing taking place mostly on the domestic market, the domestic component of its debt accounted for 67.5% of the total central government debt. The local government also borrowed mainly in the country, and its domestic debt component accounted for 99.6% of the total local government debt. As regards extra-budgetary users, the domestic component of the debt also prevailed and accounted for 68.9% of the total debt of extra-budgetary users.

As regards public debt currency structure, it should be noted that a significant part of the debt is denominated in foreign currency, with euro-denominated debt accounting for the bulk of this amount.

With a view to creating additional room for private sector financing on the domestic financial market, after a five-year break, in 2009 the government again issued bonds on the foreign financial market. Thus, in 2009, the government met part of its financing needs by issuing two Eurobonds, the first in May 2009 in the amount of EUR 750 million and the second in November 2009 in the amount of USD 1.5 billion. With a view to reprogramming liabilities falling due, in March 2010 the Republic of Croatia issued ten-year bonds on the domestic market in the amount of HRK 3.5 billion with an annual interest rate of 6.75%, and EUR 350 million in kuna equivalent value with an annual interest rate of 6.50%. Furthermore, in July 2010 two more ten-year bonds were issued on the domestic market, the first in the amount of HRK 1.5 billion with a fixed interest rate of 6.75%, and the second in kuna equivalent value of EUR 650 million value with an interest rate of 6.50%, in addition to which a Eurobond was issued in the US market in the amount of USD 1.25 billion with an interest rate of 6.625% and a maturity period of 10 years. In November 2010, for the purpose of changing the existing debt maturity and structure, the government issued a seven year bond on the domestic market worth HRK 4.0 billion at a fixed interest rate of 6.25%. A part of the total financing needs in 2010 was also met by means of short-term financing instruments, most notably syndicated loans of domestic banks and T-bills.

As regards overall public debt management, it is extremely important to define plans and direction of public debt management that builds on previous years' achievements and is closely correlated with the plan of developments in fiscal and other economic policies. Debt management is a process where main efforts are focused towards debt structure assessment and analysis with the aim of reducing generated risks, in view of their direct impact on the state budget, the financial system, and the capital market and thereby on the fiscal and macroeconomic stability of the country. The Budget Act prescribes the institutional framework for borrowing and public debt management in a way that ensures that the financial needs of the government are met at the lowest medium-term and long-term financing costs and optimum level of risk, in accordance with the given conditions. Prudent risk management is essential for the achievement of the optimum structure of debt and adequate debt management strategy.

The Fiscal Responsibility Act, as one of the key measures of the Economic Recovery Programme that introduces clear fiscal rules, is of great importance for public debt management. This Act is an instrument which ensures public finances sustainability as the use of fiscal rules will lead to necessary fiscal adjustments and ensure positive effects on public debt development.

In the forthcoming three-year period, total budget deficit and due liabilities financing needs will be met both on the domestic and foreign financial markets with the main aim of adjusting future maturities in terms of amount and due dates and at the same time creating additional space for other sectors financing.

The developments in total general government budget deficit and liabilities maturing in the forthcoming three-year period will result in higher financing needs relative to historical averages and will also have an impact on the public debt to GDP ratio.

The bulk of liabilities maturing in the 2011-2013 period relates to three bond maturities of which two are domestic bonds, one denominated in euro, worth EUR 500 million and second denominated in kuna, worth HRK 4.0 billion, and one foreign bond, worth EUR 750 million.

In accordance with the planned financing and macroeconomic and fiscal projections, in 2011 we expect to see a further increase in the public debt to GDP ratio that started in 2009 under the influence of the global economic crisis. The implementation of fiscal consolidation in the forthcoming years will result in a slower growth trend in the public debt to GDP ratio in 2012 with projected stabilisation in 2013. Further fiscal consolidation that will result from the implementation of the principles and mechanisms laid down in the Fiscal Responsibility Act will ensure a trend of steady decline in the public debt to GDP ratio, the beginning of which is expected to take place in 2014. Changes will also be seen in the levels of foreign and domestic component of public debt expressed as a share of GDP as a result of liabilities maturing during the observed period and the planned realisation of new borrowing both on the domestic and foreign financial markets.

Table 2: Projections of Public debt developments

<i>% of GDP</i>	2009	2010 p	2011 p	2012 p	2013 p
Public debt	35.4	41.6	44.2	46.3	46.7
Foreign	11.3	14.3	15.9	18.2	20.0
Domestic	24.1	27.3	28.2	28.1	26.7

Source: MF

3.1.5 Budgetary Implications of Major Structural Reforms

The implementation of major structural reforms, most notably in the enterprise sector, labour market, agriculture, public administration, education and science, health care, social welfare, the judiciary and environmental protection will undoubtedly contribute to the achievement of the objectives outlined in the Strategy of Government Programmes and the measures outlined in the Economic Recovery Programme. A detailed description of the objectives, measures and activities in each of the listed areas is given in chapter 4 of this document, entitled Structural reforms, while fiscal impacts of key measures in the framework of structural reforms are given in Annex I entitled Matrix of policy commitments. In addition to data on budgetary funds allocations for the implementation of individual measures, these fiscal impacts also include information on their financing from loans and EU pre-accession assistance funds.

The largest impact on budget is expected to come from structural reforms in the environmental, enterprise and agricultural sectors.

The activities related to water management, co-financed by IPA, will result in a net increase in budgetary allocations of an average 0.1% of GDP, although in 2011 we expect to see a fall in allocations of 0.05% of GDP.

In the 2010-2012 period we expect to see a reduction in subsidies to railways of an average 0.03% of GDP and a reduction in investments in modernisation of Croatian Railways in 2011 of 0.06% of GDP. Such reductions are in line with the implementation of activities aimed towards improving efficacy, achieving rationalisation of business operations and implementation of savings measures.

Allocations for state subsidies in agriculture and rural development will also be reduced by an average 0.04% of GDP during the 2011-2013 period.

In the framework of the health care reform, in 2010 we will see a cut in expense for sick leave of 0.08% of GDP, while expense for the acquisition of medical equipment, hospital furnishings and emergency aid reorganisation will increase until 2012, and their average effect will amount to 0.02% of GDP.

On the labour market we expect to see increased allocations from the state budget due to the fiscal impact of the raised age limit and changes in the manner of determining early old age retirement in 2010 and 2011 of an average 0.03% of GDP and an increase in the positive net direct impact on the state budget in 2012 and 2013 of 0.04% of GDP.

Fiscal impacts on the state budget are also expected to come from measures in the area of the enterprise sector, labour market, agriculture, public management, education and science, health care, the judiciary and environmental protection whose fiscal impacts on the expenditure side will as a rule exceed revenues generated on the basis of different EU assistance programmes.

3.2 SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS PROGRAMME

3.2.1 Fiscal Risks and Sensitivity Analysis of Net Lending/Borrowing and Public Debt

Fiscal Risks

Fiscal projections for the medium-term are based on the described macroeconomic assumptions and as such represent a baseline fiscal projection based on a baseline projection of macroeconomic assumptions.

Therefore, the most significant implications on the expected fiscal policy developments and results come from changes in the assumptions of developments in basic macroeconomic variables. The most important group of risks would come from a lower than projected real GDP growth as a result of further negative trends on the domestic market, i.e. as a result of a significant fall in the economic activity of Croatia's major trading partners and a slower growth in the countries in the environment or tourist-generating markets. A lower level of economic activity would directly impact the level of the expected budget revenues and would in that context represent a risk of wider budget deficit than that originally planned. Further unfavourable economic conditions would also have potentially negative impacts on the labour market which would also affect the planned fiscal amounts.

Therefore, negative effects would also be expected in terms of developments in public debt, that would, as a result of a greater need for financing, grow above the level planned under the baseline projection.

As regards negative impacts on public debt developments over a medium-term, account should be taken of the risk associated with a scenario of a significant change in the exchange rate of the domestic currency. Given the fact that a significant share of total public debt is denominated in foreign currency, depreciation of the domestic currency would result in a higher public debt level and greater difficulties in servicing this debt. Furthermore, activation of contingent liabilities (guarantees) would also lead to an increase in the level of public debt over a medium-term.

In the case of additional worsening of the conditions on the financial market and smaller capital availability, debt repayments and interest payments would also represent one of the fiscal risks, with higher amounts of maturities creating pressures on current operations in terms of increased refinancing risk and representing a heavier burden for the budget. Therefore, in public debt management it is essential to ensure that the burden of repayments is well balanced.

As regards the risks on the expenditure side, it should be mentioned that the expenditure side is determined by a Conclusion of the Croatian Parliament which provides that the level of expenditures determined under the 2010 budget revision also represents the ceiling for expenditures in the following two years, i.e. 2011 and 2012 and by the Fiscal Responsibility Act which, as an instrument of public finances sustainability, provides fiscal rules aimed at fiscal consolidation implementation in the forthcoming period and elaborates and/or reinforces, i.e. introduces individual provisions for the achievement of a higher level of fiscal responsibility. In that context, failure to implement major structural reforms at the dynamics planned under the Economic Recovery Programme would undermine successful achievement of the planned dynamics of fiscal consolidation and the structure of the expenditure side of the budget.

Net Lending/Borrowing Sensitivity Analysis

Developments in net lending/borrowing and fiscal balance can be affected over a medium-term by various factors with different impacts on the revenue and/or expenditure side of the general government budget. The analysis of fiscal balance developments builds on the baseline macroeconomic and fiscal projection, i.e. the baseline scenario. The results of the analyses carried out, i.e. the impacts of changed assumptions relative to the baseline projection are then compared to the baseline scenario. Although all the analyses carried out are based on arbitrary assumptions, they still show the effects on fiscal balance that could be expected over the medium-term if circumstances arose that would substantially change the main assumptions.

A brief overview is given below of the fiscal balance sensitivity analyses that were carried out under the assumption of a change in revenue factors and given a constant level of expenditures in line with the baseline projection. It was shown that revenues reacted strongly in crisis conditions, especially tax revenues related to personal consumption and revenues related to the labour market indicators. Considering that, under the baseline projection, revenues from taxes and contributions associated with personal consumption and labour market factors make up, on average, some 70% of general government budget revenues, an overview is given below of the impact of their changes on the overall fiscal balance. With regard to the mentioned revenues, we examined the impact on revenues that are influenced by personal consumption and labour market developments in the narrow sense, i.e. the impact on value added tax, income tax and social security contributions.

The analyses of revenues that are primarily related to personal consumption and labour market developments were carried out in the manner which assumed changes in the expected developments in these revenues over a medium-term if subjected to a two-year consecutive growth shock scenario in 2011 and 2012, with the assumptions for the year 2013 remaining unchanged. Namely, the assumption for 2011 for both revenue categories is outturn at the 2010 level, while the assumption for 2012 implies growth that was smaller by one half compared to that foreseen under the baseline medium-term projection.

The analyses made indicate a significant worsening in the fiscal balance of both revenues related to personal consumption and those closely related to developments in the labour market indicators. The effect of such shocks has also significant implications for the periods following the years in which revenues are subjected to these shocks, and the fiscal balance shows slow recovery. The analyses, in line with the assumptions on which they are based, show an average worsening in the fiscal balance during the observed period of 0.7 percentage points as a result of shock in revenues related to personal consumption and 0.3 percentage points as a result of shock in revenues related to the labour market indicators. However, caution should be exercised in the analysis of the results of the analyses made because of two important factors. Namely, the assumption of shock in 2011 does not have the same effects on revenues related to personal consumption as on revenues related to developments in the labour market indicators. Coming out from the economic crisis and gradual strengthening of economic activity pave the way for a somewhat faster recovery in personal consumption than in the labour market indicators, which usually take a little time to recover after the negative economic developments have subsided. Consequently, as regards the results of the analyses, account should be taken of the effect of baseline revenue projection that takes into account such developments and, under such baseline projection, the nominal growth in revenues related to personal consumption is greater relative to revenues related to the labour market indicators. Another important factor that should be taken into account is the fact that in these analyses shocks are observed separately from each other which is not likely to happen in a real situation and developments of mentioned revenues in shocks such as those described.

Provided that the earlier described worsening in the observed revenues were to take place simultaneously, the fiscal balance would show a significant worsening of 0.5 percentage points in 2011 up to 1.1 percentage points in 2012 and 2013. The combined effect of the described shocks should also be viewed in terms of their mutual intertwinement so the summing up of the effects of different shocks can only be an indication of the level of their simultaneous effect. It should be noted that the analyses carried out assume a constant size of the categories on the expenditure side of the budget even though changes in individual observed revenues would obviously also have, to some extent, implications for the general government budget expenditures. Constancy in expenditures in carrying out fiscal balance sensitivity analyses finds its support in legislative provisions which provide for a large consolidation contribution of the expenditure side of the budget during the observed medium-term period. Namely, as provided by the Conclusion of the Parliament, the level of expenditures for 2011 and 2012 has been capped while fiscal rules

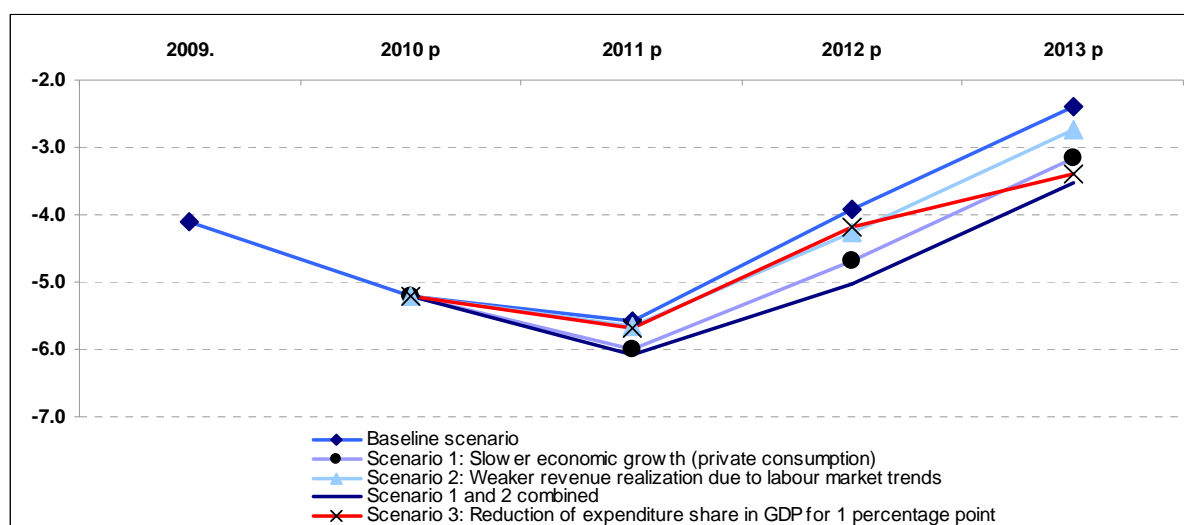
contained in the Fiscal Responsibility Act provide for restrictions in the level of total general government expenditures expressed as a share of GDP. Given that the provisions of the Fiscal Responsibility Act envisage a reduction in the general government budget expenditures to GDP ratio by a minimum 1 percentage point each year and given that the projected reduction in this ratio over a three-year period is greater than 1 percentage point, a less optimistic contraction in the expenditure to GDP ratio that would equal 1 percentage points would lead to a fiscal balance worsening until the end of the medium-term period of approximately 1 percentage point.

Table 3: Assumptions of the Baseline Scenario and Results of the Sensitivity Analysis

	2009	2010 p	2011 p	2012 p	2013 p
Assumptions (baseline scenario)					
Real GDP, growth rate	-5.8	-1.6	1.5	2.0	2.5
Inflation (GDP deflator)	3.3	0.5	1.5	2.2	2.3
Net lending (+) / borrowing (-)					
Baseline scenario	-4.1	-5.2	-5.6	-3.9	-2.4
Scenario 1: Slower economic growth (private consumption)		-5.2	-6.0	-4.7	-3.2
Scenario 2: Weaker revenue realization due to labour market trends		-5.2	-5.7	-4.3	-2.7
Scenario 1 and 2 combined		-5.2	-6.1	-5.0	-3.5
Scenario 3: Reduction of expenditure share in GDP for 1 percentage point		-5.2	-5.7	-4.2	-3.4

Source: MF

Figure 5: Results of Sensitivity Analysis



Source: MF

Public Debt Sensitivity Analysis

Developments in public debt levels are very closely related to macroeconomic assumptions and assumptions and results of fiscal policy implementation. Therefore it is of great importance to continuously conduct analyses of public debt sensitivity to various factors so as to be able to examine realistically the various implications associated with possible changes in the assumptions that determine public debt projections over the medium-term and thus pose the greatest risk and to ensure that such a risk is avoided or its effects mitigated. The public debt sensitivity analyses are based on the baseline scenario, which rests on medium-term macroeconomic projections. A series

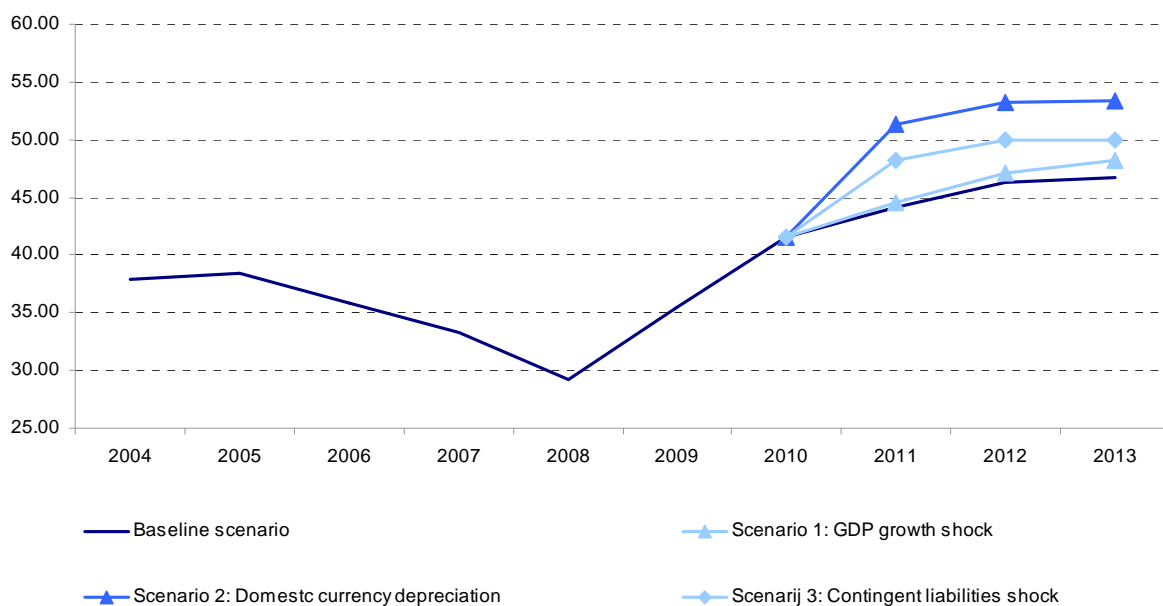
of alternative scenarios are then made whereby the assumed values are subjected to various shocks. The shocks may be connected to historical values of the values under review and their variability, but can also be arbitrary. For the purpose of this analysis, three alternative scenarios were made which examined public debt sensitivity over a medium-term.

The conducted public debt sensitivity analysis showed that depreciation of the domestic currency, especially against the euro, would have the strongest impact on its movement. The reason for this lies in the fact that a sizable share of the debt is denominated in foreign currency. The conducted sensitivity analysis reflects that the arbitrary shock of the kuna depreciating by 25% raises public debt above 53% of GDP in the 2012-2013 period.

Tests have also shown a strong reaction of the public debt, i.e. its growth to changes in contingent liabilities (guarantees). For the purposes of this analysis, a one off increase in public debt in 2011 was assumed pursuant to takeover of contingent liabilities under the restructuring program of the shipbuilding industry, according to which public debt reaches the level of 50% of GDP in 2013.

Furthermore, public debt also shows unfavourable medium-term developments when subjected to the arbitrary assumption of real GDP growth outturn in the 2011-2013 period at the half a lower level than expected. Lower GDP growth has a negative impact on the level of budget revenues and increases the risk of higher than planned fiscal deficit outturn, which requires additional financing through new borrowing.

Figure 6: Public debt as a share in GDP under certain scenarios (in %)



Source: MF

3.2.2 Comparison with Previous Programme

In this chapter, an overview is given of the total amount of revenues, expenditures and net lending/borrowing under the previous year's and this year's PEP.

A comparison of the indicators contained in the previous year's PEP relative to this year's PEP, suggests a substantial level of differences which rest on several important facts. Namely, the planned value for 2009 and its execution show a difference that also has implications for the years

to follow. However, the most significant differences between the two programmes lie in the fact of differences in medium-term macroeconomic assumptions and their effects on budget revenues and expenditures. Namely, last year's programme rested on the assumption of economic growth recovery in 2010, and the expected positive real GDP growth of 0.5% in that year and its acceleration to 3.5% in the last year of the three-year period under review. Following a drop in the real GDP growth of 5.8% in 2009, the unfavourable developments continued into 2010 with current projections suggesting a real GDP fall of 1.6%. The expectations regarding economic growth in the years following 2010 have been downsized relative to the previous programme. Such developments had a direct impact on developments in budget revenues and their projections. In addition to these most important factors, revenue collection, as well as their projections, was also affected by a number of changes in tax legislation which cumulatively led to a fall in total revenues. The expenditure side reflects the negative developments on the revenue side through maximum possible adjustment to real fiscal developments.

Table 8: Comparison of Revenue, Expenditure and Net Lending/Borrowing of the General Government according to previous year's PEP and this year's PEP

	2009	2010 p	2011 p	2012 p	2013 p
PEP 2011-2013 (% of GDP)					
Total revenue	38.5	37.8	36.3	36.8	36.6
Total expenditure	42.6	43.0	41.9	40.7	39.0
Net lending/borrowing	-4.1	-5.2	-5.6	-3.9	-2.4
PEP 2010-2012 (% of GDP)					
Total revenue	38.8	38.4	36.8	35.8	
Total expenditure	42.2	41.7	39.9	38.1	
Net lending/borrowing	-3.4	-3.3	-3.1	-2.3	
Difference					
Total revenue	-0.3	-0.7	-0.5	1.0	
Total expenditure	0.4	1.3	2.0	2.6	
Net lending/borrowing	-0.7	-2.0	-2.4	-1.6	

Source: MF

3.3 QUALITY OF PUBLIC FINANCES

In 2010, the Government of the Republic of Croatia continued to pursue reforms and other activities aimed at strengthening the quality of public finances. For the second year in a row, the budgetary process commences with the adoption of the Strategy of Government Programmes (hereinafter: Strategy), this time for the 2011-2013 period, in accordance with the new Budget Act⁷. This Strategy contains strategic objectives determined under the first Strategy of Government Programmes for the 2010-2012 period, thus ensuring continuity. Such a three-year budgetary framework is of exceptional importance for the achievement of fiscal discipline and allocation of available assets according to strategic priorities. The Strategy is described in more detail in chapter 3.5 Institutional Features of Public Finances. To ensure better connection between strategic, organisational and economic classification, the Ministry of Finance has continued to work towards

⁷ Official Gazette 87/08

improvement and changes in these budgetary classifications, which is described in more detail in chapter 3.5 Institutional Features of Public Finances. Further measures have also been taken towards the implementation of the new Development Strategy of Public Internal Financial Control for the 2009-2011 period and measures outlined in the Strategy for Improvement and Modernisation of the Processes within the State Treasury for the 2007-2011 period.

Further unfavourable economic developments in 2010 had an impact on developments in revenue and expenditure, and led to the adoption of the 2010 budget revision in August, which is described in more detail in subchapter 3.1.2 Actual Balances and Medium-Term Perspectives. It is worth adding that in the context of budget revision, the Parliament issued a Conclusion on the determination of the total level of state budget expenditure, which provided that expenditure of the state budget in 2011 was to remain at the 2010 level.

In an effort to boost credit activity in the country and stimulate economic recovery, the Government, supported by relevant instruments of the Croatian National Bank, provided active support to domestic sectors financing through three financing models. Under model "A", the Government undertook to co-finance bank lending through the CBRD. Under model "B", the Government set up a guarantee fund, assuming a share of the coverage of the risks associated with new bank loans, while the intention behind model "C" was to help entrepreneurs in difficulties with sufficient capacity and viability to survive in the market with adequate restructuring. The Government's Economic Recovery Programme (hereinafter: Programme), underlined as the main objective the creation of firm foundations for economic recovery and growth. The backbone of the Programme lies in the creation of stimulating entrepreneurial environment with an emphasis on the importance of implementation of structural reforms in the public sector. The Programme encompasses a range of measures and activities which include, among others, launching of new investment cycles in the area of energy, environmental protection, irrigation and total infrastructure strengthening, on-going liquidity monitoring and payment period shortening, investment promotion and promotion of the Croatian economy through enhanced system of economic diplomacy. Key Programme levers include reduction in public sector expenditure with increased efficacy and transparency, rechannelling of budget allocations from irrational consumption to targeted social transfers and economically feasible capital investments, smaller government involvement in economic affairs through further privatisation, increased professionalism of management in public enterprises and government institutions in line with the principles of due care of a prudent manager, launching a new investment cycle with economically measurable long-term effects and maximum private sector participation, acceleration of the implementation of reforms of the judiciary, health care, pension insurance and government and local administration.

The Fiscal Responsibility Act was also adopted in the framework of this Programme with the aim of further strengthening responsible budgetary behaviour and public finances stability. This Act introduces fiscal rules and rules for strengthening fiscal discipline which will contribute to ensuring and maintaining fiscal discipline, transparency and medium and long-term sustainability of public finances. A Public Debt Management Strategy was drawn up for the same purpose and working groups were set up to help achieve these objectives. In June 2010, the Government of the Republic of Croatia accepted a Public Investment Projects Catalogue, comprising 30 investment projects of government interest in the area of energy, tourism, water management and transport infrastructure, valued at total EUR 13.85 billion. Looking by sectors, eighteen projects are energy-related and are valued at approximately EUR 3.9 billion, five are tourism-related projects valued at approximately EUR 1.4 billion, four are water management-related projects valued at approximately EUR 4.3 billion and three are transport infrastructure-related projects valued at approximately EUR 4.3 billion. The Catalogue will be updated as new projects are added to the list of projects. The work on the drafting of a Private Sector Investment Potential Catalogue is currently in its final phase. The

realisation of these investment projects will boost economic activities in the country that will ultimately contribute to the strengthening of export capacities of the domestic economy.

Active measures were also taken with a view to reforming public administration and the judiciary, combating corruption and organised crime, promoting and boosting the Croatian economy, activating the labour market, etc.

Some of the funding necessary for the implementation of projects and reforms is expected to come from EU funds. A total of EUR 297.23 million were allocated to the Republic of Croatia through pre-accession assistance programmes CARDS, PHARE, ISPA and SAPARD of which EUR 256.89 million or 86.43% were contracted until 31 October 2010. Payments are underway; until 31 October 2010, EUR 205.28 million were paid. Under the new pre-accession IPA programme, a total of EUR 382.61 million were allocated to the Republic of Croatia for the first three years of the financial perspective 2007-2013. Amendments are currently being made to financial agreements under which the total amounts for the first five years of the financial perspective will be allocated. Until 31 October 2010, EUR 96.18 million or 25.24% of the total under the IPA programme were contracted. It should be noted that the dynamics of contracting is satisfactory and that the contracting and implementation terms determined by IPA regulations are observed.

Steady progress is achieved in the Republic of Croatia in the field of promotion of the AFCOS system for the protection of the financial interests of the EU. At its session held on 14 January 2010, the Government of the Republic of Croatia adopted a 2010-2012 National Anti-fraud Strategy for Protection of the EU Financial Interests in the Republic of Croatia and an Action Plan for its Implementation, and the competent authorities have begun with the implementation of the objectives and measures envisaged by this Strategy and the Action Plan.

With a view to strengthening the capacity of the Independent Department for Prevention Irregularities and Fraud and all the bodies involved in the AFCOS system in the RC, a *Twinning light* project IPA 2007 TAF entitled “Strengthening Croatian AFCOS system with the aim of protection of EU financial interests” is being carried out. The implementation of project activities began in October 2010 and is scheduled for completion until March 2011. The project is carried out by a team of Romanian DLAF experts (Departamentu pentru Lupta Antifrauda). The results to be achieved in the framework of project activities include improvement of procedures to be followed by AFCOS system bodies in cases of irregularities and fraud, strengthening of their mutual communication, co-operation and exchange of information, raising public awareness as regards the fight against irregularities and fraud, improving communication with the public and the media, and organisation of workshops and seminars in the area of irregularities and fraud management.

Also, in line with the Annual Training Plan, the Department provides on-going training for the representatives of the bodies in the AFCOS system (irregularity officer and representatives of bodies in the AFCOS network) and employees working on EU projects-related assignments, and employees who, in the framework of their work activities, have to act on reported irregularities and fraud. In 2010, the Department held 15 presentations for the representatives of the bodies in the system for reporting on irregularities and fraud and bodies in the AFCOS network, in the field of co-ordination of the fight against fraud in the AFCOS system and protection of the financial interests of the EU in the Republic of Croatia and irregularities and fraud management. The Department also actively co-operates with OLAF on training issues and in 2010, four seminars were held for the representatives of the bodies in the AFCOS network.

3.4 SUSTAINABILITY OF PUBLIC FINANCES

The assessment of long-term sustainability of public finances is based on long-term projections of the population of the Republic of Croatia, applying a scenario with medium fertility and migration and baseline macroeconomic assumptions of future movements, which include a changed GDP calculation methodology that is aligned with the European System of Accounts methodology, ESA 95. In comparison with the previous PEP, lower real GDP growth rates are envisaged in the initial period, as well as higher unemployment rates and new fiscal projections for the period until 2013.

The projections were made under the assumption that in the period under review there will be no significant changes in the application of existing legislation which regulate public pension and health expense and that the manner of calculating and collecting social security contributions will remain unchanged. The projections did not take into account the assumptions of the latest changes in the Pension Insurance Act whose preliminarily determined long-term positive effects grew stronger towards the end of the period under review. The projection of expected pension expense took into account the expected movements in the number of pensioners, the expected effects of adjustment of the so-called "new" and "old" pensioners and the lack of pension indexation in individual years.

The projections of health care expense envisage further implementation of health care reform, in particular in the segments of primary health care, hospital system and sick leave control. All other revenues, with the exception of social security contributions, will keep their share in GDP unchanged throughout the entire observed period, and so will all other expense, except for pension, health care and interest expense.

As regards participation rates, it is assumed that the behaviour patterns of individual economic agents will stay unchanged, with participation rates according to 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 vary slightly, primarily as a result of the fluctuation of population in these age groups.

The unemployment rate is projected as falling from 2011, reaching 7% in 2020. In the period following 2020, unemployment is expected to hold at a level of structural unemployment rate of 7.0%. The growth of productivity per employee is derived from the assumptions on real GDP growth and changes in the number of employed persons, which is determined by long-term demographic projections and assumed participation rates.

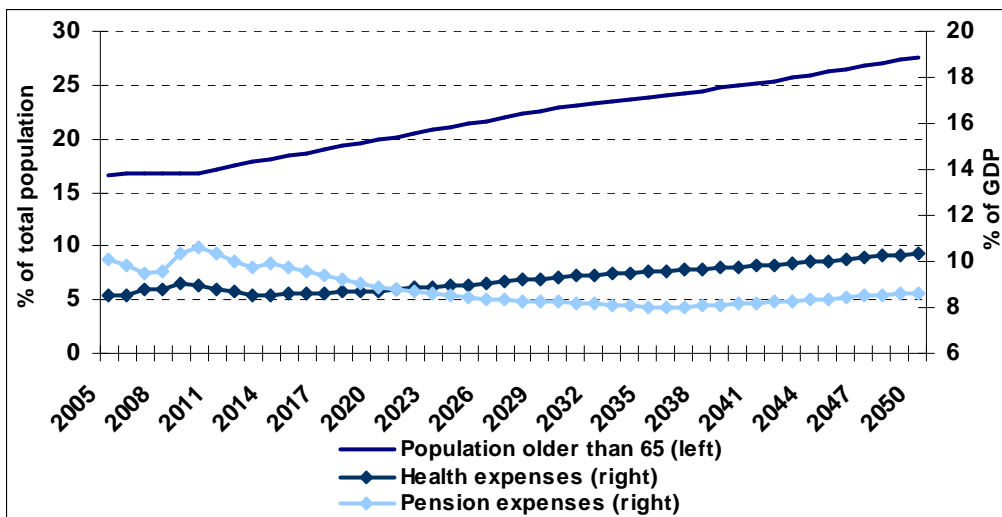
On the basis of the assumptions described above, it is estimated that revenue from pension insurance contributions will fall from 5.9% of GDP in 2005 to approximately 5.6% of GDP in 2015, and stabilise in subsequent years. The reason for this lies in a gradual increase in the share of employees claiming their pension insurance under both mandatory pillars of pension insurance, i.e. of those with a proportion of their contributions of 15% of the 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 the total amount of their contributions (20%) being paid into the first pillar. As they retire, the number of employees contributing 15% of their gross salary into the first pillar will increase. The stabilisation of the share of revenue from contributions from pensions at 5.6% of GDP after 2015 is a result of assumptions that real wage growth per employee is equal to labour productivity growth and the contribution rate is defined 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 projections also indicate a decrease in pension expense by 2.0 percentage points of GDP, i.e. from 10.6% of GDP in 2010 to 8.6% of GDP in 2050, with pensions of war veterans being excluded from the analysis. The share of pension expense in GDP is lower than projected under the previous PEP as a result of changes in GDP calculation methodology and lower real GDP growth rates in the medium-term. Although the number of the ageing population is increasing, due to the pension reform and the decrease in relative pensions paid from the first pillar, long-term projections suggest a decrease in the share of public pension expense in GDP. Such an outcome is very likely, provided that the current parameters of pension calculation are maintained, i.e. wage and price indexation of pensions. In addition, it is estimated that the share of those pensioners whose pensions are paid entirely from the first pillar will gradually decrease, while the share of those who are paid the basic part of their pensions from the first pillar and the remaining part from the second, financed from individual capitalised pension funds, will grow.

The expenses for health care are projected to increase from 6.3% of GDP in 2010 to 9.3% of GDP in 2050. The projection is based on the estimated pure effect of ageing population, reflecting changes in the growing share of older age groups that are the primary users of health care services. The projections assumed expense growth in line with labour productivity growth, the effects of the health care reform and ever increasing costs of the health care sector development, especially in the segment of expense for medicines and new technologies. In addition, it was assumed that health expense for each age and gender group would grow in line with GDP per employee growth, which means that they would follow current trends in the economy and society in general.

Expense for interest as a share of GDP will grow from 1.9% in 2010 to 3.3% in 2050. In line with projected developments in the described revenue and expenditure categories, total revenue will stand at some 37% of GDP and total expenditure at some 41% of GDP during the entire period under review.

Figure 9: Aging of Population, Health and Pension Expenses



Source: MF

3.5 INSTITUTIONAL FEATURES OF PUBLIC FINANCES

The Strategy of Government Programmes 2011-2013 adopted by the Government of the Republic of Croatia in September 2010 ensures continuity in the implementation of strategic objectives determined by the first Strategy of Government Programmes 2010-2012. By bringing together in one place the plans of all ministries, the Strategy has contributed to better co-ordination in the process of decision making on key issues both on the level of individual ministries and the Government level.

However, the key contribution of strategic planning does not lie solely in the setting of objectives and definition of the activities by which such objectives can be achieved, but also in systematic monitoring and measuring of their achievement. To this end, the Strategy of Government Programmes 2011-2013 has defined performance indicators and has set target values and in this sense has made a big step forward compared to the previous year. Performance indicators, as objectively measurable and concrete signs that something has been done, have been defined in such a way that they enable monitoring of the achievement of individual activities that have been carried out. This reinforces accountability for specific set objectives and the manner in which these objectives are achieved.

The system of monitoring relies largely on the system of internal financial controls and the system of reporting to the Ministry of Finance. In 2010, the head of each body appointed for the first time persons responsible for strategic plan implementation monitoring for each specific objective and the manner in which it is achieved (by name and function).

The preconditions for the implementation of the Strategy have been created, among others, through changes in the budget structure, i.e. by linking strategic and budgetary planning. While strategic plans define the directions of activities of ministries and other government bodies, budgets define programmes, activities and projects and ensure funds necessary for their implementation. As strategic plans cannot be implemented without funds, it was necessary to link budget programmes with the objectives contained in the strategic plans. The need for linking strategic and budgetary planning called for improvements in the existing programme and organisational classification.

In drafting of the 2010-2012 state budget, a new, substantially improved organisational classification was used and additional changes were made in the 2011-2013 state budget in line with the provisions of the Ordinance on budget classifications and reorganisations of agencies, institutes, funds and other legal persons with public authorities. The new organisational classification has been aligned with the legally defined authorities of individual bodies, particularly as regards strengthening of the role of ministries as co-ordinators of Government policies, in line with the best EU practices and SIGMA recommendations (joint OECD and European Union initiatives for assistance to developing countries).

The changes in programme classification began in 2009 with a reduction in the number of programmes from 410 to 341. Also, in 2010, the Ministry of Finance formulated in co-operation with the ministries and other government bodies 23 new main programmes, down from the previous 62 main programmes. In drafting the 2011-2013 state budget, the number of programmes was reduced from 341 to 185. The reduced number of programmes has also contributed to increased state budget transparency.

To ensure a better programme implementation monitoring in the process of drafting financial plans of state budget users for the 2011-2013 period, changes were made to the explanations to financial plans. The emphasis was laid on objectives to be achieved through these programmes and performance indicators as regards the achievement of these objectives. For the first time first and second level budget used specially prepared web applications to enter their explanations.

Based on the Budget Act⁸, which entered into force on 1 January 2009, an Ordinance on budget classifications⁹ and an Ordinance on budget accounting and Chart of Accounts¹⁰ were enacted.

The Ordinance on budget classifications defines a framework which shows and monitors on a systematic basis revenues and receipts and expenditures and expenses by responsible bodies, goal, purpose, type, location and source of financing. The structure of numerical codes and name of each classification as well as the manner in which they are mutually connected have been prescribed. Although the Ordinance entered into force on the day of its publication, it was used for the first time in the process of 2011-2013 budget planning.

The new Ordinance on budget accounting and Chart of Accounts entered into force on 14 October 2010. In line with transitional and final provisions of this Ordinance, accounting for 2010 will be conducted in accordance with the provisions of the old Ordinance on budget accounting and the Chart of Accounts¹¹, while the new Chart of Accounts and the Ordinance were used in the drafting of the budget and financial plans for the 2011-2013 period. Amendments to the Chart of Accounts were largely introduced for the purposes of alignment with the European System of Accounts, ESA 95.

In the forthcoming three-year period, the measures that will be taken towards further budgetary processes improvement include those defined by the Strategy for Improvement and Modernisation of the Processes within the State Treasury and include:

- further development and use of programme planning and performance indicators;
- further networking of budget users' financial and management information systems and the information system of the State Treasury, and;
- development of governance functions based on specific knowledge, analyses and information.

The new Budget Act has provided the necessary legislative framework for the implementation of reform steps in budget management and public finance. This Budget Act provides one of the prerequisites for the consolidation of public finances, and as one of the measures for the implementation of fiscal consolidation, the previously mentioned Fiscal Responsibility Act has been adopted. This Act regulates fiscal rules, rules for strengthening fiscal discipline and their application, and the method of reporting on the application of rules and enforcement of the Act. Fiscal rules, as set forth in this Document under subsection 3.1.2. Current fiscal trends and medium-term projections provide the assurance of cyclically adjusted primary fiscal balance of the general budget at zero or positive level during the cycle in order to achieve stabilization and reduction of public debt ratio in gross domestic product. If the budget user creates liabilities with the maturity date beyond the level anticipated by the State Budget, according to this Act, the financial plan in the next fiscal year will be reduced for the amount of created liabilities above the amount provided by the State Budget. In addition, all drafts of laws, regulations, other ordinances

⁸ Official Gazette 87/08

⁹ Official Gazette 26/10

¹⁰ Official Gazette 114/10

¹¹ Official Gazette 27/05 and 127/07

and decisions adopted by the Government, or proposed for adoption to the Croatian Parliament, can not be adopted or established without the opinion of the Ministry of Finance on the Fiscal Impact Statement. During the execution of the state budget, the Ministry of Finance can perform financial control of the lawful and purposeful use of budgetary funds at budget users and final users. The establishment of these fiscal rules and rules for strengthening fiscal discipline within which the Croatian Government will establish and implement the fiscal policy, will contribute to the assurance and maintenance of fiscal discipline, as well as to the transparency and long-term sustainability of public finances.

4 STRUCTURAL REFORMS

4.1 ENTERPRISE SECTOR

4.1.1 Competition Policy and State Aid

Competition Policy

The primary objective behind the enactment of the new Competition Act which entered into force on 1 October 2010 lies in the enhancement of efficient competition policy in the Republic of Croatia that will lead to strengthening of competition among undertakings and that will create the conditions for growth and improved competitiveness of the Croatian economy. In practice, this means better regulation, more efficient implementation of the protection of competition rights, strengthening of the position of the Croatian Competition Agency (hereinafter: the Agency), greater procedural rights of the parties and ultimately benefits for undertakings and consumers.

The adoption of the new Competition Act has provided the Agency with additional tools, in addition to the basic tools needed for the implementation of the competition policy, for real market participation and for preventing behaviour that distorts fair competition. Decisions which could not impose penalties for infringements and as many as three court instances competent for court protection that could rule against the Agency's decisions, resulted in a system in which the Agency could only issue a warning, while court sanctions were either not imposed or were negligible. As the new Competition Act places in the jurisdiction of the Agency the imposition of fines for the infringement of law which can amount to 10% of the total turnover of the undertaking and the reduction of fines or granting of immunity for cartel members who come forward and reveal the existence of a cartel, the new Act offers a much more efficacious instrument for its implementation in practice. As provided by the new Act, the criteria for the imposition of the mentioned fines are defined in detail by a special subordinate legislation.

The Act has also created the preconditions for prevention in terms of deterring undertakings from intentional or unintentional infringements of the Act. In the future, each undertaking will have to pay greater attention to its market behaviour and its behaviour relative to its competition, contract partners or users of its goods and services. Also, the new legislative solution introduces changed procedural provisions to enable that procedures are carried out in a more effective and faster fashion both for the Agency and the undertakings (for instance, it envisages a short form notification and a simplified procedure for treatment of concentrations that do not raise competition concerns).

State Aid

With EU accession negotiations of the Republic of Croatia in the final phase, the efforts of the Agency will be directed towards finalisation of restructuring in iron and steel industry and structural reforms in the shipbuilding sector which should create the conditions for this sector's market sustainability in the absence of operating aid currently provided to it.

Further strengthening of discipline of aid providers in programme shaping and state aid award process and particularly furthering of co-operation with providers of aid on the local and regional self-government level to prepare them for EU membership conditions, when the responsibility for aid control will move from the Agency to the European Commission, remain the main task of the Agency. In this context, the Agency will, aided by IPA programme assistance projects, launch a

comprehensive campaign to inform the local authorities about the rules regulating state aid. It is of utmost importance for the Agency to prepare and educate providers of state aid for use of structural funds resources that will be available to Croatian economy upon accession to the EU and which Croatian entrepreneurs will be able to use provided their programmes and projects are fully compliant with the *acquis* rules regulating state aid.

In November 2010, the Agency adopted the Annual Report on State Aid in 2009. As shown by the data collected, the amount of state aid granted in Croatia in 2009 was smaller than that in 2008 and so was its share in gross domestic product. The total amount of state aid granted stood at HRK 8.7 billion, which is a decline of 9.1% compared to 2008, while the share of total state aid in GDP stood at 2.6% in 2009, a decline of 6.5% compared to 2008 when it stood at 2.8%. Total state aid, agriculture and fisheries excluded, stood at HRK 5 billion in 2009 and accounted for 1.5% of GDP and state aid with agriculture, fisheries and transport excluded stood at HRK 3.7 billion, or 1.1% of GDP.

State aid per employee stood at HRK 5.8 thousand, a decline of 5.7% compared to HRK 6 thousand in 2008. Per capita state aid fell to HRK 1,975.4, down from HRK 2,173.1 in 2008, which is a decline of 9.1%.

As regards individual state aid instruments, subsidies, which account for 80.6% of all state aid, continued their upward trend in 2009. They were followed by state guarantees and tax reliefs which accounted for 13.3% and 4.3%, respectively, of the total state aid while state aid in the form of equity shares and favourable loans accounted for 1.2% and 0.6%, respectively, of the total state aid. By state aid categories, in 2009 horizontal and regional state aid accounted for 11.3% of the total state aid while state aid for special sectors in industry and services accounted for 44% of the total state aid (particularly state aid to transport, shipbuilding, and radio and television broadcasting). Further 42.2% of the total state aid granted went to agriculture and fisheries and 2.5% to state aid on the local level.

4.1.2 Privatisation

In mid-December 2010, the portfolio of the Croatian Privatisation Fund (CPF) comprised 769 companies of which 720 companies were available for privatisation and their equity capital stood at HRK 55.3 billion, of which HRK 13.1 billion were in state ownership. Although 54 companies were privatised in the period from September 2009 to mid-December (2 by sale through a public tender, 20 on the Zagreb Stock Exchange while 32 companies were deleted from the court register following completion of bankruptcy or liquidation procedure), the structure of the portfolio in terms of the number of companies and ownership shares remained almost unchanged in 2010 compared to the previous year. Thus, CPF is a minority owner with up to 25% share in equity capital in 80.75% of companies (621 companies). In 68 companies, it holds between 25% to 50% shares and in 80 companies, the government is still the majority owner, holding over 50% share.

The slowdown in the process of privatisation, with bankruptcy and liquidation, and to a lesser extent the sale of minority shares on the Zagreb Stock Exchange, as the main generators, is still due to the similar factors as in the previous years. On the one hand, highly indebted, mainly loss-generating companies in the portfolio which require significant restructuring are not attractive to potential investors at present conditions. On the other hand, a slowdown in the economic growth in the environment and a slowdown in international capital flows led to a fall in interest, particularly of foreign investors, for participation in the process of privatisation. Twenty-six public tenders

announced from September 2009 until end-November 2010 for the sale of majority shares in 21 companies resulted in privatisation of only two companies.

Although the time limit for the submission of bids under the second tender for the privatisation of five shipyards and one subsidiary in majority state ownership expired in May 2010, no final decision has as yet been made with regard to privatisation of three companies (Brodotrogir d.d, 3. Maj d.d. and Brodosplit d.d.) for which four bids were received. Pursuant to a Decision of the Government of the Republic of Croatia of 22 October 2010, the third tender for the privatisation of the shipyard Kraljevica was announced and on 18 November 2010, three bids were received.¹²

Tenders for the sale of 6 companies in majority state ownership and 87 companies in minority state ownership are currently underway. The completion of privatisation of the largest share of the remaining CPF portfolio, as one of the preconditions for the creation of an efficient market economy and efficient and comprehensive organisation of the remaining state property management, remain the main economic policy objectives in the area of state property management. This objective is also defined in the Economic Recovery Programme adopted by the Government in April 2010 and the Economic Recovery Programme Implementing Activities Plan of 6 May 2010 which outlines specific measures and activities and the expected dynamics of their realisation.

In accordance with the set objectives and measures aimed at centralising state property, the Government of the RC submitted to the Parliament procedure in September 2010 a draft State Property Management Act which envisages the joining of the Croatian Privatisation Fund and the Central State Administrative Office for State Property Management into a single institution, the State Property Management Agency. The joining of these institutions is expected to yield positive synergetic effects such as more efficient state property management, balanced state property management, increased value of state property and reduction in operating expenses. State property management would be based on a four-year strategy adopted by the Croatian Parliament, and an annual operating plan adopted by the Government of the RC. The draft Act also envisages the establishment of a comprehensive register of state property.

As the Economic Recovery Programme also envisages “*fast privatisation of the remaining shares in companies, except those that supply goods and services which the private sector cannot, for good reasons, be expected to supply efficiently*”, the draft Act envisages, in addition to the existing sale models (through the stock exchange and public tenders) other privatisation models such as that which makes it is possible for the Agency to accept bids in take-over procedures, and other models such as IPO organisation for selected companies, public invitation for Agency portfolio company recapitalisation, etc.

The first steps towards centralised management of shares and stakes in state ownership have already been made with the enactment of a Decision on the transfer of all shares and stakes in state ownership to the Croatian Privatisation Fund in April 2010. Until the writing of this document,

¹² Compared to the previous tenders, the text of this tender defines in more detail, in addition to the previously defined amount of own contribution (40% of total restructuring costs), the terms of reference (increase in the initial capital, investment in material and immaterial assets, loss coverage, ensuring the necessary working capital during restructuring, assumption of existing liabilities, redundancies as an issue to be dealt with by the Tenderer, i.e. the Company, etc.) as well as the upper limit for production capacity alignment (maximum 21.15% in the context of compensation measures agreed with the European Commission) and leaves out additional conditions such as employee participation in the purchase of a part of the shares following recapitalisation and reaching an agreement with social partners.

shares of 22 companies had been transferred to the CPF. Also, with a view to achieving faster and more efficient management of shares and stakes, annexes to the agreements with the owners of shares and stakes in CPF portfolio (mainly state budget users such as Croatian Institute for Health Insurance, Croatian Pension Insurance Institute, ministries, and central state administrative offices) are being signed currently which provide that it is no longer necessary to require prior permission of owners for sale, the practice which has until now slowed down the process of preparation of companies for privatisation.

4.1.3 Railway Restructuring

In the course of 2009 and 2010, the activities aimed at implementation of legislative reforms continued by the adoption of 7 new ordinances in 2009 and 2 new ordinances in 2010, all relating to railway transport safety. The beginning of operation of the Railway Market Regulatory Agency started in 2010 and currently it has 7 employees and issues the relevant decisions in accordance with its legal powers. The use of the EU pre-accession funds under the IPA and ISPA programmes continued at a satisfactory pace.

As a result of unfavourable economic trends in the environment, transport impact in railway freight transport was reduced by 20% in 2009 and by 6% in the first half of 2010 relative to the same period of the previous years. Own market revenues in railway passenger transport remained at approximately the same level, decreasing mildly in the first half of 2010 (from HRK 214.0 million in the January-June 2009 period to HRK 212.3 million to the January-June 2010 period).

As regards restructuring of the sector, the period from 2004 to 2008 was marked by the implementation of the activities set out in the Matrix of measures under PAL 1 and PAL 2 loan. The progress in the process was monitored through the performance indicators, such as operating ratio, employment reduction and privatisation of subsidiaries. After a suspension of the PAL arrangement in 2008, these indicators were no longer of interest.

In view of an evident lack of a strategic document which would set an institutional framework for the railway sector restructuring, the Ministry of the Sea, Transport and Infrastructure in cooperation with companies from the Group HŽ Holding firmly intends to adopt a new “Programme of Sustainability and Competitiveness of Railways in the Republic of Croatia”, which would encompass the activities concerning restructuring and preparation of companies for functioning on liberalised railway market. For that purpose, a tender for the selection of consultants in the preparation of that Programme was invited on two occasions, but it was cancelled on both times on technical grounds. The preparation of the invitation of a new tender is underway.

The railway companies are currently implementing the activities aimed at improving operational efficiency and rationalisation, in accordance with the Economic Recovery Programme adopted by the Government of the Republic of Croatia. In companies constituting the Group HŽ Holding, the savings measures are being implemented and the following results were achieved in the January-August 2010 period: 10.9% reduction of tangible and non-tangible costs, 3.2% reduction of costs of employees, signed Annex to the Collective Agreement with the trade unions on maintaining wages at the same level (instead of the agreed 6% increase in 2009 and 2010), the decisions on a wage cut for members of the Management Board and managers are being implemented, as well as many other measures. The largest contribution to the process of reducing the number of employees is planned to be achieved in the company HŽ Infrastruktura, by planning a net reduction of

employment of 1 139 in accordance with the Operating Plan of HŽ Infrastruktura company for the 2010-2012 period.

4.1.4 Shipyard Restructuring

The global economic crisis that strongly hit the shipbuilding market, where ship orders fell sharply, also had a great impact on the situation in the Croatian shipbuilding industry in 2010. Consequently, in 2010, the Croatian shipyards failed to meet their business plans with respect to contracting new business and partly realising the existing business.

Although they have taken measures for operational rationalisation, in terms of employment and fixed cost reduction in 2010, all shipyards in majority state ownership, with the exception of shipyard Uljanik d.d. Pula, failed to achieve considerable improvements in the business process, their realisation rather being postponed until the completion of privatisation in 2011.

For shipyard Uljanik d.d., which operates at a positive operating results, the procedure was initiated, in an agreement with the European Commission, for changing Uljanik's status of a company in difficulties, by means of a refund of all the government grants with interests, which that shipyard had received since 1 March 2006. In accordance with the agreement, the contents of the Agreement on the regulation of property law relations between the Government of the Republic of Croatia and Uljanik d.d. and the new Concession Agreement were submitted to the European Commission. By receiving the letter from the European Commission Vice President Joaquin Almunia dated 14 December 2010, stating that the Uljanik shipyard, in accordance with the European rules on state competition, had harmonized state aid received in the previous period, the process of restructuring the shipyard Uljanik has successfully completed.

All possible future state aid will have to be approved by the Croatian Competition Agency and it will have to be compliant with the *acquis communautaire*.

Since the new interest has been established for the purchase of Shipyard Kraljevica d.d., the Government of the Republic of Croatia has decided to invite the third tender for privatisation of Shipyard Kraljevica d.d., Kraljevica. Three bids were received on the tender published on 3 November 2010 by the following companies: ADRIA-MAR shipbuilding, d.o.o., Shipyard Bomex and Jadranska ulaganja d.o.o. After the analysis of the received bids by the Committee for monitoring the procedure of selling the shares of company Shipyard Kraljevica d.d., Kraljevica, under special conditions, comprising the members of the Government of the Republic of Croatia, the shipyard's Management Board, trade unions acting in the shipyard, representatives of the company Hrvatska brodogradnja – Jadranbrod d.d. and representatives of the Croatian Privatisation Fund, the Ministry of the Economy, Labour, and Entrepreneurship will propose to the Government of the Republic of Croatia further measures concerning privatisation of company Brodogradilište Kraljevica d.d.

As regards the shipyards for which the bids were received in the second round of tender procedure for privatisation, the approval of the complemented and corrected versions of the restructuring programmes is underway, which were performed by the following tenderers: DIV Tvornica vijaka d.o.o. for company Brodograđevna industrija Split d.d., CROWN INVESTMENT GmbH for Brodograđevna industrija 3. Maj d.d., Rijeka and Jadranska ulaganja d.o.o. for company Brodotrogir d.d., Trogir. The restructuring programmes for the aforementioned shipyards were

examined and evaluated provisionally by the Croatian Competition Agency and delivered subsequently for the approval to the European Commission.

The further course of privatisation of the said shipyards primarily depends on the evaluation of sustainability of the restructuring programmes by the European Commission. If the European Commission establishes that all or individual restructuring programmes for the respective shipyard are sustainable and that they, as such, meet the tender conditions, the Government of the Republic of Croatia will continue the privatisation process for such shipyards. If the European Commission establishes that the restructuring programmes for all or for individual shipyards are not sustainable, the decision on initiating bankruptcy proceedings will have to be adopted for such shipyards or another solution will have to be found, such as invitation of the third round of tender procedure for privatisation for the shipyards for which investors show interest, under the same conditions as in the previous two rounds of tender procedure for privatisation.

4.1.5 Energy

In the course of 2010, activities related to strengthening of electricity and gas market continued. The most important activity in 2010 was a preparation of the legislative framework for the application of the third package of the EU energy legislation. The study was drafted which analyses all the required changes with respect to the third package of the EU energy legislation.

All the required laws are expected to be adopted in 2011 which will enable the implementation of the third package. In the field of natural gas, the regulations adopted in the previous year are currently being implemented. Pursuant to the legislation, market prices were applied in 2010 for all the customers, except for household customers.

In the field of electricity, the process of further development of market relations based on the bilateral agreement model has continued. Contractual parties in a bilateral agreement for the supply of electricity are the buyer and supplier, whereas contractual parties to the bilateral agreements on the purchase of electricity are the supplier, trader or producer. All the buyers in the category of enterprises have a status of a privileged buyer, whereby they have taken advantage of the right to contract electricity price independently for their own market needs. Their total contracted consumption of electricity amounts to 8.4 TeraWattHours (TWh), accounting for more than 50% of the overall annual electricity consumption in Croatia. The methodology for the calculation of balancing energy, adopted by the regulatory agency¹³, has changed in a manner that the balancing energy price is related to the buyers in the category of households.

In order to ensure market relations, the activities aimed at strengthening administrative and technical capacities of the Croatian Energy Regulatory Agency and of the Croatian Energy Market Operator have continued.

Activities in the field of renewable energy sources and energy efficiency have also continued. The Government of the Republic of Croatia adopted the National Energy Efficiency Programme 2008 – 2016, the first National Energy Efficiency Action Plan for 2008 - 2010, and the National Cogeneration Potential. In the National Energy Efficiency Programme, the objective of one-percent improvement of energy efficiency per year was set, which amounts to 9% in the 2008-2016 period.

In addition, the Ordinance on Methodology for Calculation and Determination of the National Indicative Energy Savings Target in Energy End Use was adopted, defining and prescribing the

¹³ Official Gazette 94/10

method of calculating and determining the indicative energy savings target in the immediate energy consumption, in accordance with Directive 2006/32/EC on energy end-use efficiency and energy services, i.e. fully transposing Annex I of the Directive. The methodology prescribed by the Ordinance is used to determine the national indicative target set in the National Energy Efficiency Programme 2008-2016 and in the first National Energy Efficiency Action Plan for 2008-2010.

The public sector energy efficiency programmes are being implemented, such as: "Bring the House in Order", encompassing various energy efficiency measures in buildings/facilities owned by the Republic of Croatia.

In December 2010, the Croatian Parliament adopted the amendments to the Act on Biofuels for Transport, in order to incorporate the elements from the new Directive on the promotion of the use of energy from renewable sources¹⁴ in the legal framework regulating production, trade, use and promotion of production and use of biofuels. This primarily refers to the preconditions and sustainability criteria for producing raw materials for biofuels.

The Ordinance on the Measures for Promotion of use of Biofuels for Transport was adopted¹⁵, which prescribes measures to encourage the use of biofuels in transport and the method of their implementation.

Renewable energy objectives set out in the Energy Strategy of the Republic of Croatia are in line with the objectives from Directive 2009/28/EC, in accordance with the said methodology. The National Renewable Energy Action Plan (NREAP) was developed and it was forwarded by the set deadline, 30 June 2010, to the European Commission for approval.

By December 2010, 450 projects related to the renewable energy sources were entered in the Register of projects and plants for the use of renewable energy sources and cogeneration and of privileged producers.

Although the Croatian electricity transfer system is connected to the neighbouring systems very well, further connecting with neighbours has continued once 400 kV between Croatia and Hungary was put into operation, having enabled thus the first connection between the former CENTREL system and the UCTE system in 1999. With respect to PEP 2010-2012, it should be noted that a double 400 kV power-transmission line between Ernestinovo (CRO) and Pech (HU) was put into operation. In the field of co-operation with Bosnia and Herzegovina and the Republic of Serbia, the relationships were established at the level of electricity transfer companies, in order to begin with the joint cross-border transfer capacity auctions. The joint system is expected to be established in 2011 and 2012.

On the basis of the Plan of development, modernisation and construction of the gas transmission system in Croatia from 2007 to 2011, which was adopted by the Government of the Republic of Croatia and which anticipates the procurement and installation of equipment which will enable functioning of the secondary market and the gas network development in southern Croatia, the envisaged activities have continued with the planned dynamics. In March 2009, the Croatian and Hungarian gas transmission system operators signed an agreement on the construction of an interconnection pipeline that will connect these two systems. That pipeline provides technical capacity for a free gas imports in the Republic of Croatia and there are no more technical restrictions in the transport system which used to present a problem for a further liberalisation of the gas market.

On the basis of the said agreement, works on the construction of the gas interconnection between the Republic of Croatia and the Republic of Hungary were completed at end-2010, and issuance of

¹⁴ Directive 2009/28/EC

¹⁵ Official Gazette 42/10

the use permit is currently in progress. Activities regarding the construction of the LNG terminal on the island of Krk have also continued and issuance of the building permit is underway. Further development of the supply capacity for natural gas is also planned, by increasing the pipeline capacity of the gas supply route from the Russian Federation via Slovenia by 500 million cubic meters (until 2012).

In accordance with the Energy Strategy of the Republic of Croatia, adopted by the Croatian Parliament in 2009, upon the proposal of the Government of the Republic of Croatia, the activities relating to the Strategy objectives continued, which include a continuous development of the energy supply safety, competitiveness of the energy sector and sustainable energy development.

Furthermore, activities relating to the energy planning, strengthening of supply safety and energy products market in the energy sector also continued. The pre-accession instruments – IPA are used for the described activities. The energy sector is also being prepared for the use of the structural funds that will be available after the accession of the Republic of Croatia to the EU.

In order to promote development of the energy sector, further activities are also focused on further harmonisation of the domestic legislation with *acquis communautaire*, while promotion of the projects of interest to the Republic of Croatia and the Region will continue, with a special emphasis on the projects relating to the gas market and forming of compulsory stock of oil and refined petroleum products.

As a part of the accession negotiations concerning the issue of safety of crude oil and refined petroleum products supply, the Republic of Croatia was granted a transitional period, until 31 July 2012, for maintaining the compulsory stocks of crude oil and refined petroleum products in the quantity equal to a 90-day average consumption in the previous calendar year.

The transitional period was granted on the basis of the Action Plan for establishment of 90-days compulsory stocks of crude oil and petroleum products by 31 July 2012. The Action Plan which was delivered to the Brussels was revised and harmonised with the requirements of the new Directive 2009/119/EC of 14 September 2009. The revised Action Plan was accepted by the Government of the Republic of Croatia at its session held on 17 December 2009 by a Conclusion on the acceptance of the Programme for creating the preconditions and activities of HANDA aiming at ensuring 90-days compulsory stocks by 31 July 2012. In accordance with the aforementioned Directive, a new draft of the Act on Crude Oil and Petroleum Products Market will begin to be prepared in 2010. The Croatian Parliament is expected to adopt that Act in early 2011.

For the purpose of establishment of the compulsory stocks, a construction of about 800,000m³ of additional warehouse capacities is planned on the territory of the Republic of Croatia, which may eventually be of regional importance. It is estimated that about EUR 130 million will be invested only in the construction of warehouse capacities. The project of establishment of the compulsory stocks will, at the same time, be used for the development of warehouse installations for commercial warehousing, with an aim of reducing the costs of formation and replacement of compulsory stocks, and also further opening of the market and promoting competitiveness. In addition, at its session held on 1 April 2010, the Government of the Republic of Croatia adopted by its conclusion the Conclusion on the determination of priorities in the construction of power facilities. The negotiation process with the Federal Republic of Germany is in progress concerning storage of stocks of crude oil and petroleum products for the Republic of Croatia, for the purpose of maintaining 90-days stocks.

No budget funds will be used for the implementation of the indicated objectives, but economic entities will, within its means, rather use the available funds on the market principles. Foreign investors are also expected to participate in the realisation of individual projects envisaged by the

new energy strategy. Investments in the energy sector in the amount of EUR 15 billion are expected for the period until 2020.

4.1.6 Small and Medium-size Enterprises

Despite global recession, small business is still the most dynamic part of the economy. Small business ended the business year 2009 with 81,426 small and 1,390 medium-size enterprises, 96,909 crafts and 1,125 co-operatives. A total of 180,850 economic entities account for 99.7% of the total economy, employing 66% of the workers. Employment in small-business entities increased by 2.8 in 2009 compared to 2008, total revenues decreased by 6.9% and profit for the period by 13.1%. The share of small and medium-size enterprises in exports stood at approximately 44% in 2009. The analysis of financial results by activities shows that the following are the three most important activities: manufacturing, trade and information and communications with a share of more than 50% in total business results, as was the case in the past ten years. Construction and professional, scientific and technical activities also recorded good business results, whereas other activities were less significant. Depending on the period of analysis, micro economy in Croatia accounts for about 80% of the total economy.

In the Operation Plan of Small and Medium-Sized Entrepreneurship Promotion for 2008 – 2012 of the Government of the Republic of Croatia, of 18 April 2008, which is implemented through the annual Operational plans, the fundamental strategic guideline is strengthening of competitiveness of small business and it has been implemented on an on-going basis. For small countries, such as Croatia, entrepreneurship, characterised by market penetrability and higher value-added products, is crucial. Competitiveness of small business is promoted through aid for the purchase of advanced technologies and technological procedures, which are used for diversification and development of new products, along with transfer and networking of knowledge.

In addition, entrepreneurial projects involving investment in energy efficiency, environmental protection and introduction of the quality management systems and international standards are being promoted. The Croatian economy has about 1,500 fast-growing economic entities - Gezelle for which special incentives are intended, in accordance with the *de minimis* aid rules. Gazelles in small business operate in the activities involving technological innovations, production of new technology, ICT, wood industry, manufacture of ecological products, small shipbuilding, etc. Entrepreneurs improve their export capacities through aid for clusters and creation of brands¹⁶. The system of supporting institutions and regional developmental agency, as well as the established entrepreneurial zones, facilitate the beginning of entrepreneurship and growth and development of small-business entities.

¹⁶ The European Business School released the first Innovation for Development Report, 2009-2010 that measures the innovative capacity of 131 countries worldwide by the Innovation Capacity Index. The Index is based on 5 pillars of innovation capacity: institutional environment; human capital, training and social inclusion; regulatory and legal framework; research and development; and the use of ICT. The Innovation Capacity Index provides a quantification tool for policy discussions on various aspects of innovation - the methodologies allow the formulation of policy prescriptions that are country-specific and based on a nation's development stage and the nature of its political regime. According to the Innovation Capacity Index, Croatia is in 38th place out of 131 countries. Slovenia and the Czech Republic are in 31st and 32nd place, while Slovakia, Poland and Hungary are behind Croatia (in 39th, 40th, and 41st place, respectively). The strength of Croatia's innovation capacity is evident in the following indicators: number of mobile telephone subscribers, schools that have Internet access, the number of articles in scientific technical publications and the number of Internet subscribers.

Entrepreneurship for the youth, beginners and disabled people, as well as women's entrepreneurship has its place in the development of small business, especially at the regional level. In strengthening of competitive capacities of the small and medium-size enterprises, a significant part relates to training for entrepreneurship, which includes all forms of registration of entrepreneurs, i.e. companies, crafts and co-operatives. As a part of institutional development, the Ministry of the Economy, Labour and Entrepreneurship established the Registry of aid to small business, a database with data and technological solutions and the reporting system, which allow for monitoring, analysis and evaluation of the system of incentives. Drafting of Small Business Development Strategy for 2012-2020 period is being considered¹⁷.

The Republic of Croatia has been implementing the European Charter for Small Enterprises since 2003, which is the main EU document for implementation of small business development policies. In 2008, the EU adopted the Small Business Act for Europe for the purpose of further development and promotion of small and medium-size enterprises, implying that the process established by the European Charter for Small Enterprises changes and that with 2010 a new reporting cycle begins, which will monitor the implementation of the small business development policies through the application of the Small Business Act for Europe. The SEE countries have reached an agreement to measure performance by the so called policy index in a two-year reporting cycle.

The service of the Government of the Republic of Croatia for a quicker communication between entrepreneurs and citizens with state administration bodies – HITRO.HR, has been operating for more than five years (the first office was opened on 11 May 2005 in Zagreb). By using services of 61 HTIRO.HR offices more than 38,507 companies and crafts were established. Out of a total number of newly-established companies, more than 2,594 are in foreign ownership. HITRO.HR expanded to all county centres, larger cities and islands in the Republic of Croatia. In addition to cost reduction, the largest savings were made in terms of time, since the entire establishment procedure was shortened from 40 days in 2004 to 24 hours, through the project e-Tvrtka (e-Company)¹⁸.

In view of the achievements, a further systematic support to small business should be ensured, primarily through: (i) creation of conditions and implementation of institutional solutions for expanding the sources of financing (venture capital funds, equity funds, EU financial instruments), facilitating access to sources of financing of innovations and their commercialisation and increase in total investment in small business, (ii) including small business entities in financial markets and finding alternative lending sources (iii) increased use of internet and e-services (e-commerce, e-business, e-banking, e-marketing, etc.), (iv) strengthening of support of development to *new age*

¹⁷ Strategy for Women's Entrepreneurship Development 2010 – 2013 – adopted in March 2010; Analysis of development and position of crafts with the guidelines for crafts development strategy and Guidelines for a short-term crafts development 2011-2012 – completed in May 2010; Learning Strategy for Entrepreneurship 2010-2014 – adopted in June 2010; Cluster Development Strategy 2010-2015 – proposal completed; Strategy for Promoting Investment and Internationalisation 2012-2020, at the international tender – the expected deadline for delivery is end-2012.

¹⁸ The Ministry of the Economy, Labour and Entrepreneurship has developed a Programme of measures for simplifying the operation of small business entities, in accordance with the Economic Recovery Programme of the Government of the Republic of Croatia of 6 June 2010. The Programme of measures for simplifying the operation of small business entities is divided into two areas: **facilitating entry into entrepreneurship** and **facilitating operation of small and medium-size enterprises carrying out entrepreneurial activity**. The Programme defines 14 implementing entities according to their respective competence and 27 measures relating to the following areas and activities: 11 measures aimed at legislative amendments, 4 measures for systematic analysis for the purpose of rationalisation and efficiency, 5 measures for facilitating financing, 2 measures for e-business and digitalisation, 1 measure relates to education and information, 1 measure relates to advisors and consultants for entrepreneurship, specialists for providing assistance and expert support to recovery of economic entities, 2 measures for promotion of entrepreneurship and 1 measure for more strict application of the existing economic regulations.

economy (with considerable growth possibilities) including small business in tourism and cultural industries, (v) better connection of small business with research and development and entities for whom this is a core activity, (vi) giving priority to promotion of further growth and continuity of implementation of developmental projects of fast-growing economic entities, (vii) increasing overall productivity as a result of application of innovations, new technologies and research and increasing the share of small business entities which enter the market with higher value-added products, by applying advanced technological solutions, (viii) further investment in life-long learning for entrepreneurship, (ix) support to export and market competitiveness of small business through clusters, (x) flexible employment and (xi) promotion of entrepreneurship with an aim of further enhancement of entrepreneurial culture.

Small and Medium-size Enterprises in Tourism

As regards the Programme of the Government of the Republic of Croatia intended for lending to small family enterprises in tourism “Incentive for success”, the assumed obligations are being conducted. As a part of the Programme, in the 2002-2009 period, loans were granted at a subsidised interest rate to small and medium-size business entities. In the 2011-2013 period, more than HRK 210 million worth aid will be disbursed to these entities. The subsidy funds will be allocated, under the Programme, to 248 companies and 226 crafts. The said number of enterprises operates in 357 hotel and restaurant facilities for accommodation, classified as hotel-type facilities – hotel, all-suite hotel and boarding house, 79 suites and 34 summer houses. That segment of small hotel industry operates even in off-peak season, especially in smaller towns, when larger hotel systems are closed, thus directly affecting the extension of the tourist season. Small and medium-size enterprises, beneficiaries of the Programme, have 5,854 rooms and 1,097 suites and 15,150 beds, accounting for 11% of the total number of rooms available in the Croatian hotels, all-suite hotels and boarding houses, 34% of the total number of registered tourist apartments and 13% of beds in the total number of beds in hotels, all-suite hotels, boarding houses and registered tourist apartments.

In the period 2011 - 2013, implementation of the incentive measures for small and medium-size business entities in tourism through non-refundable grants is planned to be continued. Non-refundable grants will promote development and realisation of the programmes and projects for creating the preconditions which will contribute to the development of the basic, as well as improvement and enhancement of the supplementary tourism offer in the Adriatic hinterland, in the continental area and in the hinterland of the Croatian islands. Non-refundable grants will also be directed at development of the selective types of tourism at the seaside and in the coastal area and improvement of environmental protection and safety while conducting specific forms of seaside tourism. Furthermore, production of original souvenirs will be promoted, as well as restoration, valorisation and revitalisation of the cultural, traditional and natural heritage as a new tourist product. The incentives will also encompass the events for increasing competitiveness in tourism and improvement of conditions for disabled persons in hotel and restaurant accommodation facilities. The objective is to enable a better positioning in the tourist market for the segment of small and medium-size enterprises in tourism in the forthcoming short-term period, in accordance with the required quality standards.

4.1.7 Public Private Partnership

In accordance with the measures and plans set out in the last year's PEP, in September 2010 the Ordinance on setting up and maintaining of the Register of public private partnership contracts was adopted, on the basis of which the Register of public private partnership contracts (PPP) will be

established by the end of the first quarter of 2011. The Register is the central source of information about all the concluded PPP contracts, representing the uniform electronic records of all the PPP contracts concluded on the territory of the Republic of Croatia. It will have a significant impact on a systematic monitoring and studying of the gained practical experience in the implementation of the public private partnership projects and application of the knowledge acquired in this manner in the training system and preparation of new projects.

In accordance with the priorities in the actions of the Agency for PPP, determined by the Strategic Framework for the Development of the Public Private Partnership in the Republic of Croatia, and in accordance with the Regulation on training of participants in procedures for the preparation and implementation of public private partnership projects¹⁹, a comprehensive training programme is being prepared, on the basis of which the training system will be established by the end of the first quarter 2011, in cooperation with the competent bodies at the government level and units of local and regional self-government, for public sector authorities competent for the preparation and implementation of the PPP projects. In April 2010, the Agency also concluded an Agreement on business cooperation in the implementation of training for PPP with the Croatian Employers' Association, and the proposal of the Agreement was also submitted to the Croatian Chamber of Economy for its opinion, so that it is soon expected to be signed. The goal of the implementation of the training programmes in the field of public private partnership is to achieve a high level of quality of public infrastructure and public services by deepening the understanding of the procedures in this field for persons participating in the preparation and implementation of the PPP projects within public bodies and for personnel of professional associations, which is the main prerequisite for the preparation and implementation of high-quality projects.

The central management of the PPP project approval process by the Agency for PPP, in accordance with positive regulations in the field of public private partnership²⁰ and cooperation with the Ministry of Finance in a form of control of fiscal impacts and risks are aimed at project structuring, in order to minimise them and increase quality of the projects themselves, as well as quality and availability of public services. Ensuring significant capital investments without additionally burdening the budget represents an important impact. By acting in this manner, the local community units can be economically stimulated and revived and the investment environment can be improved, which in turn contributes to a better standard of the country as a whole.

The fundamental purpose of the described activities and tasks within the competence of the Agency is to establish stable processes of high-quality preparation and offer, contracting and implementation of the PPP projects at all the levels: national, regional and local. South-east European countries²¹ are faced with an additional need for a faster development of public infrastructure and the level of public services, which increase efficiency of the public sector as a whole, creating thus new economic perspective for the application of PPP in exports of the acquired know-how and experience. Accordingly, successful implementation of the PPP projects becomes crucial not only for ensuring development of public infrastructure and standard of public services, but also for the development of the economy as a whole.

¹⁹ Official Gazette 56/09

²⁰ Act on Public Private Partnership (Official Gazette 129/08), Regulation on the criteria for assessment and approval of the public private partnership projects (Official Gazette 56/09), Regulation on the content of public private partnership contracts (Official Gazette 56/09), and Regulation on the supervision of implementation of the public private partnership projects (Official Gazette 56/09).

²¹The South-East European Cooperation Process (SEECP) member states - Albania, Bosnia and Herzegovina, Montenegro, Bulgaria, Croatia, Macedonia, Moldova, Romania, Serbia, Turkey and Kosovo/UNSCR.

For the purpose of preparation and implementation of cross-border projects under the model of public private partnership, the Agency for PPP will thus, as a leading institution for public private partnership in the SEECP countries, in cooperation with the Council for Regional Cooperation, carry out activities of exchange of knowledge and experience in the field of public private partnership, in order to strengthen administrative capacity for the preparation and implementation of cross-border projects, attracting in this manner investors and financial institutions by launching high-quality cross-border PPP projects, which would be extremely useful for a broader region and the Republic of Croatia, when it comes to improvement of public service quality and economic cooperation and growth of the economy as a whole.

4.2 FINANCIAL SECTOR

At the end of June 2010, total bank assets accounted for 76.7% of total assets of all financial intermediaries. In terms of share in total assets of all financial intermediaries, housing savings banks follow with a 1.3% share. These shares indicate that the financial system in the Republic of Croatia is concentrated around banks.

Although banks' share in total assets of all financial intermediaries was declining in the period until the end of 2007, in favour of an increase in the share of investment fund and pension fund assets, in 2008 banks' share in assets of all financial intermediaries rose 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 increased withdrawal of investors due to a reduced interest in such investments, but investor confidence in funds was restored from the end of 2009.

Table 9: Financial Sector Structure (% of total assets at the end of a period)

	2005	2006	2007	2008	2009	June 2010
Banks	78.9	76.7	73.9	77.7	76.6	76.7
Open-end investment funds, net assets	2.7	4.0	6.4	2.1	2.4	2.9
Closed-end investment funds, net assets	1.1	1.4	1.7	0.9	0.8	0.8
Insurance companies	5.0	4.9	5.0	5.6	5.8	6.0
Housing savings banks	1.9	1.6	1.4	1.5	1.4	1.3
Compulsory pension funds, net assets	3.6	4.0	4.5	4.7	5.9	6.4
Voluntary pension funds, net assets	0.1	0.1	0.2	0.2	0.3	0.3
Credit unions	0.5	0.5	0.4	0.1	0.0	0.0
Leasing companies	6.2	6.8	6.5	7.2	6.8	6.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Croatian National Bank, Ministry of Finance, Croatian Financial Services Supervisory Agency

Institutional cooperation

In order to define a stronger cooperation between supervisory institutions a Memorandum of Understanding for the financial crisis management was signed by the Ministry of Finance, Croatian National Bank and Croatian Financial Services Supervisory Agency (CFSSA).

4.2.1 Banking Sector

Operation. In mid-2010, 34 banks and 5 housing savings banks operated in the Republic of Croatia. Their share in total assets of all financial intermediaries was about 77%. At the same time, the banking system was highly concentrated, 10 largest banks accounting for about 89.82% of total assets of all banks. Banks in majority foreign ownership predominate in the ownership structure, representing 90.71% of total bank assets, compared to 4.19% of bank assets in domestic state ownership and 5.10% of total bank assets in domestic private ownership.

At the end of the second quarter of 2010, total bank assets amounted to HRK 379.5 billion, which is an increase of 0.29% relative to the end of 2009. Small and medium-size banks recorded assets growth, while large banks recorded a fall in assets. In the first half of 2010, funds of majority foreign owners of banks represented the main source of growth of bank assets, accounting for 19.46% of total sources of financing. At the end of June, the share of deposits remained stable in comparison with the past three years, constituting 67.84% of total bank liabilities which mainly relates to the household sector. At the same time, HRK 407.0 billion was exposed to credit risk, of which 6.89% was classified into risk categories B and C, representing non-performing placements. Total amount of provisions for placements and off-balance sheet liabilities accounted for 3.64% of total placements and liabilities, this indicator continuing its increase which started in 2009 and hitting its record high since 2004. Bank profit recorded in the first half of 2010 amounted to HRK 1.89 billion, but 9 smaller banks recorded losses. As at 30 June 2010, capital adequacy ratio of banks stood at 19.0%, return on average equity (ROAE) stood at 6.89% and return on average assets (ROAA) at 1.17%.

Credit unions. At the end of the second quarter 2010, 23 credit unions operated in the Republic of Croatia, with total assets of HRK 513.1 million, which accounted for 0.13% of total assets of credit institutions in the Republic of Croatia on the same day. The process of alignment of savings and loan co-operatives operation with the provisions of the Credit Union Act²² was completed in September 2009, in a manner that, within the prescribed transitional period, of 104 savings and loan co-operatives which were authorised on the date of entry into force of the Act and which were entered in the court register:

- 30 savings and loan co-operatives requested from the Croatian National Bank and were granted the authorisation and continued their business as credit unions,
- 1 savings and loan co-operative (which previously merged with 4 savings and loan co-operatives) was granted the authorisation to operate as a savings bank,
- 69 savings and loan co-operatives did not file a request for transformation either in a credit union or in a savings bank, but their members decided to start a business liquidation procedure.

In the same period, the CNB granted the approval for the establishment of 3 new credit unions, in accordance with the Credit Union Act, so that the credit union system in the Republic of Croatia consisted of 33 credit unions at the end of September 2009. However, by the end of 2009 and in the first half of 2010, the regular business liquidation procedure was initiated for 9 credit unions, on the basis of the decisions adopted at the general meetings of the credit unions, whereas bankruptcy proceedings were initiated against one credit union upon the proposal of the CNB.

²² Official Gazette 141/06 and 25/09

Legislative framework. The Credit Institutions Act²³, implementing the provisions of the Capital Requirements Directive (CRD)²⁴, in the part relating to credit institutions, was adopted in September 2008. In January 2009, the Croatian National Bank adopted subordinate legislation regulating in detail calculation of credit institutions' capital adequacy, as well as a range of other subordinate legislation based on the new Credit Institutions Act²⁵. The Act prescribes that credit institutions must have minimum capital adequacy of 12 percent. The new capital adequacy calculation applies as of 31 March 2010, since the CNB transposed the amendments to the CRD, adopted in 2009 at the EU level, into the relevant subordinate legislation at the beginning of 2010²⁶.

The Consumer Credit Act, applying the provisions of the Directive on Consumer Credit Agreements, was adopted in July 2009 and it came into force on January 1st 2010. In January 2010, the Minister of Finance adopted an ordinance which specifies in more detail personnel, technical, organizational and other conditions that a lender or a loan broker must fulfil in order to obtain the approval for providing consumer credit services, contents of the request for issuing the approval, documentation that needs to be submitted along with the request, reasons for the refusal of a request, issuance of approval, validity period of the approval, fee for performing the procedure of issuing the approval, termination of approval and obligation of reporting to the Ministry of Finance, as well as an ordinance on the obligation of informing consumers of additional requirements for the calculation of effective interest rate. In accordance with the provisions of the mentioned Act, the Ministry of Finance has issued 27 approvals for providing consumer credit services.

Agreements. The cooperation between the CNB and supervisors of banks which are in majority foreign ownership, is based on the memoranda of understanding concluded with the representatives of Austria, France, Italy, Hungary, Germany and San Marino, while agreements with supervisory authorities from Bosnia and Herzegovina and Montenegro are related to the supervision of subsidiary banks in these countries. Following the entry of Swiss shareholders in the ownership structure of banks in Croatia, a memorandum of understanding with the Swiss supervisor is being prepared.

Payment system. In October 2009, the Payment System Act²⁷ was adopted, which transposed into the Croatian legislation Directive on payment services²⁸ and which will enter into force in 2011. In 2010, drafts of the Act on the Settlement Finality and Electronic Money Act²⁹ were prepared, by means of which transposition of Directives 2009/44³⁰ and 2009/110³¹ into the Croatian legislation will be completed in 2011.

²³ Official Gazette 117/08

²⁴ 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.

²⁵ Official Gazette 117/08, 74/2009, 153/09; In addition to the CRD it also encompasses the transposed provisions of Directive 2001/24/EC on the reorganisation and winding up 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.

²⁶ The amended decisions were published in the Official Gazette 2/10.

²⁷ Official Gazette 133/09

²⁸ Directive 2007/64/EC on payment system services in the internal market

²⁹ Electronic Money Act was adopted on 26 November 2010 (Official Gazette 139/10)

³⁰ Directive 2009/44/EC on settlement finality in payment and security settlement systems

³¹ Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions

Since the Payment System Act, which came into force on January 1st 2011, no longer regulates certain issues that were regulated by the National Payment System Act which has just expired, in 2010 the Act on the Implementation of Enforcement on Financial Resources was adopted as well as the related ordinances, introducing a new system of the implementation of enforcement on funds in a way that the bases for payment are submitted for the implementation to the Financial Agency that requires from banks in which accounts or debtor funds are kept, to pay obligations. In addition, this Act also regulates the way of keeping the Unified Register of Accounts as well as the treatment of Business Entities in terms of blocked accounts.

Human resources. In view of the new regulations concerning payment system and electronic money, the CNB supervision area was reorganised and new employees were recruited who will perform supervision of payment system and electronic money institutions. A considerable number of the CNB employees are involved in the training project organised by the ECB for the countries in the region.

Following the regulations on consumer credit and consumer protection, a Department for Coordination of Consumer Protection and Financial Literacy has been established within the Financial System Directorate of the Ministry of Finance.

4.2.2 Non-banking Sector

Operation. On 1 October 2010, the authorisation for conducting insurance business was issued to 25 insurance companies and 2 reinsurance companies in the Republic of Croatia. In addition, there was 30 insurance intermediation companies (insurance brokers), while 246 intermediaries conducted insurance intermediation business as natural persons. 173 crafts for insurance representation and 202 insurance representation companies (insurance agents) were engaged in insurance representation business (insurance agency), whereas 9,042 insurance agents conducted insurance representation business as natural persons (including insurance agents in the bank channel).

At the 36 vehicles technical inspection stations it is possible to contract the compulsory insurance policy for the motor vehicle owner or user, from liability for damage to third parties and additional motor vehicle accident insurance. All of the legal and natural persons listed above operate on the basis of a decision of the Croatian Financial Services Supervisory Agency (hereinafter: the CFSSA), while 25 banks obtained the authorisation by the Croatian National Bank for performing the tasks of representation in insurance, upon a prior approval by the CFSSA.

At the end of the second quarter 2010, total assets of insurance companies amounted to HRK 29.3 billion, while the assets of reinsurance companies stood at HRK 0.9 billion. Gross written premium for non-life insurance amounted to HRK 7.4 billion in 2009, compared to HRK 2.5 billion for life insurance.

On 1 October 2010, a total of 46 investment companies and credit institutions authorised to provide investment services operated in the capital market. In addition, there were 4 compulsory pension funds, 6 open-end voluntary pension funds and 15 closed-end voluntary pension funds, 34 open-end and 8 close-end investment funds, as well as two funds established under the special law (the Fund of Croatian Homeland War veterans and members of their families and the Pensioners' Fund).

Total assets of investment companies amounted to HRK 0.4 billion at the end of the second quarter 2010, net assets managed by pension companies amounted to HRK 33.4 billion, net assets managed by investment fund management companies stood at HRK 16.8 billion and assets of the funds established under the special law amounted to HRK 4.6 billion.

At the moment, there are 26 leasing companies in the Republic of Croatia, which were granted authorisation by the CFSSA, as well as 18 factoring companies. At the end of the second quarter 2010, assets of leasing companies amounted to HRK 31.4 billion, while assets of factoring companies stood at HRK 6.5 billion.

Legislative framework. In the course of 2010, the CFSSA adopted ordinances regulating insurance and capital market, as well as several technical instructions and opinions contributing to an improved and uniform application of the adopted regulations. The CFSSA organises, on an on-going basis, consultations and workshops for the entities subject to supervisions, where various issues concerning the implementation of legislation are being discussed. By the amendments to the Act on Compulsory and Voluntary Pension Funds³², the applicable Act is harmonised with Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision.

In the forthcoming period, in accordance with the obligations undertaken by the Republic of Croatia in the negotiation process, preparation of the new insurance law is planned in 2011, which will transpose Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II) into the Croatian legislation. Furthermore, the new investment funds law will also be prepared in 2011, harmonised with Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities (UCITS). The Republic of Croatia will continue to pursue the activities related to the harmonization of the regulatory framework in the area of financial system, according to the implementation timetable in line with the amendments to the *acquis communautaire*.

CFSSA, as a supervisory body for entities that provide non-banking financial services, revises and improves its approach to supervision. CFSSA has developed a system (matrix) for risk assessment in which a special emphasis is put on corporate governance of supervised entities, and it continues to work on the improvement of surveillance in order to further develop the control of the legality of business operations and to better assess the risks in business operations of a particular supervised entity. CFSSA is a signatory party of the Multilateral Memorandum of Understanding with the members of the International Organisation of Securities Commissions (IOSCO) and has already signed several bilateral cooperation agreements with non-banking financial market regulators, and in 2010 it signed an agreement with the Macedonian Agency for Supervision of Insurance and it will continue to cooperate with all regulatory bodies with which it has signed agreements in order to improve the supervision of financial market.

Accounting and Auditing. In 2010, in the field of accounting and auditing, the World Bank IDB Grant project no. TF 090 642 was carried out and completed. The aim of the Project was to strengthen the financial reporting system of trading companies in Croatia. Within the Project, methodologies for public supervision and quality control of audit firms, authorized auditors and independent auditors were developed, and the training for teams that will perform related tasks was

³² Official Gazette 124/10

performed. In 2010, regarding the legislation, the Minister of Finance issued the ordinances harmonizing regulations in accordance with the amendments to the International Financial Reporting Standards.

International cooperation with the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has started at the United Nations Conference on Trade and Development (UNCTAD). On 15 December 2010, the Republic of Croatia was elected by the acclamation as a member of ISAR for the 2010 – 2012 period.

Following the regulations on accounting and auditing, a Department for Financial Reporting has been established within the Financial System Directorate of the Ministry of Finance.

4.3 LABOUR MARKET

The economic crisis had a strong impact on the Croatian labour market in 2009 and 2010, resulting in a considerable growth in unemployment and decrease in employment. According to the data of the Central Bureau of Statistics, registered employment decreased from 1,517,783 in August 2009 to 1,440,603 in the same month in 2010, which is a fall of 5.1%. In the same period unemployment registered with the Croatian Employment Service increased from 251,005 to 283,330, which is a 12.9% growth. Unemployment of persons who were previously employed rose by 17.4%. According to the labour force survey data, unemployment rate rose from 8.9% in the second quarter 2009 to 12.4% in the same quarter of 2010.

With the purpose of mitigating impact of the crisis on employment, Croatian Parliament adopted the Act on the amendments to the Act on the Grant for Preservation of Jobs¹³ in mid 2010 which relaxed the criteria for granting aid as there were no submitted requests for the grant in the first eight months of 2010. By these amendments and 2010 budget revision, the amount of appropriated funds for this purpose was reduced from planned HRK 200 million to HRK 5 million.

4.3.1 Stimulating Employment

The measures for promoting employment are envisaged by the National Employment Promotion Plan 2009–2010, which is based on the Joint Assessment of Employment Policy Priorities (JAP). The Croatian Employment Service implements the active employment policy measures within its competence, encompassing subsidised employment, education of the unemployed and public works. The planned expenditures for active employment policy measures amount to HRK 175 million in 2010. In comparison with the realised expenditures in 2009, which amounted to HRK 93 million, the expenditures planned in 2010 rose by HRK 85 million, or 88.2%

As regards the implementation of the active employment policy measures within the competence of the Croatian Employment Service, in the first eight months of 2010, 1,790 employments of the unemployed persons were co-financed, which is 48.5% more than in the same period of the previous year. 3,882 persons participated in the training for the unemployed, a rise of 43.5%. There were 3,409 participants in public works, organised by the units of local government and self-government in cooperation with the Croatian Employment Service in the field of utility

¹³ Official Gazette 88/10. The Act was in use till the end of 2010.

infrastructure construction, cleaning, eradication of ambrosia, social services, etc., in the first eight months of 2010, which is an 88.7% increase against the same period of the previous year.

In the existing labour market conditions and within the existing fiscal capacity, there is a need for strengthening expenditures for the measures in this area. Accordingly, in the forthcoming period, expenditures for these measures will increase, and upon the accession of the Republic of Croatia to the EU, a possibility will arise to use the funds from the European Social Fund, which will bring about considerably larger expenditures for active employment policy measures.

Greater coverage of the unemployed by the active employment policy measures, especially by the measures of educational character (training), will improve their knowledge and skills and enhance their employability. Active employment policy measures will thus contribute to quality and adaptability of the labour force.

4.3.2 Social Security System

Legal Protection of Unemployed Persons

The primary form of social protection during unemployment is payment of financial compensation for unemployment³⁴. The number of financial compensation beneficiaries stood at 69,919 in August 2010, an increase of 8.7% relative to the same month of the previous year. In 2010, expenditures for financial compensation for unemployment are planned in the amount of HRK 1.6 billion.

Since the right to compensation for unemployment has expired for many persons who lost their job due to economic crisis, in October 2010, the Act on Amendments to the Act on Employment Mediation and Unemployment Rights¹⁴ was adopted, which extended or renewed the right to financial compensation. On the other hand, in order to stimulate a more active search for employment, the level of financial compensation for new beneficiaries was reduced after the first three months of use from 50% of the previous gross salary after deduction of contributions to 35% of the previous gross salary after deduction of contributions. The proposed amendments related to the extension of the right to a financial compensation from one to four months are fiscally neutral, since the required funds of approximately HRK 150 million will be provided by the savings on the amended level of financial compensation in the second period of use, in the amount of about HRK 180 million.

The said Act has also extended a possibility to receive a financial compensation for unemployment until the conditions for full old-age pension are met. That measure was adopted in order to reduce the entries into early retirement pension, i.e. to increase participation of older people in the labour force. In view of the described changes concerning greater retirement of persons among the labour force and in the labour market, until the conditions for full old-age pension are met, the application of that legal solution requires additional funds to be allocated in the forthcoming years, with an annual increase of about HRK 9 million, which may be achieved by an internal redistribution of funds collected from savings on pension expenditures due to increased reduction in the amount of early retirement pension. Accordingly, this change will have no fiscal effects.

³⁴ Financial compensation for unemployment

³⁵ Official Gazette 121/10

Pension Insurance

In the field of compulsory pension insurance based on generation solidarity (I pillar), the impact of the reform, which started on 1 January 1999, has been monitored for already 12 years. The level of pensions earned on the basis of the Pension Insurance Act has been monitored on an on-going basis and measures have been proposed for the purpose of achieving the appropriate replacement rate. The replacement rate for October 2010 amounts to 40.89% for an average pension earned under the Pension Insurance Act, i.e. 44.68% for the average old-age pension earned under the Pension Insurance Act, and 60.29% for an average old-age pension with a completed qualifying period of 40 or more years of service¹⁵.

In addition, the measures are being proposed with an aim of fiscal consolidation of the system of generation solidarity and the overall pension insurance system. The level of early retirement pension is being monitored in particular, as well as disability pension due to professional incapacity for work in the course of beneficiary's employment and minimum pension, which were raised in the past three years in order to improve financial and social security of their beneficiaries, on the basis of the Act on Amendments to the Pension Insurance Act¹⁶. In the same period, the Act on the Supplement to a Pension Earned under the Pension Insurance Act¹⁷ was in effect, which intends to correct inequality in the amount of pension earned for the same qualifying period under the previously valid regulations and pension earned under the Pension Insurance Act. The application of the aforementioned regulations, the estimated fiscal impact of which is an increase in pension costs of about 0.4% of GDP per year, has contributed, in the conditions of reduced economic activity, to an increase in the share of pension expenditures in GDP to 10.5% in 2009, relative to 9.8% in 2008¹⁸. The fiscal impact of the aforementioned acts is subject to a continuous monitoring, in order to intervene, in a timely manner, in case of a possible growth in the share of pension expenditures in GDP above the anticipated increase. Unfavourable demographic trends have significant implications for the pension system stability. For instance, the ratio of the insured persons to beneficiaries is still extremely unfavourable – in October 2010, there was 1,499,265 insured persons and 1,195,903 beneficiaries (1.25:1 ratio). In the conditions of unfavourable economic developments, which are under the influence of the economic crisis and the described demographic movements, the challenges arise in terms of maintaining the pension system stability.

In April 2010, the Government of the Republic of Croatia adopted the Economic Recovery Programme, which, among other things, envisages the activities and measures aimed at further regulation of the pension insurance system. In chapter X Social Security System of the Economic Recovery Programme, the following objectives are set out: *“ensuring a long-term sustainability of the social security system in the conditions of the population aging”* and *“improving efficiency of the social transfers by directing them exclusively at those in need”*. Short-term and mid-term measures are planned for implementing these objectives, both with respect to the system of generation solidarity and capitalised system.

In the system of generation solidarity, as regards the fulfilment of the objective of *“ensuring a long-term sustainability of the social security system in the conditions of the population ageing”*, a gradual equalisation of the age for acquiring rights to old-age and early retirement pension is envisaged, as an obligation under the Decision of the Constitutional Court of the Republic of

¹⁵ Croatian Pension Insurance Institute data for October 2010

¹⁶ Official Gazette 79/07

³⁸ Official Gazette 79/07

³⁹ CBS data

Croatia of 18 April 2007, as well as revision of the system of pensions earned under special conditions and their reduction, and preparation for phasing-out of individual categories.

Amendments to the Pension Insurance Act¹⁹ which entered into force on 1 November 2010, prescribes the increase in the age limit for entitlement to old-age and early retirement pension for women, from 60 to 65 years of age for old-age pension, i.e. from 55 to 60 years for early retirement pension, for the purpose of providing equal conditions for acquiring rights to pension for both men and women. The age limit for entitlement to old-age and early retirement pension will be raised gradually by 3 months per year, so that transitional period is 20 years. Furthermore, the same Act prescribes a change in the baseline factor for calculating early retirement pension for the purpose of a more appropriate reduction in the amount of early retirement pension. More specifically, it has proven that the present reduction (prescribed by the Act on Amendments to the Pension Insurance Act²⁰) of 1.8% per year (i.e. 9% for five years of earlier retirement) is not proportionate to the benefit of earlier retirement, in view of extended life expectancy. The baseline factor is determined relative to the total completed years of retirement (qualifying period), by reducing pension from 0.34% per month of earlier retirement for the insured persons with a completed qualifying period of 35, i.e. 36 years of service, to 0.15% per month for the insured persons with a completed qualifying period of 40 years of service (which currently applies to insured men, whereas a transitional provision will apply to insured women). At the same time, the baseline factor of 0.15% per month is determined for computing the old-age pension earned for the first time after turning 65 years of age (for 5 years maximum), i.e. in the transitional period after reaching the retirement age for an individual year in the transitional period, stimulating thus prolonged work. These, along with pensions computed taking into account salaries earned in the entire period of working life, will contribute to a rise in pensions, i.e. to an increase in the replacement rate in the long-term period.

Another anticipated measure, which is also short-term, is a revision of the system of pensions earned under special conditions and their reduction, and phasing-out of individual categories, i.e. their translation into the general system. For the purpose of implementing that measure, the comparative analysis is being prepared of the rights exercised under special regulations, on the basis of which the appropriate changes will be proposed in 2011.

In 2010, by the Act on reduction of pensions determined, i.e. earned under the special regulations governing pension insurance²¹, pensions of individual categories of the insured persons (members of the Croatian Parliament, former Government members, judges of the Constitutional Court of the Republic of Croatia and the auditor general, president of the Republic of Croatia, Croatian Homeland war veterans, political prisoners, participants in the People's Liberation War, members of the former YNA, active military personnel, police officers and authorised officials, members of the Croatian Defence Council and pension supplement granted to members of the Croatian Academy of Sciences and Arts) were reduced by 10%. The Act entered into force on 1 July 2010. In addition, in the course of 2010, pensions were not adjusted on the basis of the Act on Special Tax on Salaries, Pensions and other Receivables and it will remain so in 2011 as well, according to the Act on Postponing Pension Adjustment in the period from 1 January to 31 December 2011²², and in accordance with the Decision of the Croatian Parliament issued at the revision of the government budget, according to which the government budget expenditures will remain at the 2010 level in the following two years.

¹⁹ Official Gazette 121/10

²⁰ Official Gazette 79/07

²¹ Official Gazette 71/10

²² Official Gazette 139/10

As a part of the anticipated objective of “*improving efficiency of the social transfers by directing them exclusively at those in need*”, a change in the method of financing the minimum pension will be proposed until the end of 2012, as well as the method of achieving the same by introducing the income or property census.

By the application of the Ordinance on the procedure of convalidating decisions and individual acts from the field of pension insurance²³, the access to pension insurance rights was allowed by acknowledging the years of service (qualifying period) completed on the territory of the Republic of Croatia which was under the UN protection. A majority of the applications (relative to the estimated expected number) has already been submitted during the two years of the Ordinance application and a further decrease in the application inflow is expected in resolving that issue, since the applications for convalidation of decisions can be submitted within an unlimited period of time, i.e. when applying for regular entitlement to pension insurance.

As regards the compulsory pension insurance on the basis of individual capitalised savings (II pillar), the already mentioned Economic Recovery Programme envisaged a gradual increase in the contribution rate for the purpose of ensuring the adequate pensions for the future generations of pensioners, on which the decision will be adopted in 2011. In addition, the formula for calculating the basic pension (earned by the insured persons participating in both compulsory pension insurance pillars, for the qualifying period after the introduction of the capitalised system, i.e. as of 1 January 2002) should be reviewed and the pension funds’ investment policy should be re-examined in terms investment differentiation with respect to age cohorts (a possibility of making riskier investments for younger persons and more conservative investments for persons 5 or 10 years before the entitlement to pension insurance).

In view of high administrative costs of the capitalised system implementation, the same Programme envisages a review of a possibility to make additional savings in that system, which is also planned to be proposed in 2011.

As regards voluntary pension insurance based on capitalised savings (III pillar), unfavourable economic conditions, both in Croatia and in the world, contributed to a very mild increase in the interest of insured persons in participation in that form of additional source of income in the future (6 open-end voluntary pension funds with 159,399 insured persons in September 2010, relative to 147,764 insured persons in January 2010). In contrast, the economic situation caused stagnation, or even a mild decrease in the interest in closed-end voluntary pension funds (15 closed-end voluntary pension funds with only 17,690 insured persons, compared to 17,720 insured persons in January 2010). A small number of insured persons in closed-end voluntary pension funds is a result of a relatively poor interest of employers as sponsoring undertakings of closed-end pension funds, whereas other possible sponsoring undertakings have failed to show any interest from the very beginning of introduction of the capitalised system.

The Economic Recovery Programme introduced a measure relating to voluntary pension insurance, i.e. treatment of payments by employers to pillar III pension insurance as a tax deductible expense, which was also regulated by the amendments to the Profit Tax Act. More specifically, in accordance with the provisions of that Act, payments by employers made to voluntary pension funds on behalf of employees up to a maximum of HRK 500 monthly per employee (HRK 6,000 annually) are treated as a tax deductible expense. Accordingly, it is expected that employers will show greater interest in establishing closed-end pension funds.

²³ Official Gazette 53/08

In the second half of 2010, the Proposal of the Act on Amendments to the Act on Compulsory and Voluntary Pension Funds was prepared and forwarded in the legislative procedure. By its adoption, a complete harmonisation will be achieved with Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision, which relates to pension funds where employers act as sponsoring undertakings, i.e. to closed-end voluntary pension funds. Lower limits on investments of those funds are proposed, as well as creation of the conditions for their cross-border activities. Furthermore, a reduction of incentives from the state budget is proposed, which are granted to a voluntary pension fund management company for members of the voluntary pension fund from 25% to 15% of the paid in contribution of an individual fund member in the previous calendar year, but for a maximum contribution of HRK 5,000 per fund member in the course of one calendar year. The Ministry of Finance is authorised to supervise the lawful determination and use of the incentives. This reduction of government incentives will contribute to a reduction of expenditures of HRK 20.8 million for that purpose in 2011, compared to the expenditures planned in 2010.

The implementation of the pension system reform over the past 12 years has contributed to financial stabilisation and adjustment of the pension system to the economic and demographic movements. By introducing a three-pillar pension scheme, the focus of the reform has been placed, to a great extent, apart from the social, on macroeconomic and financial effects of the pension system – capital market development and efficient allocation of capital, domestic savings increase and economic growth. However, as a result of numerous interventions in the system of generation solidarity after the onset of the reform, the effects of the reform have been significantly mitigated and postponed. Therefore, the objective of a further development of the pension system is to achieve and maintain financial and social sustainability of that system, as well as to maintain balance between the level of pensions earned only in compulsory pension insurance based on generation solidarity and the level of pensions earned under capitalised system of pension insurance.

Social Welfare

As a result of the economic and financial situation, in the course of 2009 the strategic approach was directed at ensuring the minimum living standard for the most disadvantaged part of the population. In accordance with the predictions, a slight rise in the number of permanent support recipients was recorded in 2010. More specifically, while a mild fall in the number of permanent support recipients was recorded in 2009 relative to 2008 and 2007, a 6.2% rise was recorded in June 2010. Accordingly, 99,571 beneficiaries were recorded in June 2010, compared to 93,754 in 2009.

In 2009, the social protection programmes protected most of the inactive persons from a drastic increase in poverty (funds for social rights have not been reduced and these persons have not been directly effected by unfavourable labour market movements), while poverty risk increased to a larger extent among the active population. In 2009, the greatest efforts were made to retain the achieved level of social rights, and the existing social programmes were reviewed and reforms in individual social sectors were launched.

As a part of the Economic Recovery Programme measures, a set of measures is envisaged, which should contribute to the establishment of a more efficient and rational system of social transfers and to an exchange of information with other systems, in accordance with the Social Benefit Reform Strategy from 2007 and the Social Welfare Development Project. The first efforts in that direction were made by the of Social Welfare Development Project, which was financed by the World Bank funds, for the purpose of system modernisation and harmonisation with the EU criteria and standards, while the Social Benefit Reform Strategy has focused on a better co-ordination and

exchange of information between the various parts of the social welfare system, better targeting, equalisation and faster and higher-quality access to social benefits.

The Ministry of Health and Social Welfare is an entity in charge with the implementation of the measure "Analysis of the system of social benefits, equalisation of benefits granted on the same basis and full application of the personal identification number as an instrument of directing social policy measures". The following implementing activities are determined, among other things, as a part of this measure:

1. Updating of the list of social benefits and method of their realisation and the amount of the base for determining the benefits and updating of the list of all legislation governing the social benefit system (that activity was implemented in June 2010);
2. Proposal for rationalisation of social benefits, defining of the uniform concept of the family (household), determining of the uniform methodology for setting up the proprietary census and the proposal for the census amount for the entitlement to social benefits; the proposal for the amendments to individual pieces of legislation;
3. Proposal for administrative rationalisation of the system in terms of establishing a single point for disbursement of social benefits. All the competent state authorities are expected to actively participate and to make constructive proposals concerning rationalisation of social benefits and establishment of the single point for disbursing social benefits.

It is provided by the law that the full application of the personal identification number should start as of the beginning of 2011, as an instrument that should contribute to a better distribution of social transfers (availability of data on income and property of all citizens, which is important when granting benefits that are conditional to income and/or proprietary censuses).

For the purpose of further improvement of efficiency, transparency and information and professional basis of the system of social welfare and social benefits, the Social Welfare Act should provide for the new criteria for realising social benefits and services, establishing quality standards for social services, conditions for implementing deinstitutionalisation and development of new extra-institutional services of social welfare and supply and improvement of services that a beneficiary may realise in the processes of social integration. In addition to the proposal of the new Social Welfare Act, the proposal of the Social Welfare Development Strategy in the Republic of Croatia 2011-2016 was prepared, which places emphasis on further decentralisation and delegation of powers to the units of local and regional self-government, redefining of cash support and improvement of position of socially vulnerable groups, reorganisation of welfare centres, expansion of the social service providers' network and reduction of regional differences in service accessibility and development of services contributing to easier access to labour market for marginalised and vulnerable groups. Furthermore, the Strategy also focuses on the implementation of the Master Plan for deinstitutionalisation and transformation of social welfare centres and other legal persons in the Republic of Croatia 2011-2018, which determines the conditions and method of implementing deinstitutionalisation, simultaneously developing new extra-institutional services in the community in the area of social welfare and intergenerational solidarity. Transformation financing may be achieved by a reduction in the number of persons accommodated in institutions, which will release certain funds that will be directed at financing extra-institutional forms of care and professional support services in the community.

Protection of Motherhood and Family Allowance

In the implementation of the 2006 National Population Policy²⁴ measures, the application of the Act on Maternity and Parental Benefits and the Child Support Act continued. For the purpose of

²⁴ Official Gazette 132/06

exercising the rights prescribed by the Act on Maternity and Parental Benefits and the Child Support Act, an increase in investment of funds of HRK 92.3 million was recorded in 2010 relative to 2009, through the Ministry of Family Affairs, War Veterans and Intergenerational Solidarity. In the 2011-2013 period, a total of HRK 8.7 billion is planned to be allocated. In addition, the work of 17 county family centres continued.

Improvement of student standards

In the implementation of measures aimed at improvement of the student standard, in 2011 granting of scholarships to full-time students enrolled in university and vocational studies continued, as well as subsidising of transportation costs of full-time students and handicapped students and subsidising of accommodation and meals of full-time students. In 2011, granting of 3,000 new state scholarships is planned in several categories for full-time students enrolled in university, vocational and postgraduate studies. In 2010, the funds intended for providing scholarships to full-time students, subsidising transportation, accommodation and meal were at the level of the funds allocated in 2009, while in the 2011-2013 period, the same amount is planned to be allocated from the state budget, which would also include a slight increase in each year for each of the said measures. In 2011, the Ministry of Science, Education and Sports will subsidise students' meals for about 115,000 full-time students, accommodation in student and pupil dormitories for about 10,000 full-time students and will provide subsidies for about 7,000 students in private accommodation.

4.4 AGRICULTURAL SECTOR

Agricultural Land

The state-owned agricultural land is managed on the basis of the Agricultural Land Act²⁵, the Programmes for state-owned agricultural land management (hereinafter: the Programme) adopted by the units of local self-government for their respective region and subordinate application of the general real-estate rules. Pursuant to the Agricultural Land Act, the units of local self-government adopt the Programme for their region, which must be approved by the Ministry of Agriculture, Fisheries and Rural Development. Management of the state-owned agricultural land is not possible if the units of local self-government have not adopted the Programme, upon the approval by the Ministry of Agriculture, Fisheries and Rural Development. Out of a total 546 units of local-self government in the Republic of Croatia, 471 have agricultural land in the ownership of the Republic of Croatia, and the Programme was approved by the Ministry of Agriculture, Fisheries and Rural Development for 360 local-self government units. The Programmes encompassed a total of 545,375.04 ha of agricultural land in state ownership, which is designated for the following types of management: return 48,121.23 ha (9%), sale 225,089.83 ha (41%), lease 126,955.10 ha (23%), concession/long-term lease 129,233.57 ha (24%) and for other purpose 15,975.30 ha (3%).

The main types of state-owned agricultural land management include: sale, lease, long-term lease and concession for fish ponds. Management is performed on the basis of public tenders. 52,912 ha of the state-owned agricultural land was sold or 24% the total land planned under the Programmes. 82,183 ha was leased or 65% of the total planned under the Programmes. Long-term lease is a new form of state-owned agricultural land management and 2,305 ha of land has been managed so far in this manner. Concessions for fish ponds also represent a new form of state-owned agricultural land management and no land has been managed so far in this manner. Concessions for state-owned agricultural land is a type of management regulated by the former Agricultural Land Acts, which

²⁵ Official Gazette 152/08 and 21/10

ceased to be effective as of the date of entry into force of the existing Agricultural Land Act. The areas of agricultural land envisaged for agricultural land concession under the management Programmes, which have not so far been given in concession for agricultural land, will be managed through a long-term lease following the entry into force of the Agricultural Land Act. Since the beginning of management until present, 62,896 ha of land has been granted in concession. 93,535 ha of agricultural land in the ownership of the Republic of Croatia is used on the basis of receipts of temporary use. Approximately 293,831 ha of state-owned agricultural land has been managed in accordance with the Programmes. In the 2011-2013 period, sale of agricultural land is planned to be increased, which is possible to achieve only after settling the land registry status, performing the necessary geodetic surveys, resolving the property-law relations for the land (non-implemented consolidation (arondation), private ownership), which is a long-term and expensive process. For that reason, units of local self-government give in lease the land designated for sale until the land registry status is settled.

Regulation of the Agricultural and Food Products Market

In 2010, 4 regulations were issued which constitute, together with the Act on Regulation of the Agricultural Products Market²⁶, the legal framework regulating the fruit and vegetable market in the Republic of Croatia:

- Ordinance on fruit and vegetable manufacturing organisations²⁷
- Regulation on aid to fruit and vegetable organisations²⁸
- Ordinance on market standards for fruit and vegetable²⁹
- Ordinance on registration in the Register of fruit and vegetable traders³⁰

In 2011, activities aimed at harmonisation of legislation of the Republic of Croatia with the legislative framework of the European Union in the fruit and vegetable sector will continue, as well as the establishment of the system of control of compliance with the market standards, system of aid to manufacturing groups and manufacturing organisations, setting up of a database of traders carrying on the activity of trade in fruit and vegetables and preparation of the National Programme for sustainable operational programmes.

In the cattle production area, three pieces of subordinate legislation were issued in 2010, pursuant to the Act on Regulation of the Agricultural Products Market:

- Ordinance on the production limit in the dairy sector,
- Regulation on public interventions and private storage aid in the beef sector,
- Regulation on public interventions and private storage aid in the milk and dairy products sector, prescribing in more detail the measures for regulating the milk and beef market in accordance with the appropriate EU legal framework.

The aforementioned subordinate legislation will apply in a transitional period until the date of accession of the Republic of Croatia to the EU.

In the 2011-2013 period, in the cattle production area, alignment of the existing subordinate legislation with the amendments to the EU legislation is planned, as well as introduction of the standards at slaughtering and dissecting poultry carcasses, monitoring and improving breeding activities and continued establishment of the breeding organisations in cattle industry.

²⁶ Official Gazette 149/09

²⁷ Official Gazette 4/10

²⁸ Official Gazette 70/10

²⁹ Official Gazette 77/10

³⁰ Official Gazette 91/10

In 2011, an expert mission and study visit for the fruit and vegetable manufacturers is planned under the Dutch grant, concerning the market regulation measures in the fruit and vegetable sector. The UNECE workshop on market standards for mandarins, apples and tomatoes and control of compliance with the market standards of the products that are placed on the market, imported or exported from the Republic of Croatia will be held in Dubrovnik in October 2011.

Establishment of the Market Price Information System for the Market in Agricultural Products

In accordance with the EU legislation, the Member States are obliged to establish the market information systems, i.e. systems for monitoring and reporting on prices and quantities of agricultural products in the representative markets, for the purpose of implementing the measures prescribed by the EU Common Market Organisation. The activity of coordinating the work of the Market Information System in Agriculture (MISA), functioning as an organisational unit in the ministry competent for agriculture, is implemented through the project “Legal and institutional harmonisation with the *acquis communautaire* in the field of agriculture, technical support to the Department for Market Information System in Agriculture -MISA”. In 2011, the MISA's work plan, until the EU accession, includes setting up of monitoring of prices and quantities of agricultural products in the domestic representative market, in accordance with the EU legislation, for the following groups of products: 1. beef carcass, 2. pig carcass, 3. sheep and lamb carcasses, 4. poultry and eggs, 5. fresh raw milk and dairy products, 6. cereals and oil crops, 7. fresh fruit and vegetables (after the accession, imports from the third countries), 8. sugar, 9. tobacco, 10. agricultural inputs (fodder). In order to fully implement the Act on Regulation of the Agricultural Products Market and the Ordinance on collecting data and reporting on prices of agricultural products, it is necessary to strengthen the MISA Department human resource capacity, in accordance with the Decision of the Government of the Republic of Croatia on the acceptance of the Action Plan from February 2010.

Since food processing industry has a significant role in Croatia's entire economy, the Food Processing Industry Developing Strategy is of an extreme importance in this area, but its adoption is closely connected to the drawing up, enactment and adoption of other strategic documents, especially the Strategy for the Development of the Economy and the Processing Industry Development Strategy. Therefore, it is not possible to enact the Food Processing Industry Development Strategy before the adoption of these strategic determinations.

As a part of the aforementioned strategy, it is necessary to enhance the legislative framework, including technical regulations and laws regulating the conditions for entering the market, as well as to abolish individual outdated standards, in order for the food-processing sector to be able, upon the EU accession, to adapt as soon as possible to the competitive market economy, taking into account the principles of sustainable development and socially responsible economy, especially by strengthening competition and gradually eliminating state aid.

If the said strategies, for which the Ministry of the Economy, Labour and Entrepreneurship is responsible, are adopted, the preparation of this Strategy remains the planned objective until the end of 2013 and fulfilment of this task depends on the source and sufficiency of the budget funds. The aid planned under the 2010 budget for the development of food processing sector was reallocated under the revised budget. Funds earmarked for this purpose have not been envisaged under the 2011 budget.

State Aid in Agriculture

In the 2010, the bulk of the state aid to agriculture was administered in accordance with the provisions of the Act on State Aid to Agriculture and Fisheries. In July 2010, the new Act on State

Aid to Agriculture and Rural Development³¹ (hereinafter: the Act) was adopted, which represents the last step in the process of harmonisation of the Croatian aid scheme in agriculture with the aid regulated by the EU Common Agricultural Policy. This Act, which entered into force on 1 January 2011, regulates, during the entire pre-accession period, state aid to agriculture in a form of direct payments to agricultural farms, aid to rural development and special aid to agriculture. The Act is based on a document adopted by the Government of the Republic of Croatia at its session on 25 February 2010, entitled „Agricultural Aid System Reform in the Republic of Croatia in the 2010-2013 period –conceptual framework for agricultural policy in the pre-accession period“. The Act regulates direct payments in 2011, when individual elements of the Croatian direct payment model will be applied for the last time. For all agricultural areas where agricultural crops are grown, payments are envisaged for primary agricultural areas unrelated to the type of production (the so-called „unrelated payments“). On the basis of the analysis of all former types of direct payments, payments related to production will be retained in the most sensitive sectors, since; otherwise, a risk would arise of abandoning these productions, which include: milk, suckler cows, sheep, goat, breeding sows and feeding of oxen in cattle breeding, tobacco, sugar beet and olive oil in plant production. This is also based on the practice in the EU Member States, which did not switch immediately to unrelated payments, but gradually in the period of several years.

Furthermore, the Act introduces the application of the Regional Single Payment Scheme (the SPS scheme) as of 2012, which allows for retaining of production related payments in individual sectors (suckler cow premiums up to 100% relative to the permitted amount; sheep and goat premiums up to 50% relative to the permitted amount). The Act also regulates the State aid to agriculture, representing a separate set of regulations in the EU legislation, harmonizing the competition provisions which also relate to agriculture. This implies that in the three-year transitional period following the accession to the EU, funds will be earmarked in the state budget for the most sensitive sectors for which no aid is allocated from the EU budget. This refers to aid for sugar beet, olive oil, tobacco, dairy cows under selection control and breeding sows.

In the chapter of the Act relating to rural development, the measures are divided into the rural development measures in the period until and after the accession of the Republic of Croatia to the EU. At present, aid to rural development accounts for less than 20% of Croatia's total aid to agriculture, which should almost double until 2012. The total budget for market-pricing policy measures under the first pillar is planned to be gradually decreased, while aids relating to measures for rural development under the second pillar are to be increased considerably. Enhancing the level of competitiveness and harmonisation with the developed EU market of agricultural products and foodstuffs has remained the objective of the agricultural policy, which is planned to be achieved by a more efficient allocation of total funds earmarked for the sector aid.

Activities aimed at legislative alignment are carried out simultaneously with the intensified preparatory activities and building of implementing capacity (primarily the Paying Agency in Agriculture, Fisheries and Rural Development) for the purpose of implementing the single payment scheme to farms as of 2012.

The Act on State Aid to Agriculture and Rural Development also provides for the obligation to establish the system of granting and monitoring aid to agriculture and rural development by the units of local and regional self-government at the national level, i.e. by the Ministry of Agriculture, Fisheries and Rural Development. Accordingly, the Act also prescribes the obligation to establish a register of state aid in agriculture and rural development in 2011, which will significantly facilitate

³¹ Official Gazette 92/10

communication with the European Commission regarding the issue of state aid when Croatia becomes the EU Member State. Additional human resources will be required for the establishment of the register of state aid in agriculture and rural development.

Since the beginning of 2010 the new Act on Excise Duties has been in force. The Act regulates utilisation of gas oils for use in agriculture and fisheries under privileged tax conditions, without paying excise duty. The Act on Agriculture lays down the basic framework for formulation of right to use gas oils under privileged conditions, whereas the Ordinance on application of the Act on Excise Duties related to gas oil coloured blue for use in Agriculture, Fisheries and Aquaculture lays down detailed conditions for exercise of that right. In 2010, the previous Fuel books for farmers and Fuel books for fisheries and aquaculture were replaced by the card „Fuel for agriculture and fisheries“ (fuel card). The fuel card is issued, upon the beneficiary's request, by the Paying Agency in Agriculture, Fisheries and Rural Development, i.e. by the competent authority for granting benefits for fisheries, breeding and aquaculture.

Farm Accountancy Data Network

The establishment of the Farm Accountancy Data Network (FADN) in the Republic of Croatia is an obligation under the Act on Agriculture. Pursuant to the Ordinance on the establishment and implementation of the farm accountancy data network³², the farm accountancy data are collected by the Croatian Agricultural Extension Institute – FADN Service, through the annual FADN survey. On the basis of the sample of agricultural farms (taking into account regional aspect, farm size and production type), data are collected every year, from which structural and economic indicators related to agriculture are calculated. Maintenance of the FADN is an obligation of all EU Member States and it represents an instrument of the European Commission for assessing income of farms and the impact of the EU Common Agricultural Policy on their operation.

In 2010, the FADN pilot survey for the accounting year 2009 was carried out in 21 counties on a sample of 500 farms. The planned number of farms to be included in the survey in 2011 is 1,000 and in 2012, the final objective is to reach a representative sample of 1,500 farms. In accordance with the aforementioned required increase in coverage of farms in the sample, the fulfilment of the final objective concerning the coverage is questionable, in view of lack of staff, both in the Ministry of Agriculture, Fisheries and Rural Development as a co-ordinating body, and in the FADN Service as an implementing body. The need for administrative and budgetary strengthening of the FADN activity is also stressed in the Croatia 2010 Progress Report by the European Commission.

Rural Development

In accordance with the Council Regulation No 1698/2005, each Member State should prepare its Rural Development National Strategic Plan and Rural Development Programme for the programme period. These documents set the objectives of the rural development policy and measures for their fulfilment, which will be financed by the European Agricultural Fund for Rural Development (EAFRD). The Republic of Croatia is in process of preparation of these strategic documents.

Until the accession to the EU, in accordance with the Act on State Aid to Agriculture and Rural Development, the rural development measures will be implemented aiming at enhancing competitiveness of agricultural farms, preservation and improvement of the environment and

³² Official Gazette 46/08

biological diversity, as well as improvement of the living conditions in the rural area. These measures encompass: aid for insurance against possible damage in agricultural production, aid for preserving autochthonous and protected breeds of domestic animals, aid for capital investments in agriculture, aid to agricultural farm income, aid to ecological and integrated agricultural production and aid to areas with more difficult agricultural management conditions. These measures will be implemented until the accession of the Republic of Croatia to the EU.

At the same, use of the funds under the EU pre-accession programme continues. The implementation of the pre-accession programme SAPARD ended on 31 December 2009 and in 2010 the implementation of the programme IPARD began. In the new programme period (2007-2013), funds in the total amount of EUR 184.4 million (HRK 1.3 billion) were earmarked for IPARD programme (75% EU and 25% Croatia).

The accredited measures are the following: „Investment in agricultural farms for the purpose of restructuring and meeting the EU standards“ and „Investment in processing and selling agricultural and fish products for the purpose of restructuring and meeting the EU standards“, and in 2010, three rounds of tender for co-financing of these measures were published, of which two were completed and one is underway. In January 2011, granting transfer of powers by the European Commission for the following measures is expected: “Improvement and development of rural infrastructure” and “Diversification and development of rural economic activities” and tenders for beneficiaries of these measures were published in December 2010. The following measures are in the accreditation process: “Preparation and implementation of local rural development strategies“ (LEADER) and „Technical assistance“.

Phytosanitary Area

The planned implementation of the EU phytosanitary regulations was completed in 2010, in accordance with the Plan of activities for transposing and implementing *acquis communautaire* for that year. In 2011, transposition and implementation of the new EU regulations published in 2010 will continue. In 2010, registration in the phytosanitary register continued, as well as authorisation for issuing plant passports for those natural and legal persons who have not filed an application for registration and authorisation in the earlier periods of registration. The same activities will continue in 2011. According to the plan, that process will be completed by the end of the first quarter 2011.

In May 2010, establishment of the Phytosanitary Information System (PIS) began. The project was financed under the World Bank project and it consists of three main components: Plant health care/Seeds and propagation material, Plant protection products and Phytosanitary inspection. Functional specification for the above components will be completed in the first quarter 2011. Construction of these components and PIS implementation are planned to be completed in 2011.

Construction of the building of the Institute for Plant Protection, which operates as a part of the Croatian Centre for Agriculture, Food and Rural Affairs, is currently underway. The plan for 2011 is to continue with the construction. Completion of the construction is planned by the contractor in the first quarter of 2012, in view of performing additional works on the reconstruction of the summer house, protected monument of culture, that have arisen in the course of reconstruction, which will be followed by the equipping and accrediting of specialist laboratories. In March 2010, implementation of the twinning project IPA 2007 - Further capacity building in the area of plant protection products and pesticide residues began. Duration of the project is 15 months.

In the 2011-2013 period, activities will be focused on continuation of capacity building (which slowed down in 2010 due to recession) and professional training under the EU projects (IPA, TAIEX). At the same time, efforts will be made to further align with the new EU phytosanitary regulations and further improvement of the main business processes (registration/re-registration of plant protection products, annual programmes of post-registration control, national monitoring of pesticide residues in foodstuff of plant origin, programme of special supervision of organisms harmful to plants). A revision of the applicable Phytosanitary Strategy will be made by the end of 2013, for the purpose of harmonisation with the guidelines and objectives of EU in the phytosanitary area. In the part relating to Seed and propagation material quality, the implementation of the World Bank project "Design, development and implementation of the phytosanitary sector information system" will continue in 2011, envisaging establishment of the information system that will be used to keep records on suppliers placing agricultural reproduction material on the market. The process of harmonisation of the legislation of the Republic of Croatia with the new regulations of the European Commission and the European Council, as well as the implementation of the system of placing agricultural reproduction material on the market, will continue in 2011.

In the part relating to protection of plant breeders' rights, in 2011 legislation regulating the field of new plant variety protection and plant breeders' rights will be amended and training of experts will be organised as a part of the project with the Community Plant Variety Office.

In 2010, phytosanitary inspection continued with the supervision of the implementation of phytosanitary register and plant passport system in the plant owners registered in the phytosanitary register, who have obtained authorisation for issuing plant passports. Full implementation of the phytosanitary register and the plant passport system is expected to be completed by the end of the first quarter 2011.

In end-May 2010, realisation of the project of plant health care informatisation began, entitled "Design, development and implementation of the phytosanitary sector information system", financed by the World Bank funds, one of the major components of which is a phytosanitary inspection sub-system. It is envisaged that the project will be completed by the end of the first quarter of 2011.

For the purpose of improving the infrastructure and equipment at phytosanitary border crossings which will remain operative following the Republic of Croatia's accession to the EU, under the approved IPA 2008 project „Continued support to capacity strengthening of the veterinary, phytosanitary and sanitary border inspection“ the required building permits were obtained, tender documentation was prepared and tender was published for collecting bids. Furthermore, for phytosanitary objects that are intended to be constructed within the IPA 2009 project „Upgrading of four selected long-term veterinary and phytosanitary border inspection posts“ the required building permits were obtained, tender documentation was prepared and invitation of tender for constructing these facilities is expected in the first quarter of 2011.

Further general objectives in this field include the quality improvement of performing special supervision of harmful organisms, supervision of the implementation of the integrated phytosanitary register and plant passport system, development and implementation of the integrated information and communication system in the phytosanitary sector, improvement of infrastructure and equipment at phytosanitary border crossings which will remain operative after the accession of the Republic of Croatia to the EU, further capacity building of phytosanitary inspection by

increasing the number of phytosanitary inspectors and further upgrading of knowledge of phytosanitary inspectors.

Agricultural Inspection

As regards building of administrative capacity, it should be noted that as of 1 January 2010 agricultural inspection uses in its work the computer programme for supporting the work of agricultural inspection (e-Inspector). Furthermore, as regards the training for agricultural inspectors, a seminar was organised in February 2010, within TAIEX, concerning the performance of inspection supervision of the application of the plant protection products. In 2011, training for agricultural inspectors is planned concerning the application of the plant protection products through the TAIEX programme. In the 2011-2012 period, further training and providing of inspectors with IT equipment and cars are planned.

Food Quality and Safety

The activities of the Ministry of Agriculture, Fisheries and Rural Development (MAFRD) as the co-ordinator of bodies and institutions that are a part of the system for food and feed safety continued in 2010. In the segment of official controls the following documents and regulations were adopted and published:

- Procedures for carrying out official controls in the area of food and feed safety – published on the MAFRD web site;
- Operational instructions for inspections in the area of food and feed safety– published on the MAFRD web site;
- Ordinance on rules of establishment of the national network of institutions in the area of food and feed safety³³;
- Ordinance on the amendments to the Ordinance on microbiological criteria for food³⁴;
- Ordinance on authorisation of official and reference laboratories for food and feed³⁵;
- Ordinance on the increased levels of official controls on imports of certain food or feed of non-animal origin which represent a known or emerging risk³⁶;
- List of food and feed of non-animal origin that is on the basis of known or emerging risk to be subject to an increased level of official controls on imports³⁷;
- Ordinance on special conditions governing the import of certain foodstuffs from certain third countries due to contamination risk by aflatoxins³⁸;
- Operational instructions for audits in the area of food and feed safety – published on the MAFRD web site;

In the segment of food labelling and quality, harmonisation with the relevant EU regulations continued in 2010. On the basis of the Food Act³⁹, the regulation was adopted governing the quality requirements for coffee extracts and chicory extracts:

- Ordinance on coffee extracts and chicory extracts⁴⁰.

³³ Official Gazette 43/10

³⁴ Official Gazette 89/10

³⁶ Official Gazette 86/10

³⁷ Official Gazette 119/10

³⁸ Official Gazette 119/10

³⁹ Official Gazette 120/10

⁶⁰ Official Gazette 46/07

⁶¹ Official Gazette 81/10

In March 2010, training of agricultural inspectors and food quality inspectors was organised through TAIEX project – a study visit to Italy concerning the performance of inspection supervision in the field of designation of origin, protected geographical indication and traditional specialty guaranteed labels for agricultural products and foodstuffs. In the 2011-2013 period, activities aimed at administrative capacity building of agricultural inspection and food quality inspection are planned, relating to employment of new inspectors, training and further procurement of IT equipment and cars for inspectors.

Veterinary Area

In 2010, 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. Furthermore, the veterinary check of farms, which has been performed since 2008, continued in 2010, for the purpose of control of implementation of measures and programmes in veterinary area, labelling and registration of animals, animal health, animal welfare, implementation of the imposed measures and programmes and keeping records on farms. As a part of veterinary check of farms, animal owners are trained concerning the requirements of multisegmented harmonisation they will be required to comply with in order to be eligible for state subsidies.

In 2010, in accordance with the Ordinance on the requirements with which veterinary organisations, veterinary practice and veterinary service must comply in the system of performing veterinary activity⁴¹, the Veterinary Directorate began to conclude the Contract on delegating official control tasks to a control body. In accordance with the Regulation (EC) No 882/2004 ("hygiene package"), transposed into the Croatian legislation in 2007 through the Food Act, Veterinary Act and "Ordinance on official controls on food of animal origin"⁴², official controls on food of animal origin, feed and by-products of animal origin may be performed by official veterinarians and control bodies. The Veterinary Act and the implementing regulation provide that certain official control tasks may be delegated to veterinary organisations, as control bodies, if they are compliant with two main conditions: they are accredited in accordance with the standard HRN EN ISO/IEC 17020:2005 and they have a sufficient number of suitably qualified and experienced staff free from any conflict of interest when carrying out official controls.

Until December 2010, 11 veterinary organisations were accredited, with which the Veterinary Directorate entered into Contract on delegating official control tasks to a control body, while 62 veterinary organisations are in the accreditation process. Such a strategy of delegating tasks to control bodies is in accordance with the Economic Recovery Programme of the Government of the Republic of Croatia, in the part relating to rationalisation of public administration system through delegating tasks to bodies outside the state administration and limiting and reducing public service employment.

Establishment of the Central Veterinary Information System (CVIS), in accordance with the Veterinary Act⁴³, as the unified system of registries and computer programmes represents the most important structural measure in the mid-term period. The project was financed by the World Bank under the title „Design, development and implementation of the Central Veterinary Information System“. The project is being implemented by the company S&T Hrvatska d.o.o., with which the contract was concluded on 4 August 2010, and the time limit for realisation is 11 months.

⁶² Official Gazette 45/09

⁶³ Official Gazette 99/07

⁶⁴ Official Gazette 41/07

Fisheries

As regards the last year's PEP 2010-2012, in the part relating to fisheries, all the measures and objectives planned in 2010 were fulfilled, apart from equipping 15-18 meter vessels with the vessel monitoring system and preparation of the Operational programme for implementing structural measures in fisheries. Vessels in the 15-18 meter category were not equipped with the vessel monitoring system since the appeals were received at the public tender against the implementation of the public procurement procedure and the final decision about the appeal is to be reached by the State Commission for Control of Public Procurement Procedures. Depending on the decision of the State Commission, the required further actions will be taken as regards the implementation of this measure.

The Act on Structural Support and Market Regulation in Fisheries⁴⁴ created the legal framework for the enactment and adoption of the National strategic plan of fisheries development and Operational programme for implementing structural policy measures and creating administrative capacity. Since creation of administrative capacity is one of the most important elements in the implementation of structural measures in fisheries, on 18 March 2010, the Government of the Republic of Croatia adopted the Decision on the description of the system of management and control of the implementation of the Operational fisheries programme. The Marine Fisheries Act⁴⁵, which created a legal basis for the adoption of the National Programme of Data Collection, was also adopted in 2010. The National Strategic Plan, Operational Programme and National Programme of Data Collection are subject to consultations with the European Commission. Furthermore, in 2010, the Government of the Republic of Croatia also adopted the Decision on institutional and operational capacity and administration of the Republic of Croatia in the area of fisheries supervision, control and inspection.

In order to establish a system of structural measures in fisheries in 2011, it is planned to complete the preparation of the National Strategic Plan and the Operational Programme which will, based on the situation, priorities and objectives, identify measures to be financed in the fisheries sector, in accordance with the *acquis communautaire*. The final draft will be made in intensive consultations with the sector. The aim during the pre-accession period is to improve the strength of entities in the fisheries sector in order for them to be able to equally participate on the market and make use of the structural mechanisms upon the date of accession of the Republic of Croatia to the EU. The Operational Programme is planned to be created by using technical assistance under the IPA 2009 pre-accession programme. This is one of the most important priorities in the fisheries sector.

Depending on the decision of the State Commission, in view of the highest priority of the measure of implementing the satellite surveillance in all the vessels larger than 15 meters, the appropriate measures will be taken in 2011 to fully implement this measure.

In 2011, it is planned to complete drafting of the National Programme of Data Collection and to forward it for the adoption, aiming at ensuring a single system of collecting data on sustainable management of marine bio-resources in accordance with the EU legislation (the system of collecting scientific data required for implementing the EU common fisheries policy). The preparation of the programme started with the technical assistance under the IPA 2009. This is a high-priority measure.

⁴⁴ Official Gazette 153/09

⁴⁵ Official Gazette 56/10

Strengthening of monitoring and control is one of the measures of the highest priority in fisheries. That activity encompasses two measures - the establishment of the VMS and the strengthening of monitoring and control upon unloading and at sea. For the purpose of strengthening control upon unloading, a part of measures was envisaged through structural mechanisms and a part through the segment of general strengthening of the fisheries inspection. As part of strengthening of monitoring and control at sea it is envisaged, in the 2011-2013 period, to take important steps in the training of inspectors, procurement of equipment (vehicles, vessels, technical equipment), as well as connecting different services that carry out control under the Marine Fisheries Act.

In view of the obligations arising from the membership of the Republic of Croatia to the EU, in the coming three-year period, significant resources are planned to be allocated to the issue of aligning the fisheries efforts with the available resources, where possibilities should be considered of redirecting some of the fishing fleet activities and appropriate financing mechanisms should be provided. In addition, in the part of supervision and control of the fisheries activities, the mechanism of establishing the automated identification system (AIS), which the Republic of Croatia is obliged to establish in all the fishing vessels in excess of 15 meters, also represents an important element.

4.5 PUBLIC ADMINISTRATION REFORM

In 2010, the process of state administration reform continued and implementation of the measures determined by the State Administration Reform Strategy 2008-2011 is underway. In March 2010, the Expert Commission was formed for a review of the Strategy, composed of the representatives of state administration bodies, academic community, trade unions and Transparency International Croatia. The Strategy was also reviewed by the SIGMA experts who made their comments and recommendations for the Strategy improvement to the Ministry of Public Administration. Also, the Expert Commission proposed that creating a new State Administration Reform Strategy, which will to some extent follow the EU financial perspective in the use of structural instruments, starts at the beginning of 2011. Furthermore, the current phase of the programming i.e. drafting of the National Strategic Reference Framework (2012-2013), drafting of the Operational Programme for the strengthening of administrative capacity (2012-2013), and preparation of project proposals to a large extent rely on a State Administration Reform Strategy. Also, additional involvement of the Ministry of Public Administration in the implementation of the Croatian Government Economic Recovery Programme measures, which are also partially complement with the implementation of the measures from the Strategy, is significant. For the purpose of implementing the state administration reform, the Ministry of Public Administration develops projects aimed at restructuring state administration bodies, increase transparency and integrity of state administration, joint coordination of state administration bodies and their cooperation with citizens, social partners and the private sector, local and regional authorities and civil society in the preparation of the acceptance of policies and regulations, development of effective models of communication across all state administration bodies, and development of effective models of consultations, coordination and cooperation among state administration bodies regarding the development, implementation and monitoring of sectoral public policies, regulations and projects. Since these projects are part of the Operational Programme "Administrative Capacity Development", their financing is planned from the structural funds of the European Union, therefore, funds for project implementation will be fully ensured in the state budget, and then the same will be refunded from the EU structural funds in accordance with the signed financial agreement. Implementation of these projects should start in course of 2012, i.e. 2013.

In order to build a more effective system of local self-government and better functioning of public administration as a citizen's service it was assessed necessary to approach to the local self-government system reform in Croatia. With the aim of reform of the local and regional self-government, in July 2010, the Government of the Republic of Croatia issued the Guidelines for a functional decentralisation and territorial reorganisation. This document determines the objectives of the local and regional self-government reform, criteria for optimal territorial restructuring, as well as the principles for the implementation of the functional decentralization and territorial restructuring process. The primary objective of the local self-government reform is to create a more rational, higher-quality and more efficient local self-government and to improve the availability, speed, quality and prices of services provided and ensured by the local self-government units for citizens. Following the adopted Guidelines, in September 2010, Croatian Government adopted a Decision on the establishment and appointment of members of the working group on Decentralisation and territorial restructuring. The working group comprises representatives of relevant ministries, representatives of academic and professional institutions, economic sector, NGOs, civic initiatives, and representatives of national associations of local and regional self-government units. The process of functional decentralization and territorial reorganization plans to be implemented in phases established by Guidelines, in the period from July 2010 (beginning of the first phase) till May 2013 (end of the fourth, also the last phase).

In view of the beginning of implementation of the new General Administrative Procedure Act, as of 1 January 2010, the Ministry of Public Administration completed the project documentation for the project: "Support to the Implementation of the General Administrative Procedure Act – IPA 2008". Project documentation for this project was published on the website of the Central Financing and Contracting Agency and EuropeAid until the end of first December 2010, followed by evaluation of the received interests for further participation in this project. By mid-December 2010, the Shortlisted Panel Committee compiled a list, where among 15 candidates, 8 most mature bids were selected for further preparation of project documentation. With regard to the selection process and envisaged signing of the contract for the implementation of this project, beginning of the project implementation is expected in the third quarter of 2011. The project is composed of three components: efficient monitoring of implementation of the General Administrative Procedure Act, implementation of educational activities with an aim of efficient application of the new Act and strengthening private sector and citizen awareness of the advantages of the application of the new Act, and it will result in the preparation of expert material and organisation of training for employees in the bodies that will implement the General Administrative Procedure Act. The project purpose is to improve the work of public administration in order to create a favourable business environment and, as a consequence, to improve the standard of the Croatian citizens, whereas the primary objective is to provide capacity required for the implementation of the General Administrative Procedure Act at all levels of public administration, along with raising the level of public awareness about the contents of the Act. Croatian Government adopted a Conclusion on the obligation to harmonize the procedural provisions of laws with the General Administrative Procedure Act. The Conclusion defines a period of 6 months for preparation of proposals for amendments of laws that are aligned with the General Administrative Procedure Act, and the Ministry of Public Administration is responsible for monitoring the implementation of the Conclusion. Regarding the implementation of the Conclusion, the Ministry of Public Administration submitted to all central public administration bodies an analysis of existing procedural rules with the categorization of deviation from the provisions of the General Administrative Procedure Act, which was made in the program framework of bilateral assistance "Supporting the development of the capacity of the public sector" of the Ministry of Foreign Affairs of the Kingdom of Denmark. The analysis also contains recommendations of project professionals for further actions in the process of harmonization of special procedural provisions

with the General Administrative Procedure Act. Central public administration bodies are obliged to designate coordinators responsible for cooperation with the Ministry of Public Administration and provide information on the number and the name of laws that are going to be harmonized with the provisions of the General Administrative Procedure Act. Appointment of coordinators and delivery of a list of laws that will be harmonized is in the course, and the Ministry of Public Administration will report the Croatian Government on regularly basis on that issue.

In the Civil Servants Training Centre of the Ministry of Public Administration training for civil servants is continuously provided, and in the 1 January – 31 October 2010 period, 439 activities, relating to general training programmes for civil servants, were implemented and 4,892 participants successfully completed the programmes. Since in that period the long-term activities were also organised (some of which lasting throughout the year), these figures are likely to increase by the end of 2010. The purpose of the education is to provide continuous training to civil servants for the tasks of the respective position and to improve professional capacities and skills required for performing the tasks entrusted to them. Croatian Government, at its session held on 3 December 2010, adopted the Regulation on establishing the National School for Public Administration, whose activity is education and training of civil servants, both public and local and regional self-government, and in the legal entities with public authority, with the aim of continuing to raise the level and quality of their knowledge, skills and abilities, to form a professional, effective and efficient public sector that will provide timely and quality public services, in accordance with generally accepted best standards.

Furthermore, a detailed analysis of the work of public agencies is being carried out for the purpose of establishing the basis for regulating the system of public agencies in the Republic of Croatia in accordance with the EU standards. Regulation of the system of public agencies will also be based on the experience of EU Member States and SIGMA recommendations regarding the public agencies, presented in November 2009, as a part of the project “Assistance to Croatia in the field of European integration and public administration reform”, as well as on the results of the analysis conducted by the experts from the Norwegian Agency for Public Management and e-Government (Difi) in the selected agencies in Croatia and their recommendations and guidelines for regulating the issue of public agencies in Croatia. The goal of the analysis was to increase efficiency of the overall public administration and to avoid overlapping of the tasks entrusted to public or state administration bodies, through a reduction in the number of public agencies and rationalisation of the number of employees. In this regard, during May and June 2010, the Ministry of Public Administration in collaboration with other central public administration bodies conducted an analysis of the rationalization of the organization and scope of work of the agencies on the basis of which the Croatian Government adopted a Conclusion on the reorganization of the agencies, bureaus, funds and other legal persons with public authorities (July 2010), in which a part of bodies merged with one another, a part was acquired by a corresponding ministry or other institutions, while a part was abolished. Also, the Government adopted a Conclusion on uniform criteria for establishing the agencies, bureaus and other regulatory bodies (October, 2010), and central public administration bodies are in accordance with these conclusions prepared legal acts regulating the new organizational structure of the 14 agencies.

The Government of the Republic of Croatia adopted the Action Plan for the implementation of the Civil service human resources development strategy 2010 – 2013, which determines the activities, performance indicators, time limits for implementation and implementing bodies. The Action Plan envisages the key activities through 6 specific objectives, which will allow for a higher-quality human resources management. In accordance with the Action Plan and Operational Programme „Development of administrative capacity“, the Ministry of Public Administration develops the

projects aimed at establishing a common system of selection and employment in the civil service and the establishment of the management career development system, whose implementation is planned for the beginning of 2013. The purpose of these projects is to create prerequisites for employment of the highest quality personnel and their retaining in the civil service, while resources for the implementation of the projects will initially be allocated in entirety from the state budget, since the projects are also planned to be financed from the EU structural funds.

The Act on Salaries in local and regional self-government, by which the local and regional self-government units are authorized by its official documents prescribe the coefficients and the basis for calculating salaries, but only within the limits prescribed by this Act and allowed total funds for salaries, which must not exceed 20% of the operating revenues of local units, was adopted in February 2010. In addition, further wage restrictions are prescribed for the employees in local units that receive current grants from the state budget in the amount higher than 10% of unit's operating revenues. Salaries of employees in these units must not be higher than salaries in the state civil service. In this way, the Act directs the local units on rational and efficient behavior, and encourages them to further efforts to increase their fiscal capacity. This Act shall apply to the entry into force of a special law that will in a unique way organize salaries in the state civil service, public services and local and regional self-government. In order to standardize the salaries system of civil servants in public services, state bodies and local and regional self-government it is planned to prepare the unique law concerning salaries for the entire public sector in 2011, that would create conditions for effective implementation of the principle of the right to equal salary for equal work, ensure transparency in management of civil servants salaries in the public sector and facilitate the implementation modalities and monitoring of the fiscal effects. Also, putting the emphasis on almost Croatian membership in the EU and the use of structural instruments, and in the framework of development of human resources in the civil service, the Government adopted a Strategy of institutional development and capacity building for the management of European funds.

For the purpose of increasing transparency of work of public administration and political parties and for the purpose of enhancing exercising of the right to access to information, the preparation of the Act on Financing Political Activities and Election Campaign and the Act on Amendments to the Act on the Prevention of Conflict of Interest in the Exercise of Public Office is underway, with the participation of representatives of the target groups and non-governmental organisations. In connection with the implementation of these measures, Croatian Parliament adopted the Act on Amendments to the Act on the Right to Access to Information⁴⁶, in which are embedded observations of the European Commission and SIGMA on 10 December 2010. In accordance with the revised Action Plan associated with the Corruption Prevention Strategy, in April 2010, the Draft Amendments to the Code of Ethics of Civil Servants was prepared, which predicts prescribing of protection of ethics commissioners in performing the procedure of establishing whether a complaint against unethical and possible corruptive behaviour of civil servants is grounded. The purpose of these amendments is to increase contribution of civil servants in fighting corruption and, as a consequence, to improve work quality of state administration and enhance citizens' confidence in public authorities.

In the field of development of electronic administration, which is implemented by the implementation of the e-Administration Development Strategy 2009-2012, the activities planned for 2010 were implemented. One of the most important activities was the adoption of the Decision of the Government of the Republic of Croatia on the establishment of the Croatian Interoperability

⁴⁶ Official Gazette 144/10

Framework⁴⁷, on the basis of which the Council and Co-ordination for state administration informatisation were established, with a main task of strategic management of interoperability establishment. The Standard project of electronic office was adopted and implementation of other projects continued, which are implemented within the Strategy for the purpose of increasing efficiency of state administration and rationalisation of the existing issues in state administration by means of information and communication technology.

By implementing the state administration reform and territorial reorganisation and decentralisation of the units of local and regional self-government, efficiency and rationality will be improved, while costs of the administration will be reduced, which is also the purpose of the adjustment of public agency system, and alignment of the procedural acts and subordinate legislation with the new General Administrative Procedure Act and continued education of civil servants will ensure the uniform application of the Act and a higher quality protection of citizens' rights. Education of civil servants, concern for human resources development and regulation of the issue of salaries in the public sector will ensure greater motivation of civil servants for higher quality performance and reduce outflow of quality personnel, which will eventually result in greater satisfaction of public service users and confidence in public administration, which will be supported by a more efficient protection of the right to access to information.

4.6 OTHER REFORMS

4.6.1 Development of a Knowledge-based Society

Implementation of the basic documents setting forth the educational and economic policies are continued systematically, in accordance with the Economic Recovery Programme of the Government of the Republic of Croatia and the Strategy of the Government Programmes for the period 2011–2013, with an aim of developing education and science as preconditions for the economic development and growth. The application of the national pedagogical standards, the Vocational Education Act, the National Curriculum Framework, modernisation and adjustment of vocational programmes and adult education programmes and implementation of the state secondary school-leaving exams and national exams, systematically contribute to ensuring a permanent quality education.

In 2009, Croatia participated in the PISA examination of the knowledge and skills of students, and participation in PIRLS examination is planned in 2011. In addition, participation in the international project TIMESS, ICILS, TALIS, ESCL is prepared, for the purpose of enabling a more realistic evaluation of Croatian students' achievements, learning outcomes and comparability at the European level. A special attention will be paid to improvement of the education outcomes in the field of mathematics, natural and technical sciences at all the educational levels.

On the basis of the Vocational Training Strategy 2009-2013, the Education and Teacher Training Agency set up an information system for managing, registration and processing of data on activities related to the improvement of human resources in education institutions. A special attention will be devoted to the improvement of professional knowledge and skills of teachers of mathematics, natural and technical sciences.

The campaign “Knowledge comes first”, annual university fairs and “career days” will promote the importance of investing in education and will better inform young people about the possibilities of

⁴⁷ Official Gazette 84/10

continuing their education, study programmes and employment possibilities. A special accent will be put on learning for entrepreneurship, innovation and strengthening of co-operation between education institutions, economy and scientific institutions. The Act on the Croatian Qualification Framework is being prepared and better connection between formal, non-formal and informal forms of education will be developed, as well as teaching and study programmes, in accordance with the labour market needs.

At the level of higher education, a special attention will be paid to a lifelong learning. The new Act on Universities will define the uniform strategy for university development, whereas the general Act on Higher Education and the amendments to the Adult Education Act will expedite the introduction of the lifelong learning programme at all higher education institutions. The Bologna process has been systematically implemented. The integration of the university continues, study programmes are evaluated and student and teacher mobility is strengthened.

In the forthcoming period, investment in research and development and in new technologies will be additionally stimulated and scientists-researches in the private sector will be especially stimulated to participate in the scientific and research programmes of the public scientific and education institutions, along with mobility of researchers. The changes are planned in the national innovation system, in the system of state aid to research and development projects, as well as the introduction of the new programmes aimed at development of new products and technologies in the private and public sector. The Scientific and Technological Policy of the Republic of Croatia 2011-2015 will be adopted, along with development strategies for individual scientific priorities and the Science Act, whereas special attention will be devoted to evaluation and re-accreditation of all scientific and research organisations, consolidation of the scientific potential and cooperation with the European Research Area.

4.6.2 Health Care Reform

Owing to health care reform, financial stabilisation of the health care system was achieved and for the purpose of further improvement of the health care system stability the required interinstitutional cooperation will be established for monitoring data on the overall spending on health care - both public and private (EUROSTAT SHA methodology). The financial stabilization of the health care system is reflected inter alia in the state of arrears. Thus, the arrears of hospitals at 31 March 2008 amounted to HRK 2.3 billion, and at 30 November 2010 amounted to HRK 1.5 billion. Also, arrears of the Croatian Health Insurance Institute at 31 December 2008 amounted to HRK 1.2 billion, and at 30 November 2010 amounted to HRK 406.1 million.

Furthermore, the abolition of medical committees and the appointment of authorised physicians for field work reduced the rate of sick leave, and thus the costs for sick leave, which is shown in the attached tables of financial performance. Thus, daily average sick leave lacking from work in 2008 was 57 796 persons, while in 2009 for the same reason the sick leave lacking was 53 385 persons, and in the first nine months 2010 the monthly average for sick leave lacking was 46 615 people.

In order for all the staff in the emergency medical assistance team to be trained in the same manner, as a part of the reorganisation of emergency medical assistance project, residencies in emergency medicine will begin for doctors and nurses/medical technicians and emergency care algorithms will be developed. In order to provide emergency medical assistance to anyone requiring emergency care within the shortest time interval possible, sanitary transfer will be separated from emergency medical assistance and for the purpose of ensuring equal accessibility, a new network of emergency medical assistance will be established.

Informatisation of the health care system, i.e. all hospitals, will make the national waiting list a unique and transparent. This means that one person will not be registered in more health institutions for the same examination, which was the earlier practice. In 2011, that part of the system will continue to be arranged. Following the completion of primary health care informatisation, as a result of which the "paperless doctor" project will be realised, fully enabling the electronic operation of the health care system (e-health care), in 2011, integration of hospitals in the existing central health care information system (CEZIH) will be implemented.

For the purpose of enhancing, promoting and monitoring health care quality at all the health care system levels, the Agency for Quality and Accreditation in Health Care will prepare the accreditation manual, where the procedure of hospital accreditation will be explained in detail, form submission of application for accreditation and carrying out accreditation procedure to issuing of the accreditation decision. Training will be provided, relating to the implementation of accreditation. Training will be provided for persons responsible for quality, internal and external evaluators, as well as the persons who will carry out hospital self-assessment according to the accreditation standards. Hospital accreditation will start in the first quarter of 2011, when accreditation of the first 10 hospitals is planned. In 2011, classification of hospitals into categories will be performed. Hospitals will be classified into 4 categories: national, regional, country and local. Classification into categories will be performed for the purpose of ensuring the minimum standards of professional development, rational administrative management and rational management of facilities, equipment and workers. The measures will be implemented of strengthening the segment of one-day treatment and day hospitals, which will reduce health care costs and increase satisfaction of patients with the health care system.

After the introduction of sophisticated models of payment for services in primary health care and in the hospice segment of hospital treatment (capitation and payment for the work performed, diagnostic and therapeutic groups) for the purpose of increasing health care system efficiency, additional improvement of the payment methods is planned, taking into account the most advanced health care systems in the world. This includes adjustment of the existing payment models so that they value the effect of the care itself on the health status of a patient and the efforts made to improve the health care quality. The implementation of the national costing study of the diagnostic and therapeutic groups will allow for a more precise and equitable setting of hospital services prices at the national level. This will provide for hospital management clear information on efficiency of their production processes in comparison with other hospitals.

After launching two pilot projects of palliative care in 2010, definition and implementation of a comprehensive system of palliative care is planned, together with network development at the national level. In this manner, a burden of patients who do not need expensive hospital care, but rather intensive health care (e.g. patients in terminal stage of malignant diseases), will be lifted from acute hospitals. The measures will slow down the inevitable increase in costs caused by ageing of the population, development of medical technologies and increased expectations of the users. A change in the system of approving hospital and out-of-hospital rehabilitation by defining clear criteria on the basis of which a right to rehabilitation is acquired, which are again based primarily on a functional status and possible improvement of the status by providing rehabilitation (EBM), increasing the role of doctors carrying out rehabilitation in determining the rehabilitation length and by introducing the payment system through diagnostic and therapeutic procedures (DTP) in out-of-hospital rehabilitation. The measures will slow down the inevitable increase in costs caused by ageing of the population and increased number of patients with locomotor diseases. Due to increased efficiency in providing services, implementation of outsourcing of non-core activities (catering, cleaning, security, preparation of food, etc.) and IT activities will begin in

hospitals in 2011. Preparation of medical product code books will allow for defining more acceptable prices at the national level, since today different hospitals acquire the same products at different prices. Compulsory management training will be introduced for the hospital management. Implementation of the measure will allow for more rational operation for the hospital managements. The application of the indicators for monitoring medicines consumption will be defined and implemented in 2011, at the level of family medicine offices. Regular reporting of primary health care doctors on costs of prescribing medicines will rationalise, according to a number of indicators, prescription of medicines, which will slow down the inevitable growth of costs of medicines.

4.6.3 Judicial Reform

In May 2010, the revised Action Plan associated with the Judicial System Reform Strategy⁴⁸ was adopted. The measures divided to a number of activities, time limits, competent authorities and the required funds for the implementation of measures are clearly defined. By the entry into force of the Judicial Academy Act⁴⁹ in January 2010, the Judicial Academy became an independent institution, separate from the Ministry of Justice. Apart from various activities undertaken for the purpose of an autonomous functioning of the Judicial Academy, in September 2010, a tender was invited for the admission of the first 60 candidates to the State School for Judicial Officials⁵⁰, a constituent part of the Judicial Academy.

In 2010, e-document, an Integrated Court Case Management System (ICMS), was introduced at 60 planned courts. The process of physical rationalisation of courts continued; during 2010, three permanent offices were physically moved to three municipal courts. In addition, three permanent offices were physically moved to three seats of misdemeanour courts. The Act on Courts' Territorial Jurisdiction and Seats, which rationalises the network of commercial and county courts, the Enforcement Act and the Act on Public Enforcement Agents were adopted on 23 November 2010 by the Croatian Parliament. In 2010, measures under the Action Plan for the implementation of the new Criminal Procedure Act⁵¹ were taken. The revised Action Plan associated with Anti-Corruption Strategy was adopted on 18 March 2010. On 10 June 2010, the Government of the Republic of Croatia adopted the Action Plan for the probation system development in the Republic of Croatia for the period 2010-2014. In August 2010, the first public tender was invited for the employment of staff in Directorate for Probation and Support to Victims and Witnesses⁵².

The continued enhancing of independence, impartiality, professionalism and efficiency of the judicial system will increase citizens' confidence in institutions and the rule of law, which is an important precondition for Croatia's economic development and the promotion of capital investments into the country. Since in 2010, the greatest stress in implementing the judicial system reform was placed on achieving independence and impartiality of the judicial system, in the coming

⁴⁸ On 20 May 2010, the Government of the Republic of Croatia adopted the revised Action Plan associated with the Judicial System Reform Strategy

⁴⁹ Official Gazette 153/09

⁵⁰ Official Gazette, Announcements 112/10

⁷² A systematic training was provided to judges, state attorneys, police officers and lawyers, the equipment was procured for the needs of the Office for the Prevention of Corruption and Organised Crime (USKOK), and premises for interrogation of defendants in USKOK offices were refurbished.

⁷³ Official Gazette 95/10

period, the greatest attention will be devoted to enhancing efficiency of the judicial system and completion of the reforms which started in that area. The measures aimed at enhancing efficiency of the judicial system, will, among other things, contribute to the economic recovery of the country. In that regard, in the period until 1 January 2012, all the necessary actions are planned to be taken for the establishment of the two-instance administrative jurisdiction and for the beginning of work of public enforcement agents⁵³, as a part of the enforcement system reform.

In the forthcoming period, building up of the prison system will continue, in terms of strengthening administrative and accommodation capacity. At the same time, further actions will be taken with an aim of full implementation of the probation system. In accordance with the adopted subordinate legislation⁵⁴, further physical rationalisation of courts and state attorney offices will continue. In 2011 and 2012, the e-document system (ISCM) is planned to be introduced at all the courts and the Case Tracking System (CTS) at all the municipal state attorney's offices. As regards the infrastructure development, in the 2011-2013 period, construction of Trg pravde (the Square of Justice) in Split and Zagreb⁵⁵, Municipal Court in Karlovac, the building of the State Attorney's Office (USKOK) in Zagreb and Municipal State Attorney's Office in Pula will continue. Furthermore, IT equipment for the judicial bodies will be procured in the coming period. Further improvement and strengthening of the *pro-bono* legal aid system is planned. In the field of combating corruption, implementation of the Action Plan associated with the Anti-Corruption Strategy will continue.

4.6.4 Environmental Protection

In the period 2011-2013, the activities of the Croatian Environment Agency (hereinafter: the Agency) will continue concerning its core activity - collecting and integrating the collected data and information related to the environment, for the purpose of ensuring and monitoring the implementation of the environmental protection and sustainable development policy. Establishment and management of the national Environmental Protection Information System (EPIS) will continue in accordance with the adopted EPIS Programme, by incorporating new databases on specific thematic areas and sub-areas of the Agency itself into the system, along with the databases of the associate institutions. EPIS will be further developed and upgraded in accordance with the Shared Environmental Information System – SEIS of the European Environment Agency and by introducing and applying the IT security system compliant with the standards HRN ISO/IEC 27001:2005 and HRN ISO/IEC 17799:2005. The preparation of the Report on the State of the

⁵³According to Article 2 of the Act on Public Enforcement Agents, adopted on 23 November 2010, the public enforcement agency determines enforcement on the basis of authentic instruments, i.e. conducts enforcement on the basis of enforcement titles pursuant to the provisions of the Enforcement Act or some other special regulation, except when determination and conducting of enforcement is within the exclusive competence of court or another body, takes the necessary actions concerning the performance of enforcement on the territory of the Republic of Croatia and performs other tasks. Public enforcement service is performed by public enforcement agents as autonomous and independent agents, having capacity of persons of public confidence.

⁷⁵ Ordinance on determining time limits for the provision of working, spatial, technical and other conditions at the seats of the merged courts (Official Gazette 119/08), Ordinance on determining time limits for the provision of working, spatial, technical and other conditions at the seats of the merged misdemeanour courts (Official Gazette 04/10), Ordinance on determining time limits for the provision of working, spatial, technical and other conditions at the seats of the merged state attorney's offices (Official Gazette 04/09)

⁷⁶ Trg pravde in Zagreb is a complex where the Municipal Criminal Court is located and where all the Zagreb judicial institutions are planned to be moved in the future. Similar project is envisaged in Split.

Environment in the Republic of Croatia covering the period 2005-2008 is in its final stage and it will be published in the first quarter of 2011.

A revision of the National List of Indicators (NLI) of the state of the environment will be completed by mid-2011. The National List of Indicators (15 thematic areas) is prepared for the purpose of establishing, managing, developing, co-ordinating and maintaining the uniform Environmental Protection Information System (EPIS). The Agency will continue to pursue the activities relating to the keeping of the Greenhouse Gas Register and to prepare for the establishment of the system of trading in greenhouse gas emissions.

Activities will continue on the implementation of the Kyoto Protocol, which includes the obligations related to reducing greenhouse gas emission and those related to the on-going reporting on greenhouse gas emissions and on the implementation of the flexible mechanisms. In end-September 2010, the amendments to the implementing regulation on greenhouse gas emission quotas and emission trading was adopted, which include aircraft activities and prescribe the obligation to report on emissions and on tonne-kilometres of aircraft operators. The aircraft operators will be obliged to monitor greenhouse gas emissions for the calendar year 2012 and to submit the verified reports, in order to deliver the verified Report of emissions and tonne-kilometres to the Ministry of Environmental Protection, Physical Planning and Construction in 2013.

EU *acquis communautaire* relating to certain fluorinated greenhouse gases, adopted by the end of 2010, will be transposed into the Croatian legislation by the end of 2011. In 2011, harmonisation of the Croatian legislation with the new *acquis communautaire* will continue, and the new Regulation on the substances that deplete the ozone layer and on certain fluorinated greenhouse gases will be adopted, which will transpose Regulation 1005/2009 EC on the substances that deplete the ozone layer into the national legislation. Activities will continue aimed at implementing the Montreal Protocol and supervising the consumption of substances that deplete the ozone layer.

As regards the progressive abolishing of HCFCs (hydrochlorofluorocarbons) consumption in the Republic of Croatia, the implementation of two projects for abolishing R 141b consumption in the sector of foam production is underway. The projects are financed by the funds of the Multilateral fund for the implementation of the Montreal Protocol and the Republic of Italy. The companies will use as a replacement the substances which do not affect the climate change, i.e. which do not have a global warming potential. In the refrigeration sector, implementation of the projects for progressive abolishing of consumption of HCFCs, used in refrigeration and air conditioning systems.

At the end of 2009 and in early 2010, the Centres for collecting, recovering and reusing the substances that deplete the ozone layer in Zagreb, Rijeka and Split were granted operating licenses by the Ministry of Environmental Protection, Physical Planning and Construction and began their operation.

As regards air quality, in 2011, the implementation of the measures from the Air Quality Protection and Improvement Plan will continue to be monitored. In 2010, the remaining 12 stations for continuous air quality monitoring and the measurement laboratory were put into operation, for which equipment was procured under the PHARE project „Establishment of air quality monitoring and management system“. As of 1 January 2010, monitoring of air quality, maintaining, and servicing of stations within the national network is done by the Meteorological and Hydrological Service, which was given the National Air Quality Monitoring Network for use. In 2010, the draft

Action Plan for Reduction of Air Pollution by Ground-Level Ozone was prepared. As a part of the bilateral project between the Republic of Croatia and the Flemish Government, the project „Support to the preparation of the National action plan for reduction of airborne PM and nitrogen oxides NO_x in the Republic of Croatia (Directive 2008/50/EC)“ is being implemented. Until the end of 2011, draft action plans will be prepared within the project for the selected populated areas (agglomerations) where limit values for PM and/or NO_x are exceeded. The preparation of the National action plan for reduction of PM and NO_x concentrations in ambient air in the Republic of Croatia is planned by the end of 2012.

In 2011, a new air quality assessment will be performed in accordance with the criteria set by the new Directive 2008/50/EC on ambient air quality and cleaner air for Europe, along with a review of division of the Republic of Croatia into zones and agglomerations with respect to the established air quality categories. By the end of 2012, monitoring of airborne particles PM_{2.5} is planned to be established for the purpose of determining the indicators of average exposure and the national exposure reduction target. The proposal of the new project is being prepared, “Modernisation of air quality monitoring network at the state and local level”, which will be proposed for EU co-financing through structural funds and which should, in the 2012-2013 period, establish a modern and functional air quality monitoring network on the territory of the Republic of Croatia, for the purpose of supporting further harmonisation of the Republic of Croatia with the requirements of the new Directive 2008/50/EC on ambient air quality and cleaner air for Europe. In 2012, the new National plan for the implementation of the Stockholm Convention on Persistent Organic Pollutants will be prepared in accordance with the requirement under the amended Convention which introduced new pollutants.

Directive 2009/126/EC on stage II petrol vapour recovery during refuelling of motor vehicles at service stations was fully transposed in the Croatian legislation on 16 December 2010 by the Regulation on technical environmental protection standards for reducing emissions of volatile organic compounds during refuelling of motor vehicles at petrol stations. In early 2012, a part of Directive 2009/30/EC amending Directive 98/70/EC as regards the specification of petrol, diesel and gas-oil and introducing a mechanism to monitor and reduce greenhouse gas emissions, on amending Council Directive 1999/32/EC as regards the specification of fuel used by inland waterway vessels and repealing Directive 93/12/EEC is planned to be transposed in the national legislation by the adoption of the new Regulation on petroleum-derived liquid fuels.

In 2011, the process of harmonisation of the Croatian legislation with the new *acquis communautaire* will continue and the new Air Quality Act will be adopted, which will transpose in the national legislation Directive 2008/50/EC of ambient air quality and cleaner air for Europe.

In the field of waste management, activities were continued on the rehabilitation and closing of the existing waste disposal sites and a total of 114⁵⁶ waste disposal sites are planned to be rehabilitated in 2010. By the end of November 2010, rehabilitation of a total of 92 official waste disposal sites was completed and of another one in December. The rehabilitation of the waste disposal sites is co-financed by the Environmental Protection and Energy Efficiency Fund, which has concluded contracts on the rehabilitation of the total of 299 waste disposal sites with local self-government units. In February 2010, a contract was concluded with the contractor and in April 2010, a contract was concluded on supervising the works on the construction of the waste management centre (WMC) Bikarac in Šibenik-Knin County, co-financed under the ISPA programme. The building

⁵⁶ Work programme of the Energy Efficiency and Environmental Protection Fund for 2010, Zagreb, April 2010

permit for works on Bikarac was issued in October 2010 and it became final on 26 November 2010. At that point, the construction works began and they are expected to last until November 2011. A tender for the supply of equipment required for the future WMC Bikarac will be sent to the Delegation of the European Union in January 2011, whereas tender invitation is expected in February 2011. In June 2010, the European Commission accepted the application for modification of IPA III b component of the Environmental Operational Programme. In this manner, additional EUR 43.2 million of IPA funds for the 2010-2011 period was allocated to that Operational Programme. EUR 21.26 million out of that amount was allocated to the area of waste management, i.e. for the project of constructing the county/regional WMCs. In mid-2010, the application was submitted to the European Commission for a modification of the approved IPA projects of WMCs construction in Istria County and in Primorje-Gorski Kotar Country and it was accepted. By that application the extent of the aforementioned projects is expanded by including the mechanical-biological waste treatment plants in the acceptable costs of the project. Signing of the Project Agreement (BPA) for both centres (Kaštijun and Maršićina) is expected at the beginning of 2011. Additional WMC construction projects to be co-financed from the EU funds (IPA and structural funds) are in the preparatory phase.

In the field of water management, activities aimed at strengthening and establishing the integrated water management system continued through intensive investments in the water management infrastructure. On the basis of the Water Act⁵⁷ and Water Management Financing Act, the bulk of the subordinate legislation was adopted, aimed at strengthening and reforming the existing water management financing system, as well as increasing the annual funding. The remaining subordinate legislation based on the aforementioned acts was adopted in the fourth quarter of 2010. Legislative harmonisation with EU directives was implemented in accordance with the Programme⁵⁸. Decision on determining the vulnerable areas is in the procedure of coordination and establishment of its impact on the agricultural production. The allocation of funds from the state budget, grants, loans and the EU assistance funds for the period 2011-2013 is envisaged for the following projects: the implementation of capital water supply and drainage system development projects; capital projects of the protection of water and sea against pollution; capital irrigation system projects; IBRD - regional project for the management of the Neretva and Trebišnjica rivers, implemented in cooperation with Bosnia and Herzegovina; the ISPA 'Project of drainage and waste water purification in Karlovac', the ISPA technical assistance for the preparation of projects under the IPA programme; inland waters project; and projects under IPA III b programme - Slavonski Brod, Knin, Drniš and application for Sisak.

As a part of the implementation of the Regulation on sea bathing water quality⁵⁹, in 2010 the national database on sea bathing water quality was upgraded, and the browser for the public concerning the sea bathing water quality was improved, in terms of allowing for comments and proposing new sampling points, with an aim of enhancing sea bathing water quality management. The browser contains beach photos and characteristics, i.e. equipment contained in the sea bathing water profiles. The profiles were made on 1 May 2010 for 913 sampling points and compiled in the database. The national annual report on the sea bathing water quality on beaches of the Croatian Adriatic was prepared on 15 December 2010.

⁵⁷ Official Gazette 153/09

⁷⁹ Programme of the Government of the Republic of Croatia for assumption and implementation of the *acquis communautaire*

⁸⁰ Official Gazette 73/08

Within the process of transposing and implementing the Marine Strategy Framework Directive (2008/56/EC), efforts were made in 2010 to draft the national regulation which would transpose the provisions of the Directive into the national legislation. The implementing act will prescribe the obligations and time limits for the preparation and implementation of the national marine environment protection strategy. That strategy will encompass the assessment of the state of and pressures on marine environment, determination of the good status of marine environment, establishment of a set of environmental targets and the associated indicators until 2012, i.e. preparation of the monitoring programmes for the on-going assessment of the environmental status until 2014 and preparation of the programme of measures for achieving or maintaining good environmental status of marine environment until 2015. Drafting of that regulation was completed in December 2010.

In 2009, implementation of the 1st stage of the Project of strengthening the coastal water quality supervision system - the Project against pollution of water in the coastal area (IBRD loan) was completed and in 2010, efforts were made to ensure the conditions for the implementation of the 2nd stage of the Project.

In the field of nature protection, the priorities for the period 2011-2013 primarily relate to the completion of the process of alignment of the legislation with the *acquis communautaire* (including the new environmental *acquis*), establishing the necessary implementing mechanisms and building up the administrative capacity by employing new experts and providing training to existing and new employees. In 2011, additional expert work is planned on defining the proposal for the EU NATURA 2000 Ecological Network and especially on further identifying and mapping of potential marine habitats in N2000 network. It is also envisaged to carry out a part of activities aiming at the establishment of the NATURA 2000 Ecological Network through the implementation of 3 projects under IPA programme in 2011 and 2012. The Republic of Croatia is obliged to submit the proposal for the NATURA 2000 Ecological Network (the database containing complete data on localities (areas) as prescribed by the Habitats Directive) to the European Commission until the date of accession. In the coming period, the Regulation on internationally important ecological areas will be prepared and the Regulation on ecological network declaration will be amended. In the forthcoming period, the ecological network areas, protected areas and wild species management will be improved by the preparation and adoption the management plans and the establishment of the control system. Efforts will also continue to be made to establish the unified nature protection information system and to protect the new areas pursuant to the Nature Protection Act. It is also envisaged to carry out a part of activities through the implementation of the five-year Project of integration into the EU NATURA 2000 Ecological Network (2011-2015), in order to strengthen the nature protection system for fulfilling the obligations under the relevant directives and to strengthen capacity for structural funds. As a part of the project preparation advance by the World Bank (IBRD P4500-HR), the final report was prepared in 2010, which was used as a basis of defining the activities under the Project.

With an aim to further enhance the capacity of the industrial sector to implement the IPPC Directive⁶⁰, a project under the IPA I component programme entitled "Establishment of centres for implementation of IPPC on regional level in Croatia" was approved in 2009, for the purpose of providing support to the operators of industrial plants required to obtain IPPC permits, and to other

⁶⁰ IPPC Directive - the aim of the IPPC Directive is to achieve an integrated approach to prevention and control of pollution caused by industrial and agricultural activities. The integrated approach also encompasses the issue of new, the so-called, Environmental permits (in the Republic of Croatia - Integrated environmental protection conditions) for the operation of new and existing plants.

participants in the permit issuance procedure on regional level. The start of the project implementation is envisaged for the beginning of 2011 and it will last for 16 months.

For the purpose of verifying the functioning of the system of inclusion of organisations in the EMAS⁶¹ system, the implementation of the pilot projects was planned in the course of 6 months, starting from December 2010. Promotional activities for the introduction of the EMAS system in companies and organisations continued.

In 2010, the guidelines on preparation of the studies on environmental impact of wind power plants have been prepared, as well as the guidelines on public participation in environmental impact assessment procedures. Aiming at a more efficient implementation of the strategic assessment and further education of all participants in the procedure, appropriate instructions for specific parts of the procedure (screening, scoping and participation of the public) will continue to be drafted. In 2012, implementation of the IPA 2010 project - "Strengthening of capacities for the implementation of the strategic environmental impact assessment on regional and local level" will begin. The planned completion of the project is 2013. In 2011, the project IPA 2007 - "Strengthening of capacities for the implementation of SAPARD (measures 1 and 2) and IPARD programmes (measures 101 and 103)" will be implemented.

In the area of chemicals, plans for 2011 include the adoption of subordinate legislation aimed at further harmonisation with the REACH Regulation in the area of hazardous chemicals whose transportation has been forbidden or restricted and in the area of safety and technical data sheets.

In the area of biocidal products, the Ordinance on amendments to the Ordinance on the list of existing active substances permitted in biocidal products, the Ordinance on amendments to the Ordinance on the list of existing active substances not permitted in biocidal products and the List of biocidal products approved to be placed on the market of the Republic of Croatia are planned to be enacted in 2011.

In the area of GMO, the Regulation on cross-border transfer of GMO⁶² was adopted in 2010. In the course of 2011, strengthening of capacities is planned through participation in international seminars/workshops on the subject of deliberate release into the environment of GMOs, as well as making amendments to the applicable legislation on the threshold for genetically modified organisms in products below which such products need not be labelled as products containing genetically modified organisms when placed on the market.

The procedure of accrediting legal persons for performing the expert tasks of noise protection, carrying out of professional examinations in the field of noise protection and preparation of strategic noise maps and action plans are planned to be continued in 2011.

In the field of forestry, the project National Forest Resources Inventory of the Republic of Croatia (CRONFI) was completed in 2010. An analysis of the applicability of the Register of Forestry Fires was performed and deficiencies were eliminated, which has improved the Register, making it fully operational. The Register of Forest Ecosystems Damages contains approximately ten sub-registers which were developed during 2010. In addition, the basic database was established, the internet

⁶¹ EMAS - voluntary standard (applicable at the level of EU and EEC) for all public and private organisation wishing to assess and improve their eco management.

⁸³ Official Gazette 89/10

interface was designed and equipping of the laboratory for physical and chemical examinations began. The existing National Forest Policy and Strategy will be revised in 2011 and the National Forest Programme will be created afterwards.

5. ECONOMIC POLICY MATRIX

5.1. ENTERPRISE SECTOR AND RESTRUCTURING		
5.1.1. Competition and state aid		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Alignment of Croatian legislation with the <i>acquis communautaire</i> in the field of market competition based on the Competition Act	<ul style="list-style-type: none"> • Adoption of Regulation on block exemption in the transport sector • Adoption of Regulation on the registration procedure and criteria for the assessment of concentration of entrepreneurs • Adoption of Regulation on block exemption of agreements between entrepreneurs not operating on the same level of production • Adoption of Regulation on block exemption of agreements between entrepreneurs operating on the same level of production or distribution • Adoption of Regulation on technology transfer block exemption agreements • Adoption of Regulation on block exemption granted to agreements on distribution and servicing of motor vehicles • Adoption of Regulation on block exemption granted to insurance agreements • Adoption of Regulation on the definition of the relevant market 	I quarter 2011
Preparation of the Agency and other stakeholders in the competition system for accession to the European Union	<ul style="list-style-type: none"> • Training in the field of competition for the employees of the Croatian Competition Agency, other regulatory bodies and the judiciary (through IPA 2007 twinning project) • Increasing awareness among the members of the academic community, local business community, bodies of local authorities and the general public (through IPA 2007 CroCompete project) • Training in the field of state aid among providers of state aid on the central and local level, including preparation for the use of structural funds, through IPA 2007 twinning project and CroCompete project 	2011-2012 2011 2011-2012
Establish sustainability of the Croatian shipbuilding industry to be able to operate on market principles	<ul style="list-style-type: none"> • Completion of state aid granting procedure for Croatian shipyards 	I quarter 2011
Alignment of Croatian legislation with the <i>acquis communautaire</i> in the field of state aid	<ul style="list-style-type: none"> • Adoption of rules on state aid in accordance with the procedure prescribed by the Regulation on state aid 	Continuously
5.1.2. Privatisation		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Preparation of privatisation plan for all state-owned companies, except for the companies supplying goods and services which cannot be efficiently supplied by the private sector for justifiable reasons	<ul style="list-style-type: none"> • Adoption of the Strategy of the Government of the Republic of Croatia for privatisation of state-owned companies, along with preparation of the List of companies eligible for privatisation and the Plan for privatisation of state-owned companies 	2011
Implementation of the privatisation plan for state-owned companies - until accession to the European Union	<ul style="list-style-type: none"> • Drawing up the Report for the Government of the Republic of Croatia on annual realisation of the privatisation plan for state-owned companies 	IV quarter 2011
Privatisation of shipyards		Continuously
5.1.3. Railway restructuring		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Alignment of legislation with the EU <i>acquis communautaire</i>	<ul style="list-style-type: none"> • Drawing up subordinate legislation 	Continuously
Liberalisation of the railway transport market	<ul style="list-style-type: none"> • Drawing up a network report • Allocation of routes to operators • Establishment of the Railway Transport Safety Agency 	Continuously Continuously 2011
Restructuring and modernisation of railway companies	<ul style="list-style-type: none"> • Preparation and definition of restructuring indicators 	Continuously
Implementation of the Railway Infrastructure National Programme	<ul style="list-style-type: none"> • Drawing up annual maintenance and modernisation plans 	Continuously
5.1.4. Restructuring of the shipbuilding industry		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Restructuring of shipyards	<ul style="list-style-type: none"> • Implementation of own shipyard restructuring programme as is the case with the shipyard Uljanik d.d. • Privatisation of shipyards by way of public tenders 	I quarter 2011 I quarter 2011
5.1.5. Energy		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Establishment of a system which is in line with EU practices	<ul style="list-style-type: none"> • Alignment with the Third Energy Package • Adjustment of the internal market with the EU conditions • Adjustment of the infrastructure to market needs • Refined petroleum products - increase the level of reserves in oil and refined petroleum products so that they reach the EU levels and conduct fuel extraction in accordance with the EU standards 	2012 - continuously

5.1.6. Small and medium-size enterprises		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Competitiveness and innovation	<ul style="list-style-type: none"> • Strengthening competitiveness of small businesses • Innovation and new products • Stimulate fast-growing small business entities • Entrepreneurship of women • Entrepreneurship of young persons, new entrants and handicapped persons • Entrepreneurship in the culture and culture-related industries • Clusters • Development of crafts and trades • Development of cooperatives • Use of new technologies and technological procedures • Introduction of EU standards • Linking SMEs and R&D • Marketing and advertising of small business entities • Promote entrepreneurship • Coordination of activities in e-trade and e-business enhancement, public portals for small businesses 	Continuously
Improvement of entrepreneurship financing	<ul style="list-style-type: none"> • Low-cost lending • Financial instruments for regional development of entrepreneurship • Guarantees • Analysis of the requirements for EU financial instruments 	Continuously
Development of entrepreneurial support infrastructure	<ul style="list-style-type: none"> • Stimulate development of the Croatian Agency for Small Business • Stimulate regional development agencies • Training and development of a network of consultants • Support to development of entrepreneurial centres, technological parks and business incubators 	Continuously
Lifelong learning in entrepreneurship	<ul style="list-style-type: none"> • Project of the national learning programme for entrepreneurship in formal and informal education • South East European Centre for Entrepreneurial Learning (SEECEL) • Students' entrepreneurial incubators • Education for crafts and trades and cooperatives • Children's entrepreneurship week • Co-financing of universities with specialist entrepreneurial programmes • Pupils' cooperatives and pupils' firms 	Continuously
Competitiveness of Croatian tourism market	<ul style="list-style-type: none"> • Training of staff in the tourist industry • Stimulate tourist events • Development of the hotel and catering industry 	Continuously
Development of the tourism sector	<ul style="list-style-type: none"> • Development of new tourist products and destination management • Stimulate placement of ecological products in tourism • Stimulate development of new tourist products and destination management 	Continuously
Development of selective types of tourism	<ul style="list-style-type: none"> • Stimulate development of special types of off-shore tourism • Development of nautical, fishing and diving tourism • Improve quality and heighten security in pursuing special types of off-shore tourism • Protection of the submarine world and coastal area with the purpose of diversifying the tourist offer and preservation of the sea as a tourist resource basis • Stimulate and develop special types of onshore tourism - extend the tourist offer to include the mainland • Develop a basic and additional offer in undeveloped mainland destinations, the Adriatic coast hinterland and islands' heartland • Heighten security and enhance experience in pursuing special types of onshore tourism 	Continuously
Cultural, traditional and natural heritage for the purpose of tourism promotion	<ul style="list-style-type: none"> • Stimulate making of authentic Croatian tourist souvenirs • Renewal, evaluation and revitalisation of cultural, traditional and natural heritage as a new tourist product • Development of a tourist offer in the areas where tourism is underdeveloped (particularly in rural and highland areas and on islands), which have tourism potentials in cultural and natural heritage • Protection, renewal and evaluation of cultural heritage through its inclusion in the tourist offer and protection, renewal and evaluation of natural heritage through its inclusion in the tourist offer 	Continuously
Development of small and medium-size enterprises in tourism	<ul style="list-style-type: none"> • Stimulate development of small family hotel business 	Continuously

5.1.7. Public-private partnership		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improved quality of public infrastructure and public services	<ul style="list-style-type: none"> • Training of employees of the Agency for Public Private Partnership • Organisation of the Register of public-private partnership agreements • Scientific analysis of practical experiences 	Continuously I quarter 2011 Continuously
Changed role of public bodies in the implementation of public private partnerships	<ul style="list-style-type: none"> • Training of participants in the procedures of preparation and implementation of public-private partnership projects 	Continuously
Enhanced competitiveness of the public and the private sectors	<ul style="list-style-type: none"> • Implementation of the Regulation on the criteria for assessing and approving public private partnership projects • Implementation of the Regulation on the supervision of implementation of agreements on public private partnership projects 	Continuously
Implementation of cross-border projects according to a public-private partnership model	<ul style="list-style-type: none"> • Coordination of exchange of know-how in the field of public-private partnership in SEECP Member States 	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"> • EU legislation monitoring 	Continuously
Organisation of the supervisory body, human resources development	<ul style="list-style-type: none"> • Presentations for banks, credit unions and savings banks of new legislation to be adopted in 2011 and implemented from 2012 and onwards • Training of supervisors in connection with new legislation and banking risks • Improving the system of prudential reporting of banks 	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"> • Acquis communautaire monitoring and alignment where necessary • Supervision of entities - risk-based supervision • Education of the public and investors 	Continuously 2011-2013 Continuously
5.3. LABOUR MARKET		
5.3.1. Employment stimulation		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Increase employment and employability through alignment of supply and demand on the labour market	<ul style="list-style-type: none"> • Analysis and independent evaluation of annual employment stimulation plans 	Continuously
Focus the measures of active employment policy on particularly sensitive groups on the labour market (young persons and long-time unemployed)	<ul style="list-style-type: none"> • Adoption of a new National employment stimulation plan for the 2011- 2012 period 	2011-2012
5.3.2. Social security system		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Analysis of the system of social benefits, equalisation of benefits granted on the same basis and full application of the personal identification number as an instrument of directing social policy measures	<ul style="list-style-type: none"> • Proposal for rationalisation of social benefits, defining of the uniform concept of the family (household), determining of the uniform methodology for setting up the proprietary census and the proposal for the census amount for the entitlement to social benefits; the proposal for the amendments to individual pieces of legislation • Enactment of a new Social Welfare Act • Proposal for administrative rationalisation of the system toward establishing a one-stop office for payment of social security benefits 	2011 2011 2011
Deinstitutionalisation of the social security system	<ul style="list-style-type: none"> • Planning a network of social services at the level of all counties in the Republic of Croatia • Development of alternative accommodation capacities, such as foster families, family homes and housing communities for an organised supported lodging • Transformation of social welfare institutions and development of a network of non-institutional services 	2013 2013 2016
Systematic protection of maternity and family support improvement	<ul style="list-style-type: none"> • Ensuring the rights of parents and persons with the same functions and responsibilities as parents, who take care of children, to time and monetary support to enable maternity protection, care for the newborn and its upbringing and coordination of family life and business career in accordance with the Act on Maternity and Parental Benefits • Ensuring the right to child support which is gained and paid depending on the total amount of household income and other conditions regulated under the Act on Child Support 	2011-2013
Systematic protection of the rights and interests of children and vulnerable groups and alignment with international standards	<ul style="list-style-type: none"> • Drawing up and adoption of the National strategy for the protection of children against abuse and neglect • Drawing up and adopting a Protocol on the procedure in case of serious neglect of a parent, adoptive parent, guardian or another person pertaining to the responsibility to provide for or care for a child • Working out the National plan to prevent sexual exploitation of children • Initiating the procedure for signing and ratification of the Convention on the Protection of Children and Cooperation in Respect of Intercountry Adoption (The 1993 Hague Convention) 	2012 2011 2012 2011
Improvement of student standard and availability of higher education to a larger number of students in the Republic of Croatia	<ul style="list-style-type: none"> • Providing scholarships to regular students - student state scholarships to regular students of university, vocational and postgraduate studies • Subsidizing transportation costs of regular students and handicapped students, subsidizing costs of meals and accommodation of students in students' and pupils' dorms in the Republic of Croatia 	Continuously

5.4. AGRICULTURAL SECTOR		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improve competitiveness and adjustment to the EU market standards	More efficient distribution of total budgetary funds earmarked for aid within the sector between the 1st pillar (market price supports) and the 2nd pillar (rural development)	Continuously
Introduction of the Central Veterinary Information System	<ul style="list-style-type: none"> Analysis of the existing database Developing a full database 	2011
Prevention and control of contagious diseases in animals	<ul style="list-style-type: none"> Establishment of crisis response centres and their furnishing Monitoring programme implementation Implementation of veterinary inspection of farms Collection and harmless disposal of animal cadavers 	Continuously
Uniform animal marking system	<ul style="list-style-type: none"> Implementation of animal marking 	Continuously
Improve competitiveness of agricultural farms, preserve and improve the environment and biological diversity, and improve living conditions in rural areas	<ul style="list-style-type: none"> Implementation of rural development measures from the instrument for pre-accession assistance IPA component V of IPARD programme 2010-2013: investment in agricultural farms for the purpose of restructuring and reaching EU standards, investment in processing of and trading in agricultural and fish products for the purpose of restructuring and reaching EU standards, improvement and development of rural infrastructure, diversification and development of rural economic activities, preparation and implementation of local rural development strategies (LEADER) Implementation of rural development measures from the state budget funds: aid for insurance against potential damages in agricultural production, aid for preservation of authentic and protected breeds of domestic animals, aid for capital investments in agriculture, agricultural farm income support, aid for ecological and integrated agricultural production and aid for the areas where conditions for agricultural husbandry are unfavourable 	<p>until completion of IPARD programme</p> <p>until accession of the Republic of Croatia to the European Union</p>
Improve the situation in the food processing sector in the Republic of Croatia	<ul style="list-style-type: none"> Drawing up the Strategy for development of the food processing industry Adoption of the National operational programme of subsidies for the food processing sector 	2011-2013
Consolidation of average agricultural farm	<ul style="list-style-type: none"> A programme of agricultural land consolidation in the Republic of Croatia for the 2009 - 2021 period 	Continuously until 2021
Establishment of structural measures in fisheries	<ul style="list-style-type: none"> Preparation of a final text of a National strategy plan Drawing up an operational programme Implementation of the measures in accordance with EFF 	2011-2013
Establishment of a uniform data collection system in fisheries	<ul style="list-style-type: none"> Drawing up a National programme for data collection and its implementation 	2011-2013
Establishment of a vessel monitoring system (VMS)	<ul style="list-style-type: none"> Acquisition of vessel monitoring devices (including VMS and AIS) 	2011-2013
Further strengthening of fishing inspection service	<ul style="list-style-type: none"> Providing equipment to the inspection service 	2011-2013
Installation of AIS device on fishing vessels	<ul style="list-style-type: none"> Installation of devices 	2012-2013
Inspection service strengthening	<ul style="list-style-type: none"> Construction and furnishing of long-term veterinary and phytosanitary border inspection posts 	2011-2012
5.5. PUBLIC ADMINISTRATION REFORM		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improve efficiency, enhance rationalisation and reduce costs of the administration	<ul style="list-style-type: none"> Promotion and implementation of the Public Administration Reform Strategy Implementation of territorial reorganisation and decentralisation of regional and local self-government units Adjustment of the system of public agencies with EU standards 	<p>2011-2013</p> <p>Continuously</p> <p>2011-2012</p>
Uniform application of the new General Administrative Procedure Act and higher-quality protection of citizens' rights in administrative procedures	<ul style="list-style-type: none"> Alignment of procedural acts and subordinate regulations with the new General Administrative Procedure Act and providing training to civil servants for proper application of the General Administrative Procedure Act 	2011-2013
Increase motivation of civil servants for a quality work and decrease drain of quality personnel from the civil service	<ul style="list-style-type: none"> Implementation of the Action plan for the implementation of the Strategy for the development of human resources in public administration for the 2010-2013 period Regulation of the issue of salaries in the public sector by adoption of relevant legislative regulations Continuation of training at the Centre for professional training and improvement of the employees at the Ministry of Public Administration 	<p>2011-2013</p> <p>2011-2012</p> <p>Continuously</p>
Higher-quality and more efficient protection of information access rights	<ul style="list-style-type: none"> Improvement of legislative regulations related to the protection of information access rights 	2011
Optimal utilisation of financial resources from EU structural funds	<ul style="list-style-type: none"> Preparation of the governing body of the OP ACD for the utilisation of financial resources from EU structural funds 	Continuously
Establishment of an IT-supported central registry of civil servants	<ul style="list-style-type: none"> Consolidation of information on the employees in the public administration 	2011

5.6. OTHER REFORMS		
5.6.1. Development of a knowledge-based society		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improve quality of primary and secondary education	<ul style="list-style-type: none"> • Increase the number of children and young persons included in the education system • Draw up a national curriculum • Implement the state school-leaving exam • Achieve national pedagogical standards in accordance with the coefficient of feasibility • Develop Croatian Qualifications Framework • Increase the number of persons included in adult education in accordance with the requirements of the economy • Develop a quality assurance system 	Continuously 2013 Continuously Continuously 2011-2012 Continuously Continuously
Further implementation of the Bologna process	<ul style="list-style-type: none"> • Develop vocational and university programmes in accordance with the requirements of the economy and labour market • Improve quality assurance in the system of higher education • Strengthen cooperation between the system of higher education and the private sector • Encourage and enhance university integration • Conduct external evaluation of the quality of institutions of higher education 	Continuously Continuously Continuously 2011-2013 Continuously
Strengthening of science and research and their connection with the economy	<ul style="list-style-type: none"> • Encourage development of centres of excellence and scientific infrastructure • Encourage commercialisation of research results and the transfer of knowledge and technologies, with a view to boosting long-term economic development • Strengthen resources in the science and technologies 	Continuously
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"> • Drawing up and implementation of a "master plan" of health care institutions • Reorganisation of hospital system (outsourcing of non-medical activities) • Reduce expenditures for sick leaves 	2011-2013 2011-2013 Continuously
Improve the system of control of health care system expenditures	<ul style="list-style-type: none"> • Completion of informatisation of primary health care and commencement of informatisation of hospitals 	2011-2013
Improved availability of health care	<ul style="list-style-type: none"> • Acquisition of medical equipment and refurbishment of hospitals • Reorganisation of emergency medical service and construction of integrated emergency hospital admission units 	2011-2013
5.6.3. Reform of the judiciary		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Strengthening independence of the judiciary	<ul style="list-style-type: none"> • Enrolment of the first generation of students in the National school for judicial officials 	2011
Improve efficiency of the judicial system	<ul style="list-style-type: none"> • Implementation of the activities for establishment of a two-instance administrative judicature • Implementation of the activities required for the beginning of work of public enforcement agents • Strengthening of administrative and accommodation capacities in the prison system • Implementation of the activities required for full establishment of a probation system • Physical merger of courts and state attorney's offices • Introduction of ICMS and CTS systems in courts and municipal state attorney's offices • Construction of the Justice Square in Zagreb and Split • Extension and renovation of the Municipal Court in Karlovac • Extension and renovation of the building of the State Attorney's Office/Office for the Prevention of Corruption and Organised Crime in Zagreb • Renovation of the building of the Municipal State Attorney's Office in Pula • Acquisition of IT equipment for judicial bodies • Further strengthening of the system of free legal assistance • Entering into force of the new Criminal Procedure Act • Establishing a professional organisation at the Probation Directorate 	2011-2012 2011-2012 Continuously 2011-2012 Continuously 2011-2012 Continuously 2011-2012 Continuously 2011-2012 2011-2012 2011-2012 2011-2012 2011-2012 2011-2012 2011 2012
Prevention of corruption	<ul style="list-style-type: none"> • Implementation of the Action Plan and the Anti-Corruption Strategy 	Continuously

5.6.4. Environmental protection		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Establishment of a comprehensive waste management system	<ul style="list-style-type: none"> • Construction of county/regional waste management centres • Recovery of municipal waste dumping sites through change of use, further use or closure • 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 • Further development of the waste management information system by the Croatian Environment Agency (as part of Environmental Protection Information System) 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2011-continuously</p>
Improvement of the whole system of air quality management and creation of conditions for systematic resolution of problems related to climate changes	<ul style="list-style-type: none"> • Assessment of air quality in accordance with the criteria laid down in the new Directive 2008/50/EC on ambient air quality and cleaner air for Europe and revision of the classification of the territory of the Republic of Croatia into designated areas and populated areas according to air quality categories. Determination of designated areas and populated areas within which limit values for PM10 could be exceeded because of the impact of winter-salting of roads. • Development and upgrading of the Air Quality Information System as part of the Environmental Protection Information system • Keeping the Register of greenhouse gas emissions • Implementation of the Plan for the allocation of greenhouse gas emission quotas to legal entities • Establishment of the greenhouse gas emission trading system • Annual assessment of air quality at designated areas and in populated areas on the territory of the state • Drawing up the Action Plan for reduction in air pollution by ground-level ozone at designated areas and in populated areas of the Republic of Croatia • National Action Plan for airborne particulate matters and nitrogen dioxide (NO2) in designated and populated areas of the Republic of Croatia within which limit values are exceeded • Establishment of monitoring of airborne particulate matters PM2.5 with a view to determining average exposure indicator and the national exposure reduction target • EU project "Modernisation of air quality monitoring networks at national and local levels" - preparation and implementation of the project through EU structural funds • Joining EU Emission Trading System and trading in emission units within the framework of EU ETS following accession of the Republic of Croatia to EU • Inclusion of aviation activity in the system of reporting emissions of greenhouse gases and tonne-kilometres (drawing up a monitoring plan, monitoring of emissions, drawing up a report of greenhouse gas emissions) • Collection of Reports of greenhouse gas emissions from installations 	<p>2011</p> <p>2011-continuously</p> <p>2011-continuously</p> <p>2012</p> <p>upon accession of the Republic of Croatia to the EU</p> <p>2011-continuously</p> <p>2011</p> <p>2012</p> <p>2012</p> <p>2012-2013</p> <p>2013</p> <p>2011-2013</p> <p>Continuously</p>
Integration of environment protection objectives in other sector policy planning and implementation for the purpose of promoting sustainable development	<ul style="list-style-type: none"> • International reporting in accordance with the assumed obligations and reporting to the Republic of Croatia in accordance with national legislation and international obligations • Establishment and maintenance of the Environmental Protection Information System • Drawing up further guidelines for the implementation of the EIA and SEA procedures • IPA 2007 - Strengthening the capacities for the implementation of SAPARD (measures 1 and 2) and IPARD programmes (measures 101 and 103) • IPA 2010 - Strengthening the capacities for the implementation of a strategic environment impact assessment at regional and local levels • Reporting in accordance with the assumed international obligations and reporting to the Republic of Croatia • Drawing up a report on the state of the environment in the Republic of Croatia in the 2005-2008 period 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2011</p> <p>2011-2013</p> <p>2011- continuously</p> <p>I quarter 2011</p>
Establishment of industrial pollution control system	<ul style="list-style-type: none"> • Further development and upgrading of the Environmental Pollution Register and the Register of installations containing hazardous materials within the Information System of Installations and Emissions as part of the Environmental Protection Information System 	<p>2011- continuously</p>
Strengthening regional capacities for the implementation of IPPC Directive	<ul style="list-style-type: none"> • Setting up regional centres for the implementation of IPPC Directive 	<p>2013</p>
Strengthening and establishment of the system of integrated water management with greater investment in the water management infrastructure	<ul style="list-style-type: none"> • Development and establishment of an information system on the richness and quality of water and linking the water information system with the Environmental Protection Information System • Establishment of the system of reporting on waste waters • Preparation and adoption of the Water Areas Management Plan • Adjustment and establishment of a system of reporting on the quality, quantity and use of water and waste waters in accordance with WISE requirements (Water Information System for Europe) 	<p>2011- continuously</p> <p>2011- continuously</p> <p>2011</p> <p>2011- continuously</p>

<p>Strengthening and establishment of the system of integrated water management with greater investment in the infrastructure for public water supply and drainage, systems of protection against damage caused by water and irrigation systems</p>	<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; rehabilitation and completion of the existing and building of new public drainage systems • Reduction in losses in the existing water supply systems and an increase in connections to the public water supply systems (regional water supply systems), rehabilitation and completion of the existing and building of new water supply systems • Continuation of activities on the establishment of zones of sanitary protection of drinking water at source • Improvement of the existing and development of new public irrigation systems • Strengthening/reform of the existing system of water management financing and ensuring an increase in annual allocations (adoption of new subordinate legislation based on the Act on Water Management Financing) • Strengthening of water management planning - preparation, development and adoption of a water areas management plan • Greater investments in the construction of regulation and protective water structures and structures used for basic land reclamation through drainage 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2011</p> <p>2011</p> <p>Continuously</p>
<p>Sea and marine environment protection</p>	<ul style="list-style-type: none"> • Preparation of the annual National Adriatic Sea Monitoring Report • Preparation of the annual report, brochures and maps on sea water quality on beaches • Establishment and maintenance of the national database for the purpose of entering, processing and evaluation of the sea quality in terms of its acceptability for swimming, reporting to and informing the public • Carrying out assessment of the state of and pressures on the marine environment • Determination of the good state of the marine environment • Identification of a group of objectives and associated indicators • Establishment and further development of the Information System Sea; the database including the indicators of the state of the marine environment, mariculture and fisheries; reports on the state of the sea; upgrading of IT support for the purpose of implementation of the Marine Strategy Framework Directive and the national implementing legislation • Adjustment of the software support and the sea modelling and monitoring data from Phase I of the Project on the protection against pollution of waters in the coastal area in order to make them suitable for use by professional institutions and interested public • Strengthening control of the quality of waters in the coastal area (Project on the protection against pollution in the coastal area) - Phase II 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2012</p> <p>2012</p> <p>2012</p> <p>Continuously</p> <p>2011-2012</p> <p>2011-2014</p>
<p>Improvement of the nature protection system</p>	<ul style="list-style-type: none"> • Alignment of reporting with reporting at international level 	<p>2011 - continuously</p>
<p>Protection of natural values</p>	<ul style="list-style-type: none"> • Reporting on protected areas (CDDA) 	<p>2011 - continuously</p>
<p>Strengthen management and control in the nature protection</p>	<ul style="list-style-type: none"> • Administrative strengthening of nature protection institutions at state and regional level, including inspection service • Preparation, adoption and revision of the existing implementing regulations based on the Nature Protection Act • Revision of sector legislation and development of mechanisms for the incorporation of nature protection guidelines through cooperation between various sectors 	<p>Continuously</p>
<p>Ensure a good state of preservation of species and habitat and achieve an optimal preservation model for the use of protected areas and N2000 areas</p>	<ul style="list-style-type: none"> • Management of the national eco-network and implementation of protection measures • Protection of new areas, revision of the existing ones; Development of a system of protected areas, review and digitalisation of the borders of protected areas • Establishment of the NATURA 2000 network and monitoring • Implementation of wolf and lynx management plans • CITES implementation activities <p>International cooperation in the area of protection of nature (projects implementation):</p> <ul style="list-style-type: none"> • EU NATURA 2000 Integration in the ecological network Project (World Bank loan) • Identification and establishment of the marine areas of the NATURA 2000 network (IPA TAIB 2007) • Development of a faunal and speleological database (CRO fauna and CRO speleo) as part of the Environmental Protection Information System (IPA TAIB 2007) • Strengthening the capacities for preparation of management plans and strengthening the inspection of nature protection for the proposed NATURA 2000 areas (IPA 2009) 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2011-2016</p> <p>2011-2012</p> <p>2011-2012</p> <p>2011-2012</p>
<p>Improvement of the entire forestry system</p>	<ul style="list-style-type: none"> • Revision of the national forestry policy and strategy • The National Forestry Programme 	<p>2011</p>
<p>Establishment of a system of continuous forest supervision</p>	<ul style="list-style-type: none"> • The Programme of measures for data collection and the establishment of the registry of forest damage • Establishment and maintenance of a comprehensive information system and registry on forest fires 	<p>Continuously</p>
<p>Efficient and harmonised implementation of the national policy in the field of chemical safety</p>	<ul style="list-style-type: none"> • Implementation of the National Programme of chemical safety • Adoption of subordinate legislation to regulate the area of hazardous chemicals whose marketing is prohibited or restricted • Adoption of an Ordinance on amendments to the Ordinance on the list of existing active substances permitted in biocidal products, Ordinance on amendments to the Ordinance on the list of existing active substances which are not permitted in biocidal products and the List of biocidal products approved for placement on the market of the Republic of Croatia • Legislative amendments regulating the level of genetically modified organisms in products below which the products placed on the market do not have to be marked as products containing genetically modified organisms 	<p>Continuously</p> <p>2011</p> <p>2011</p> <p>2011</p>
<p>Noise</p>	<ul style="list-style-type: none"> • Authorisation of legal entities for the performance of professional noise protection tasks, implementation of professional exams in the field of noise protection, development of strategic noise maps and action plans 	<p>2012</p>

Annex I Matrix of Policy Commitments

	2010	2011	2012	2013
OVERALL ASSESSMENT OF FISCAL IMPACTS OF MAJOR IMPLEMENTING MEASURES				
A. Implementation				
B. Net direct impact on the budget	-133,033,936	-413,542,598	357,028,098	-47,405,450
B1. Direct impact on revenues	93,251,387	259,628,447	79,299,249	-227,489,971
B2. Direct impact on expenditures	226,285,324	673,171,045	-277,728,849	-180,084,521

I. ENTERPRISE SECTOR				
Total (1+2+3+4)				
A. Implementation				
B. Net direct impact on the budget	95,420,936	433,562,737	89,432,926	-172,580,704
B1. Direct impact on revenues	49,556,464	64,044,643	26,981,507	-156,784,719
B2. Direct impact on expenditures	-45,864,472	-369,518,094	-62,451,419	15,795,985

1. Competition and State Aid

Implementation of administrative and professional activities in connection with the protection of competition and activities concerning the authorisation, monitoring of implementation and recovery of general and special state aid within the framework of the Croatian Competition Agency's regular work

A. Implementation				
B. Net direct impact on the budget	188,100	-1,015,479	-207,150	-257,000
B1. Direct impact on revenues	2,560,729	937,784	-4,180,413	-1,983,422
B2. Direct impact on expenditures	2,372,629	1,953,263	-3,973,263	-1,726,422

Note: Activities of the Croatian Competition Agency are partly financed by EU assistance funds

2. Railway Restructuring

Total				
A. Implementation				
B. Net direct impact on the budget	76,739,548	409,042,235	97,879,424	-157,538,134
B1. Direct impact on revenues	46,995,735	63,106,859	31,161,920	-154,801,297
B2. Direct impact on expenditures	-29,743,813	-345,935,376	-66,717,504	2,736,837

Subsidies

A. Implementation				
B. Net direct impact on the budget	89,320,158	137,779,842	68,800,000	-8,900,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-89,320,158	-137,779,842	-68,800,000	8,900,000

Investment in Modernisation

A. Implementation				
B. Net direct impact on the budget	-2,130,796	277,406,910	30,054,424	-154,468,134
B1. Direct impact on revenues	50,125,834	68,196,376	31,161,920	-154,801,297
B2. Direct impact on expenditures	52,256,630	-209,210,534	1,107,496	-333,163

Note: The measure is partly financed by ISPA 2005 and IPA programmes

MSTI, Reforms, Development Studies, Alignment of Legislation

A. Implementation				
B. Net direct impact on the budget	-10,449,814	-6,144,517	-975,000	5,830,000
B1. Direct impact on revenues	-3,130,099	-5,089,517		
B2. Direct impact on expenditures	7,319,715	1,055,000	975,000	-5,830,000

Note: The measure is partly financed by PHARE 2006 programme

3. Small and Medium-Size Enterprises

Total				
A. Implementation				
B. Net direct impact on the budget	19,068,288	25,805,981	-8,044,348	-14,575,570
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-19,068,288	-25,805,981	8,044,348	14,575,570

Lifelong Entrepreneurial Training

A. Implementation				
B. Net direct impact on the budget	247,030	2,088,800	-1,100,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-247,030	-2,088,800	1,100,000	

Competitiveness and Innovations				
A. Implementation				
B. Net direct impact on the budget	22,748,519	20,916,377	-2,372,998	-5,115,424
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-22,748,519	-20,916,377	2,372,998	5,115,424
Improvements in Financing				
A. Implementation				
B. Net direct impact on the budget	36,949,595	-30,057,652	2,757,652	-4,177,223
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-36,949,595	30,057,652	-2,757,652	4,177,223
Construction and Development of Entrepreneurial and Business Infrastructure, Consultancy Services				
A. Implementation				
B. Net direct impact on the budget	1,750,000	-5,637,400	-2,398,002	-627,923
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-1,750,000	5,637,400	2,398,002	627,923
Regional Competitiveness				
A. Implementation				
B. Net direct impact on the budget	11,663,344	40,999,656	-10,000,000	-5,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-11,663,344	-40,999,656	10,000,000	5,000,000
Stimulating Tourism Development				
A. Implementation				
B. Net direct impact on the budget	-52,090,200	-2,403,800	5,069,000	345,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	52,090,200	2,403,800	-5,069,000	-345,000
Promotion of Tourism				
A. Implementation				
B. Net direct impact on the budget	-2,200,000	-100,000		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	2,200,000	100,000		
4. Public-Private Partnership				
Total				
A. Implementation				
B. Net direct impact on the budget	-575,000	-270,000	-195,000	-210,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	575,000	270,000	195,000	210,000
Training for Participants in the Procedures Relating to the Preparation and Implementation of PPP projects				
A. Implementation	X			
B. Net direct impact on the budget	-50,000	-100,000	-100,000	-100,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	50,000	100,000	100,000	100,000
Organisation of the Registry of PPP Agreements				
A. Implementation		X		
B. Net direct impact on the budget		-25,000	25,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures		25,000	-25,000	
Coordination of Exchange of Know-how in PPP area in SEECF Member States				
A. Implementation		X		
B. Net direct impact on the budget		-100,000	-10,000	-10,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		100,000	10,000	10,000
Implementation of the Regulation on the criteria for assessing and approving public-private partnership projects				
A. Implementation	X			
B. Net direct impact on the budget	-350,000	-50,000		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	350,000	50,000		
Training for Employees of the Agency for Public-Private Partnership				
A. Implementation				
B. Net direct impact on the budget	-45,000	-10,000	-10,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	45,000	10,000	10,000	

Scientific Analysis of Practical Experiences

A. Implementation				
B. Net direct impact on the budget	20,000	15,000		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-20,000	-15,000		
Implementation of the Regulation on the supervision of implementation of public-private partnership agreements				
A. Implementation	X			
B. Net direct impact on the budget	-150,000		-100,000	-100,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	150,000		100,000	100,000

II. LABOUR MARKET**Total (1+2+3+4+5+6+7+8)**

A. Implementation				
B. Net direct impact on the budget	-39,976,800	-66,103,300	112,000,600	64,896,200
B1. Direct impact on revenues	-29,000,000	-49,000,000	53,000,000	58,000,000
B2. Direct impact on expenditures	10,976,800	17,103,300	-59,000,600	-6,896,200

1. Active Employment Policy

A. Implementation				
B. Net direct impact on the budget	-83,000,000	4,000,000	-17,000,000	-80,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	83,000,000	-4,000,000	17,000,000	80,000,000

2. Job Preservation

A. Implementation	X			
B. Net direct impact on the budget	195,000,000			
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-195,000,000			

Note: The Act was applicable until the end of 2010

3. Rights During Unemployment Period

A. Implementation				
B. Net direct impact on the budget	-321,000	127,000	140,000	-140,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	321,000	-127,000	-140,000	140,000

4. Increasing Mandatory Retirement Age and Change of the Method of Determination of Early Retirement Pension

A. Implementation	X			
B. Net direct impact on the budget	-59,000,000	-143,000,000	144,000,000	143,000,000
B1. Direct impact on revenues	-29,000,000	-49,000,000	53,000,000	58,000,000
B2. Direct impact on expenditures	30,000,000	94,000,000	-91,000,000	-85,000,000

5. Implementation of Regulations Aimed at Protecting Maternity and Family Support

A. Implementation				
B. Net direct impact on the budget	-92,655,800	83,869,700	-4,039,400	13,136,200
B1. Direct impact on revenues				
B2. Direct impact on expenditures	92,655,800	-83,869,700	4,039,400	-13,136,200

6. Providing Scholarships to Regular Students

A. Implementation				
B. Net direct impact on the budget		-1,000,000	-1,000,000	-1,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		1,000,000	1,000,000	1,000,000

7. Subsidizing Students' Accommodation and Meals

A. Implementation				
B. Net direct impact on the budget		-10,000,000	-10,000,000	-10,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		10,000,000	10,000,000	10,000,000

8. Transportation Services for Students and Handicapped Students

A. Implementation				
B. Net direct impact on the budget		-100,000	-100,000	-100,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		100,000	100,000	100,000

III. AGRICULTURE				
Total (1+2+3+4+5+6+7+8)				
A. Implementation				
B. Net direct impact on the budget	-345,699,811	34,096,247	146,994,416	300,383,661
B1. Direct impact on revenues	14,555,003	132,606,851	-1,394,902	-79,663,677
B2. Direct impact on expenditures	360,254,814	98,510,604	-148,389,317	-380,047,338
1. State Aid in Agriculture and Rural Development				
A. Implementation				
B. Net direct impact on the budget	-178,480,294	71,238,151	105,101,800	284,162,573
B1. Direct impact on revenues				
B2. Direct impact on expenditures	178,480,294	-71,238,151	-105,101,800	-284,162,573
2. Establishment of the Market Price Information System for the Agricultural Products Market				
A. Implementation				
B. Net direct impact on the budget	-102,454	11,000	-23,000	10,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	102,454	-11,000	23,000	-10,000
3. IPARD Implementation				
A. Implementation	X			X
B. Net direct impact on the budget	-39,749,152	-29,140,667	5,324,693	-258,333
B1. Direct impact on revenues		75,000,000	51,081,150	-59,977,875
B2. Direct impact on expenditures	39,749,152	104,140,667	45,756,457	-59,719,542
Note: The measure is partly financed by the EU assistance funds				
4. Implementation of the World Bank Project of Alignment of Agricultural Legislation with the Acquis Communautaire				
A. Implementation				X
B. Net direct impact on the budget	-52,344,838	7,261,023	52,148,000	23,060,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	52,344,838	-7,261,023	-52,148,000	-23,060,000
5. Establishment of the Farm Accountancy Data Network (FADN)				
A. Implementation	X			
B. Net direct impact on the budget	-180,000	-82,000	-812,000	-420,500
B1. Direct impact on revenues				
B2. Direct impact on expenditures	180,000	82,000	812,000	420,500
6. Construction and Furnishing of Long-Term Phytosanitary and Veterinary Border Inspection Posts				
A. Implementation	X			X
B. Net direct impact on the budget	-2,642,266	-17,947,527	15,784,618	4,805,175
B1. Direct impact on revenues	7,926,794	51,527,583	-45,037,379	-14,416,998
B2. Direct impact on expenditures	10,569,060	69,475,110	-60,821,997	-19,222,173
Note: Construction and furnishing of phytosanitary and veterinary border inspection posts is partly financed by EU assistance funds				
7. Veterinary Practice				
A. Implementation				
B. Net direct impact on the budget	-58,220,760	552,465	-27,970,265	-15,217,213
B1. Direct impact on revenues				
B2. Direct impact on expenditures	58,220,760	-552,465	27,970,265	15,217,213
8. Structural Measures in the Fisheries				
A. Implementation				
B. Net direct impact on the budget	-13,980,047	2,203,801	-2,559,430	4,241,959
B1. Direct impact on revenues	6,628,209	6,079,268	-7,438,673	-5,268,804
B2. Direct impact on expenditures	20,608,256	3,875,467	-4,879,243	-9,510,763
Note: The measure is partly financed by EU assistance funds				

IV. PUBLIC ADMINISTRATION REFORM				
Total (1+2+3+4)				
A. Implementation				
B. Net direct impact on the budget	2,821,486	-1,768,750	-6,060,503	-11,463,574
B1. Direct impact on revenues	1,095,200	2,183,051	3,278,249	-5,463,747
B2. Direct impact on expenditures	-1,726,286	3,951,801	9,338,752	5,999,827
1. Implementation of Activities Relating to E-administration				
A. Implementation				
B. Net direct impact on the budget	2,821,486	-1,404,500	612,000	613,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-2,821,486	1,404,500	-612,000	-613,000
2. Implementation of the Action Plan for the Implementation of the Strategy for the Development of Human Resources in Public Administration for the 2010-2013 period				
A. Implementation				X
B. Net direct impact on the budget				-2,764,658
B1. Direct impact on revenues				
B2. Direct impact on expenditures				2,764,658
3. Alignment of Special Procedural Acts with the New General Administrative Procedure Act and Training of Civil Servants for the Application of the General Administrative Procedure Act				
A. Implementation	X			
B. Net direct impact on the budget	0	-364,250	-364,250	607,083
B1. Direct impact on revenues	1,095,200	2,183,051	3,278,249	-5,463,747
B2. Direct impact on expenditures	1,095,200	2,547,301	3,642,499	-6,070,830
Note: The measure is partly financed by the EU assistance funds				
4. Promotion and Implementation of the Public Administration Reform Strategy				
A. Implementation			X	
B. Net direct impact on the budget			-6,308,253	-9,919,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures			6,308,253	9,919,000
V. DEVELOPMENT OF A KNOWLEDGE-BASED SOCIETY				
Total (1+2+3+4+5+6+7+8+9+10+11)				
A. Implementation				
B. Net direct impact on the budget	47,088,368	5,386,812	5,326,976	8,019,090
B1. Direct impact on revenues	22,566,909	58,662,458	24,060,310	-57,677,066
B2. Direct impact on expenditures	-24,521,459	53,275,646	18,733,334	-65,696,156
1. Education Development				
A. Implementation				
B. Net direct impact on the budget	7,114,914		-50,196	335,644
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-7,114,914		50,196	-335,644
2. Development of the National Curriculum for Pre-School, Primary-School and Secondary-School Education				
A. Implementation				
B. Net direct impact on the budget	1,044,453	-356,923		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-1,044,453	356,923		
Note: Partial funding has been secured by a World Bank loan, while the remainder has been allocated from the budget.				
3. National Exams and State School-Leaving Exam				
A. Implementation				
B. Net direct impact on the budget	-6,171,959	-10,057,560	1,017,184	696,898
B1. Direct impact on revenues	-6,918,465	-12,096,928	0	0
B2. Direct impact on expenditures	-746,506	-2,039,368	-1,017,184	-696,898
Note: The measure is partly financed by the EU assistance - IPA				
4. Application of National Pedagogical Standards in Accordance with Feasibility Coefficient				
A. Implementation				
B. Net direct impact on the budget	4,381,295	7,114,333	12,904	9,910
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-4,381,295	-7,114,333	-12,904	-9,910
5. Development of the Croatian Qualifications Framework				
A. Implementation				
B. Net direct impact on the budget	113,939	-633,852	17,181	18,564
B1. Direct impact on revenues	9,848,917	14,925,412	17,311,658	-34,887,021
B2. Direct impact on expenditures	9,734,978	15,559,264	17,294,477	-34,905,585
Note: The measure is partly financed by the EU assistance - IPA				

6. Strengthening the Quality of Adult Education				
A. Implementation				
B. Net direct impact on the budget	-1,674,438	800,000	2,155	94,433
B1. Direct impact on revenues	4,653,750	21,407,250	-20,786,750	-4,033,250
B2. Direct impact on expenditures	6,328,188	20,607,250	-20,788,905	-4,127,683
Note: The measure is partly financed by the EU assistance - IPA				
7. Development of the Quality Assurance System				
A. Implementation				
B. Net direct impact on the budget	-272,067	153,479	1,344	3,607
B1. Direct impact on revenues	4,393,140	12,310,720	-3,239,010	-9,152,375
B2. Direct impact on expenditures	4,665,207	12,157,241	-3,240,354	-9,155,982
Note: The measure is partly financed by the EU assistance - IPA				
8. Continued Implementation of the Bologna Process				
A. Implementation				
B. Net direct impact on the budget	884,694	74,964	9,411	31,253
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-884,694	-74,964	-9,411	-31,253
9. Strengthening Resources in the Science and Technologies				
A. Implementation				
B. Net direct impact on the budget	-11,879,850	-140,427	-40,893	2,558,095
B1. Direct impact on revenues				
B2. Direct impact on expenditures	11,879,850	140,427	40,893	-2,558,095
10. Development of Centres of Excellence and Scientific and Technological Infrastructure				
A. Implementation				
B. Net direct impact on the budget	15,413,480	1,334,337	-16,828,870	5,969,129
B1. Direct impact on revenues	10,589,567	22,116,004	30,774,412	-9,604,420
B2. Direct impact on expenditures	-4,823,913	20,781,667	47,603,282	-15,573,549
Note: The measure is partly financed by the EU assistance - IPA				
11. Commercialisation of Research Results				
A. Implementation				
B. Net direct impact on the budget	38,133,908	7,098,461	21,186,756	-1,698,443
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-38,133,908	-7,098,461	-21,186,756	1,698,443
Note: Declared funds include IBRD funds				

VI. HEALTH CARE REFORM				
Total (1+2+3+4+5)				
A. Implementation				
B. Net direct impact on the budget	256,395,020	-232,219,475	-24,947,733	1,562,617
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	-256,395,020	232,219,475	24,947,733	-1,562,617
1. Reduction in Expenditures for Sick Leaves				
A. Implementation	X			
B. Net direct impact on the budget	259,900,000			
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-259,900,000			
2. Informatisation of Primary Health Care				
A. Implementation		X		
B. Net direct impact on the budget	16,935,051	-39,769,674		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-16,935,051	39,769,674		
3. Acquisition of Medical Equipment and Refurbishment of Hospitals				
A. Implementation				
B. Net direct impact on the budget	-17,054,737	-111,679,844		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	17,054,737	111,679,844		
4. Reorganisation of Emergency Medical Assistance				
A. Implementation				
B. Net direct impact on the budget	-2,735,294	-78,208,957	-24,984,525	1,497,304
B1. Direct impact on revenues				
B2. Direct impact on expenditures	2,735,294	78,208,957	24,984,525	-1,497,304
5. Accreditation of Hospitals				
A. Implementation				
B. Net direct impact on the budget	-650,000	-2,561,000	36,792	65,313
B1. Direct impact on revenues				
B2. Direct impact on expenditures	650,000	2,561,000	-36,792	-65,313

VII. JUDICIAL REFORM				
Total (1+2)				
A. Implementation				
B. Net direct impact on the budget	28,870,309	-5,221,875	-28,192,815	-8,531,781
B1. Direct impact on revenues	-13,342,869	3,343,735	-14,388,787	-4,794,000
B2. Direct impact on expenditures	-42,213,178	8,565,610	13,804,028	3,737,781

1. Judicial Reform

A. Implementation				
B. Net direct impact on the budget	19,964,461	-452,985	-37,462,212	-8,026,946
B1. Direct impact on revenues	-10,378,629	2,244,865	-6,156,057	644,000
B2. Direct impact on expenditures	-30,343,090	2,697,850	31,306,155	8,670,946

Note: The judicial reform is partly financed by EU assistance funds and donations made by international organisations, and their impact on revenues is shown in row B1. Minor portion of the planned funds shown in row B2 has been secured from the Council of Europe Development Bank and the World Bank loan.

2. Prevention of Corruption

A. Implementation				
B. Net direct impact on the budget	8,905,848	-4,768,890	9,269,397	-504,835
B1. Direct impact on revenues	-2,964,240	1,098,870	-8,232,730	-5,438,000
B2. Direct impact on expenditures	-11,870,088	5,867,760	-17,502,127	-4,933,165

Note: The judicial reform in the part related to the prevention of corruption is partly financed by EU assistance funds, donations made by international organisations and 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	-177,953,445	-581,274,994	62,474,232	-229,690,959
B1. Direct impact on revenues	47,820,680	47,787,710	-12,237,128	18,893,238
B2. Direct impact on expenditures	225,774,125	629,062,704	-74,711,360	248,584,197

1. Integrating Environmental Protection Goals in the Planning and Implementation of Other Sectoral Policies for the Purpose of Promoting Sustainable Development (MEPPPC, CEA)

A. Implementation				
B. Net direct impact on the budget	-615,800	1,167,300	864,500	275,000
B1. Direct impact on revenues	0	1,300,000	2,363,000	0
B2. Direct impact on expenditures	615,800	132,700	1,498,500	-275,000

Note: The implementation is also financed by IPA programme

2. Air Quality and Climate Protection (MEPPPC)

A. Implementation				
B. Net direct impact on the budget	6,084,286	355,514	715,200	-300,000
B1. Direct impact on revenues	298,504	-4,128,504	0	0
B2. Direct impact on expenditures	-5,785,782	-4,484,018	-715,200	300,000

Note: The implementation is also financed by IPA programme

3. Waste Management (MEPPPC)

A. Implementation				
B. Net direct impact on the budget	142,059	250,941	-253,000	547,000
B1. Direct impact on revenues	20,842,176	28,623,004	106,830,940	25,855,380
B2. Direct impact on expenditures	20,700,117	28,372,063	107,083,940	25,308,380

Note: The implementation is also financed by IPA programme

4. Water Management (MAFWM)

A. Implementation				
B. Net direct impact on the budget	-180,047,000	-570,491,492	66,301,047	-224,347,687
B1. Direct impact on revenues	26,680,000	6,250,000	-112,650,000	0
B2. Direct impact on expenditures	206,727,000	576,741,492	-178,951,047	224,347,687

Note: The implementation is also financed by IPA programme

5. Protection of the Sea and Marine Environment (MEPPPC)

A. Implementation				
B. Net direct impact on the budget	-4,002,787	-3,217,213	-314,500	1,714,500
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	4,002,787	3,217,213	314,500	-1,714,500

6. Nature Protection (MC)					
A. Implementation					
B. Net direct impact on the budget	872,797	-7,512,653	-6,526,500	-7,613,130	
B1. Direct impact on revenues	0	9,083,210	-2,861,068	-6,222,142	
B2. Direct impact on expenditures	-872,797	16,595,863	3,665,432	1,390,988	
Note: The implementation is also financed by IPA programme					
7. Establishing Industrial Pollution Control System (MEPPPC)					
A. Implementation					
B. Net direct impact on the budget	-188,000	-836,191	728,085	125,526	
B1. Direct impact on revenues	0	6,660,000	-5,920,000	-740,000	
B2. Direct impact on expenditures	188,000	7,496,191	-6,648,085	-865,526	
Note: The implementation is also financed by IPA programme					
8. Chemicals and GMOs (MHSW)					
A. Implementation					
B. Net direct impact on the budget	349,000	-289,200	559,400	257,832	
B1. Direct impact on revenues	0	0	0	0	
B2. Direct impact on expenditures	-349,000	289,200	-559,400	-257,832	
9. Forestry (MRDFWM):					
A. Implementation					
B. Net direct impact on the budget	-548,000	-702,000	400,000	-350,000	
B1. Direct impact on revenues	0	0	0	0	
B2. Direct impact on expenditures	548,000	702,000	-400,000	350,000	

Annex II Statistical Appendix

Table 1a: Macroeconomic Prospects

Percentages unless otherwise indicated	ESA Code	2009	2009	2010	2011	2012	2013
		Level (bn EUR) ¹		Rate of change			
1. Real GDP at market prices	B1*g	32.0	-5.8	-1.6	1.5	2.0	2.5
2. GDP at market prices	B1*g	45.4	-2.7	-1.1	3.0	4.3	4.9
Components of real GDP							
3. Private consumption expenditure	P3	25.8	-8.5	-1.9	1.8	2.5	2.8
4. Government consumption expenditure	P3	8.9	0.2	-1.0	-0.5	-1.2	-0.9
5. Gross fixed capital formation	P51	11.2	-11.8	-11.7	3.0	4.4	5.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	0.9	2.0	2.1	2.2	2.5	2.8
7. Exports of goods and services	P6	16.4	-16.2	4.2	4.4	4.8	5.9
8. Imports of goods and services	P7	17.9	-20.7	-1.9	4.7	5.6	6.8
Contribution to real GDP growth²							
9. Final domestic demand		46.0	-8.6	-4.5	1.7	2.4	3.0
10. Change in inventories and net acquisition of valuables	P52+P53	0.9	-1.2	0.1	0.2	0.3	0.3
11. External balance of goods and services	B11	-1.5	4.7	2.6	-0.4	-0.7	-0.9

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] Current prices

^[2] Central Bureau of Statistics applies chain-linking method in the calculation of GDP at constant prices. Basic chain-linked indices are calculated by using the time series at prices of the previous year by linking to the referent year (2000 = 100). Real growth rates are calculated by using the series of basic chain-linked indices. The time series at constant prices of the previous year are additive (GDP and GVA equal the sum of categories and subcategories), while the time series at constant prices of the referent year are not additive (GDP and GVA do not equal the sum of categories and subcategories). This non-additivity of GDP and GVA sums results from using the basic chain-linked indices on detailed structure of categories and subcategories.

Table 1b: Price Developments

Percentage changes, annual averages	ESA Code	2009	2010	2011	2012	2013
1. GDP deflator		3.3	0.5	1.5	2.2	2.3
2. Private consumption deflator		2.5	1.1	2.2	2.5	2.5
3. HICP		-	-	-	-	-
4. National CPI change		2.4	1.1	2.2	2.5	2.5
5. Public consumption deflator		3.1	0.5	1.6	1.8	2.2
6. Investment deflator		-1.1	-1.3	2.3	2.9	2.9
7. Export price deflator (goods & services)		0.0	1.0	1.0	1.9	1.8
8. Import price deflator (goods & services)		-3.8	0.8	2.8	2.9	2.8

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 Code	2009	2010	2011	2012	2013
		Level/Rate of change				
1. Population (thousands)		4,429	4,429	4,429	4,429	4,429
2. Population (growth rate in %)		-0.1	0.0	0.0	0.0	0.0
3. Working-age population (persons) [1]		2,736	2,731	2,726	2,723	2,719
4. Participation rate		64.5	64.2	64.4	64.7	65.1
5. Employment, persons [2]		1,605	1,542	1,552	1,572	1,592
6. Employment, hours worked [3]		n.a.	n.a.	n.a.	n.a.	n.a.
7. Employment (growth rate in %)		-1.9	-3.9	0.6	1.3	1.3
8. Public sector employment (persons); NCEA - O,P,Q categories		289.7	290.1	286.9	283.8	280.7
9. Public sector employment (growth in %)		1.3	0.2	-1.1	-1.1	-1.1
10. Unemployment rate [4]		9.1	12.0	11.7	10.8	10.0
11. Labour productivity, persons [5]		-4.0	2.4	0.8	0.7	1.2
12. Labour productivity, hours worked [6]		n.a.	n.a.	n.a.	n.a.	n.a.
13. Compensation of employees [7]	D1	0.3	-4.1	1.6	4.3	4.9

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 of 15-64 years^[2] ILO definition^[3] ILO definition^[4] ILO definition^[5] Real GDP per person employed^[6] Real GDP per hour worked^[7] Average Gross Earnings of Persons in Paid Employment * Employment by ILO definition

Table 1d: Sectoral Balances

Percentages of GDP	ESA code	2009	2010	2011	2012	2013
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	7,2	4,3	5,7	6,5	7,5
<i>of which:</i>						
- Balance of goods and services		-3,8	-1,7	-2,7	-3,6	-4,6
- Balance of primary incomes and transfers		-1,7	-1,1	-1,1	-1,1	-1,1
- Capital account		0,1	0,1	0,1	0,1	0,1
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	11,3	9,5	11,3	10,5	9,9
3. Net lending/borrowing of general government		-4,1	-5,2	-5,6	-3,9	-2,4
4. Statistical discrepancy		1,8	-	-	-	-

Source: CNB, MF

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

Table 1e: GDP, Investment and Gross Value Added

	ESA Code	2009	2010	2011	2012	2013
GDP and investment						
GDP level at current market prices (in domestic currency)	B1g	333.1	329.2	339.2	353.7	371.0
Investment ratio (% of GDP)		24.7	21.8	22.3	23.0	23.8
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		2.1	0.7	1.1	1.2	1.4
2. Industry (excluding construction)		-8.5	-1.6	1.7	2.1	2.9
3. Construction		-6.1	-15.2	0.5	0.7	1.5
4. Services		-3.8	-0.4	1.7	2.0	2.6

Source: CBS, MF

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

Table 1f: External Sector Developments

EUR million unless otherwise indicated		2009	2010	2011	2012	2013
1. Current account balance (% of GDP)	% of GDP	-5.5	-2.8	-3.8	-4.7	-5.7
2. Export of goods	EUR million	7,703	8,597	9,110	9,884	10,868
3. Import of goods	EUR million	15,090	15,148	16,341	17,893	19,808
4. Trade balance	EUR million	-7,387	-6,552	-7,231	-8,009	-8,940
5. Export of services	EUR million	8,454	8,599	8,905	9,323	9,808
6. Import of services	EUR million	2,778	2,807	2,916	3,048	3,200
7. Service balance	EUR million	5,676	5,792	5,988	6,275	6,608
8. Net interest payments from abroad	EUR million	-1,420	-1,261	-1,231	-1,305	-1,410
9. Other net factor income from abroad	EUR million	-382	-309	-421	-471	-542
10. Current transfers	EUR million	1,036	1,085	1,127	1,240	1,388
11. <i>Of which:</i> from EU	EUR million	-	-	-	-	-
12. Current account balance	EUR million	-2,477	-1,245	-1,768	-2,271	-2,896
13. Foreign direct investment	EUR million	1,210	1,003	1,255	1,540	1,862
14. Foreign reserves	EUR million	10,376	11,566	11,075	11,089	11,055
15. Foreign debt [1]	EUR million	43,089	45,434	47,602	49,920	52,515
16. <i>Of which:</i> public	EUR million	-	-	-	-	-
17. <i>O/w:</i> foreign currency denominated	EUR million	-	-	-	-	-
18. <i>O/w:</i> repayments due	EUR million	-	-	-	-	-
19. Exchange rate vis-à-vis EUR (end-year)	NCU/EUR	7.31	7.32	7.31	7.31	7.31
20. Exchange rate vis-à-vis EUR (annual average)	NCU/EUR	7.34	7.27	7.30	7.30	7.30
21. Net foreign saving	% of GDP	-	-	-	-	-
22. Domestic private saving	% of GDP	-	-	-	-	-
23. Domestic private investment	% of GDP	-	-	-	-	-
24. Domestic public saving	% of GDP	-	-	-	-	-
25. Domestic public investment	% of GDP	-	-	-	-	-

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] Round tripping excluded

Table 2: General Government Budgetary Prospects

	ESA code	2009 Level	2009	2010	2011 % of GDP	2012	2013
Net lending (B9) by sub-sectors							
1. General government	S13	-4.671	-4.1	-5.2	-5.6	-3.9	-2.4
2. Central government	S1311	-4.797	-3.8	-5.0	-5.3	-3.6	-2.2
3. State government	S1312	0.000	0.0	0.0	0.0	0.0	0.0
4. Local government	S1313	0.126	-0.3	-0.2	-0.3	-0.3	-0.2
5. Social security funds	S1314	0.000	0.0	0.0	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	134.826	38.5	37.8	36.3	36.8	36.6
7. Total expenditure[1]	TE	139.497	42.6	43.0	41.9	40.7	39.0
8. Net borrowing/lending	EDP.B9	-4.671	-4.1	-5.2	-5.6	-3.9	-2.4
9. Interest expenditure	EDP.D41 incl. FISIM	5.033	1.7	1.9	2.2	2.2	2.2
p.m. 9a. FISIM		0.000	0.0	0.0	0.0	0.0	0.0
10. Primary balance[2]		0.362	-2.4	-3.3	-3.4	-1.7	-0.2
Components of revenues							
11. Total taxes (11 = 11a+11b+11c)		79.351	22.0	21.7	20.5	20.5	20.4
11a. Taxes on production and imports	D2	57.171	15.5	16.2	16.0	16.1	16.0
11b. Current taxes on income and wealth	D5	22.177	6.5	5.5	4.5	4.4	4.5
11c. Capital taxes	D91	0.003	0.0	0.0	0.0	0.0	0.0
12. Social contributions	D61	41.186	12.2	12.0	11.8	11.8	11.8
13. Property income	D4	1.601	0.8	0.4	0.4	0.3	0.2
14. Other (14 = 15 - (11+12+13))		12.689	3.6	3.7	3.7	4.3	4.1
15 = 6. Total revenue	TR	134.826	38.5	37.8	36.3	36.8	36.6
p.m.: Tax burden (D2+D5+D61+D91-D995)[3]		122.137	34.9	34.1	32.6	32.5	32.5

[1] Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

Table 2 (continued)

	ESA code	2009 Level	2009	2010	2011 % of GDP	2012	2013
Selected components of expenditures							
16. Collective consumption	P32	0.000	0.0	0.0	0.0	0.0	0.0
17. Total social transfers	D62 + D63	53.489	17.0	17.6	16.8	16.1	15.5
17a. Social transfers in kind	P31 = D63	10.716	3.3	3.6	3.3	3.2	3.0
17b. Social transfers other than in kind	D62	42.773	13.6	14.0	13.5	13.0	12.5
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	5.033	1.7	1.9	2.2	2.2	2.2
19. Subsidies	D3	8.130	2.4	2.3	2.2	2.1	2.0
20. Gross fixed capital formation	P51	6.961	1.8	1.8	1.9	1.7	1.5
21. Other (21 = 22- (16+17+18+19+20))		65.883	19.6	19.4	18.8	18.7	17.7
22. Total expenditures ^[1]	TE	139.497	42.6	43.0	41.9	40.7	39.0
p.m. compensation of employees	D1	33.66513	10.6	10.8	10.5	10.0	9.6

^[1] Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

Source: MF

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

Table 3: General Government Expenditure by Function

Percentages of GDP	COFOG Code	2009	2010	2011	2012	2013
1. General public services	1	4.5				
2. Defence	2	1.5				
3. Public order and safety	3	2.4				
4. Economic affairs	4	4.8				
5. Environmental protection	5	0.3				
6. Housing and community amenities	6	1.5				
7. Health	7	6.2				
8. Recreation, culture and religion	8	1.2				
9. Education	9	4.2				
10. Social protection	10	14.6				
11. Total expenditure (item 7 = 22 in Table 2)	TE	42.6				

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	2009	2010	2011	2012	2013
1. Gross debt [1]		35.4	41.6	44.2	46.3	46.7
2. Change in gross debt ratio		6.1	6.2	2.6	2.1	0.5
Contributions to change in gross debt						
3. Primary balance[2]		2.4	3.3	3.4	1.7	0.2
4. Interest expenditure (incl. FISIM)[3]		1.7	1.9	2.2	2.2	2.2
5. Stock-flow adjustment		2.0	1.0	-3.0	-1.8	-1.9
<i>of which:</i>						
- Differences between cash and accruals[4]		0.0	0.0	0.0	0.0	0.0
- Net accumulation of financial assets[5]		0.0	0.0	-0.6	0.2	0.2
<i>of which:</i>						
- Privatisation proceeds		0.0	0.0	0.5	0.2	0.2
- Valuation effects and other[6]		0.0	0.0	-0.2	-0.2	0.0
p.m. implicit interest rate on debt[7]		5.7	5.4	5.4	5.2	5.0
Other relevant variables						
6. Liquid financial assets[8]		0.0	0.0	0.0	0.0	0.0
7. Net financial debt (7 = 1 - 6)		35.4	41.6	44.2	46.3	46.7

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	2009	2010	2011	2012	2013
1. Real GDP growth (%)	B1g	-5.8	-1.6	1.5	2.0	2.5
2. Net lending of general government	EDP.B.9	-4.1	-5.2	-5.6	-3.9	-2.4
3. Interest expenditure (incl. FISIM recorded as consumption)	EDP.D.41 + FISIM	1.7	1.9	2.2	2.2	2.2
4. Potential GDP growth (%) [1]		-1.2	-1.2	0.1	1.3	1.9
Contributions:						
- labour						
- capital						
- total factor productivity						
5. Output gap		-1.6	-2.0	-0.5	0.1	0.7
6. Cyclical budgetary component		-0.6	-0.7	-0.2	0.1	0.1
7. Cyclically-adjusted balance (2-6)		-3.5	-4.5	-5.4	-4.0	-2.5
8. Cyclically-adjusted primary balance (7-3)		-1.8	-2.6	-3.2	-1.8	-0.3

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, Member States can use their own figures (SP).

Table 6: Divergence from Previous Programme

	2009	2010	2011	2012	2013
1. GDP growth (% points)					
Previous update	-5.9	0.5	3.0	3.5	
Latest update	-5.8	-1.6	1.5	2.0	2.5
Difference	-0.1	2.1	1.5	1.5	
2. General government net lending (% of GDP)					
Previous update	-3.4	-3.3	-3.1	-2.3	
Latest update	-4.1	-5.2	-5.6	-3.9	-2.4
Difference	0.7	2.0	2.4	1.6	
3. General government gross debt (% of GDP)					
Previous update	33.2	35.5	36.5	36.5	
Latest update	35.4	41.6	44.2	46.3	46.7
Difference	-2.2	-6.1	-7.6	-9.8	

Source: MF

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

Table 7: Long-term Sustainability of Public Finances

Percentages of GDP	2000	2005	2010	2020	2030	2040	2050
Total expenditure	-	42.5	43.0	40.2	40.9	41.9	43.7
of which:							
- Age-related expenditures	-	15.5	16.9	14.7	15.3	16.2	17.9
- Pension expenditure	-	10.1	10.6	8.9	8.2	8.1	8.6
- Social security pension	-	-	-	-	-	-	-
- Old-age and early pensions	-	-	-	-	-	-	-
- Other pensions (disability, survivors)	-	-	-	-	-	-	-
- Occupational pensions (if in general government)	-	-	-	-	-	-	-
- Health care	-	5.5	6.3	5.8	7.1	8.1	9.3
- Long-term care (this was earlier included in the health care)	-	-	-	-	-	-	-
Education expenditure	-	-	-	-	-	-	-
Other age-related expenditures	-	-	-	-	-	-	-
Interest expenditure	-	1.9	1.9	2.4	2.7	3.0	3.3
Total revenues	-	39.0	37.8	36.6	36.6	36.6	36.6
<i>of which:</i> property income	-	-	-	-	-	-	-
<i>of which:</i> from pensions contributions (or social contributions, if appropriate)	-	5.9	5.8	5.6	5.6	5.6	5.6
Pension reserve fund assets	-	-	-	-	-	-	-
<i>of which:</i> consolidated public pension fund assets (assets other than government liabilities)	-	-	-	-	-	-	-
Assumptions							
Labour productivity growth	-1.2	3.5	1.9	3.1	2.2	1.1	1.1
Real GDP growth	2.9	4.2	-1.6	3.2	1.2	0.3	0.2
Participation rate males (aged 20-64)	67.8	69.6	71.0	72.4	72.6	71.9	72.8
Participation rates females (aged 20-64)	55.5	56.8	57.7	58.8	59.0	58.4	59.2
Total participation rates (20-64)	61.5	63.1	64.2	65.6	65.7	65.1	65.9
Unemployment rate	16.1	12.7	11.6	7.0	7.0	7.0	7.0
Population aged 65+ over total population	-	16.6	16.8	19.6	22.6	24.7	27.3

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

Table 8: Basic Assumptions on the External Economic Environment

Variable (annual growth rates in %, if not otherwise stated)	Assumptions for								
	2009		2010		2011		2012		2013
		<i>change*</i>		<i>change*</i>		<i>change*</i>		<i>change*</i>	
	Interest rates (in % p.a., annual averages)								
- Short-term interest rate ¹ (annual average)ž	1.23	0.0	0.79	-0.8	1.02	-1.7	1.33	-1.8	1.76
- Long-term term interest rate ² (annual average)	3.34	0.0	2.57	-1.2	2.97	-	-	-	-
	Exchange rates (annual average “-“: depreciation)								
Exchange rate vis-à-vis €	7.34	0.0	7.27	-0.1	7.30	0.0	7.30	0.0	7.30
USD / € **	1.39	0.0	1.30	-0.2	1.26	-0.1	1.26	-0.1	1.27
Nominal effective exchange rate	89.6	2.6	90.0	4.4	91.0	4.3	90.7	3.9	90.8
Real effective exchange rate ***	84.4	2.5	85.1	5.8	85.5	6.4	84.3	6.0	83.3
	GDP (in real terms)								
- World	-0.6	0.7	4.6	1.7	4.3	0.0	4.5	0.0	4.6
- Euro Area	-4.1	0.1	1.1	1.1	1.3	-0.1	1.8	0.0	1.8
	World trade (in real terms)								
Country export markets	14.6	-0.5	4.1	3.7	3.7	0.2	5.2	0.6	5.4
World volume of trade	11.1	1.3	10.2	9.0	6.5	1.3	6.7	0.3	6.9
	International prices								
World import prices (goods, in €)	-8.7	2.4	3.5	0.1	0.7	-1.5	0.6	-0.8	0.7
Oil Prices**** (USD per barrel)	61.8	-0.2	78.9	-3.2	89.9	10.4	91.5	10.5	92.5

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

** Projected values of USD/€ for 2010, 2011 and 2012 are from Foreign Exchange Consensus Forecast (November, 2010).

*** Effective exchange rate is calculated as a weighted mean of bilateral exchange rates of HRK against EUR (weight 79.0%) and HRK against USD (21.0%).

For derivation of the real effective exchange rate the CPI is used as deflator.

**** Projected values of oil prices for 2010, 2011, 2012 and 2013 refer to Crude Oil Futures prices traded on the NYMEX

1 IMF (GAS September 2010), euro 6m libor.

2 Bloomberg, German 10-year note.

Annex III Structural Reforms Agenda and Achievements

Structural reforms agenda and achievements show realisation of the measures that were to be implemented in 2010 under the 2010-2012 PEP.

MAIN MEASURES UNDER THE 2010-2012 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
ENTERPRISE SECTOR			
Competition and state aid			
<p>Adoption of Regulation on block exemption in the transport sector</p> <p>Adoption of Regulation on the procedure and criteria for imposing and calculating penalties</p> <p>Adoption of Regulation on criteria for reducing penalties or acquittal from penalties</p> <p>Adoption of Regulation on the registration procedure and criteria for the assessment of concentration of entrepreneurs</p> <p>Adoption of Regulation on block exemption of agreements between undertakings not operating on the same level of production</p> <p>Adoption of Regulation on block exemption of agreements between undertakings operating on the same level of production or distribution</p> <p>Adoption of Regulation on technology transfer block exemption agreements</p> <p>Adoption of Regulation on block exemption granted to agreements on distribution and servicing of motor vehicles</p> <p>Adoption of Regulation on block exemption granted to insurance agreements</p> <p>Adoption of Regulation on the definition of the relevant market</p>	Yes	I quarter 2011	The Regulation on the procedure and criteria for imposing and calculating penalties and the Regulation on criteria for reducing penalties or acquittal from penalties were published in the Official Gazette 129/10.
<p>Training as regards the application of new legislation for the employees of the Croatian Competition Agency, other regulatory bodies and the judiciary (through IPA 2007 programme twinning project)</p> <p>Training as regards the application of new legislation for students, local business community, bodies of local authorities and the public in general (through a services agreement in the context of IPA 2007 programme)</p>	In progress	<p>July 2012</p> <p>December 2011</p>	<p>The Croatian Competition Agency has been implementing the twinning project since July 2010. Initial training activities within the Croatian Competition Agency and in cooperation with the sector regulators (Croatian Post and Electronic Communications Agency) have been carried out.</p> <p>The Croatian Competition Agency has been implementing the Services Agreement (CroCompete project) since December 2009. During 2010, the major part of the training for students of the Faculty of Economics and Business and the Faculty of Law was completed, several seminars for the local business community and bodies of local authorities were held and a number of activities covered by media were performed with a view to informing the general public.</p>
Adoption of a rule on state aid in accordance with the procedure prescribed by the Regulation on state aid	Yes	The measure is being implemented on an ongoing basis	During 2010, three decisions on the publishing of rules on state aid were adopted and the Decision on amendments to the Decision on the publishing of a list of rules on state aid was also adopted (Official Gazette 31/10).
<p>The completion of the state aid approval procedure for Croatian shipyards</p> <p>Professional training of the employees of the Croatian Competition Agency and providers of state aid (on the central and local level) through an IPA 2007 programme project</p>	In progress	<p>I quarter 2011</p> <p>July 2012</p>	<p>The state aid approval procedure for Croatian shipyards is in progress, and since November 2010, in this process the Croatian Competition Agency has had the support of consultants through an IPA 2008 project.</p> <p>Professional training of the employees of the Croatian Competition Agency and state aid providers is provided at all levels through an IPA 2007 project, and the project's initial activities performed in cooperation with independent experts and the twinning partner from the Great Britain took place in 2010.</p>

Privatisation			
Transformation of the Croatian Privatisation Fund, introduction of new models of privatisation and preparation for sale of companies in majority ownership	Yes	By the end of 2010	At present, a proposed Act is in parliamentary procedure.
Privatisation of five shipyards and one subsidiary	Yes	Ongoing (until privatisation completion)	The second public tender procedure for privatisation of shipyards was announced on 15 February 2010 and closed on 19 May 2010. Four bids were received for three shipyards (Brodotrogir, Brodosplit and 3. MAJ), whereas no bid was received for the shipyards Uljanik and Kraljevica. In the meantime, the Government of the Republic of Croatia took a decision to announce the third public tender procedure for the shipyard Kraljevica.
Professionalisation of management of a part of the portfolio (mainly minority stakes)	No	2010	A comprehensive concept and new methods of management of the state property are elaborated in detail in the proposal of the State Property Management Act, which is currently in parliamentary procedure and is expected to be adopted by the end of 2010. According to the said proposal of the Act, privatisation of minority stakes through closed-end investment funds has not been envisaged.
Continuation of privatisation of the Croatian Railways	Yes	Ongoing	
Railway restructuring			
Drawing up subordinate legislation	Yes	2010	The activities are being carried out on an ongoing basis. In 2009, seven ordinances and in 2010 two ordinances in the field of safety of railway transportation were drafted.
Drawing up a network report	Yes	2010	A new Network Report is drawn up every year (legislative provision). The Network Report for 2012 is being drawn up and is to be finalized soon.
Allocation of routes to operators	Yes	2010	The activities are being carried out on an ongoing basis. Currently, two operators are active: HŽ Cargo and HŽ Putnički prijevoz.
Establishment of the Railway Transport Safety Agency	Yes	2010	Election of the director of the Agency is under way. According to the plan, the Agency should start operations by the end of 2010.
Drawing up annual maintenance and modernisation plans	Yes	2010	The activities are being carried out on an ongoing basis. Planning is carried out within the framework of annual business plans, which are adopted by railway companies.
Restructuring of the shipbuilding industry			
Adoption of the National Programme for Shipbuilding Industry Restructuring	No	Postponed	In order to speed up restructuring of the shipbuilding industry by way of privatisation of certain shipyards, it was decided to draw up restructuring programmes on a case-by-case basis.
Announcement of the first round of public invitations for tenders for privatisation of shipyards in majority state-ownership	Yes	1 August 2009	All bids received in the tender procedure have been rejected.
Announcement of the second round of public invitations for tenders for privatisation of shipyards in majority state-ownership	Yes	15 February 2010	Bids for privatisation of the companies Brodograđevna industrija Split d.d., Brodograđevna industrija 3 MAJ d.d. from Rijeka and Brodotrogir d.d. from Trogir have been received.
Announcement of the third round of public invitations for tenders for privatisation of the shipyard Kraljevica d.d.	Yes	2 November 2010	Three bids have been received.
The shipyard Uljanik d.d. coming out of company in difficulties status	Yes	December 2010	Through implementation of its own Restructuring Programme and repayment of unadjusted state aid, the shipyard Uljanik d.d. came out of the economic hardship.
Implementation of the Restructuring Programme for the shipyards in majority state ownership that are suffering hardship	No	2011-2015	The implementation is expected to start in 2011 following acceptance of individual shipyard restructuring programmes.
Energy			
Alignment with the Third Energy Package	Yes	Continuous/in progress	The most important activity in 2010 relates to the preparation of legislative framework for the application of the Third Energy Package. A study, which analyses all required changes in accordance with the Third Energy Package, has been made. It is expected that all necessary laws that will enable implementation of the Third Energy Package will be enacted during 2011. In the field of natural gas, the regulations adopted in the preceding year have been applied. Based on legislative provisions, in the course of 2010 market prices were applied in practice to all customers, except households. In last year's PEP it was stated that the Croatian and the Hungarian operator of the gas transport system had signed an agreement on the construction of a gas pipeline which should integrate both systems. This pipeline ensures technical possibilities for unrestricted import of gas into the Republic of Croatia and there are no more technical restrictions in the transport system which posed a problem in further liberalisation of the gas market. In the field of refined petroleum products, the Croatian Compulsory Oil Stocks Agency (HANDA) continues its activities in accordance with plans.
Adjustment of the internal market to EU conditions			
Adjustment of the infrastructure to market needs			
Refined petroleum products - monitoring oil and refined petroleum products reserves on EU level and fuel extraction in accordance with EU standards			

Small and medium-size enterprises			
Strengthening competitiveness of small businesses Innovation and new products Stimulate fast-growing small business entities Entrepreneurship of women Entrepreneurship of young persons, new entrants and handicapped persons Entrepreneurship in the culture and culture-related industries Clusters Development of crafts and trades Development of cooperatives Use of new technologies and technological procedures Introduction of EU standards Linking SMEs and R&D Marketing and advertising of small business entities Coordination of activities in e-trade and e-business enhancement, public portals for small businesses Promotion of entrepreneurship	Yes	Continuously	These measures were implemented in 2010 and will be implemented continuously until 2012 in accordance with the 2008-2012 Programme of Incentives to Small and Medium-Size Enterprises of the Government of the RoC (adopted on the basis of a Conclusion of the Government of the RoC of 18 April 2008). The Programme's implementing act is the annual Operational plan for stimulating small and medium-size entrepreneurship in the current budget year. In 2010, the Operational plan was adopted based on a Conclusion of the Government of the RoC of 25 February 2010. The stimulating environment is based on the Act on Small Business Development Incentives (Official Gazette 29/02 and 63/07), the adopted budget plan and projection, legislation governing the establishment of small business entities (companies, crafts and trades, cooperatives, profit institutions and other entities of small and medium-size enterprises), the State Aid Act (Official Gazette 140/05) and subordinate legislation governing state aid. The Government of the RoC adopted on 30 June 2008 the Decision on the strategic and institutional framework for the use of structural instruments of the European Union in the Republic of Croatia. The Decision defines structural instruments of the European Union, strategic documents of the RoC for the use of structural instruments, the bodies in charge of coordination of structural instruments, verification of payments from structural funds elements and review, and the bodies in charge of preparation and management of certain strategic documents. The strategic documents for the use of structural instruments of the European Union to be agreed between the Republic of Croatia and the European Commission are: National strategic referential framework and Operational programmes. In the Republic of Croatia, 15 operational programmes have been established for the use of structural instruments. The Operational programme for competitiveness and innovation is one of the programmes whose preparation and management comes within the competence of the Ministry of the Economy, Labour and Entrepreneurship, which will cooperate with the Ministry of Science, Education and Sports, Business Innovation Centre of Croatia (BICRO d.o.o.) and the Croatian Agency for SME (HAMAG) in the performance of its tasks.
Low-cost lending Financial instruments for regional development of entrepreneurship Analysis of the requirements for EU financial instruments Guarantees	Yes	Continuously	
Stimulate development of the Croatian Agency for Small Business Stimulate regional development agencies Training and development of a network of consultants Support to development of entrepreneurial centres, technological parks and business incubators	Yes	Continuously	
Project of the national learning programme for entrepreneurship in formal and informal education South East European Centre for Entrepreneurial Learning (SEECEL) Students' entrepreneurial incubators Education for crafts and trades and cooperatives Children's entrepreneurship week Co-financing of universities with specialist entrepreneurial programmes Pupils' cooperatives and pupils' firms	Yes	Continuously	
Public-private partnership			
Training of employees of the Agency for Public Private Partnership	Yes	Continuously	In the period between 11 January and 2 July 2010, the Agency was the beneficiary of an IPA 2007 twinning light project „Strengthening of the Administrative Capacity of the Agency for Public Private Partnership in the Implementation of the New Public Private Partnership Legislation“, and during this period training was provided for the employees of the Agency for Public-Private Partnership. An internal training programme in specific topics related to public-private partnership was continuously implemented throughout 2010.
Adoption of an ordinance on the organisation and keeping of the Register of Public Private Partnership Agreements	Yes	September 2010	The Governing Council of the Agency for Public-Private Partnership adopted on 29 September 2010 the Ordinance on the organisation and keeping of the Registry of Public-Private Partnership Agreements.
Scientific analysis of practical experiences	Yes	Continuously	A Screening Report on Croatian Public Private Partnership legislation in comparison with best European practices was made as part of the twinning light project; the Practical Manual for the Preparation and Conduct of PPP Projects was prepared on the basis of the report on Croatian Act on Public Private Partnership with regard to best European practices, along with a Draft comprehensive set of standardized documents for PPP projects (in Croatian and English).

Coordination between the Agency for Public-Private Partnership and the Ministry of Finance in the activities of approval and implementation of public-private partnership projects	Yes	Continuously	Active cooperation between the Agency for Public-Private Partnership and the Ministry of Finance, particularly on the tasks of assessment and approval of PPP projects and participation in training programmes.
Training of participants in the procedures of preparation and implementation of public-private partnership projects	Yes	Continuously	In the course of May 2010, the Agency for Public-Private Partnership held in Split, Osijek, Rijeka and Zagreb two-day seminars on public-private partnership. In April 2010, the Agency entered into an Agreement on Business Cooperation with the Croatian Employers' Association in the provision of training in the field of public-private partnership.
Implementation of the Regulation on the supervision of implementation of agreements on public-private partnership	Yes	Continuously	The measure is being implemented on an ongoing basis.
Implementation of the Regulation on the criteria for assessing and approving public-private partnership projects	Yes	Continuously	During 2010, the Agency dealt with 9 proposals of PPP projects at various finalisation levels.
FINANCIAL SECTOR			
Banking sector			
EU legislation monitoring	Yes	Continuously	Preparatory activities for amendments in accordance with amendments to Capital Requirements Directive, cooperation with the Central European Bank in the field of staff training and internal presentations on the topic of amendments to EU legislation.
Presentations for banks, credit unions and savings banks of new legislation to be adopted in 2009 and implemented from 2010 onwards	Yes	Continuously	The presentations with regard to reporting on the basis of amendments to the Credit Institutions Act and relevant subordinate legislation were held in January, May and October 2010.
Improving the system of prudential reporting of banks (FINREP, COREP)	Yes	Continuously	Development of a data warehouse which supports collection of data for prudential reporting.
Non-banking sector			
Act on Electronic Money Institutions	Yes	November 2010	The Act on Electronic Money was adopted in Croatian Parliament on 26 November 2010.
EU acquis communautaire monitoring and alignment where necessary	Yes	Continuously	The risk analysis matrix for assessment of operational risks of supervised entities was developed - the Agency makes continuous efforts to improve direct and indirect supervision in order to identify both whether individual supervised entities operate in accordance with the law and the level of risk exposure of their operations. In 2010, the Agency launched a new website "Regulatory information publication and educational service - RIPE (www.ripe.hanfa.hr)
Supervision of entities - supervision based on risk assessment	Yes	2010-2012	
Education of the public and investors	Yes	Continuously	
LABOUR MARKET			
Employment stimulation			
Analysis and independent evaluation of annual employment stimulation plans	Yes	17 June 2010	The Government of the RoC adopted a report on the implementation of active employment policy measures for 2009.
Act on Subsidies for Job Preservation	Yes	14 July 2010	Since, during 2009, there was very little interest in the use of the subsidies under this Act (only five applications for 236 employees in total), amendments were made to reduce the number of requirements which must be met by employers in order to be entitled to these subsidies and preserve jobs through reduction in working hours.
Social security system			
Act on Amendments to the Act on Employment Mediation and Unemployment Rights	Yes	28 October 2010	The Act was published in the Official Gazette 121/10.
Ensure minimum living standards for the most underprivileged part of the population	Yes	2010	A proposal of a Draft Social Welfare Act has been prepared for a public discussion. Enactment of a new Social Welfare Act is expected in the first quarter of 2011. The measure is implemented on an ongoing basis simultaneously with ensuring technical conditions in other systems. The measure is implemented as part of the county social planning and development of a Master deinstitutionalisation plan, whose adoption is in progress. The measure is implemented on an ongoing basis through trainings provided by social welfare centres throughout Croatia
Enactment of a new Social Welfare Act	No	2011	
IT networking of the social welfare system and statistical alignment with EUROSTAT methodology	Yes	2010	
Broadening of the social services network through the introduction of the mechanism of local social planning	Yes	2010	
Improve work organisation of social services through the introduction of a new model of organisation of social welfare centres aimed at higher efficacy and greater focus on users' needs - "one stop office" throughout Croatia	Yes	2010	

Drawing up and adoption of the National strategy for the protection of children against abuse and neglect	No	2012	The National strategy for the protection of children against abuse and neglect has not been adopted because of the need to prepare organisational structure for the competence for development of the Strategy.
Drawing up and adopting a Protocol on the procedure in case of serious neglect of a parent, adoptive parent, guardian or another person pertaining to the responsibility to provide for or care for a child	No	2011	The Protocol has not been adopted because of the need to prepare organisational structure for the competence for drawing up of the Protocol.
Working out the National plan to prevent sexual exploitation of children	No	2012	The National plan to prevent sexual exploitation of children has not been adopted because of the need to prepare organisational structure for the competence for its development.
Initiating the procedure for signing and ratification of the Convention on the Protection of Children and Cooperation in Respect of Intercountry Adoption (The 1993 Hague Convention)	No	2011	The procedure for signing and ratification of the Convention on the Protection of Children and Cooperation in Respect of Intercountry Adoption (the 1993 Hague Convention) has been initiated, the Convention is at the stage of submission to competent government bodies in order to obtain their opinion, and the completion is expected during 2011.
Participation in the drawing up of operational plan for the future ESF	Yes	2010	The measure is implemented on an ongoing basis.
Supervision of the implementation of the projects financed from IPA 2007-2009	Yes	2010	The measure is implemented on an ongoing basis.
Implementation of the project "Establishment of Support for Social Inclusion and Employment for Socially Vulnerable and Marginalised Groups"	Yes	2010	The project is implemented in accordance with planned deadlines.
Ensuring the right to child support which is gained and paid depending on the total amount of household income and other conditions regulated under the Act on Child Support	Yes	2010	With a view to achieving the measures of the National Population Policy, the activities relating to application of the Act on Maternity and Parental Benefits and the Act on Child Support have been continued. The work of the foundation Croatia for Children, which became operative in 2009, has been continued as well.
Improvement of the system of family aid in accordance with the National Population Policy (application of the implementing regulations based on the National Population Policy)	Yes	2010	
Continuation of work of the established family centres and branches of family centres	Yes	2010	In 2010, the operation of 17 founded family centres was continued. No further investments are planned. The establishment of new centres will be considered after financial resources are ensured.
Providing scholarships to regular students - student state scholarships to regular students of university, vocational and postgraduate studies	Yes	Continuously	
Subsidizing transportation costs of regular students and handicapped students, subsidizing costs of meals and accommodation of students in students' and pupils' dorms in the Republic of Croatia	Yes	Continuously	
AGRICULTURAL SECTOR			
More efficient distribution of total budgetary funds earmarked for aid within the sector	Yes	Continuously	Rural development policy will be the pivotal part of the future European policy in Croatia. This policy currently accounts for a share of less than 20% in the total Croatian agricultural aid, which should be nearly doubled in the next two years.
Development of the Vineyard Register	Yes	November 2010	The Vineyard Register has been established on the basis of the Ordinance on a vineyard register, obligatory statements, accompanying documents and wine cellar records (Official Gazette 121/10, 132/10) in accordance with EU legislation. The Vineyard Register forms an integral part of the Register of agricultural farms and is kept by the Paying Agency for Agriculture, Fisheries and Rural Development. Transfer of data from the Register of Grape, Wine and Fruit Wine Producers to the Vineyard Register is in progress.
Drawing up a Food Processing Industry Development Strategy	No	2011	Activities on the drawing up of the Strategy involved the drawing up, enactment and adoption of the Strategy for the Development of the Economy, whose implementation was the responsibility of the Ministry of Economy, Labour and Entrepreneurship. Therefore, before these strategic determinations were defined, it was not possible to start working on the draft of the Food Processing Industry Development Strategy. Furthermore, as no sufficient funds had been envisaged under the 2010 budget, the appointed committee did not start working on the drafting of the strategy.

Adoption of the National operational programme of subsidies for the food processing sector	No	2011-2012	The operational programme was not adopted in 2010 as its adoption is closely connected to the adoption of the Food Processing Industry Development Strategy and to budgetary funds for the 2011-2013 period.
Adoption of a new Act which will regulate direct payments throughout the pre-accession period	Yes	15 July 2010	The Act on State Aid to Agriculture and Rural Development (Official Gazette 92/2010) was adopted on 15 July 2010 and entered into force on 1 January 2011.
Establishment of the Central Veterinary Information System	Yes	4 August 2010	The project under the name "Design, development and implementation of the central veterinary information system" is financed by the World Bank. The project is implemented by the company S&T Hrvatska d.o.o., which on 4 August 2010 signed an agreement stipulating the completion term of 11 months.
Entering into an agreement on delegation of official inspection tasks to an inspection body	Yes	30 June 2010	In accordance with the Ordinance on the requirements which must be met by veterinary organisations, veterinary practice and veterinary service in the veterinary activity implementation system (Official Gazette 45/09), a procedure to enter into agreements with accredited veterinary organisations was initiated on 30 June 2010.
Establishment of crisis response centres and their furnishing	Yes	Continuously	Every year the Veterinary Directorate of the Ministry of Agriculture, Fisheries and Rural Development adopts a national crisis response plan, which contains a list of measures that are carried out in case of outbreak of a specific disease. In 2010, National Crisis Management Plans were adopted in respect of foot-and-mouth disease, classical swine fever, avian influenza, Newcastle disease, bluetongue disease, bovine spongiform encephalopathy and African swine plague.
Monitoring programme implementation	Yes	Continuously	Serological monitoring is carried out on a regular and ongoing basis with the aim of timely detecting any outbreak of a disease.
Collection and harmless disposal of animal cadavers	Yes	Continuously	The Veterinary Practice Act, Article 48, paragraph 1: animal cadavers and by-products of animal origin which are not intended for human consumption must be disposed of in the prescribed manner to ensure that these units will not endanger human or animal health or the environment. In the Republic of Croatia, utilisation tasks are carried out by the company Agroproteinka d.d.
Financing rural development measures from pre-accession assistance programme SAPARD	Yes	31 December 2009	The pre-accession assistance programme SAPARD was completed on 31 December 2009.
Financing rural development measures from the instrument for pre-accession assistance IPA component V of IPARD programme 2010-2013: investment in agricultural farms for the purpose of restructuring and reaching EU standards, investment in processing of and trading in agricultural and fish products for the purpose of restructuring and reaching EU standards, improvement and development of rural infrastructure, diversification and development of rural economic activities, preparation and implementation of local rural development strategies (LEADER)	Yes	Until completion of IPARD programme	The implementation of the measures of IPARD programme started at the beginning of 2010 after accreditation had been received, and will be implemented until accession of the Republic of Croatia to the European Union.
Financing rural development measures from the state budget: aid for insurance against potential damages in agricultural production, aid for preservation of authentic and protected breeds of domestic animals, aid for capital investments in agriculture, agricultural farm income support, aid for ecological and integrated agricultural production and aid for the areas where conditions for agricultural husbandry are unfavourable	Yes	Until accession of the Republic of Croatia to the European Union	
Implementation of animal marking	Yes	Continuously	Since beginning of 2010, in addition to marking by means of ear tags, an electronic identification system (bolus) was introduced for sheep and goats. Bolus is an electronic data record about the cattle which remains in the digestive tract of the animal for the rest of its life.
Ordinance on the quality of sheep trunks and halves - classification and rating of sheep trunks and halves on the slaughter line	Yes	5 March 2010	The Ordinance on the quality of sheep trunks and halves was published. (Official Gazette 30/10)
Ordinance on the marking of beef - a system of marking of beef which ensures traceability control	Yes	1 May 2010	The Ordinance on the marking of beef was published (Official Gazette 52/10)
A programme of agricultural land consolidation in the Republic of Croatia for the 2009-2021 period	Yes	Continuously until 2021	

Drawing up a National Strategic Plan	No	1 April 2011	The final text of the National Strategic Plan is to be adopted through the intensive consultations with the sector. This stage of drafting the final text is taking place just now.
Operational Fisheries Programme	No	1 August 2011	The legislative basis for the adoption of the Operational Fisheries Programme is provided by the Act on Structural Support to Fisheries and Regulation of the Fisheries Market. As the Operational Programme is the implementing document of the National Strategic Plan, it can be drawn up only after the National Strategic Plan has been drafted and accepted.
Drawing up a National programme for data collection and its implementation	No	1 April 2011	Drawing up of the said programme started with a technical support under the pre-accession fund IPA 2009. The document along with a draft intended for submission to further procedure is expected to be ready mid-December. Submission to further procedure is foreseen for February 2011, and adoption for beginning of April 2011.
Acquisition of vessel monitoring devices	No	1 February 2011	Some complaints have been received following completion of a public tender procedure, and the final decision is to be taken by the State Complaints Committee, which is still pending. Depending on the final decision of the Committee, appropriate activities will be undertaken.
Inspection service strengthening	Yes	18 March 2010	The Government of the Republic of Croatia passed the Decision on institutional and operational capacities and administration of the Republic of Croatia in the field of supervision, control and inspection in the fisheries.
PUBLIC ADMINISTRATION REFORM			
Alignment of special procedural legislation with the new General Administrative Procedure Act	Yes	May 2010	The implementation of the measure is in progress (the regulations that need to be aligned have been identified and will be submitted to further procedure).
Application of the Human Resources Development Strategy	Yes	2010	The alignment of the provisions of the Act on Civil Servants with the Strategy is in progress.
Adjustment of the system of public agencies with EU standards	Yes	2010	An analysis of the system of public agencies has been carried out and the system rationalisation is under way in line with the recommendations given following the analysis.
Regulation of the issue of salaries in the public sector	Yes	2010	Preparatory activities for new uniform legal regulations related to salaries of the employees in the government and public sector are in progress.
Implementation of activities envisaged under the Implementing Plan for E-administration Development Strategy for the 2009-2012 period, planned for 2010	Yes	2010	
Drawing up the first annual report on E-administration Development Strategy for the 2009-2012 period, in 2009	Yes	March 2010	
Drawing up a semi-annual report on E-administration Development Strategy for the 2009-2012 period	Yes	October 2010	
OTHER REFORMS			
Development of a knowledge-based society			
Implement the state school-leaving exam	Yes	February-September 2010	
Health care reform			
Reduction in the number of groups in respect of which the costs of supplementary health insurance policies are paid by the state budget	Yes	June 2010	
Abolition of special medical committees of the Croatian Institute for Health Insurance and appointment of authorised physicians for field work	Yes	2010	Abolition of special medical committees and appointment of authorised physicians of the Croatian Institute for Health Insurance was fully implemented in 2009. The measures aimed at increasing work functionality of authorised physicians were being implemented during 2010 and these included their equipping with netbooks with a possibility of making connection to the database of the Croatian Institute for Health Insurance from the elected physician's office. In addition, during 2010 the powers of authorised physicians were changed (approval by an authorised physician for home care is no longer necessary), so that they can direct their efforts toward the area of work of special interest to the Institute.
National waiting lists and establishment of a central unit for making appointments in all hospitals	Yes	1 May 2010	Implementation of the measure is under way and after completion of informatisation of the health care system it will be fully implemented. Upon completion of informatisation of all hospitals, which is at the final stage, national waiting lists will be made transparent. It is expected that these activities will be continued in 2011.

Introduction of rules on ethical advertising of medicines	Yes	May 2010	During 2010, almost all pharmaceutical companies that are authorised for trade in the medicines listed on the lists of medicines of the Croatian Institute for Health Insurance entered into an Agreement on ethical advertising of medicines with the Croatian Institute for Health Insurance (60 agreements in total). The measure has been fully implemented.
Reorganisation of emergency medical service	Yes	2010	Reorganisation of emergency medical service is a project which is implemented at the national level. In 2010, it was implemented in the city of Zagreb, and the project continues to run.
Reorganisation of the hospital network in Zagreb	Yes	July 2010	During 2010, the public health service network was changed in relation to the hospital segment in Zagreb by annexation of hospitals (Jordanovac Hospital to the University Hospital Centre Zagreb, Vuk Vrhovac Hospital to Merkur Hospital, and the Children's Hospital Zagreb, the University Hospital for Tumours and the Accident Hospital to Sestre Milosrdnice Hospital). There were additional changes within the public health service network in that the hospitals founded by the City of Zagreb were merged (7 hospitals have been merged into two entities: Sveti Duh Hospital and the Specialist Psychiatric Hospital Vrapče Zagreb).
Reform of the judiciary			
Revision of the Action Plan of the Judiciary Reform Strategy	Yes	20 May 2010	
Revision of the Action Plan of the Corruption Prevention Strategy	Yes	18 March 2010	
Establishment of the Judicial Academy as an independent institution	Yes	1 January 2010	
Enrolment of the first generation of students in the National school for judicial officials	In progress	1 January 2011	On 29 October 2010, a public announcement of vacancies was published in the Official Gazette 112/10, Notices, and it related to the enrolment of the first generation of candidates for judges and state attorneys in the National school. It is expected that the candidates will be enrolled by the end of 2010.
Further rationalisation of municipal and misdemeanour courts and state attorney's offices	In progress	2019	The process of physical rationalisation of courts was continued; during 2010, three standing services were physically merged with three municipal courts. Also, three standing services were physically merged with three seats of misdemeanour courts.
Rationalisation of the network of county and commercial courts	Yes	2019	The Act on the territorial jurisdictions and seats of courts was adopted on 23 November, providing for rationalisation of the network of commercial and county courts. The number of county courts was reduced from 21 to 15, whereas the number of commercial courts was reduced from 13 to 7. Plans have been made to implement physical rationalisation measures in the period from 2011 to 2019.
Introduction of ICMS - ICMS planned to be introduced in 60 courts (30 municipal, 19 county and 11 commercial courts)	Yes	31 December 2010	By 30 November 2010, ICMS was introduced in 60 courts, as planned.
Drafting of a new Enforcement Act and Act on Public Enforcement Agents	Yes	2010	The Enforcement Act and the Act on Public Enforcement Agents were adopted in Croatian Parliament on 23 November 2010.
Establishing a professional organisation at the Probation Directorate	In progress	2012	In its 60th session held on 10 June 2010, the Government of the RoC adopted the Action Plan for Probation Development in the Republic of Croatia for the 2010-2014 period. In August 2010, a public announcement of vacancies was published for the recruitment of employees at the Directorate for Probation and Victims and Witnesses Support.
Implementation of the common information system for the land registry and the cadastre	Yes	2010	A test production of the common information system for the land registry and the cadastre is being carried out at the municipal courts in Zadar and Požega, and detected errors are corrected.
Environmental protection			
Drawing up further guidelines and provide training for the implementation of the EIA and SEA procedures	Da	December 2010	The segment of the training and guidelines that relates to SEA on a regional and local level is covered by IPA 2010 project - Strengthening the capacity for implementation of strategic environmental impact assessment at regional and local level, whose realisation is scheduled for the 2011-2013 period.
Draw up a report on the state of the environment in the Republic of Croatia in the 2005-2008 period	No	I quarter 2011	The period for expert review of texts by competent institutions has been extended.

Inclusion in the greenhouse gas emission trading system	No	Upon accession of the Republic of Croatia to the EU	In accordance with a decision of the Government of the RoC and the Ministry of Environmental Protection, Physical Planning and Construction
Adoption of the Regulation on technical environment protection standards for reduction in emissions of volatile organic compounds resulting from refuelling of motor vehicles at service stations, in accordance with the obligation imposed by the Directive 2009/126/EC on Stage II petrol vapour recovery during refuelling of motor vehicles at service stations	Yes	2010	
Adoption of amendments to the Regulation on the quality of liquid petroleum fuels (Official Gazette 53/06, 154/08 and 81/10) in accordance with the obligation imposed by the Directive 2009/30/EC amending Directive 98/70/EC on the quality of petrol and diesel fuels and Directive 1999/32/EC relating to a reduction in the sulphur content of certain liquid fuels	Yes	2010	
Drawing up the Action Plan for reduction in air pollution by ground-level ozone in designated and populated areas of the Republic of Croatia	No	End of 2011	In 2010, the Action Plan for reduction in air pollution by ground-level ozone was drawn up and, after the text has been adjusted, it will be submitted to the adoption procedure in 2011.
Annual assessment of air quality at designated areas and in populated areas on the territory of the state, and review of air quality categories	Yes	2010	
Establishment and maintenance of air quality information system (as part of the Environmental Protection Information System)	Yes	2010	
Implementation of the Plan for the allocation of greenhouse gas emission quotas to legal entities	No	2012	Because of the requirements of Directive 2003/87/EC with regard to the procedure for approval of the "Plan for the allocation of greenhouse gas emission quotas in the Republic of Croatia" by the European Commission, and specifically with regard to the requirement to ensure verified information on emissions from each installation covered by the Emission Trading System, derogation from Directive 2003/87/EC for Croatia until 31 December 2012 was requested.
Establishment of the greenhouse gas emission trading system	Yes	2010	In the last quarter of 2010, amendments to the Regulation on greenhouse gas emission quotas and the method of emissions allowance trading from 2008 were adopted. As from 1 January 2010, operators started the greenhouse gas emissions monitoring process.
Adoption of an implementing regulation on the conditions for the conduct of verification of facility emissions reports	Yes	2010	The Ordinance on the requirements for issuing approvals to legal persons for performing professional environmental protection activities (Official Gazette 57/10), which lays down, among other things, requirements that must be met by the legal persons which will verify the Greenhouse Gas Emission Reports.
Development of action plans for the reduction in airborne particulate matters (PM) and NOx for specific areas in the Republic of Croatia	No	End of 2012	In 2009, the project "Support for the preparation of a national action plan for the reduction in airborne particulate matters (PM) and NOx in the Republic of Croatia (Directive 2008/50/EC)" was proposed within a bilateral project of the RoC and the Flemish Government. The project was not approved by Belgium until March 2010. It has been foreseen that the project will be carried out until July 2011. Foreseen deadline for the preparation of action plans for selected agglomerations where PM and/or NOx values are exceeded is the end of 2011. A complete National action plan for the reduction in airborne particulate matters (PM) and NOx in the Republic of Croatia will be drawn up by the end of 2010.
Development of hazardous waste management system including identification and management of "hot spots" in Croatia - Phare 2006	Yes	November 2010	The project PHARE 2006 was completed on 30 November 2010. Preparation of a Final Report is under way.
Strengthening/reform of the existing system of water management financing and ensuring an increase in annual allocations (amendments to/adoption of new subordinate legislation based on the Act on Water Management Financing)	Yes	1 January 2011	
Strengthening of water management planning - continuation of work on the adoption of water management plans in two water areas	No	30 November 2011	A draft of the Water Areas Management Plan has been drawn up.
More intensive implementation of water protection measures, especially with respect to the preparation and implementation of infrastructural water protection projects; rehabilitation and completion of the existing and building of new public drainage systems	Yes	Continuously	

Reduction in losses in the existing water supply systems and an increase in connections to the public water supply systems (regional water supply systems), rehabilitation and completion of the existing and building of new water supply systems	Yes	Continuously	The Plan for Wolf Management in the Republic of Croatia and the Action Plan for the 2010–2015 period was adopted in accordance with Article 96, paragraph 2 of the Nature Protection Act (Official Gazette 70/05 and 139/08).
Improvement of the existing and development of new irrigation systems	Yes	Continuously	
Greater investments in the system of protection against damage caused by water	Yes	Continuously	
Adoption of the Plan for Wolf Management in the Republic of Croatia	Yes	15 July 2010	
Adoption of the Plan for Lynx Management in the Republic of Croatia	Yes	7 September 2010	The Plan for Lynx Management in the Republic of Croatia and the Action Plan for the 2010–2015 period was adopted in accordance with Article 96, paragraph 2 of the Nature Protection Act (Official Gazette 70/05 and 139/08).
International cooperation in the area of protection of nature (projects implementation):			
The World Bank's advance (IBRD P4500-HR) for the preparation of EU NATURA 2000 Integration Project	In progress	1 March 2011	A final report has been prepared as part of the World Bank's advance (IBRD P4500-HR) and will serve as a basis for the implementation of the five-year EU Natura 2000 Integration Project for the purpose of strengthening the nature protection system in order to fulfil the obligations imposed by EU directives and strengthening the capacity for structural funds. In the forthcoming period, formal activities related to loan authorisation will be continued.
Adoption of the Management Plan for Učka Nature Park	Yes	23 February 2010	The Management Plan for Učka Nature Park establishes the management goals, implementation and monitoring of the achievement along with the assessment of costs of realisation of the planned management measures for a period of ten years.
Further development and upgrading of the facilities and emissions information system	Yes	Continuously	
Implementation of the National programme of chemical safety	Yes	Continuously	Alignment of the legislation in the field of chemicals and biocidal products was continued and to that end the following regulations were adopted: 1. List of hazardous chemicals whose marketing is prohibited or restricted (Official Gazette 17/06, 39/10) 2. Ordinance on amendments to the Ordinance on classification, marking, labelling and packaging of hazardous chemicals (Official Gazette 113/10) 3. Ordinance on amendments to the Ordinance on the list of existing active substances permitted in biocidal products (Official Gazette 36/10) 4. Ordinance on amendments to the Ordinance on the list of existing active substances which are not permitted in biocidal products (Official Gazette 36/10)
Adoption of subordinate legislation to regulate the area of hazardous chemicals whose marketing is prohibited or restricted and classification, marking and packaging of hazardous chemicals	Yes	1.) 1 April 2010 2.) 4 October 2010	1.) List of hazardous chemicals whose marketing is prohibited or restricted (Official Gazette 17/06, 39/10) 2.) Ordinance on amendments to the Ordinance on classification, marking, labelling and packaging of hazardous chemicals (Official Gazette 113/10)
Adoption of 1. Ordinance on amendments to the Ordinance on the list of existing active substances permitted in biocidal products (OG 36/10) 2. Ordinance on amendments to the Ordinance on the list of existing active substances which are not permitted in biocidal products (OG 36/10)	Yes	1.) 24 March 2010 2.) 24 March 2010	1. Ordinance on amendments to the Ordinance on the list of existing active substances permitted in biocidal products (Official Gazette 36/10) 2. Ordinance on amendments to the Ordinance on the list of existing active substances which are not permitted in biocidal products (Official Gazette 36/10)
Legislative amendments regulating the level of genetically modified organisms in products below which the products placed on the market do not have to be marked as products containing genetically modified organisms	Yes	17 March 2010	Regulation on the level of genetically modified organisms in products below which the products placed on the market do not have to be marked as products containing genetically modified organisms (Official Gazette 33/2010)
The Programme of Fire Prevention Measures	No		The measure was not implemented because of lack of financial resources, and its implementation has not been planned for the upcoming period.
Drawing up and implementation of the project "National Forest Resources Inventory of the Republic of Croatia"	Yes	2 December 2010	