



REPUBLIC OF CROATIA



2009 PRE-ACCESSION ECONOMIC PROGRAMME

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1 OVERALL ECONOMIC POLICY FRAMEWORK AND OBJECTIVES

The framework and objectives of the economic policy of the Republic of Croatia are defined in a series of strategic documents of the Government of the Republic of Croatia, namely: the Strategic Development Framework for 2006-2013, the Government Programmes Strategy 2010-2012, the Economic and Fiscal Policy Guidelines and the Pre-accession Economic Programme (PEP).

The main objective of the economic policy in the current changing macroeconomic environment is to preserve macroeconomic stability and create conditions for recovery and stable economic growth. This year's PEP reflects the set economic policy objective and describes in detail the macroeconomic developments and projections, further direction of the fiscal policy, as well as the key structural reforms in the 2010-2012 period.

In the circumstances of financial restrictions and a declining economic activity the emphasis is put on fiscal policy, which will, within the set framework, aim to achieve the set economic objectives. In this sense, the fiscal policy will be focused on fulfilling the twelve general objectives laid down in the Government Programmes Strategy:

- Macroeconomic and economic stability;
- Optimum environment for the development of a competitive economy;
- Strengthening of the state of law and the rule of law;
- Promoting knowledge, excellence and culture;
- Uniform regional development;
- Strengthening of social equality;
- Positioning of Croatia as one of the leading European tourist destinations;
- More competitive sector of agriculture, food industry and fisheries;
- Further strengthening of the international status of the Republic of Croatia;
- Improving the police and armed forces as the citizens' services;
- Health care, maintaining and improving health;
- Environmental protection and spatial development.

Supporting macroeconomic and fiscal policy, the implementation of key structural reforms will be continued in the medium-term in accordance with the priorities of the Government of the Republic of Croatia. With this view, further measures will be taken, aiming at improving the entrepreneurial climate, further improving the financial sector, completing reforms of the public administration, the judiciary reform and combating corruption, and at restructuring and privatisation of dependent sectors. In addition, further measures will be taken aimed at ensuring social fairness concurrently ensuring financial sustainability of the health and social security systems, environment protection, incentives to employment and further development of a knowledge-based society.

2 MACROECONOMIC DEVELOPMENTS

2.1 CURRENT MACROECONOMIC DEVELOPMENTS

The negative effects of the global economic crisis began to spill over to Croatia in the second half of 2008 which as a result led to weakening of the economic activity. Real gross domestic product grew by 2.4%, which is a slowdown of 3.1 percentage points compared to 2007. GDP calculation according to the expenditure method shows a slower growth of all GDP components compared to 2007, with the exception of gross fixed capital formation which rose by 8.2% in real terms and thus, as projected under the previous year's PEP, contributed the most to GDP growth (2.3 percentage points). Personal consumption which rose by 0.8%, its lowest real growth since 1999, and whose contribution to GDP growth amounted to 0.6 percentage points, had the largest impact on economic growth slowdown in 2008. Government consumption grew by 1.9% in real terms and thus contributed to GDP growth with 0.4 percentage points, equally as changes in inventories (which include statistical discrepancy). Real goods and services imports grew by 3.6% and goods and services exports grew by 1.7%, though the growth of both categories slowed down compared to 2007. The contribution of goods and services exports was 0.8 percentage points and, given a larger negative contribution of goods and services imports of -2.1 percentage points, the contribution of net exports in 2008 was negative and stood at -1.3 percentage points.

Real GDP growth in 2008 was 0.1 percentage points lower than that projected under the previous year's PEP (2.5%). However, account should be taken of the fact that in early 2009 the Central Bureau of Statistics introduced a new methodology for national GDP calculation which is in line with the methodology of the European System of Accounts (ESA 95). GDP calculation was improved with the inclusion of the estimate of grey economy, new estimate of imputed housing rent and new estimate and distribution of financial intermediation services indirectly measured.¹ These changes led to an increase in several years' nominal GDP levels and a correction in real growth of GDP and its categories on the expenditure side. As a result, full comparison of last year's projections and realisations in 2008 is not possible. However, it is evident that the largest departure from the achievement of projections for 2008 was seen in personal consumption and in goods and services imports and exports whose growth levels fell short of the projections.

In the first three quarters of 2009, GDP fell by 6.2% in real terms, as a result of a fall of 6.7% in the first, 6.3% in the second and 5.7% in the third quarter. The largest contribution to GDP decline in the first three quarters of 2009 came from personal consumption (5.9 percentage points). Personal consumption fell by 8.8% in real terms year-on-year in the first three quarters, as a result of a decline of 9.9% in the first, 9.4% in the second and 6.9% in the third quarter. Gross fixed capital formation fell by 12.4% in real terms in the first quarter of 2009 and by 12.7% and 10.5%, respectively, in the second and third quarter, i.e. by 11.9% in the first three quarters, thus contributing 3.7 percentage points to GDP fall. The contribution of the change in inventories to GDP fall amounted to 2.3 percentage points in the first three quarters, while the contribution of government consumption was positive and stood at 0.1 percentage points. Government consumption was the only component which recorded real year-on-year growth in the first three quarters of 2009. Its 1.5% growth was the result of a 3.9% growth in the first, a 1.2% growth in the second and a 0.6% fall in the third quarter. Real goods and services exports fell by 17.5% and goods and services imports fell by 23.1% in the first three quarters of the year. As a result, the contribution of net foreign demand to real GDP growth was positive and amounted to 5.4 percentage points. Real goods and services exports fell by 14.2% in the first, 19.8% in the second

¹ For details, see www.dzs.hr

and 17.6% in the third quarter while goods and services imports fell by 20.9% in the first, 24.7% in the second and 23.5% in the third quarter of 2009.

Available monthly indicators of economic activity for the last quarter of 2009, point to a further, although slower, fall in economic activity.

Industrial production fell by 10.9% in the first, 9.4% in the second and 9.0% in the third quarter of 2009, on a year-on-year. It fell by 8.6% year-on-year in October and November and in the first eleven months of 2009 it fell by 9.5% on a year-on-year basis. In terms of sections and divisions, the largest contribution to the fall in industrial production in the first eleven months came from manufacturing, i.e. manufacture of fabricated metal products, except machinery and equipment, manufacture of basic pharmaceutical products and pharmaceutical preparations, manufacture of machinery and equipment and manufacture of food products.

Retail trade turnover recorded a real year-on-year decline of 16.9% in the first quarter, 16.4% in the second and 13.6% in the third quarter of 2009. In October it fell by 15.4% in real terms. In the first ten months of 2009, retail trade turnover declined by 14.4% year-on-year, in nominal terms, while in real terms it fell by 15.6%. The most significant contribution to retail trade fall by branches in the first ten months of 2009 came from automotive fuels and motor vehicles.

The number of tourist nights fell on a year-on-year basis by 1.3% in the first eleven months of 2009. In the first and the second quarter of 2009, the number of tourist nights fell by 16.7% and 3.3%, respectively, on a year-on-year basis, while in the third quarter they held steady at the levels achieved in the same period 2008. In October and November, the number of tourist nights declined by 5.7% on a year-on-year basis. According to balance of payments data, tourism revenues stood at EUR 5.8 billion in the first nine months of 2009, a decrease of 15.2% compared to the same period 2008.

The labour market was marked by unfavourable developments in 2009 which were seen in rising unemployment and falling employment on a year-on-year level. In the first eleven months of this year, the average number of unemployed persons rose by 24,192, or 10.2% compared to the same period 2008. Preliminary data provided by the Central Bureau of Statistics (CBS) indicate that the average number of employed persons fell by 45,631 or 2.9% in the first eleven months of 2009, on a year-on-year basis. Administrative unemployment rate stood at 14.7% on average in the first eleven months of the year, 1.5 percentage points up from the same period 2008. The Labour Force Survey data available for the first three quarters of 2009, also point to growing unemployment. The average Labour Force Survey unemployment rate stood at 9.0% in the first three quarters of 2009, an increase of 0.7 percentage points compared to the same period 2008.

Unfavourable economic developments had an impact on developments in wages whose year-on-year growth kept steadily declining towards the end of the year. The nominal and real growth of average gross wage slowed down in the first ten months of 2009 compared to the same period 2008. The nominal growth of average net wage in the first ten months of 2009 slowed down compared to the same period 2008 but its real growth accelerated, following strong inflationary pressures in the previous year. As a result, the average nominal gross wage rose by 2.8% on a year-on-year basis in the first ten months of 2009 while the average real gross wage grew by 0.3% on a year-on-year basis. The average net wage grew by 3.2% nominally and by 0.7% in real terms in the first ten months of 2009, compared to the same period 2008.

Following strong acceleration of inflation to 6.1% in 2008, inflationary pressures eased in 2009. In the first eleven months of 2009, inflation stood at 2.4%, and in November 2009 the consumer price index grew by 1.8%. The largest contribution to consumer prices growth in November came from the prices under the influence of administrative decisions (prices of gas for households, tobacco products and services in health). By contrast, the fall in prices of food and prices of clothing and

footwear, greatly influenced by the decrease in aggregate demand and lower prices of commodities on the world market, contributed the most to alleviating consumer prices growth. Core inflation grew by 3.1% on a year-on-year basis in the first eleven months of 2009 and in November it rose by 0.9% year-on-year. Producers' price indices of industrial products fell by 0.6% year-on-year in the first eleven months of 2009.

The average nominal exchange rate of the kuna against the euro stood at 7.34 HRK/EUR in 2009, depreciating 1.6% compared to 2008. Depreciation of the exchange rate of the kuna was fuelled by stronger domestic demand for foreign exchange needed for the settlement of foreign liabilities falling due during the period of decreased foreign capital inflows. In the first nine months of 2009, the real effective exchange rate of the kuna depreciated 1.9%, deflated by consumer prices, i.e. appreciated 1.7%, deflated by producer prices.

In 2009 negative year-on-year growth rates of monetary aggregates were recorded. Money (M1) fell by 10.4% year-on-year in November 2009, with the largest contribution to its fall coming from the fall in demand deposits. Total deposits with banks (demand deposits included) rose by 4.2% year-on-year in November 2009. The most significant contribution to their fall came from kuna deposits which shrank by 20.7% in November, while foreign currency deposits grew steadily throughout the year on a year-on-year basis, reaching 19.7% growth in November. Such developments are the result of substitution of a part of household kuna deposits by foreign currency deposits as a result of the effects of the spillover of the financial crisis to the domestic market. Broadest money (M4) rose by 2.5% on a year-on-year basis in November 2009.

Credit activities of banks slowed down so that total bank credit to the non-banking sector fell by 0.7% in the first eleven months of 2009. Year-on-year growth of total domestic credit slowed down from 10.5% at the end of 2008 to 1.3% in November 2009. The year-on-year growth of loans to enterprises slowed down from 12.3% at the end of 2008 to 3.9% at the end of November 2009, while the year-on-year growth of loans to households slowed down from 12.1% to -0.3% during the same period.

The balance of payments current account deficit rose from 7.6% of GDP in 2007 to 9.2% of GDP in 2008, mainly as a result of a year-on-year deficit increase of 14.4% in the goods account. The deficit in the goods account was only partially covered by a high surplus in the services account which rose by 11.0% compared to 2007. The surplus in the services account was mainly attributable to increased revenue from tourism which stood at EUR 7.5 billion in 2008, growing 10.5% on a year-on-year basis. The increased balance of payments current account deficit in 2008 was also due to a 40.8% increase in the income account deficit and a small fall of 0.7% in the current transfers account surplus. The coverage of imports of goods and services by exports of goods and services stood at 83.8% in 2008, falling by 1.4 percentage points compared to 2007. In 2008, current account deficit was largely financed by direct investments, whose net inflow in that year amounted to EUR 3.2 billion, a decrease of 7.6% compared to 2007. Net other investments were EUR 3.0 billion in 2008, increasing by 123.5% compared to 2007. The largest contribution to the increase in other investments came from the banking sector. The portfolio investment account saw a net outflow of EUR 627 million in 2008. Net errors and omissions stood at EUR -1.6 billion in 2008, while international reserves shrank by EUR 330 million. On account of the new methodology for GDP calculation, the comparison between the realisation and the projection of the balance of payments current account as a percentage of GDP under the previous year's PEP is not possible. However, if we look at absolute amounts, we can see that the realisation and the projection of the balance of payments current account are almost equal.

In the first nine months of 2009, current account deficit stood at EUR 941 million, falling by EUR 1.5 billion or 61.9% on a year-on-year basis. This is the result of a year-on-year narrowing of the deficit in the goods account of EUR 2.8 billion, a decrease of the surplus in the services account of

EUR 1.2 billion, a decrease of the deficit in the income account of EUR 5.7 million and a decrease of the surplus in the current transfers account of EUR 21.8 million. The coverage of imports of goods and services by exports of goods and services stood at 97.6% in the first three quarters of the year. Developments in the financial account were marked by a large net inflow from other investments of EUR 2.1 billion in the first nine months of the year, an increase of 14.0% compared to the same period 2008. The direct investments account saw a net inflow of EUR 869 million, a decrease of 61.8% compared to the first nine months of 2008. The portfolio investments account recorded a net outflow of EUR 499 million in the first three quarters. Net errors and omissions stood at EUR –1.7 billion, while international reserves declined by EUR 106 million in the first nine months of 2009.

Goods imports fell more sharply than goods exports on a year-on-year basis in 2009, causing a narrowing in merchandise trade deficit. In the first eleven months of 2009, goods exports fell by 21.0% on a year-on-year basis and goods imports fell by 26.3%. The coverage of goods imports by goods exports stood at 49.1% in the first eleven months of the year which is an increase of 3.3 percentage points compared to the same period 2008. The largest contribution to the fall in exports in the first nine months of 2009 came from manufacture of other transport equipment, manufacture of coke and refined petroleum products, manufacture of chemicals and chemical products and manufacture of machinery and equipment. The categories which contributed the most to the decline in goods imports were manufacture of motor vehicles, trailers and semi-trailers, manufacture of other transport equipment, manufacture of basic metals, extraction of crude petroleum and natural gas and manufacture of coke and refined petroleum products.

Looking at geographical distribution of foreign trade in the first eleven months of 2009, 61.1% of the total Croatian goods exports went to exports to the European Union Member States and compared with the same period 2008, exports to the EU fell by 20.9%. Goods imports from the EU Member States accounted for 62.8% of the total Croatian goods imports in the first eleven months of 2009, falling by 27.6% compared to the same period 2008. By individual countries, the following countries accounted for the largest share of the total Croatian goods exports in the first eleven months of 2009: Italy (19.4%), Bosnia and Herzegovina (13.0%), Germany (11.1%), Slovenia (7.4%) and Austria (5.4%). Goods exports to Bosnia and Herzegovina, Austria, Slovenia, Germany and Italy declined by 34.0%, 26.7%, 24.7%, 17.9% and 19.5%, respectively, compared to the same period 2008.

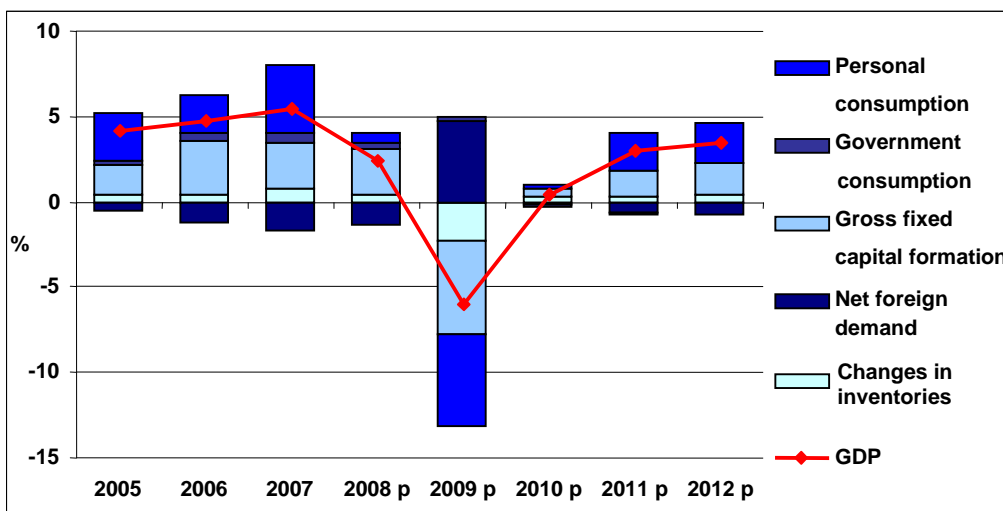
2.2 MID-TERM MACROECONOMIC PROGRAMME

Macroeconomic projections are based on released GDP and balance of payments data for the first three quarters of the year and other high-frequency indicators of economic activities available for the first eleven months of 2009. In this programme we use the same basic characteristics of the macroeconomic policy mix as we used previously since they proved adequate under new crisis conditions, while taking into account the existing limitations. The potential of fiscal policy measures in addressing real economic contraction is limited due to growing external vulnerabilities and less favourable conditions of financing. In such conditions, and given that maintaining macroeconomic stability is a priority, 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 for the economy. 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

The spillover of the effects of global economic crisis to the Croatian economy which started towards the end of 2008 were seen in a fall in the economic activity in 2009. The main channels of transmission of the negative effects of the crisis to the domestic economy were a fall in foreign demand for Croatian exports, changes in investor risk perception and the resulting worsening of the conditions on global financial markets and deepening pessimism in terms of economic expectations. However, following the blow of the crisis in the first half of the year which led to a sharp fall in the majority of GDP components, in the remaining part of 2009 we expect to see a gradual slowdown in the fall in economic activity. Such expectations can be confirmed by recent economic developments around the world, domestic high-frequency economic indicators released so far and released GDP data which point to a real decline slowdown in the third quarter of the year. The forecasts see domestic economy recovery taking place already in 2010, which is in line with the last projections released by relevant international institutions which point to a recovery of the global economy. Thus, in accordance with the above-mentioned, the projection for the entire 2009 puts the real GDP fall at 5.9%. In 2010, we expect a real GDP growth of 0.5% and its acceleration to 3.0% in 2011 and 3.5% in 2012.

Figure 1: Contributions of categories of aggregate demand to real GDP growth



Source: CBS, MFIN

The largest contribution to the fall in economic activity in 2009 is expected to come from a decline in personal consumption. Projections point to a real fall in personal consumption of 8.5% in 2009, largely driven by a sharp fall in consumer optimism which was visible already in the second half of 2008 and is reflected mainly in postponement of purchases of greater value durable consumer goods. Shrinking propensity to consume is also closely correlated with unfavourable developments in the capital markets which lead to a fall in the financial assets of households. A decline in the real amount of consumer loans granted to households will also contribute significantly to the fall in personal consumption. Certain negative impact is also expected to come from increased repayments of the existing household loans due to rising lending interest rates of banks. The negative influence of the main determinant of personal consumption, real net wage bill will be moderate in 2009, while greater negative contribution is expected to come from employment than real wages.

Government consumption is estimated to grow by 1.0% in real terms in 2009, and thus provide a small positive contribution to economic activity. In the conditions of fallen domestic and foreign

demand, gross fixed capital formation is also expected to drop by 11.3% in real terms and thus make a large contribution to GDP fall. The reasons for such a huge fall in investment consumption should be sought in a sharp fall in business optimism, decreased capital availability and high financing costs in the country and abroad. Fallen demand for real estate and a real fall in the amount of home loans will lead to a fall in investment in construction. The fall in aggregate investments also includes a significant real fall in investment of the general government. Inventories are also expected to make a significant contribution to the fall in economic activity in 2009 and their share in GDP is expected to fall to 0.9%.

Net exports are expected to make a significant positive contribution to real GDP growth in 2009. As a result of strong contraction in domestic demand, goods and services imports are expected to fall by 21.9% in real terms. As the already mentioned fall in investments is expected to lead to a pronounced fall in imports of capital products, since a large share of investments can be attributed to imported equipment. In addition to contribution coming from personal consumption contraction, imports will also be affected by the expected change in the structure of personal consumption with a fall in the share of durable consumer goods compared to non-durable consumer goods. And finally, economic activity weakening is expected to bring about a fall in demand for imports of intermediate goods and energy. In view of the expected contraction in economic activity of Croatia's major export partners, merchandise exports are also expected to decline sharply. As regards services exports, released balance of payments data for the first nine months indicate a decline of 16.4% which is a lower decrease than the one recorded at merchandise exports. Developments of the exports of services were to the highest extent determined by the contraction of revenues which were negatively influenced by the lower tourist consumption, despite the favourable volume indicators. The real fall in goods and services exports in 2009 is estimated at 17.6%, evidently a much smaller fall compared to imports.

The fall in economic activity in 2009 is accompanied by a fall in employment and unemployment growth. The Labour Force Survey unemployment rate will reach 9.9% in 2009. A much faster fall in GDP compared to fall in employment of 2.7%, will result in a sharp fall in average labour productivity in 2009. A decline in labour productivity and slower adjustment of gross wages to changed economic conditions will result in a growth of unit labour cost in 2009.

In 2010 and subsequent years, we expect real growth in all components of GDP on the expenditure side except government consumption whose positive growth rate is not expected until 2012. Projections for 2010 indicate slight positive contributions to economic growth of all components of domestic demand except government consumption. As regards personal consumption, in 2010 we expect to see its small recovery and real growth of 0.4% mainly as a result of regained consumer optimism. As a result of slower fall in employment compared to 2009 on the one hand, and acceleration in the real fall in net wages on the other hand, the negative contribution of the real net wage bill to personal consumption growth is expected to be somewhat smaller than in 2009, while the contribution of consumer household loans will be negligible. A small positive impact on disposable household income in 2010 will come from the expected fall in lending interest rates of banks. The forecasts for personal consumption growth until the end of the projection period see its acceleration to 3.6% in 2011 and 3.7% in 2012 as a result of growth in disposable household income and positive psychological effects resulting from the increase in the value of financial assets of households and approaching accession to the European Union.

The projection of government consumption points to a real decline of 1.0% in 2010 and 0.5% in 2011, and its small recovery to 0.3% in 2012. Any significant investment consumption growth might have to be put off due to persisting uncertainties as regards the speed of economic activity recovery, capital availability and terms of financing. As it is also evident that the inflow of foreign capital will not be as large as it used to be in the previous years, business sector financing will

largely depend on the mechanism of allocation of funds of the domestic financial system. Accordingly, in 2010 we expect to see a small real growth in gross fixed capital formation of 0.9%, which will be followed by stronger acceleration to 4.2% in 2011 and 5.2% in 2012. A certain amount of inventory renewal and their positive contribution to economic growth is expected already in 2010, but this trend will be more visible towards the end of the projection period. The share of inventories in GDP will thus increase from 1.1% in 2010 to 1.8% in 2012. Under the assumption of stabilisation of economic conditions in the country and economic growth recovery of the country's major foreign trading partners, in 2010 we expect to see a somewhat faster growth of exports than imports of goods and services and a small negative contribution of net exports to economic growth. Exports will thus grow 3.2% and imports 3.0% in real terms. However, in the following two years, the negative contribution of net exports to economic growth will be more pronounced, but still much smaller in absolute amounts than in the pre-2009 period. The real growth of goods and services exports will accelerate from 4.8% in 2011 to 5.9% in 2012, while real imports will grow 5.3% in 2011 and 6.4% in 2012.

Although the beginning of recovery in labour market volume indicators will not start before 2011, negative developments in the labour market in 2010 will be of a much lower intensity than those in 2009. In 2010, we expect employment to fall by 0.6% and the Labour Force Survey unemployment rate to rise to 10.3%. In 2011, we expect employment growth of 0.9% and the Labour Force Survey unemployment rate growth of 9.9%. A bigger recovery in labour market indicators is not expected before 2012 when employment will grow 1.6% and the Labour Force Survey unemployment rate will fall to 9.1%. In accordance with developments in GDP and employment, average labour productivity will see moderate recovery in 2010 and a somewhat bigger growth in the following two years, while its most significant growth is expected in 2011. In 2010, we expect to see a slight increase in unit labour costs, mainly as a result of a slowdown in the growth of nominal gross wages. Unit labour costs are expected to accelerate gradually again by 2012, though its levels are expected to be over two times smaller than those observed in 2008 and 2009.

2.2.2 Inflation

The average annual rate of inflation of consumer prices in 2008 stood at 6.1% which is 0.1 percentage points below the rate forecast at the time of drafting the previous Pre-accession Economic Programme (2009-2011). The main reason for this lays in a higher than expected fall in the prices of crude oil and other raw materials in the global market in the period after September. At the end of 2008, there was a considerable weakening in domestic inflatory pressures on the demand side, which was more pronounced than originally anticipated.

Table 1: Consumer price index
(average annual rate of change)

	2008	2009 p	2010 p	2011 p	2012 p
CPI PEP 2009 - 2011	6.2	3.5	3.2	2.9	-
CPI PEP 2010 - 2012	6.1	2.5	2.7	3.0	3.0

Sources: CBS, MFIN

The annual rate of inflation in 2009 slowed down to 1.8% in November from 2.9% in December 2008. Looking by components, the largest contribution to inflation slowdown came from the fall in the annual rate of change in the prices of food which fell from 5.0% in December 2008 to -1.0% in November. Such developments are the result of a considerable fall in domestic demand (which

boosted competition on the domestic market and led to a decrease in margins) and favourable effects of the base period, i.e. a sharp increase in the prices of many food products which took place during the same period previous year when these prices were influenced by a high level of crude oil and food raw material prices on the global market. Given the usual seasonal dynamics and the negative base period effect, the annual rate of change in the prices of food is expected to rise slightly to approximately -0.4% in December 2009. It has been estimated that the average annual rate of change in the prices of food will slow down from 10.6% in 2008 to 1.9% in 2009.

Annual increase of the energy prices amounted to 3.8% in November 2009. This was mainly the result of an increase in the annual rate of change in the price of gas and refined petroleum products². The annual rate of change in the prices of energy is expected to grow until the end of the year (as a result of an unfavourable effect of the base period, i.e. as a result of a large fall in the prices of crude oil in the same period 2008 but also as a result of the projected increase in the prices of crude oil in the global market) to approximately 7.8% in December 2009. It has been estimated that the average annual rate of change in the prices of energy will fall from 7.8% in 2008 to -1.2% in 2009.

The annual rate of change in the consumer price index in November 2009, food and energy excluded, was 2.8% which is the same as in December 2008. This is the result of increase in tobacco products prices due to increased excises and to a lesser extent from increased prices in the health sector due to the introduction of co-payments for medical and hospital services. On the other side, the contribution of the prices of catering and transport services³ was decreased. Such developments can be attributed to aggregate demand weakening and reduced cost pressures on price growth. The projection has foreseen an increase in the annual rate of change in consumer price index, food and energy excluded, to 3.4% in December, exclusively due to the unfavourable effect of the base period, i.e. a larger than usual seasonal fall in the prices of clothing and footwear in December 2008. We expect that the average annual rate of change of the consumer price index, food and energy excluded, will rise slightly from 3.5% in 2008 to 3.6% in 2009.

As a result of developments in the above-mentioned inflation components, the average annual consumer price inflation rate is expected to stand at 2.5% in 2009. This is 1.0 percentage points below the inflation rate forecast under the previous PEP. The main reason for this lies in much more favourable developments in consumer prices than expected in the last quarter of 2008, which resulted in a much smaller effect of inflation transmission from 2008 to 2009. The annual rate of inflation is expected to stand at 3.0% at the end of 2009, which is lower compared to 3.6% under the previous PEP.

The forecast of developments in consumer price inflation in 2010 has been made under the assumption of a relative stability of the exchange rate of the kuna against the euro and the projection is built on the assumption that the average nominal exchange rate of the kuna against the euro in 2010 will stand around the level of HRK 7.33 /EUR⁴. Given the expected weakening of the US dollar against the euro on the global foreign exchange market, the average nominal exchange rate of the kuna against the US dollar is expected to appreciate by 5.0%. The strengthening of the exchange rate of the kuna against the US dollar will alleviate inflationary pressures of rising prices of crude oil in the global market and will have a favourable effect on developments in prices of imported final products paid in US dollars. Inflationary pressures arising from developments in

² The annual rate of change in the prices of refined petroleum products continues to be negative. However, it rose from -15.7% in December 2008 to -11.0% in October 2009.

³ Reduced inflationary pressures on prices of food products had a stabilising effect on the prices of catering services, in particular food and beverages in restaurants while the fall in the prices of refined petroleum products led to a fall in the prices of transport services on an annual level.

⁴ A mere 0.3% lower average annual exchange rate compared to 2009.

domestic demand in 2010 should also ease, bearing in mind the expected stagnation in personal consumption compared to 2009. Besides, in 2010, we expect to see a weakening of inflationary pressures on the cost side, given the projected slowdown in the annual growth rate of unit labour costs in the whole economy as a result of slower growth of compensations per employee and rising labour productivity due to a fall in employment.

Imported inflationary pressures are expected to be somewhat stronger in 2010 than in the previous year as a result of recovery in the prices of crude oil and other raw materials in the global market. The largest contribution in this regard is expected to come from the expected recovery of the global economy which will generate increased global demand for raw materials and boost their further price growth. According to data from forward contracts traded on the New York commodities exchange, it is expected that the average price of a barrel of crude oil in the global market could reach USD 82.1, an increase of 32.3% compared to the previous year. IMF analysts also forecast that the prices of raw materials without energy will rise by a small 2.4%⁵ on average in 2010 compared to the year before, but that the food raw material prices in the global market will remain relatively stable.

Thus, the annual rate of inflation is expected to grow slightly from 3.0% in December 2009 to 3.1% in December 2010, while the average annual rate of inflation will increase to 2.7%. One of the risks for inflation projection realisation in 2010 lies in the possible faster growth of prices of crude oil and other raw materials in the global market. By contrast, should economic activity fall last longer than expected and should it be bigger than expected, there is a risk that inflation might be lower than expected. The projected annual inflation for 2011 and 2012 is 3.0%.

2.2.3 Monetary and Exchange Rate Policies

The monetary policy pursued by the Croatian National Bank (CNB) is based on maintaining the stability of the exchange rate of the kuna against the euro, which serves as a nominal anchor used to achieve price stability as the main objective of the CNB. In its choice of such a monetary policy, the CNB is governed by the most important characteristics of the Croatian economy. As a small, open and largely euroised economy, its existing level of external debt, particularly that of the private sector, additionally stresses the need for such a choice of monetary policy. Each significant change in the exchange rate in such conditions could have a great impact on domestic price developments, affect the level of indebtedness and the possibility of financing liabilities, which might ultimately jeopardise the stability of the entire banking and financial system.

Global financial crisis which had spread from the United States to Europe in the second half of 2008 had a significant impact on Croatia as well. The main challenges facing the CNB in this context were to maintain the stability of the exchange rate of the domestic currency and to maintain foreign exchange liquidity in the conditions of greatly reduced capital inflows from abroad and the need to ensure funds for large foreign liabilities repayments.

The first response of the domestic sectors, particularly households, to the crisis was to withdraw their savings and time deposits in October 2008. However, owing to joint actions taken by the central bank, commercial banks and the Government of the Republic of Croatia, the pressure on deposits withdrawals was successfully eased. As the CNB revoked in October a decision on the marginal reserve requirements that the banks were obligated to pay on any increase in external debt, foreign currency funds previously set aside were thus set free and the banks again had easier access to foreign borrowing. At the same time, the Government of the Republic of Croatia adopted

⁵ Data based on last available IMF forecasts (31 August 2009)

a decision on the increase in the deposit guarantee scheme which, together with regular savings deposit payments, helped regain confidence in the domestic banking system.

Additional negative impacts of the global crisis on Croatia towards the end of 2008 and in early 2009 were seen in a significant increase in the price of foreign borrowing of domestic private sectors and the government and in the fact that many foreign investors were not keen on international financing because of large uncertainties. In such circumstances, high level of reserves accumulated in the previous years showed to be of extreme importance for the stability of the Croatian banking system as they enabled the central bank to relax its monetary policy instruments and improve foreign exchange liquidity of the system at the time when the pressure was the highest. Thus, through changes in certain instruments (revocation of the decision on the marginal reserve requirements, reduction in the rate of reserve requirements, reduction in the rate of the minimum required foreign currency claims on two occasions, changes in the regulations governing reserve requirements currency structure) and interventions in the foreign exchange market, the CNB freed approximately net HRK 4.2 billion in the last quarter of 2008 and in the first two months of 2009.

Apart from central bank response, the willingness of foreign banks to continue financing Croatian banks in their ownership also proved to be of extreme importance during that period. In the last quarter of 2008 alone, domestic banks borrowed from their majority owners approximately EUR 2.1 billion. Thus, CNB measures and bank borrowing ensured sufficient liquidity to prevent instability on the foreign exchange market. The banks used the largest share of foreign exchange inflows and freed bank reserves to finance the central government, while placements to the private sector were almost stagnant. In such circumstances, the central bank measure on the restriction of placements growth which is not in force anymore, did not, in effect, present an obstacle to private sector financing by domestic banks.

In the remaining part of 2009, monetary environment was marked by much better stability and did not call for additional changes in monetary policy instruments so the central bank maintained system stability and liquidity through its regular operations. June 2009 was marked by a large inflow of foreign currency associated with a foreign issue of central government euro bonds. Converting the foreign currency received, the central bank created kuna liquidity which, coupled with a lower level of reverse repo operations helped maintain stability of the monetary environment. The summer months and the tourist season did not bring about any significant pressures on the exchange rate, so this period was marked by an absence of central bank interventions. The central bank did not have to intervene until early October when, due to accelerating appreciation pressures brought about by foreign currency inflows associated with foreign borrowing of a number of state-owned companies, the central bank purchased EUR 234 million worth of foreign currency from the banks. The international government bond issue which generated a significant inflow of foreign currency in November also contributed to domestic currency appreciation, prompting the central bank to purchase EUR 56 million from the government. As these foreign exchange transactions ensured sufficient banking system liquidity, the CNB did not hold any repo auctions in the last quarter of 2009. Looking at the whole 2009, domestic currency didn't weaken, but slightly strengthen in its value from 7.32 HRK/EUR at the end of 2008 to 7.31 HRK/EUR at the end of 2009 which means that the objective of maintaining the stability of the exchange rate of the kuna was successfully achieved.

Monetary environment until the end of 2009 and in 2010 is expected to be characterised by stagnation in economic activity, easing of inflationary pressures and by foreign liabilities that fall due during that period. Therefore, in managing cash supply the CNB will be governed primarily by the financing needs of the domestic sectors. In this regard, the CNB has already lifted its restriction

on banks' credit growth⁶ while further CNB efforts directed towards maintaining appropriate liquidity level in 2010 are intended to have a beneficial effect on the growth of bank placements to the private sector. Against such a background, the CNB intends to continue pursuing the same monetary policy as it has pursued so far, with foreign exchange transactions remaining the main instrument of liquidity creation. Open market operations will be used for short-term liquidity management and for maintaining stability in the money market, while reserve requirements will continue to be the main instrument of sterilisation.

The year 2010 is expected to see a mild recovery in monetary and credit aggregates. The growth of placements to the government, although still present, should be somewhat slower than in 2009, as the government plans to rely mainly on the foreign market for its financing needs.

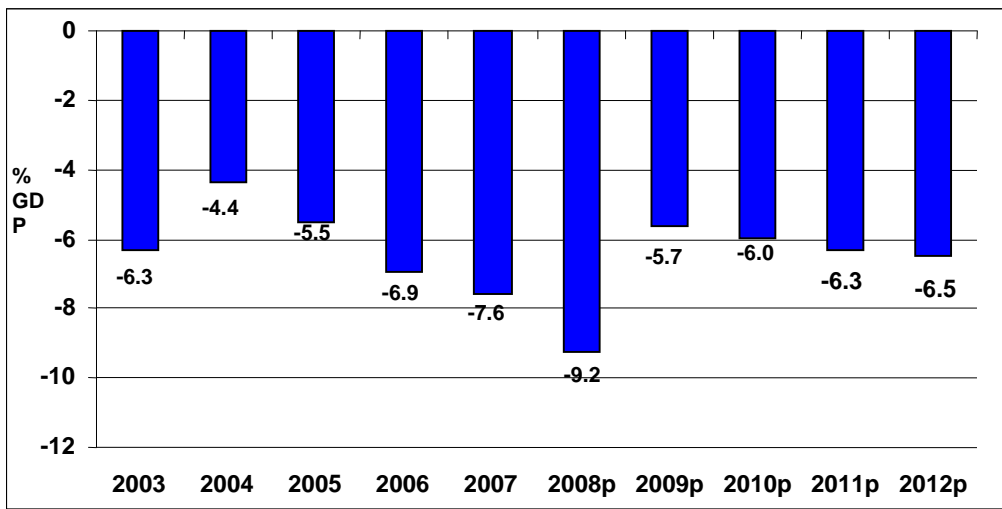
As regards banking system capitalisation, it should be stressed that the capital adequacy ratio of banks is higher than that in the neighbouring countries and that the domestic banking system is prepared to a great extent to withstand any shocks that may arise from negative developments in the real sector of the economy. This is primarily the result of central bank activity which encouraged extensive bank recapitalisation in the previous years by means of amendments and tailoring of different decisions in the area of prudential regulations. A one-off increase in the capital adequacy of banks is expected in early 2010, as a result implementation of prudential regulations based on Basel II.

2.2.4 External Sector

The year 2009 was marked by a strong contraction in the balance of payments current account deficit as a result of the weakening in domestic and foreign demand which, among others, led to a significant fall in the volume of international trade in goods and services. In the first nine months of 2009, goods and services exports fell by 19.5% and imports by 26.1% compared to the same period 2008 which resulted in an exceptionally large narrowing of goods and services trade deficit. A slight contraction of the surplus was also seen in the current transfers account while factor income recorded a negative balance similar to that observed in the previous year. In the last quarter of 2009, we expect to see similar trends in goods and services trade and in current transfers, while income account is expected to see a widening of the deficit. On an annual level, current account deficit could thus fall to 5.7% of GDP, following a record 9.2% of GDP in 2008. In the forthcoming years, the balance of payments deficit could start widening slightly again, following economic recovery which will boost imports growth and cause a small worsening of the balance of trade. Increased energy and raw materials prices as a result of global economic recovery could also contribute to balance of trade worsening. As a result, until 2012 the expected balance of payments current account deficit might reach 6.5% of GDP.

⁶ Decision on repealing the Decision on the subscription of compulsory CNB bills (OG 142/09, 30 November 2009)

Figure 2: Balance of payments current account deficit



Source: CNB, MFIN

Compared to the previous PEP, the relative indicator of current account deficit for 2008 was corrected downwards by 0.8 percentage points due to a review of nominal GDP data. The relative indicator of deficit for 2009 was also corrected downwards, but mainly due to the expected strong contraction of the current account deficit. In light of a considerably lower estimated deficit for 2009, in the years that follow we cannot expect fast recovery back to the levels before global recession, and, as a result, the projected current account deficit for 2010 and 2011 is lower than that projected under the previous PEP (by approximately 2 to 3 percentage points of GDP on average, the major share of which can also be attributed to the deficit correction).

The fall in goods exports in 2009 could reach over 20% on an annual basis as suggested by poorer results in the first eleven months of the year and absence of any significant recovery in foreign demand expected in December. A fall in exports could be felt in most of the sections of the Standard International Trade Classification (SITC), except in case of some agricultural products which benefited from lifted export restrictions and regulatory changes in respect of their traffic and in case of a small fraction of food and medicinal and pharmaceutical products. In the next few years, total goods exports could begin to recover, albeit slowly. Such developments should be driven by gradual strengthening of foreign demand and implementation of structural reforms in the economy. After strong contraction in 2009 that will, according to the results achieved in the first eleven months of the year, hit a large majority of SITC sections, goods imports are expected to start growing again in the forthcoming years. Their growth will be driven by recovery in domestic investment activity and personal consumption as well as the expected small growth in import prices. The annual growth in goods imports might even start accelerating slightly towards the end of the projection period, along with economic growth acceleration.

The expected developments in international services trade are mainly based on forecasts in respect of income from tourism. The expected fall in income in 2009 is larger than suggested by volume indicators for the first ten months of the year which point to only a small drop in the number of foreign tourist arrivals and stays compared to the previous year. Despite a satisfactory number of tourist arrivals and stays, foreign tourists evidently spent much less in the peak season than the year before. The fall in average consumption per traveller may be associated not only with reduced prices of package travel which aimed to draw foreign tourists but with a general fall in tourist consumption, which could have been expected in the situation of economic crisis that hit most of the countries from where tourists arrive. In the forthcoming years we can expect a gradual recovery in income from tourism, owing to rising disposable income of foreign tourists and to the fact that,

despite global economic crisis, Croatia has obviously been recognised as a desirable tourist destination.

Deficit in the factor income account is expected to grow steadily throughout 2009, although much slower than in the previous years. Deficit widening could to a large extent be attributed to a fall in income from investments of the central bank and commercial banks abroad. Interest expenses could continue to grow until the end of the year, though much slower than in the previous years due to the fact that external debt growth also slowed down. By contrast, it is expected that, on account of poorer business results of domestic companies and banks in foreign ownership in the current year, expenses on equity investment (dividend payouts and retained earnings) could be smaller than in the previous year. It is expected that with gradual economic recovery in the following years will probably see a steady negative balance growth in the factor income account and even its acceleration over time. The reason for this is the expected increase in expenses on equity investments and interest expenses which might start growing fast as a result of increased foreign borrowing. With economic recovery, we expect to see gradual growth in income, most notably compensation of employees.

In 2009 we expect to see a small decrease in the positive balance in current transfer account, mainly due to lower income based on workers' transfers. In the forthcoming years, we expect to see an increase in government sector income based on intergovernmental transfers, mainly the EU pre-accession funds. Other, private sources of income, mainly from workers' remittances from the eurozone countries, could also grow slightly as a result of economic acceleration in these countries. Expenses are also expected to grow slightly, both as a result of government expenses for non-resident pensions and workers' remittances.

Unfavourable global economic conditions and cautiousness of foreign investors, especially as regards investment into transition markets, could result in a fall in foreign direct investment in Croatia to 3.5% of GDP until the end of 2009 (excluding round direct investments). Of all foreign direct investments, direct equity investments could feel this fall the most, as they are particularly vulnerable to the risk of economic conditions worsening. The amount of retained earnings will decrease too as a result of poorer business results of companies and banks in foreign ownership. As regards structure by activities, the expected equity investment until the end of the year could be achieved mainly in trade, real estate activities and in some other activities in the context of projects already underway. In the forthcoming years, the intensity of foreign investment could grow only to an extent as more significant interest of foreign investors will probably not take place until economic conditions are fully stabilised. In any case, the amount of investment in the 2010-2012 period is not expected to exceed high investment levels in the period before the economic crisis which were characterised by large privatisation projects and significant amounts that went into bank recapitalisation. However, progress achieved in the process of accession to the European Union should give a positive boost to foreign investment as this process implies legislative harmonisation with the *acquis communautaire*, implementation of necessary reforms, land registry reform, etc.

Judging by the results achieved in the first nine months of the year and the expected slow economic activity in the remaining part of the year, it is probable that external debt growth throughout 2009 will be much slower than in the previous years. However, due to a simultaneous decrease in nominal GDP, the external debt to GDP ratio will probably increase (the external debt to GDP ratio is expected to reach 93.3%⁷ at the end of 2009, which is an increase compared to 82.6% at the end of 2008). Looking by sectors, throughout 2009 companies are expected to see the largest fall in debt growth as a result of scarce financing possibilities and smaller needs for current activities financing. By contrast, after reducing its foreign liabilities in the previous years, the central

⁷ Gross external debt balance does not include round direct investment which totals EUR 1.5 billion.

government is expected to increase its debt stock by approximately EUR 1 billion in 2009. The same situation can be expected to take place in 2010 when the government is expected to meet its increased needs for financing current deficit and domestic and foreign liabilities that fall due during that period (including a 500 million Euro bond issued in 2003 and regular payments under the London Club) by means of bond issues or foreign borrowing. In the 2010-2012 period, companies' debt stock might start growing again, although it is not probable that it will reach growth dynamics before the crisis. Growing external debt of companies could lead to a slight total external debt growth. Given the expected nominal GDP growth in the period following the year 2010, we expect to see only a slight increase in the relative indicator of external debt (from 96% of GDP in 2010 to 97% of GDP in 2012).

3 PUBLIC FINANCES

3.1 GENERAL GOVERNMENT BALANCE AND DEBT

3.1.1 Fiscal Policy and Medium-Term Objectives

In the forthcoming medium-term period, fiscal policy will be directed at continued fiscal consolidation aiming at overall economic recovery, concurrently ensuring social fairness.

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

The individual steps for achieving the set objectives are presented as part of twelve general objectives laid down in the Government Programmes Strategy:

- *macroeconomic and economic stability* – will be achieved through efficient management of public finances through further improvement of budgetary processes, fiscal consolidation, efficient public debt management, strengthening of the systems of internal financial controls and internal audit, further development of macroeconomic statistics, collecting fiscal revenues in a fair and effective manner and strengthening of capacities to use European Union funds;
- *optimum environment for the development of a competitive economy* – the achievement of this objective will be aided by the improvement of the energy system and more efficient use of national resources, investment stimulation and attracting of direct investments, intensification of economic diplomacy and strengthening of export activity, application and implementation of intellectual property rights, changing the production programme in favour of knowledge-intensive products, strengthening of the national quality infrastructure, speeding up of transport with concurrent better quality protection and supervision of the economy and creation of a more developed, competitive and flexible labour market;
- *strengthening of the state of law and the rule of law* – will be achieved through pressing ahead with the reform of the judiciary that is directed at the development and reinforcement of judicial power, education and training of the staff working in judicial authorities, network rationalisation and increasing the transparency in the work of the judicial authorities, as well as rationalisation of costs of judicial proceedings, followed by prevention of corruption and organised crime, more robust protection of human rights and freedoms, strengthening of legal safety in economic transactions and real-estate transactions and finally through development of capabilities and raising the quality of public services and administration;
- *promoting knowledge, excellence and culture* – will be achieved through the development of efficient management of the educational system, boosting the excellence of the scientific system, creating an IT society by establishing the model of electronic government, optimum development of the ICT infrastructure, development of culture and artistic creation and management of cultural assets;
- *uniform regional development* – this goal will be achieved by means of promoting the competitiveness of different Croatian regions by providing support for entrepreneurial activities, branding original traditional products and developing new and existing commercial infrastructure. In addition, sustainable development of less developed regions will be encouraged by the construction of housing, municipal and economic infrastructure aid to local and regional self-government units and tax relief, as well as investments in the transport system and sustainable development of water management;

- *strengthening of social equality* – will be achieved by socially reinforcing the family, children and the young, through comprehensive care of disabled Homeland War veterans and their family members, strengthening of the social security system for workers and coordinating of the protection of the social minimum for the unemployed, development of a sustainable pension insurance system directed, *inter alia*, at achieving social justice;
- *positioning of Croatia as one of the leading European tourist destinations* – will be achieved by stimulating sustainable exploitation of natural, cultural and historical resources, development and improvement of the tourism product provided by different destinations through incentives to entrepreneurs, education and training of staff in tourism, encouraging the use of pre-accession and other international funds, as well as promoting the development of tourism infrastructure and effective promotion of the tourist product and services;
- *more competitive sector of agriculture, food industry and fisheries* – will be achieved through the consolidation of farms and agricultural land planning, improvement of market mechanisms for selling agricultural, food and fisheries products, protection of the health of humans, animals and plants, protection of consumers' interest as well as through rural development;
- *further strengthening of the international status of the Republic of Croatia* – will be achieved through strengthening of bilateral visits, holding of the political bilateral consultations and exchange of options, Croatia's participation in international forums, stepping up of activities aimed at entering the managing/operating bodies of various multilateral organisations and institutions that are important for the Republic of Croatia and meeting of nuclear safety obligations assumed under international conventions and bilateral agreements;
- *improving the police and armed forces as the citizens' services* – will be carried out through the reform of the criminal police, combat against corruption and organised crime, increased safety of road traffic, strengthening of the security of state borders through good organisation, training and technical equipment of the border police and intensification of the work of military and diplomatic missions in the NATO and European Union Members;
- *health care, maintaining and improving health* – will be provided through reorganisation and improvement of urgent medical aid, development and standardisation of health care infrastructure, informatisation of the health care system and improvement of health care for disabled persons, through supervising the legality of work of health care establishments and health care workers as well as through promotion of healthy lifestyles;
- *environmental protection and development* – will be carried out through efficient environmental management, undertaking activities directed at improvement of the cadastre and designated use of space, through 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

Starting from 2004, successful fiscal consolidation has been an important characteristic of the fiscal policy of the Republic of Croatia. This, together with the implementation of structural reforms of public finances and the improvement of the budgetary process, set the foundations for resilience of public finances. The deficit recorded lower levels year after year, decreasing by 0.5 percentage points in the period 2005-2007. In 2008, it continued reducing, declining by 1.1 percentage points to 1.4% of GDP. Although revenue collection deteriorated in the second quarter of 2008 due to

reduced economic activity, such movements did not have a negative effect on the planned deficit since substantial savings were made on the expenditure side. This is confirmed by the data on the decline in the share of total expenditures in gross domestic product by 2.0 percentage points, while total revenues reduced by 0.9 percentage points relative to the year before.

Table 2: Revenue, Expenditure and Net Lending/Borrowing of the Consolidated General Government 2005-2008

<i>% of GDP</i>	2005	2006	2007	2008.
Net lending/borrowing	-3.5	-3.0	-2.5	-1.4
Total revenue	38.9	39.2	40.3	39.4
Total expenditure	42.4	42.2	42.8	40.8

Source: MF

Further deterioration of macroeconomic conditions in 2009 led to a need for new measures aimed at ensuring the stability and liquidity of public finances. The first 2009 budget revision was thus adopted in April 2009, reducing total revenues by 2.6 percentage points of GDP and total expenditures by 1.9 percentage points of GDP relative to the initial budget plan. The base for calculation of salaries in state and public services was lowered to the December-2008 level, while the base for calculation of salaries to government officials was lowered by 10%. The second and third budget revisions were adopted in July, decreasing the projected revenues by 1.9 percentage points of GDP and the projected expenditures by 0.5 percentage points of GDP relative to the previous plan. On the revenue side, amendments to the value added tax raised the VAT rate from 22% to 23%. In addition, a special tax on salaries, pensions and other receivables was introduced⁸, that is, on net payments exceeding HRK 3,000 (the rate is 2%) and net payments exceeding HRK 6,000 (the rate is 4%). The application of this tax is limited by law until the end of 2010, at the latest. In addition, the Act on Special Tax on Receipts from Independent Activity and other Receivables⁹ was adopted, taxing receipts exceeding HRK 3,000 (2%) and HRK 6,000 (4%), which will remain in force until 28 February 2011, at the latest. The Act on Fees for the Provision of Services in Mobile Electronic Communication Networks¹⁰ introduced a fee for the provision of services of mobile electronic communication networks, totalling 6% of the base, i.e. of revenues from services provided during the calculation period. In total, the fiscal effect of these measures in 2009 is estimated at some 0.4% of GDP. On the expenditure side, further savings were made as well as redistributions within the budget. The base for the calculation of salaries of government officials was decreased by additional 5% and so were pensions regulated by the Act on the Rights and Obligations of Representatives in the Croatian Parliament¹¹ that were lowered by 10%. In addition, the decision regarding the free transport of secondary school students was repealed, as well as the decision regarding free schoolbooks for all pupils, except for pupils from low income families. The said amendments to the budget of July 2009 envisaged for a budget deficit of 3.4% of GDP under the ESA 95 methodology.

It is noteworthy that the 2009 data in this year's Pre-accession Economic Programme are related to the budget revision adopted at the end of July 2009.

⁸ Official Gazette 94/09

⁹ Official Gazette 119/09

¹⁰ Official Gazette 94/09

¹¹ Official Gazette 86/09

According to preliminary data and projections for 2009, the overall general government budget deficit might be higher than planned. The reason for this is the estimated increase in arrears of between 0.1% and 0.2% of GDP and payments on the basis of guarantees, which are, in line with the methodology used in this document, treated as expenses thus increasing the deficit. They are estimated at around 0.4% of GDP more than planned. The estimated net effect of the lower level of revenue and expenditure could contribute to an increase in deficit of between 0.1% and 0.2% of GDP.

Medium-Term Fiscal Projections

Medium-term fiscal projections for the period 2010-2012 provide an overview of the movements of revenue, expenditure, net lending/borrowing and general government budget financing, without taking into account the financial package, i.e. assets from the EU funds and Croatia's obligations towards the EU budget as of the date of accession.

Consolidated General Government Revenue

The consolidated general government revenue planned for 2010 as well as revenue projections for the period 2011-2012 are based on the projections of macroeconomic variables and expected revenues of the 2009 budget, taking into account the effects of legal amendments on the revenue side adopted in July, within the framework of the third budget revision for 2009. These amendments are related to the change of the VAT rate from 22% to 23% whose annual effect is estimated at some 0.4% of GDP, to the introduction of the special tax on salaries, pensions and other receivables, the revenue from which is expected to amount to some 0.7% of GDP, and to the introduction of the fee for the provision of services in mobile electronic communication networks whose annual effect is estimated at some 0.1% of GDP. The overall effect of amendments to legislation in 2010 is estimated at some 1.2% of GDP. In accordance with the above said, the total consolidated general government revenue in 2010 is planned at the level of 38.4% of GDP. This is a reduction of 0.4 percentage points of GDP relative to 2009.

Towards the end of the medium-term period, the revenue of the consolidated general government budget will be determined by the gradual recovery of economic activity but also by the lack of revenue from the special tax on salaries, pensions and other receivables after 2010. In relation to this tax it is noteworthy that the need for this source of income will be monitored on an ongoing basis, in particular from the aspect of economic circumstances, the state of public finances and the significance that this tax has on taxpayers, with a view of its earlier withdrawal even before the expiry of the set deadline. Accordingly, consolidated general government revenue indicates a declining trend of its share in GDP, from 36.8% in 2011 to 35.8% in 2012.

VAT revenue planned in 2010 is expected to reach 11.5% of GDP, declining by 0.2 percentage points of GDP by the end of 2012 to 11.3% of GDP. VAT revenue is planned on the basis of the expected developments in private consumption, taking into account the annual effect of the increase in VAT rate from 22% to 23%.

Revenue from personal income tax, corporate income tax, custom fees and excise duties will also decrease its share in GDP in the medium-term period. Revenue from corporate income tax is planned on the basis of altered macroeconomic circumstances and, considering its time impact, range between 2.4% of GDP in 2010 to 2.2% of GDP in 2012. Excise duties as a share of GDP will also see a decline, from 3.2% in 2010 to 3.0% in 2012. Projections of revenues from excise duties have taken into account economic growth rates and trends these revenues have followed thus far. Regarding the share in total excises, revenue from excises on oil is the most significant one, followed by revenue from excise duties on tobacco and tobacco products and excise duties on cars.

The share of revenue from customs fees and duties will go down, from 0.5% of GDP in 2010 and 2011 to 0.4% of GDP in 2012, without any major changes to the laws and regulations regarding foreign trade. Revenue from personal income tax is planned on the basis of the expected movements of nominal gross wage and total employment, ranging from 3.1% of GDP in 2010 to 2.9% of GDP in 2012.

Social contributions are closely linked to the economic activity in the period when they are collected and the previous period, considering the dynamics of the influence of the overall economic activity on the labour market or more explicitly on the major factors for the movement of contributions, gross wages and employment. Revenue from social contributions has, in accordance with the above said, been planned to gradually reduce their share in GDP, from the level of 12.1% in 2010 to the level of 11.4% in 2012.

Property revenue includes revenues from the profit of enterprises and financial institutions, revenues from dividends, concessions, property leases, interests and other property revenues, which is expected to stand at the average level of 0.4% in the medium term.

Consolidated General Government Expenditure

Consolidated general government expenditure, in the period 2010-2012 will be determined by key objectives and measures of the Government Programmes Strategy, aiming at maintaining the long-term sustainability of public finances and creating preconditions for economic growth and recovery. In this context, fiscal policy in the medium term will be oriented towards further fiscal consolidation paired with continued structural reform and investment into the promotion of entrepreneurship, uniform regional development, promotion of knowledge and excellence and protection of socially vulnerable groups. In addition, activities will be continued relating to the adjustment of the Republic of Croatia to the EU accession process, in particular relating to the speedy accommodation of returnees and refugees, alignment of the agricultural system to the EU rules, establishment and management of the Schengen system, modernisation and informatisation of customs, judiciary reform, administrative capacities, construction and equipment of border crossings, adjustment to the European system of statistics, etc. Taking all this into account, the total expenditure of the consolidated general government will range from 41.7% of GDP in 2010 to 38.1% of GDP in 2012.

Expense for social benefits, accounting for an average share of 40.3% in total expenditure, will decrease its share from 16.9% of GDP in 2010 to 15.3% of GDP in 2012. It is for the major part related to expense for pensions and health care. The projections of pension expense are based on the expected developments in the number of pensioners, as well as assets needed to pay out pension supplements aimed at eliminating the differences between the pensions of the so-called "old" and "new" pensioners. There will be no indexation of pensions in 2010, i.e. their adjustment in accordance with the growth of gross salaries and consumer prices, as laid down under the Act on Special tax on Salaries, Pensions and other Receivables. Health care allocations are influenced by the ongoing health care reform, particularly with regard to primary and secondary health care, aiming at ensuring the financial sustainability of the health care system. In addition, this expenditure category includes funds required for exercising rights on the basis of social welfare, material and legal protection of unemployed persons, maternity and child allowance.

Compensation of employees in public and state administration, with the average share of 25.2% in total expenditure, makes up the second largest expenditure item within the general government budget. In the following three years, its share will decrease by 0.7 percentage points of GDP, i.e. from 10.4% in 2010 to 9.7% in 2012. This expense planned in 2010 envisages 0.5% growth for past

labour and 2.2% growth of salaries in the segment of science and education in accordance with the Agreement on Supplements to Salaries in the Science and Education Sector.

Expense for intermediary consumption which relates mostly to expense for the use of goods and services earmarked for compensation of employees, material, energy and services, is expected to average 4.5% of GDP. It will be largely determined by already mentioned activities and projects financed under the EU pre-accession assistance programmes and activities and projects connected with the EU accession process, that are for the most part used for strengthening the administrative capacity.

Expense for subsidies will continue to decrease from 2.1% of GDP in 2010 to 1.8% of GDP in 2012. This decrease is primarily related to the decrease in subsidies in agriculture amid the change in the agricultural policy oriented towards the European subsidy system, Croatian railways, shipbuilding and marine transport.

Expense for property income will stand at 1.9% of GDP in 2010, reducing its share by 0.2 percentage points of GDP by the end of 2012, primarily under the influence of the estimated interest expense trend.

Other current transfers, which comprise current grants and current donations, are projected at some 1.3% of GDP, whereas capital transfers, which are comprised of capital grants and capital donations are planned to stand at 1.9% 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. In the period 2010-2012, it will maintain an average level of 1.9% of GDP, primarily under the influence of activities associated with capital investments in the field of health care and social welfare, science, education, judicial system, road infrastructure, water protection, etc.

Table 3: Revenue, Expenditure and Net Lending/Borrowing of the General Government 2008-2012

ESA 95	% of GDP	2008	2009p	2010p	2011p	2012p
TR	Total revenue	39.4	38.8	38.4	36.8	35.8
	<i>Main components of total revenue:</i>					
P.11	Market output	3.3	3.1	3.1	3.0	2.8
D.211	Value-added tax	12.1	11.1	11.5	11.4	11.3
D.61R	Social contributions, receivable	12.0	12.5	12.1	11.7	11.4
D.5R	Current taxes on income, wealth etc., receivable	6.5	6.5	6.4	5.6	5.4
D.51A	- of which: personal income tax	3.1	3.2	3.1	3.0	2.9
D.51B	corporate income tax	3.1	2.9	2.4	2.3	2.2
D.212	Taxes and duties on imports excluding VAT	0.6	0.5	0.5	0.5	0.4
D.214	Taxes on products, except VAT and import taxes	3.9	3.8	3.8	3.6	3.5
D.214a	- of which: excises	3.5	3.2	3.2	3.1	3.0
D.4R	Property income, receivable	0.5	0.7	0.4	0.4	0.4
TE	Total expenditure	40.8	42.2	41.7	39.9	38.1
	<i>Main components of total expenditure:</i>					
P.2	Intermediate consumption	5.1	5.2	4.7	4.5	4.2
D1.P	Compensation of employees	9.8	10.3	10.4	10.0	9.7
D.3P	Subsidies, payable	2.4	2.4	2.1	1.9	1.8
D.4P	Property income, payable	1.5	1.6	1.9	1.8	1.7
D.62P	Social benefits other than social transfers in kind, payable	12.5	13.6	13.4	12.8	12.3
D.631	Social transfers in kind	3.1	3.5	3.5	3.2	3.0
D.7P	Other current transfers, payable	1.4	1.5	1.3	1.3	1.3
D.9P	Capital transfers, payable	2.4	1.9	1.9	1.8	1.8
P.5	Gross capital formation	2.1	1.8	1.9	1.9	1.8
B.9	Net lending/net borrowing	-1.4	-3.4	-3.3	-3.1	-2.3

Source: MF

Net Lending/Borrowing

In accordance with the expected economic recovery and commitment of fiscal policy towards ensuring long term stability, it is expected that the process of fiscal consolidation will continue with ongoing narrowing of the general government budget deficit from 3.3% of GDP in 2010 to 3.1% of GDP in 2011 and 2.3% of GDP in 2012. The greatest contribution to this will come from the budgetary central government, whose deficit in 2010 will total 3.1% and in 2011 2.9% of GDP. It is noteworthy that the fiscal impact of the special tax on salaries, pensions and other receivables has not been included since, under law, it is to be applied until the end of 2010, i.e. until the beginning of 2011. Towards the end of 2012, the budgetary central government deficit will reduce by additional 0.8 percentage points of GDP. During the entire medium-term period extra-budgetary users will maintain the same deficit level and so will local and regional self-government units, totalling 0.1% of GDP on average.

Table 4: Revenue, Expenditure and Net Lending/Borrowing of the General Government 2008-2012 According to Government Level

ESA 95	% of GDP	2008	2009p	2010p	2011p	2012p
Budgetary central government - unconsolidated						
TR	Total revenue	33.9	33.5	33.3	31.8	31.0
TE	Total expenditure	35.1	36.8	36.3	34.7	33.1
B.9	Net lending/net borrowing	-1.3	-3.2	-3.1	-2.9	-2.1
Extrabudgetary users - unconsolidated						
TR	Total revenue	1.8	1.6	1.6	1.6	1.5
TE	Total expenditure	2.0	1.7	1.7	1.7	1.6
B.9	Net lending/net borrowing	-0.1	-0.1	-0.1	-0.1	-0.1
Local government - unconsolidated						
TR	Total revenue	4.9	4.8	4.6	4.5	4.3
TE	Total expenditure	4.9	4.8	4.7	4.5	4.4
B.9	Net lending/net borrowing	0.0	0.0	-0.1	-0.1	-0.1
Consolidated general government						
TR	Total revenue	39.4	38.8	38.4	36.8	35.8
TE	Total expenditure	40.8	42.2	41.7	39.9	38.1
B.9	Net lending/net borrowing	-1.4	-3.4	-3.3	-3.1	-2.3

Source: MF

Financing of the General Government Budget

The total level of the required financing in the forthcoming medium-term period will be determined by movements of financial assets as well as liabilities maturing in the period.

The movement of total required financing in the period 2009-2012 is largely determined by the increase of the negative fiscal balance amid changed economic circumstances. The trend of continuous reduction in the volume of required financing from the pre-crisis period, as a direct result of fiscal consolidation, was interrupted by the increase in the negative balance in 2009. However, it is noteworthy that the fiscal consolidation process and consequently the reduction of the negative fiscal balance will continue towards the end of the medium term which will affect the movements of total required financing. As regards financial assets, net acquisition of financial assets will have a positive sign during the entire medium-term period, which indicates continued higher expense than receipts. Finally, the total required financing in the medium term will be determined by the level of repayments, i.e. maturing liabilities.

The major portion of liabilities is made up of maturing syndicated loans of domestic banks, worth EUR 1.63 billion and four maturing bonds, of which two foreign bonds, worth EUR 1.25 billion and two domestic bonds; one euro denominated bond, worth EUR 500 million, and one kuna denominated bond, worth HRK 3 billion.

Table 5: Overview of Bonds Maturing in the Period 2010 – 2012

Bond	Date of issue	Amount (million)	Interest rate	Maturity
Domestic bonds				
Series 08 D-10	08.03.2005	3.000 HRK	6.75%	08.03.2010
Series 03 D-12	23.05.2002	500 EUR	6.88%	23.05.2012
International bonds				
Euro - EUR V 2010	24.02.2003	500 EUR	4.63%	24.02.2010
Euro - EUR III 2011	06.03.2001	750 EUR	6.75%	14.03.2011

Source: MF

The total required financing in the medium-term period will be funded in the domestic and foreign financial market. The main characteristics of such borrowing will be the matching future maturities by term and amount, with the emphasis on borrowing through foreign securities whose amounts over the years will reflect the need to cover the fiscal balance and the level of overall due foreign repayments. Domestic sources of financing will be used to cover domestic due liabilities.

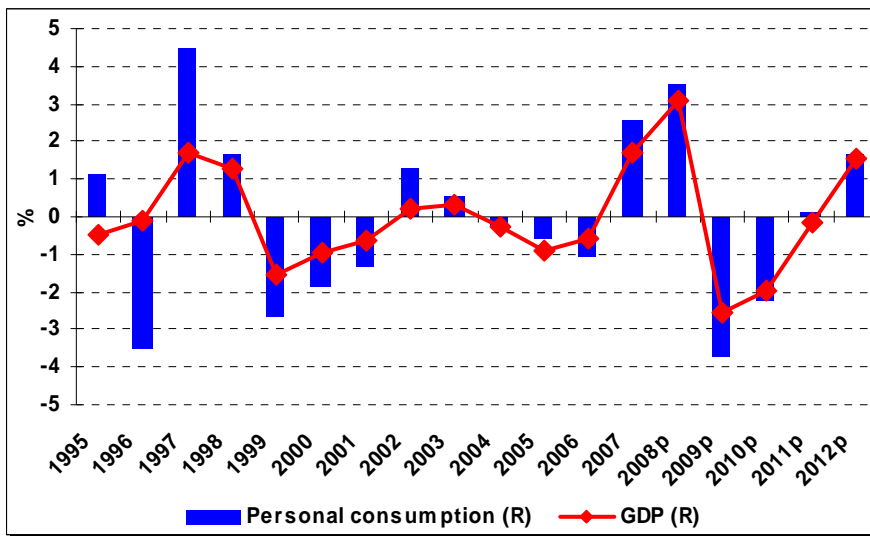
3.1.3 Estimate of the Cyclically Adjusted Primary Deficit

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

The calculation of cyclically adjusted deficit was based on the method of the European Central Bank¹². Personal income tax, corporate income tax, VAT, 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 $\lambda=300$.

¹² Bouthévilain 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:

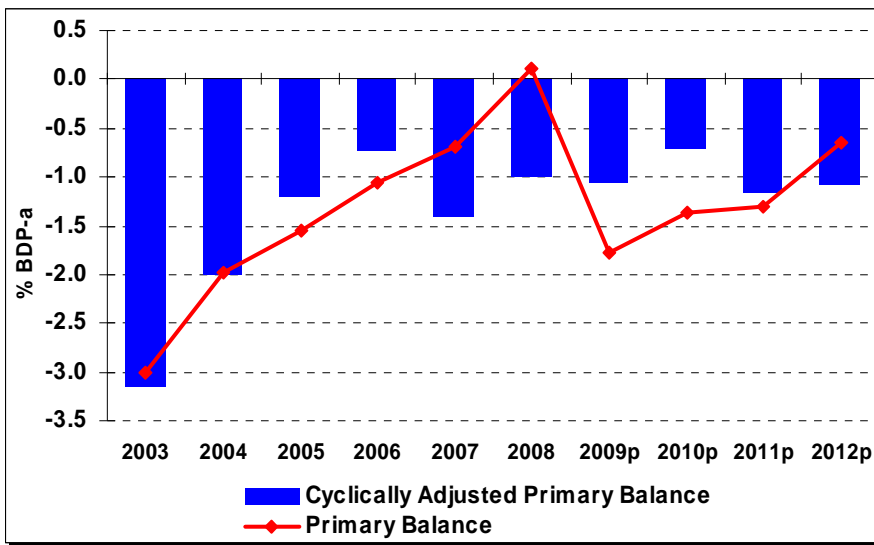
$$\Delta \ln X_t^i = \alpha + \beta(\ln X_{t-1}^i - \gamma \ln V_{t-1}^i + \phi + \delta + \dots) + \delta_1 \Delta \ln V_t^i + \delta_2 \Delta \ln V_{t-1}^i + A + \zeta,$$

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 basis in the same and the preceding period.

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

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 real budget balance and the cyclical balance. The primary deficit of consolidated general government is used for the calculation of structural budget balance, as the expense for interest is not the result of current fiscal policy.

Figure 4: Primary Balance and Cyclically Adjusted Primary Balance

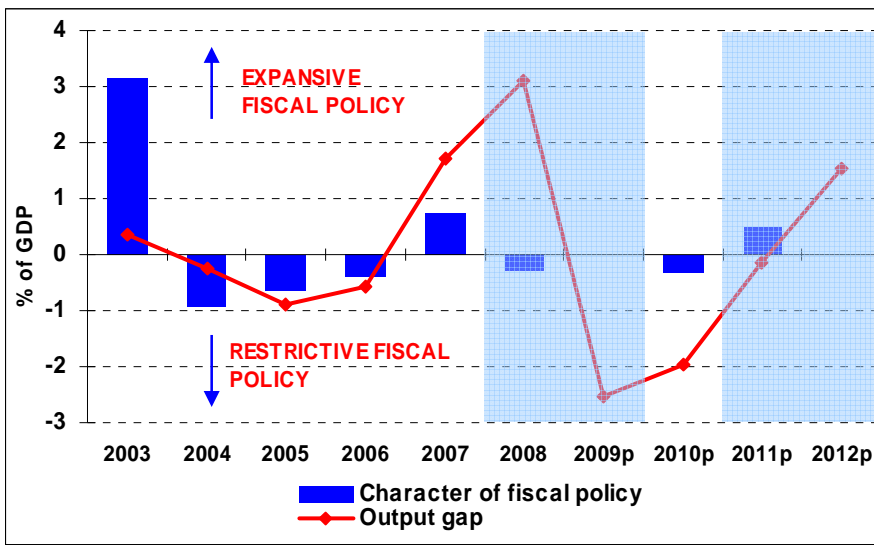


Source: MF

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 relation between expansionary or restrictive fiscal policy and the output gap in the period 2003-2008 indicates the pro-cyclical character of the fiscal policy in the period 2003-2007 and its anti-cyclical character in 2008. Based on projections for 2009, the output gap is expected to be negative with pro-cyclical character of the fiscal policy, while in the years 2011 and 2012 fiscal policy is expected to have an anti-cyclical character.

Figure 5: Character of Fiscal Policy



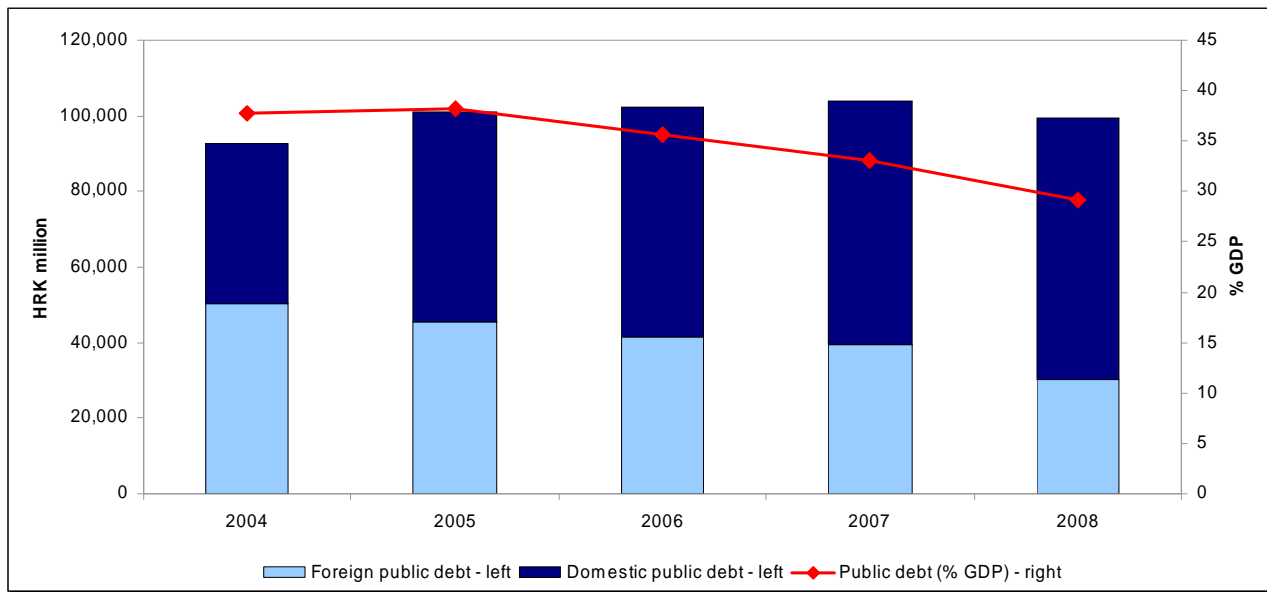
Note: Shaded areas represent periods of anti-cyclical fiscal policy.
Source: MF

3.1.4 Debt Levels and Developments

The process of fiscal consolidation enabled the level of net lending/borrowing to be significantly reduced in the period since 2004 which resulted in positive impact on the movements of public debt as a share of GDP. Consequently, the share of public debt in GDP in 2006 was reduced by 2.6 percentage points in comparison with the preceding year. In 2007, it came to a further decrease of the share by 2.6 percentage points, while in 2008 public debt stood at 29.1% of GDP.

As regards the movements in the foreign and domestic components of public debt, it came to the increase in the domestic component of public debt in the past several years, i.e. to the reduction in the foreign component of public debt. In the period 2004-2008, the foreign component of public debt continually declined from 54.1% in 2004 to 30.4% in 2008. The domestic component went up continually from 45.9% in 2004 to 69.6% in 2008. These developments resulted from the orientation to mostly domestic sources for the purpose of financing the general government deficit.

Figure 6: Public Debt 2004-2008



Source: MF

The majority of the public debt is associated primarily with borrowing through securities, followed by loan borrowings. The period 2004-2008 was characterised by the Government's orientation towards securing financing through issues in the domestic market, which reduced the dependence on international capital markets. It has also had a positive impact on external debt developments and has contributed to the development of the domestic financial market.

At the end of 2008, the largest share of public debt was related to the budgetary central government (93.3%), followed by the debt of extra-budgetary users (4.8%) and local government (1.9%). In terms of the currency structure, it is noteworthy that about 4/5 of the debt is denominated in foreign currency, mostly in Euros.

With regard to the overall public debt management, it is of great importance to define adequate plans and direction of public debt management, which builds on previous years' achievements and is closely associated with the fiscal and other economic policy plans. The Budget Act lays down the institutional framework for borrowing and public debt management in a way which enables the Government to satisfy its financial needs by generating the lowest medium and long-term financing costs, incurring the optimum risk level under the given circumstances.

Taking into account the changes in financial markets, including the domestic market, and maturing foreign liabilities, a share of 2009 financing needs was met by issuing a foreign bond in May 2009, when, after five years, the Republic of Croatia returned to the foreign financial market to issue a eurobond worth EUR 750 million at the price of 99.675% of the nominal amount, fixed annual rate of 6.5% and maturity in 2015. In November 2009, the second bond was issued in the US financial market, worth USD 1.5 billion, at the fixed rate of 6.75% and 10-year maturity. As a result of the abovementioned changes in financial conditions and changes in domestic and global macroeconomic conditions, a share of 2009 total financing needs was met through short-term instruments, primarily syndicated loans of domestic banks and T-bills.

In the forthcoming three-year period, the need for financing the overall budget deficit and due liabilities will be met both in the domestic and the foreign financial market, with the primary objective to match future maturities by amount and term concurrently freeing additional room for the financing of other sectors.

The general government deficit and due liabilities movements in the forthcoming three-year period will result in higher financing needs relative to the historical average, which will reflect itself in the share of public debt in GDP.

Consequently, the share of public debt in GDP will rise in the forthcoming period from the estimated level of 33.5% of GDP in 2009 to over 37% of GDP at the end of the period under review, tending to stagnate in the last year. In addition, it will come to certain changes in the levels of the foreign and domestic component of public debt expressed as a share of GDP in consequent of maturing liabilities in the period under review and the planned new borrowing both in the domestic and the foreign financial market.

Table 6: Projections of Net Lending/Borrowing and Public Debt

<i>% of GDP</i>	2008	2009 p	2010 p	2011 p	2012 p
Public debt	29.1	33.5	36.1	37.3	37.4
Foreign	8.8	10.5	13.2	14.1	15.8
Domestic	20.2	22.9	22.9	23.2	21.6

Source: MF

3.1.5 Budgetary Implications of Major Structural Reforms

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

Accordingly, in the medium-term period 2010-2012, net increase of budgetary allocations for the purpose of implementing certain structural measures will stand at some 0.04% of GDP on average, out of which the budgetary revenue relating to some of those measures will record an average increase of 0.03% of GDP, while the expenditure will increase by 0.07% of GDP on average.

In this context, it is important to stress the most important measures having fiscal effects in the forthcoming period. The forthcoming medium-term period will thus be marked by the reduction in subsidies to Croatian Railways and the agricultural sector. With regard to the policy of agricultural state aid, the overall budget for market-pricing policy is planned to be reduced, while subsidies for rural development measures will go up. These developments in the agricultural state aid segment will result in the net decrease of budgetary allocations of 0.05% on annual basis.

In the forthcoming period, the net increase of budgetary allocations for health care reform will total 0.03% on annual basis. However, due to investment in hospital equipment and the necessary reorganisation of urgent medical aid, budgetary allocations will increase in 2011. In 2012, when the primary health care informatisation project is completed expenditure growth will slow down again.

The net decrease in budgetary allocations for the purpose of implementing the pro-natal policy measures in the period under review will amount to 0.01% of GDP on annual basis. The year 2010 will be marked by the increase in these expenditures, while after that they will start reducing. Other measures in the enterprise sector, labour market, agricultural sector, public administration,

education and science, health care and the judicial system will also produce fiscal effects on the expenditure side, which, in principle, exceed the revenues resulting from the utilisation of various EU pre-accession assistance programmes.

3.2 SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS PROGRAMME

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

Fiscal Risks

The changes in macroeconomic variables have significant implications for the fiscal developments, i.e. for the expected direction and result of the fiscal policy. For example, a lower level of real GDP has a direct impact on the level of expected budgetary revenues. Lower rates of economic growth could result from further global negative trends, i.e. from the deepening of the economic crisis and the reduction in economic activity of Croatia's most important trade partners, as well as from the growth reduction in the countries of the region or tourism generating markets.

Delayed crisis impacts, *inter alia* the impacts on the financial system and the labour market would be stronger than expected, negatively influencing the projected fiscal policy results.

In case of lower than planned GDP growth rate, net lending/borrowing in the forthcoming period would rise, consequently affecting public debt movements.

Debt servicing and interest payments, especially in the case of a further deterioration of the conditions in the financial market, also present a fiscal risk because when larger amounts of debt fall due for payment they create pressure on current business operations in the sense of refinancing risk increase, i.e. pose greater burden on the budget. Public debt management should therefore ensure that debt-servicing burden is evenly distributed.

On the expenditure side, it is necessary to emphasise the risk of one-off growth of expenditures relating to the non-implementation of structural reforms with the foreseen dynamics. In addition, changes in the implementation of envisaged reforms would impact current business results, especially in the circumstances of less favourable economic developments.

Net Lending/Borrowing Sensitivity Analysis

Net lending/borrowing and fiscal balance can be affected by various factors in the medium-period, having different impacts on the revenue and/or expenditure side of the general government budget. The analysis of the fiscal balance movement builds on baseline macroeconomic and fiscal projection, i.e. baseline scenario. The analyses carried out and their results, i.e. the impacts of changed assumptions, are then compared to the baseline scenario. While those analyses were carried out on the basis of arbitrary assumptions, they still show what effects of net lending/borrowing could be expected in the next medium-term period if circumstances arose that would substantially change the main assumptions.

An overview is given below of the fiscal balance sensitivity analysis, assuming a change in the revenue factors. The level of expenditures was assumed in line with the baseline projection. It was shown that revenues reacted strongly in crisis conditions, especially tax revenues related to personal consumption. Considering that, under the baseline projection, revenue from taxes and contributions connected with personal consumption and labour market factors makes up, on average, around 70% of general government budget revenue, an overview is given below of the impact of its changes on the overall fiscal balance. With regard to the mentioned revenue, we reviewed the impact on revenue under the influence of personal consumption and labour market

factors in the narrow sense, i.e. the impact on value added tax, personal income tax and social security contributions.

Further, the analysis was carried out in a manner which assumed a change in the revenue from personal income tax and social security contribution in the medium-term period that would lead to the deterioration in the nominal annual growth rate, i.e. a fall by one percentage point, for two years in a row, in 2010 and 2011. Such an assumption resulted in the deterioration of the fiscal balance of some 0.2 percentage points in the whole medium-term period.

As regards the value added tax, it was assumed that personal consumption growth in 2010 would amount to zero (only a half of the assumed growth under the baseline projection for 2011). The results showed that under such a scenario the fiscal balance would deteriorate by 0.3 percentage points in 2010 and 0.6 percentage points during the rest of the medium-term period. When reviewing these results, one should take into consideration the yearly impact of the increase of the VAT rate from 22% to 23%.

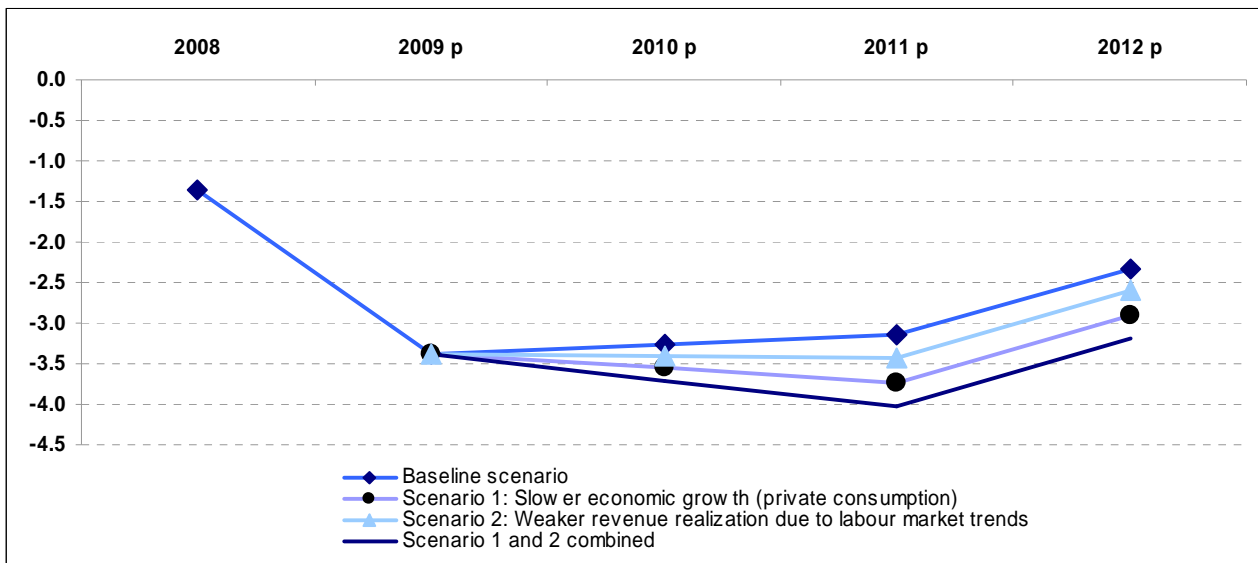
In the circumstances where it would come to the simultaneous deterioration in the observed revenue factors, the fiscal balance would deteriorate substantially, from 0.4 percentage points in 2010 to 0.9 and 0.8 percentage points in 2011 and 2012 respectively. It should be noted that the analyses that were carried out assumed that categories on the expenditure side of the budget were constant, although changes in individual reviewed sources of revenue would certainly, to an extent, affect the general government budget expenditure.

Table 7: Assumptions of the Baseline Scenario and Results of the Sensitivity Analysis

	2008	2009 p	2010 p	2011 p	2012 p
Assumptions (baseline scenario)					
Real GDP, growth rate	2.4	-5.9	0.5	3.0	3.5
Inflation (GDP deflator)	6.4	2.8	1.8	3.0	3.0
Net lending (+) / borrowing (-)					
Baseline scenario	-1.4	-3.4	-3.3	-3.1	-2.3
Scenario 1: Slower economic growth (private consumption)		-3.4	-3.6	-3.7	-2.9
Scenario 2: Weaker revenue realization due to labour market trends		-3.4	-3.4	-3.4	-2.6
Scenario 1 and 2 combined		-3.4	-3.7	-4.0	-3.2

Source: MF

Figure 7: Results of Sensitivity Analysis



Source: MF

Public Debt Sensitivity Analysis

Public debt movements are directly connected with macroeconomic results and assumptions of fiscal policy implementation. Therefore it is of great importance to continuously conduct public debt sensitivity analysis so as to realistically understand various implications of possible changes of assumptions that determine public debt projections in the medium-term and thus pose the greatest risk, as well as to be able to review all of the possibilities for risk avoidance or mitigation. The public debt sensitivity analyses are based on the baseline scenario, which rests on medium-term projections. A series of alternative scenarios are then applied with assumed values being kept at a certain (historical level) or subjected to various shocks. The shocks are usually connected to historical values of the values under review and their variability, but can also be arbitrary.

In the sense of the Budget Act public debt is defined as the general budget or general government debt.

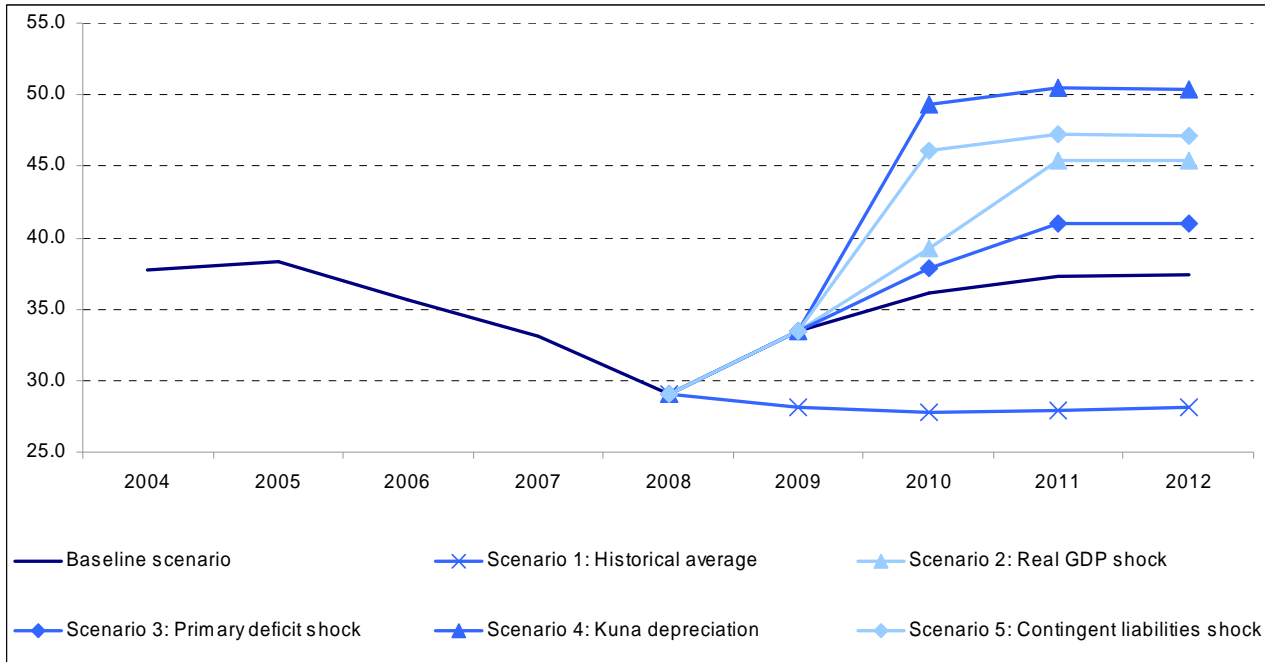
The conducted public debt sensitivity analysis showed that depreciation of the kuna, especially of the kuna against the euro, would have the strongest impact on its movement. The reason for this lies in the fact that a sizable share of the debt is denominated in foreign currency. The conducted sensitivity analysis reflects that the arbitrary shock of the kuna depreciating by 25% raises public debt to some 50% of GDP in the period under review.

Tests have also shown a strong reaction of the public debt to changes in contingent liabilities (guarantees). For the purpose of this test, it was assumed that public debt in 2010 would go up by the amount of contingent liabilities arbitrarily set at 10% of GDP, which is almost the total amount of guarantees. In addition, public debt demonstrates an unfavourable medium-term trend relating to an arbitrary assumption of a decline in the real GDP rate in 2010 and 2011, at the level expected in 2009. In such a case, public debt in the medium-term would rise to some 45% of GDP. In addition, public debt demonstrated an unfavourable trend in case of primary deficit changes since deficit is the main debt generator, especially because of the fact that the effects of the primary deficit shock subside slowly and last to the end of the period under review.

On the other hand, analyses in which the assumptions or the real GDP growth rate, real interest rate and primary balance are kept at their historical (average) values from 2008 onward show an opposite trend relative to the above conducted analysis. In this case, the debt movement changes,

and the share of public debt in GDP decreases. This result differs from the baseline scenario based on medium-term macroeconomic projections, taking into account the current macroeconomic developments and projected developments in the medium-term that changed substantially in relation to historical averages.

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



Source: MF

3.2.2 Comparison with Previous Programme

In this chapter, an overview is given of total revenue, expenditure and net lending/borrowing levels presented in the previous year's and this year's PEP. However, it should be noted that serious changes have occurred since the publication of last year's PEP which make direct comparison between the previous year's PEP and the this year's PEP difficult.

As already discussed in previous chapters, the 2009 plan and consequently projections for the forthcoming years, which made up the integral part of the last year's PEP, were significantly changed already within the framework of the first budget revision in April 2009 due to changed macroeconomic conditions. Under the ESA 95 methodology, total revenue decreased by 2.6 percentage points of GDP in the first budget revision relative to the initial plan, while expenditure were cut by 1.9 percentage points. Consequently, net lending/borrowing increased by 0.8 percentage points. Within the framework of the second budget revision in July 2009 revenue decreased by 2.3 percentage points relative to the previous plan, expenditure by 0.4 percentage points, and net lending/borrowing increased by 1.9 percentage points. The third budget revision that was also adopted in July 2009 raised revenues by 0.4 percentage points, reduced expenditures by 0.1 percentage points relative to the previous plan and decreased net lending/borrowing by 0.5 percentage points to the level of 3.4% of GDP.

In addition, other changes occurred that render direct comparison of the two programmes difficult. Apart from different assumptions relating to economic activity, i.e. the nominal GDP and thus the share of revenue, expenditure and net lending/borrowing, at the end of January 2009 GDP

calculation was adjusted to the ESA 95 methodology, thus including the unofficial economy, financial intermediation services and imputed rent into the new calculation.

Further, the comparison of revenue and expenditure and consequently net lending/borrowing is made difficult due to the introduction of new sources of revenue within the framework of the third budget revision.

Finally, the level of revenue, expenditure and net lending/borrowing in the two programmes should also be reviewed from the aspect of coverage of the general government indicators.

Table 8: Comparison of Revenue, Expenditure and Net Lending/Borrowing of the General Government according to 2008 PEP and 2009 PEP

	2008	2009 p	2010 p	2011 p	2012 p
2009 PEP (% of GDP)					
Total revenue	39.4	38.8	38.4	36.8	35.8
Total expenditure	40.8	42.2	41.7	39.9	38.1
Net lending/borrowing	-1.4	-3.4	-3.3	-3.1	-2.3
2008 PEP (% of GDP)					
Total revenue	45.7	45.2	44.8	44.4	
Total expenditure	46.9	46.1	45.4	44.4	
Net lending/borrowing	-1.3	-0.9	-0.6	0.0	
Difference					
Total revenue	-6.3	-6.4	-6.4	-7.7	
Total expenditure	-6.1	-4.0	-3.7	-4.5	
Net lending/borrowing	-0.1	-2.5	-2.6	-3.1	

Source: MF

3.3 QUALITY OF PUBLIC FINANCES

In 2009, numerous activities were undertaken aiming at improving the quality of public finance. Some of the activities include the continuation of measures envisaged under the Strategy for Improvement and Modernisation of the Processes within the State Treasury for 2007-2011, while others relate to measures implemented with a view to mitigate the effects of the global economic crisis.

Due to its sound institutional and legislative framework, the Republic of Croatia endured the first wave of negative impacts of the global financial crisis rather well but its later spill-over to the real sector led to lower collection of budget revenue. Therefore, the Government took a series of measures in 2009, aiming at fighting the effects of the crisis and ensuring the stability of public finances. A package of 10 anti-recession measures was adopted in February 2009, as well as three budget revisions, adjusting both the revenue and the expenditure side of the budget, as described in more detail in Section 3.1.2 Actual Balances and Medium-Term Perspectives.

Moreover, aiming at creating additional room for the financing of the private sector in the domestic financial market, the Government issued a eurobond after being absent from foreign financial markets for five years. The first issue was in May, worth EUR 750 million and maturing in 2015, while the second issue was in November, worth USD 1.5 billion and with a 10-year maturity.

These measures contributed to the stability of public finances in 2009 in the circumstances of an economic crisis and created a starting point for implementation of the fiscal policy in the

forthcoming three-year period, aiming at ensuring system liquidity and creating the preconditions for economic recovery.

As regards the improvement of the budgetary process, under the new Budget Act,¹³ which entered into force on 1 January 2009, the budgetary planning process and preparation of the 2010 budget started with the creation of strategic plans for the three year period. Accordingly, the Government adopted the Government Programmes Strategy for the three year period in September 2009, defining twelve major objectives of the fiscal policy. More detailed information on implemented changes and additional measures for improvement of the budgetary process may be found in Chapter 3.5 Institutional Features of Public Finances.

In the context of managing public finances, it should be noted that the Government adopted the Development Strategy of Public Internal Financial Control for the period 2009-2011 in September 2009, as part of budgetary reforms launched within the Strategy for Improvement and Modernisation of the Processes within the State Treasury 2007-2011 and in line with the new Budget Act. Previous Strategies were directed at creating the necessary preconditions for the establishment and development of the said system in budgetary users, including the setting up of a regulatory framework and organisational capacities, while the new Strategy is oriented towards further development of the established system as a tool of the management structure for responsible, transparent and successful management of budgetary funds.

Further improvement of the quality of public finances will be affected by continued implementation of structural reforms in the labour market, health care, public administration the judiciary and other areas.

Aiming at the prevention of a further rise in the number of the unemployed, i.e. further termination of employment contracts and prevention of additional costs associated with workers who have been laid off, new flexibility measures have been introduced in order to enable business entities do adapt to new circumstances and retain the largest possible number of workers on the payroll, thus preventing a surge in unemployment. The Employment Protection Act¹⁴ was adopted for this purpose in July 2009. In addition, the adoption of the new Labour Act¹⁵ in December 2009 completed the process of harmonisation of the Labour Act with the *acquis communautaire*. The National Plan for Promoting Employment (2009-2010) lays down the main principles of the state employment policy, as well as the responsibilities and tasks of the competent state administration authorities and public institutions.

The Ministry of Administration was established in July 2009 within the framework of public administration reform, with an aim to direct the reform and the modernisation process in public administration and ensure the preconditions for the strengthening of management administrative capacities of the authority competent for state administration reform. In addition, the new General Administrative Procedure Act¹⁶ was adopted and efforts were invested in strengthening the electronic administration and developing human resources.

Further, efforts aimed at strengthening the independence, impartiality, professionalism and efficiency of the judiciary have been continued, aiming at increasing the citizens' confidence in government institutions and the state of law as an important precondition for Croatia's economic development and promotion of capital investments in Croatia. Organisational and institutional changes were introduced by establishing special offices and bodies competent for implementing the measures aimed at successful combating against corruption and organised crime.

¹³ Official Gazette 87/08

¹⁴ Official Gazette 94/09

¹⁵ Official Gazette 149/09

¹⁶ Official Gazette 47/09

Improvements were also achieved in the public procurement system by establishing the Central Public Procurement Office of the Republic of Croatia¹⁷ in November 2009. It is estimated that this public procurement model will generate substantial savings for the budget.

In addition to the funds allocated from the state budget, a significant role is played by assistance under the EU programmes. As part of assistance programmes, i.e. pre-accession programmes, CARDS, PHARE, ISPA and SAPARD, by 30 June 2009 the Republic of Croatia ensured EUR 239.8 million or some 80.7%. Contracting under the ISPA programme is under way, which will raise the final percentage. EUR 159.4 million was paid out until 30 June 2009.

In the first half of 2009, the European Commission allocated EUR 40.3 million to the Republic of Croatia for programmes PHARE, ISPA, SAPARD and IPA – component IV.

On 5 June 2009, the Republic of Croatia and the European Commission signed a financial agreement on the allocation of funds under the IPA 2008 programme – component I. A total of EUR 35.8 million was allocated for 55 projects, financing projects within the competence of the Central Finance and Contracting Agency.

As regards the strengthening of the administrative framework for the implementation of the EU assistance programmes, it is noteworthy that the Anti-Fraud Coordinating Structure (AFCOS) is fully functional and is prepared for timely detection and reporting on irregularities and fraud. With a view to optimise AFCOS efficiency, training is provided on an ongoing basis and drawing up of the National Strategy for Combating Fraud and Protection of the EU Financial Interests entered its final phase. The strategy represents a strong framework for efficient and effective coordination, communication, cooperation and exchange of information among authorities in the AFCOS system. Implementing the measures from the strategy and meeting objectives will ensure strong protection of financial interests of the EU. The Agency for Regional Development of the Republic of Croatia was established at the end of December 2008, while the Paying Agency for Agriculture, Fisheries and Rural Development was established in 2009. Their establishment has an important role in the implementation of the regional development policy and the agriculture policy of the Republic of Croatia.

3.4 SUSTAINABILITY OF PUBLIC FINANCES

The assessment of long-term sustainability of public finances is based on the long-term projections of the population of the Republic of Croatia, applying a scenario with medium fertility and medium migration and baseline macroeconomic assumptions of future movements, which include a changed GDP calculation methodology that is aligned with the methodology of the European System of Accounts, ESA 95. In comparison with the previous PEP, lower real GDP growth rates are envisaged in the initial period, higher unemployment rates and new fiscal projections for the period until 2012.

The projections have been made under the assumption that in the period under review there would be no significant changes in the application of existing legislation which regulate public pension and health expenses and that the manner of calculating and collecting social security contributions would remain unchanged. The projection of expected pension expenditures took into account the expected movements in the number of pensioners, the expected effects of equalisation of the so-called "new" and "old" pensioners and the lack of pension indexation in 2010. The projections of health care expenditures envisage the continued implementation of health care reform, in particular in the segments of primary health care, hospital system and sick leave control. All other sources of

¹⁷ Official Gazette 138/09

revenue, with the exception of social security contributions, as a share of GDP will remain the same, as well as all other expenses, except for pension, health care and interest expenses. It is noteworthy, that the revenue side in 2010 took into account the effects of the special tax on salaries, pensions and other receivables on annual basis.

As regards participation rates, it is assumed that the behaviour patterns of individual economic agents will remain 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 to fall, reaching 10.3% in 2010. As from 2013, the structural unemployment rate is expected to hold at the level of around 7.0% and remain unchanged until 2050. The growth of productivity per employee is derived from the assumptions on real GDP growth and changes in the number of employed persons, which is determined by long-term demographic projections and assumed participation rates.

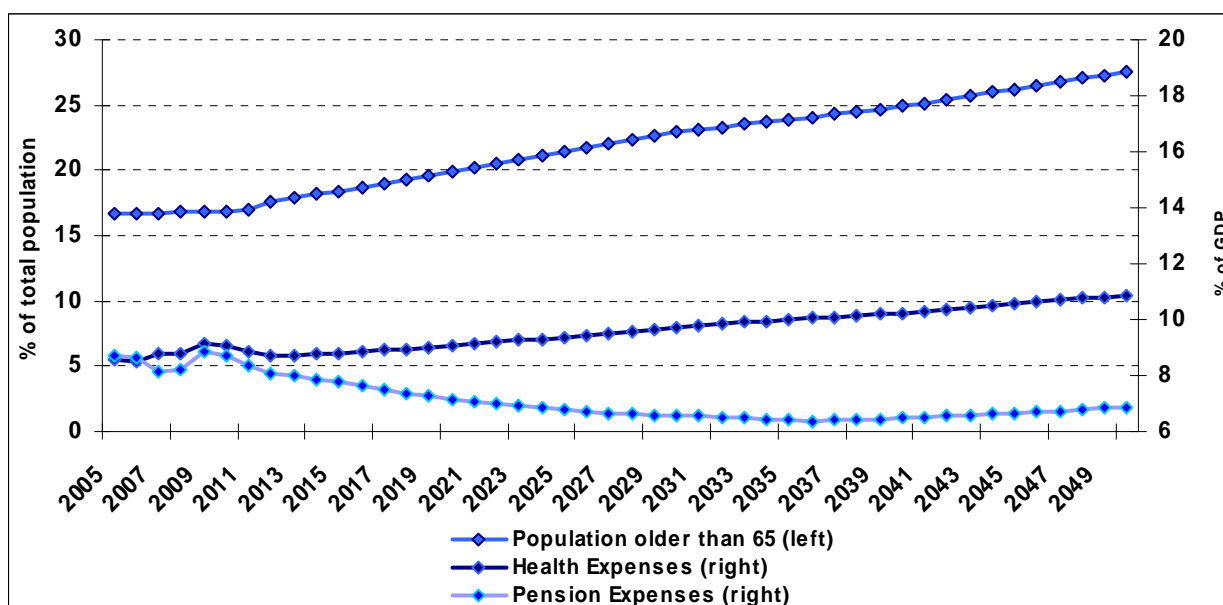
On the basis of the assumptions described above, a fall in revenue from pension insurance contributions is estimated: from 5.9% of GDP in 2005 to 5.3% of GDP in 2015, stabilising in subsequent years. The reason for this is a gradual increase in the share of employees claiming their pension insurance under both mandatory pillars of pension insurance, that is, 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 public fund. The stabilisation of the share of revenue from pension expenditures at 5.3% of GDP after 2015 is a result of assumptions that real growth of wage per employee is equal to labour productivity and of the contribution rate definition as a constant portion of wages, where higher first-pillar contributions for older employees are taken into account for the purpose of pension insurance contributions.

The projections also indicate a decrease in pension expenses by 1.8 percentage points of GDP, i.e. from 8.7% of GDP in 2005 to 6.9% of GDP in 2050, with pensions of war veterans being excluded from the analysis. The share of pension expenses in GDP is slightly lower than projected in the previous PEP, mostly as a result of changes in the GDP calculation methodology but also due to lower real GDP growth rates in the medium-term. Although the number of the aging population is increasing, the pension reform and the decrease of relative pensions paid from the first pillar give rise to long-term projections of the decrease of the portion of public pension expenses in GDP. Such an outcome is likely if 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, which is going to be paid from individual capitalised pension funds, will grow.

The public expenses for health care are projected to increase from 5.5% of GDP to 10.5% of GDP in 2050. The projection is based on the estimated pure effect of aging population, reflecting the changes marked by the growing share of older age groups that are the primary users of health care services. The projections assumed expenditure growth in line with the growth of labour productivity, also including the effects of the health care reform and increasing expenses of health care development, especially in the segment of expenses for medicines and new technologies. In addition, it was assumed that health expenses for each age and gender group would grow in line with GDP per employee, which means that they would follow the current trends in the economy and society as a whole.

Expenses for interest as a share of GDP will grow from 1.9% in 2005 to 2.7% in 2050. In line with projected developments of described revenue and expenditure categories, the total revenue will stand at some 36.6% of GDP and total expenditure at some 40.8% 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 new Budget Act¹⁸ entered into force on 1 January 2009, introducing the following novelties in comparison with the 2003 Budget Act:

- strategic planning and the obligation to prepare a three-year Government programmes strategy in order for strategy priorities and goals of the Government policies to have a direct influence on the allocation of funds within the budget;
- a multi-year budgetary framework, since in addition to the annual budget the Croatian Parliament will also adopt budget projections for the following two years;
- more flexibility in the execution of the budget because the budget will be adopted at a less detailed level, contributing to a better budget overview;
- the possibility to carry over to the following budgetary year activities and projects financed from the EU pre-accession assistance funds and capital projects when they are not completed by the end of the current year;
- inclusion of consents issued by local and regional self-government units to institutions and legal persons in their ownership in the scope of possible borrowing by the unit, as well as the obligation to obtain authorisation from the minister of finance prior to granting

¹⁸ The Budget Act (Official Gazette 87/08) specifies the instrument for public expenditure management and regulates the process of planning, preparation, adoption and execution of the budget, asset and debt management, public debt management, borrowing and issuance of guarantees by the central government and the units of local and regional self-government, budgetary relations in the public sector, accounting and budgetary supervision.

guarantees to institutions and legal persons owned by local units, thus ensuring prior control over guarantee issuance.

In accordance with the provision of the new Act, the Government of the Republic of Croatia adopted a Government Programmes Strategy 2010-2012 in September 2009, which was prepared on the basis of strategic plans of ministries and other government administration bodies. Strategic plans were drawn up on the basis of existing strategic documents and plans, taking into account the set objectives and changes in the environment.

The 2010-2012 Strategy clearly defines goals and priorities to be implemented by the programmes of the Government of the Republic of Croatia within the set time limit. Strategic plans provide an overview of sectoral goals and the Government Programmes Strategy ensures the allocation of budgetary funds to goals which will achieve the greatest impact in priority areas.

In the forthcoming three-year period, measures aimed a development of budgetary processes defined under the Strategy for Improvement and Modernisation of the Processes within the State Treasury will continue. They are:

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

In addition, during the same period the area of expert evaluation and assessment of the justifiability and efficiency of investment projects financed by budgetary users will be regulated by a Government Regulation.

The purpose of the Regulation is to improve the management of investment projects by budgetary users:

- by taking more efficient decisions on investment priorities,
- by enabling the development of assessment of investment proposal and managing the costs of approved projects in order to improve the value-for-money ratio,
- by providing high-quality information on completed projects to use the gained experience in the preparation and implementation of future projects.

As a result, projects will be chosen that contribute the most to achieving the priority objectives of the Government at the lowest cost, while on the other hand, the notification system will enable all interested parties to monitor project progress and enable the Ministry of Finance plan for funds in the state budget more realistically.

4 STRUCTURAL REFORMS

4.1 ENTERPRISE SECTOR

4.1.1 Competition Policy and State Aid

Competition Policy

Effective competition and ensuring level playing field for all the entrepreneurs on the market, regardless of their market strength and size, represent the conditions without which significant changes in the economic structure, improved investments, introduction of new products and services, increased innovation in all economic sectors and enhanced well being of Croatian consumers cannot be expected. The task of competition law and policy is to establish the conditions for the development of such competition, i.e. to prevent and prohibit market conduct restricting competition, weather by entering into prohibited agreements, abuse of dominant position or through mergers and acquisitions that can have negative impact on the market. Although the Croatian Competition Agency (hereinafter: the Agency) has been very active, intervening, in the course of 2009, on several markets to prevent the actions that are contrary to the competition rules (telecommunications, gas distribution, sale of refined petroleum products, provision of airport services, etc.), not all the conditions are present yet for development of the effective competition system in the Republic of Croatia, in view of the Agency's limited competence (it is not competent for the banking sector) and a lack of power to impose sanctions for violating the law. More specifically, the competition system established by the Competition Act, adopted in 2003¹⁹ and harmonised with the fundamental competition rules contained in the *acquis communautaire*, has, nevertheless, left the penalties for violating the aforementioned Act within the authority of more than 100 misdemeanour courts with territorial jurisdiction in the Republic of Croatia. The practice has shown that such a system is not effective since penalties are imposed rarely and involve small amounts, so that the violators of the Act are not punished adequately and deterrence, the target effect of the Agency's decisions, has not been achieved. Accordingly, for the purpose of improving efficiency of the Agency's operation and enhancing effectiveness of the competition system, it was necessary to adopt a new legislative framework for market competition, which would eliminate the previously mentioned deficiencies of the existing one, providing the Agency with the required instruments for the application of competition regulation (e.g. introduction of the so-called leniency programme to fight cartels). The new Competition Act²⁰ was adopted in the Croatian Parliament at the end of June 2009 and its application starts in 2010. Accordingly, the new Competition Act will strengthen the role of competition law in the Croatian legal system and enhance the role of the Agency by increasing its authority in detecting and then punishing the offenders adequately, promoting thus competition law and policy, especially when providing opinion regarding the compliance of the new and existing legislation with the competition legislation (competition advocacy).

State Aid

The establishment of the state aid control system represents another important instrument for creating the conditions for the development of effective competition, the aim of which is to prevent aid from putting individual entrepreneurs unjustifiably in a more favourable market position relative to their competitors.

¹⁹ Official Gazette 122/03

²⁰ Official Gazette 79/09

The state aid control system in Croatia is fully aligned with *acquis communautaire* and the Croatian Competition Agency is authorised to perform control of state aid grants and repayments. Accordingly, in the past several years, the system of granting state aid was established, based on aid schemes, whereas individual aid is granted in increasingly smaller number of cases, as an exception, and predominantly in the case of restructuring of entrepreneurs facing difficulties or as a remuneration for providing services of general economic interest. In addition all aid schemes, including those based on awarding tax exemptions for new investments, in free zones, as well as in the areas of special state concern and hilly and mountainous areas, are fully aligned with the aid regulations, the application of which began in 2009. Activities are also underway focused on restructuring the shipbuilding sector, through shipyard privatisation, with an aim of abandoning the present method of allocating aid to this sector, and creating the conditions for establishing economic and market sustainability of that sector. In addition, changes in the aid system for Croatian Radio and Television are being prepared, which will, without prejudice to the role of that institution as a public service provider in realising democratic, social and cultural needs of the Croatian citizens, align the existing legislation governing this field with the state aid regulations.

Owing to the application of the new system of granting state aid and observance of rules encouraging granting of aid for horizontal goals and discouraging aid for covering operating costs, positive developments in this area were recorded 2008, despite the global financial and economic crisis which also spilt over to the Croatian economy. More specifically, according to the data compiled and processed by the Agency for the purpose of drawing up the Annual Report on the State Aid in accordance with the methodology of the European Commission, less aid was granted in Croatia in 2008 compared to 2007 and their share in GDP was also reduced. Total state aid granted in 2008 amounted to HRK 8,810.5 million, which is 17.6% less than in 2007, whereas the share of total aid in GDP stood at 2.6% in 2008, a 24.4% reduction compared to 2007, when it stood at 3.4%.

According to categories of state aid, that for horizontal purposes and for regional goals accounted for 18.1% of the total amount of state aid in 2008, while state aid for special sectors in the field of industry and services accounted for 39.7% (of which the greatest part related to transport, radio and television broadcasting, shipbuilding and tourism). Another 40.2% of the total allocated state aid went to agriculture and fisheries, while state aid on the local level amounted to 2.0%. Total state aid, excluding agriculture and fisheries amounted to HRK 5,272.8 million in 2008, representing 1.5% of GDP, and if agriculture, fisheries and transport are excluded, total state aid amounted to HRK 3,820.1 million or 1.1% of GDP.

As regards individual state aid instruments, the upward trend of subsidies continued in 2008, comprising 78.7% of total state aid, followed by tax exemptions with an 11.7% share and shares in equity with a 4.6% share, state guarantees (4.5%) and aid in a form of more favourable loans (0.5%).

4.1.2 Privatisation

In mid-September 2009, the Croatian Privatisation Fund (CPF) portfolio encompassed 783 companies (736 companies available for sale) with total equity capital of HRK 59.8 billion, out of which HRK 16.5 billion is in state ownership. Although 86 companies were privatised last year (4th quarter of 2008 and first three quarters of 2009) (3 companies by a sale through a public tender, 35 on the Zagreb Stock Exchange and 48 companies were deleted from the court register following a completion of bankruptcy or winding-up proceedings), the portfolio structure by the number of companies and ownership shares has remained almost unchanged compared to the previous year, so that CPF is a minority owner with up to 25% share in equity capital in 80% of the companies (627

companies), in another 72 companies the share ranges between 25% and 50%, whereas in 84 companies the state is still a majority owner with more than 50% share in capital.

In addition to the existing share portfolio structure, where companies facing operational difficulties are predominant and, as such, unattractive to investors, the global economic crisis also had a significant influence on the achieved privatisation dynamics, resulting in a decreased interest of potential investors in investments in the entire region. Consequently, regardless of a large number of invited public tenders (24 tenders were invited for sale of 15 companies, out of which 9 companies were from the CPF portfolio and the remaining 6 related to Croatian Railways subsidiaries), only three companies were privatised.

By inviting a tender (in early August) for privatisation of five shipyards and one subsidiary in majority state ownership, the activities started to resolve the issue of long-term sustainability of the shipbuilding sector which is, from the aspect of privatisation, the most complex and demanding sector that has remained in the CPF portfolio.

The wording and conditions of the tender, agreed with the European Commission included the following: sale of four shipyards at the initial price of one kuna, two shipyards ('Uljanik' d.d., Pula and subsidiary 'Brodosplit – Naval and Special Vessels Shipyard' d.o.o.) at their nominal value, sale of 25% of equity capital of company 'Uljanik'd.d. to managers and employees under special conditions and submitting of a business plan for a period of minimum 5 years, anticipating the restructuring plan for a period of maximum 5 years following the date of concluding the share sale contract. The compulsory content of the restructuring plan comprises adequate compensation schemes and significant own contribution of at least 40% of total restructuring costs, along with the liability of a potential investor to co-ordinate the restructuring plan with the Croatian Competition Agency and the European Commission.

Notwithstanding huge interest of potential investors expressed in the process of shipyard privatisation (34 tender dossiers were purchased), only two valid tenders were received under the tender procedure which closed on 30 September 2009 (one tender for 'Brodotrogir' d.d. and another one for a subsidiary of Shipbuilding Industry 'Split', 'Brodosplit - Naval and Special Vessels Shipyard' d.o.o.). However, the submitted tenders did not meet the tender conditions, so that invitation of new tenders is expected in early 2010.

As regards other privatisation activities, it should be noted that privatisation of the only remaining agricultural conglomerate held in the CPF portfolio, the company Vupik d.d., Vukovar, was completed since the Government of the Republic of Croatia issued a decision on the selection of the successful tenderer at the end of 2009.

In the course of 2009, despite intense efforts aimed at privatisation of Croatian Railways subsidiaries (14 tenders were invited for 6 companies), not a single company was sold.

Completion of privatisation of the largest part of the remaining portfolio of the Croatian Privatisation Fund (CPF), as one of the preconditions for creating an efficient market economy, has remained the primary objective of the economic policy in the field of privatisation. Privatisation dynamics will also be determined, apart from the quality of the present share portfolio, by the speed of economic recovery at the global level, i.e. by the speed of overcoming recession, primarily in the EU Member States which are traditionally the most important foreign investors in Croatia, who in the previous period showed interest in individual sectors.

The announced concept of privatisation of a part of the CPF equity portfolio through closed-end investment funds, envisaging a transfer of shares in companies in minority state ownership to closed-end investment funds, the management of which would be entrusted to professional management companies selected at public tenders, has not so far been realised due to a considerable fall in share value on the capital market. However, that concept is still being

considered as a possible privatisation model and its implementation, in view of the planned state's exit strategy from closed-end investment funds through an IPO, will depend to a large extent on the speed of the capital market recovery.

Since the state's share portfolio has constantly been decreasing and a need has arisen for introducing new models which would simplify the procedures and expedite the privatisation process, a possibility of the CPF restructuring into a common umbrella institution for privatisation is being considered. In addition, the Government of the Republic of Croatia is expected to define the new model and institutional framework for the state assets management in the course of 2010.

4.1.3 Railway Restructuring

Achievements in the railway sector in 2009 pertain primarily to further activities aimed at aligning domestic legislation with *acquis communautaire*. The implemented activities ensure further enhancement of business processes, more efficient operation of railway companies and other criteria in accordance with the railway development guidelines and strategy.

In 2009, two new pieces of legislation were adopted: the Act on Amendments to the Railway Act²¹ and the Act on Amendments to the Act on the Agency for the Railway Services Market Regulation²². By the adoption of that legislation governing railway transport, two benchmarks were met for closing the negotiating chapter 14 – Transport Policy. The first benchmark relates to the beginning of operation of a Regulatory Body (Agency for the Railway Services Market Regulation), whereas the second benchmark relates to ensuring independence for the Railway Infrastructure Manager function.

The operation of the Agency for Railway Services Market Regulation is independent, with the main task of creating the conditions for non-discriminatory access to the railway services market in the Republic of Croatia. The Agency submits the annual report on its work to the Croatian Parliament and it has been awarded, by law, the supervisory and appeal function. In June and July 2009, the Agency's Articles of Association were adopted and the Governing Council and temporary director of the Agency were appointed, followed by recruitment of staff.

Furthermore, the Railway Transport Safety Agency was established with the task of ensuring the conditions of transport safety and security, implementing regulatory functions in terms of technical and safety arrangements, investigative and supervisory procedures and certification of documents relating to soundness and safety in the railway system. The primary objective is to introduce the uniform safety criteria into the rail transport system in Croatia, as a part of the EU rail transport system. The activities of adopting the Articles of Association and appointing the Agency's director are underway and are planned to be completed in the course of 2010.

In accordance with the Railway Act²³ and the Act on the Division of Croatian Railways²⁴, the company 'HŽ – Infrastruktura' d.o.o. performs the role of Railway Infrastructure Manager (the Manager). The existing EU practice is focused on providing functional independence, as a result of which the Railway Act currently in force was amended. Functional independence of the Manager was achieved through a provision which stipulates that members at the managerial level of the infrastructure Manager cannot at the same time perform any other functions in related companies and/or in the umbrella company 'HŽ – Holding'. As in the previous period, the liability has

²¹ Official Gazette 75/09

²² Official Gazette 75/09

²³ Official Gazette 123/03, 30/04, 79/07, 75/09

²⁴ Official Gazette 153/05

continued to be imposed on the Manager to publish the Network Report. The new Network Report for the Timetable 2009/2010, in contrast to the previous report, contains the calculation and charging models for the usage of routes. The usage of routes is charged to the existing railway operators, i.e. 'HŽ – Cargo' d.o.o. and 'HŽ – Putnički prijevoz' d.o.o.

Fulfilment of the objective of legislative harmonisation has also continued through the activities of adopting new ordinances. In 2008 and 2009, six and four new ordinances, respectively, were adopted. The new ordinances relate to the field of railway transport safety and completion of all subordinate legislation is expected by the first half of 2010.

For the purpose of introducing a new model of public financing based on contracts, along with the existing multi-year Contract on railway infrastructure management, a new form of Contract on subsidising services of general economic interest (PSO Contract) is being prepared and developed. The first proposal of the new PSO Contract was made according to the European practice, for which positive comments of partners were received. Passenger railway services in local and regional transport are being financed under the Contract, whereas the presentation of revenues and expenses by tracks and trains represents a constituent part of the Contract. The main characteristics of that Contract were presented at the European Commission peer mission annual meeting held in Zagreb in September 2009, where a positive opinion about the aforementioned Contract was received.

In the previous period, co-operation under ISPA, IPA and PHARE programmes continued.

The objective of railway companies restructuring is being implemented in terms of further separation of business operations between newly established companies, i.e. between the Infrastructure Manager and the service provider.

4.1.4 Shipyard Restructuring

The employment and productivity level of Croatian shipyards achieved in 2008 continued in the first half of 2009. However, due to the lack of liquidity which affected shipyards especially in the 4th quarter of 2009, it recorded a decrease. Significant improvements concerning internal weaknesses of shipyards are to be resolved after the completion of privatisation which is planned for 2010, and which is in line with the strategic commitment of the Government of the Republic of Croatia to privatize the state portfolio aiming at its efficiency improvement, sustainability and competitiveness in compliance with the EU competition policy rules.

In order to identify the optimal model and strategy for the future position of shipyards, the Government of the Republic of Croatia continually co-operates with the representatives of the European Commission within the framework of the negotiating chapter 8 - Competition Policy.

In that sense, the Government of the Republic of Croatia and the European Commission achieved a certain level of agreement through technical consultations held in 2008 and 2009. According to the Government Decision of 11 and 30 July 2009, in August 2009 the Croatian Privatisation Fund published an international invitation to tender for the purchase of shares in shipbuilding industry.

Pursuant to the invitation to tender for privatisation of six shipyards (five shipyards and one subsidiary) which was published in national and international publications (Financial Times, Loyds List, Trade Winds and The Economist), 34 tender dossiers were purchased, out of which five for Shipbuilding Industry '3. Maj' d.d., six for the Shipbuilding Industry 'Kraljeвица' d.d., nine for 'Brodosplit – Naval and Special Vessels Shipyard' d.o.o., five for Shipbuilding Industry 'Split'

d.d., eight for Shipbuilding Industry 'Brodotrogir' d.d. and one for Shipbuilding Industry 'Uljanik' d.d. The evaluation committee defined that three tenders were received by the deadline, out of which one was incomplete and therefore declared invalid. The two valid tenders were submitted by Croatian companies – the company 'More Trogir' d.o.o., Split for the purchase of a share in Shipbuilding Industry 'Brodotrogir' d.d., Trogir, and the company 'Adria mar brodogradnja' d.o.o. from Zagreb for the purchase of a share in 'Brodosplit – Naval and Special Vessels Shipyard' d.o.o. After evaluation of tenders which was carried out separately for each of the shipyards by the evaluation committee comprised of the representatives of the Government of the Republic of Croatia, members of the board of directors, representatives of trade union engaged in the respective shipyard, representatives of the company 'Hrvatska brodogradnja – Jadranbrod' d.d. and representatives of the Croatian Privatisation Fund, both tenders were rejected since they did not meet the tender conditions.

In accordance with the agreement reached with the European Commission, the second round of tender procedure for privatisation of shipyard industry companies is being prepared. Pursuant to the Decision of the Government of the Republic of Croatia the second round of tender procedure should be launched by 15 February 2010, at the latest.

4.1.5 Energy

In the course of 2009, activities related to strengthening of electricity and gas market continued.

In the field of natural gas, the following subordinate legislation was adopted, based on the Gas Market Act²⁵, which completes the legislative framework for that field: General terms and conditions for natural gas supply²⁶, Network rules for gas distribution system²⁷, Rules for the gas storage system²⁸, Network rules for the transmission system²⁹ and Ordinance on natural gas market organisation³⁰. In addition, market activities were separated from regulated activities and operators for individual activities in the field of gas were introduced, including operators for LNG terminals and natural gas storages. As regards gas supply safety, the Regulation on natural gas supply safety³¹ was adopted at the end of 2008, in connection with Directive 2004/67/EC.

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. By October 2009, 47 666 buyers used their status of a privileged buyer, whereby they have taken advantage of the right to contract electricity independently for their own market needs. Their total contracted annual consumption of electricity amounts to 8.2 TeraWattHours (TWh), accounting for more than 50% of the overall annual electricity consumption in Croatia.

²⁵ Official Gazette 40/07 and 15/08

²⁶ Official Gazette 43/09

²⁷ Official Gazette 50/09

²⁸ Official Gazette 50/09

²⁹ Official Gazette 50/09

³⁰ Official Gazette 50/09

³¹ Official Gazette 112/08, 92/09 and 153/09

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. In 2009, the construction of a double 400 kV power-transmission line between Ernestinovo (CRO) and Pech (HU) continued and it is planned be completed in 2010. Connecting with Bosnia and Herzegovina also continued by putting a reconstructed 220kV power-transmission line Mraclin – Prijedor into operation in April 2009, which was out of operation since 1992 due to the war. The Croatian and Serbian transmission system operators are considering a possibility of further connecting Croatia with Serbia.

On the basis of the Plan for 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 in 2006 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 transport system operators signed an agreement on the construction of a pipeline that will connect these two countries and thereby provide the assurance of gas supply in the Republic of Croatia. Activities regarding the construction of the LNG terminal on the island of Krk, managed by a consortium of foreign companies, have also continued.

In order to ensure market relations, activities aimed at strengthening the administrative and technical capacities of the Croatian Energy Regulatory Agency, which at the moment counts 49 employees, and the Croatian Energy Regulatory Agency (HERA), which, pursuant to the new legislation, apart from the electricity market has become competent for natural gas market, have continued.

In the sector of oil and oil derivatives, in December 2009 the Croatian Compulsory Oil Stock Agency (HANDA) created the Programme of Activities of the HANDA aiming at ensuring the maintenance of the compulsory 90-day stock of oil and oil derivatives until 31 July 2012. At the moment the Republic of Croatia maintains the level of stock of oil and oil derivatives in line with the negotiating position dynamics. Preparation activities for construction of new warehouse capacities which will serve this purpose are in progress. Activities will be carried out in line with the Plan for Delivery, Dynamics of Formation and Replacement of Compulsory Stocks of Oil and Oil Derivatives, Storage Organisation and Regional Layout³².

On 16 October 2009, the Croatian Parliament adopted the Energy Strategy of the Republic of Croatia until 2020. The Strategy is harmonised with the EU energy policy. The primary objectives of the Strategy include competitiveness of the energy sector, energy supply safety and sustainable development. Furthermore, the EU objectives were transposed into the objectives of the national energy policy.

In December 2008, the Act on Energy Efficiency in Direct Consumption³³ was adopted, followed by the Act on Biofuels for Transport³⁴. In 2010, the adoption of the National Action Plan for Renewable Energy Sources until 2020 is expected, which will be drafted in compliance with the objectives set in the Energy Strategy of the Republic of Croatia until 2020.

³² Official Gazette 149/09

³³ Official Gazette 152/08

³⁴ Official Gazette 65/09

Parallel to the development of the new Strategy, the Republic of Croatia Energy Efficiency Programme until 2016 was prepared, along with the first National Action Plan for Energy Efficiency. Furthermore, the adoption of the National Potential for Cogeneration in the Republic of Croatia is expected in the first quarter of 2010. Based on guidelines from the National Action Plan for Energy Efficiency and in co-operation with the UNDP the implementation of the following programmes is in progress: 'House in Order' and 'Systematic Energy Management in Cities and Counties'. The action plan creates a comprehensive database on all public facilities and their energy consumption, which will provide insight into energy consumption in the entire public service sector.

4.1.6 Small and Medium-size Enterprises

In the first nine months of 2009, Croatian entrepreneurs conducted their businesses in unfavourable economic and financial conditions caused by the economic crisis. More specifically, in the period January-September 2009, 83,368 entrepreneurs submitted their financial reports, out of that 67,242 micro, 9,177 small and 1,438 medium-size economic entities, 992 co-operatives and 4,519 crafts – individual traders. Business results demonstrate decline in all of the basic business indicators (total revenue declined by 10.97%, revenue from sales declined by 11.46%, exports declined by 11.74% and expenditure declined by 9.15%). Small business entities realise majority of their revenue from sales in the country and therefore depend on domestic demand. A decline of 34.37% in gross-profit was recorded, while investments in long-term assets declined by 13.15%. A number of persons employed in small business entities in the period January-September 2009 recorded a decline of 0.9% in comparison to the same period of 2008. At the same time employment in small business entities expressed as a share in Croatian economy retained a high level of 66.3%. The main characteristic of the Croatian economy was a large concentration of the number of entrepreneurs and of the employed in trade and in manufacturing. In the structure of the Croatian economy, trade and manufacturing together account for almost half of the number of entrepreneurs and the employed. As regards other activities, in terms of the number of the employed, construction has an important role, followed by transport and warehousing and professional, scientific and technical activities.

The service of the Government of the Republic of Croatia for a quicker communication between entrepreneurs and citizens with state administration bodies – HITRO.HR, commemorates its fourth anniversary³⁵. By using services of 61 HTIRO.HR offices more than 30,000 companies and crafts were established. Out of a total number of newly-established companies, more than 2,000 were 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). In addition to accelerating the establishment procedure, the objective of the project e-Tvrtka is unification of the court and public notary practice and better

³⁵ Since end-August 2009, HITRO.HR has been awarded with a 'Good Practice Label', an award granted by the European Commission for the best European eGovernment solutions and it is included in the catalogue of renowned projects 'ePractice.eu', as a part of the 'European eGovernment Awards 2009' contest. At this year's Corporate Registries Forum conference in the Republic of South Africa HITRO.HR was pronounced as the best method of providing services in the field of company registration and the use and application of electronic solutions. Croatia's results outdid those of its competitors from 42 countries from Europe, Africa, Asia, Australia and New Zealand. Consequently, Croatia was, for the first time, classified among the best performers. On-line registration of companies, applied at commercial courts in co-operation with the Public Notary Chamber contributed most to the first position of HITRO.HR service.

transparency of the establishment procedure. In addition, it expanded to the service of establishing other types of companies and to reporting of a change in a company by electronic means.

The integrated implementation of the Programme of Incentives to Small and Medium-Size Enterprises 2008 – 2012 of the Government of the Republic of Croatia has been in progress since 18 April 2008. In strengthening competitive capacity of small and medium-size enterprises, a significant progress has been made by the established programme guidelines in the mid-term period 2008 – 2012, based on the target allocation of resources through various types of incentives³⁶. The measures for promoting competitiveness through networking in entrepreneurship have been implemented on an on-going basis and preparation of the Cluster Development Strategy is underway and is planned to be completed in 2010. In order to expedite and increase women's involvement in entrepreneurship (female unemployment exceeded 60% of total unemployment), the Strategy for Women's Entrepreneurship Development 2010 – 2013 will be adopted at the beginning of 2010, which will be followed by drafting of the action plan. Investments in development of entrepreneurial zones in units of local self-government will continue, as well as aid for operation and strengthening of developmental agencies, entrepreneurial centres and incubators and technological parks. The so-called soft incentives will be provided in a form of co-financing of promotional activities as regards operation of small enterprise associations, Croatia's participation in internationally important projects, management of the existing public e-services and keeping the State Aid Registry³⁷. The public-private dialogue forum established in 2008 will meet on a continuous basis, in accordance with the adopted objectives and activities. Favourable financing, including interest subsidies, in the conditions of reduced credits to small business will demand additional adjustments of the annual Operational Plans for Incentives to Small and Medium-size Enterprises³⁸. In the area of training for entrepreneurship, with an aim of enhancing competitiveness, projects are being implemented which promote entrepreneurship through life-long learning. The South-East European Regional Centre for Development of Entrepreneurial Competencies was established, which is a result of a years-long successful implementation of the EU principles of the Charter for Small Enterprises, regulating small and medium-size enterprises policies in the group of south-east European countries³⁹. Croatia is entrusted with the role of establishing an independent institution for the development of entrepreneurial competencies, in view of its leading position in the implementation of the principles of small and medium-size enterprises development.

The Croatian IT sector operates in accordance with the open market laws and the Republic of Croatia legislation, whereas domestic companies are exposed to fierce competition from the global economic entities, requiring adjustment to the business conditions on the international market. Broadband internet should be developed more intensely, since its inadequacy is already considered

³⁶ The Programme of Incentives to International Competitiveness and Internationalisation of Croatian Economy 2009 – 2010 was adopted, which provides the framework for the projects of incentives to strengthening international competitiveness and internationalisation of the Croatian economy.

³⁷ According to the preliminary results of the Global Entrepreneurship Monitor (GEM) 2007 – 2008 survey on entrepreneurial activity, Croatia took 24th place among 43 countries included in the survey. Total entrepreneurial activity index (TEA), which determines the percentage of persons whose entrepreneurial activity is shorter than 42 months in the adult population, has doubled in Croatia since 2002, implying that in 2008, out of each 100 persons 7.59% was engaged in an entrepreneurial activity.

³⁸ The Operational Plan for Incentives to Small and Medium-size Enterprises for 2009 provides for the implementation of a credit project for favourable financing of small enterprises 'Local projects for small enterprise development'. Under the aforementioned credit project, as a form of state aid, interests on entrepreneurial credits are subsidised and one of the credit purpose is modernisation of operations and job preservation. The credit line is being implemented in co-operation with counties and commercial banks and is directly focused on promoting regional economic development.

³⁹ Albania, Bosnia and Herzegovina, Montenegro, Kosovo/UNSCR 1244, Macedonia, Serbia, Turkey and the Republic of Croatia.

by the ICT entrepreneurs, who are exporters of IT and internet solutions, as an obstacle for spreading the business in and outside the region. By the Strategy for Broadband Internet Access Development, the Republic of Croatia fulfilled its primary objective – 500,000 users by the end of 2008. Accordingly, at the end of 2008, there were 683,207 broadband internet users in Croatia. The total density of broadband connections thus accounts for 15.39%. In 2009, the implementation of that Strategy will be assessed and a new strategic framework will be prepared, which will allow for further development of the broadband internet access and improvement of the overall competitiveness of the Croatian information society.

Entrepreneurial activity in Croatia is based on knowledge and innovations, competitiveness through product diversification, development of new products and export orientation. Since preparation of documents for the EU Structural Funds⁴⁰ has started, activities will be considered and implemented aimed at strengthening the Croatian Bank for Reconstruction and Development (HBOR)⁴¹, changing the role and tasks of the Croatian Agency for Small Business (HAMAG) and its function in implementing the guarantee schemes⁴², examining further possibilities for venture capital funds for entrepreneurial projects involving innovation and new technology and other forms of financing small business (micro loans, loans for beginners in entrepreneurship, etc.).

In accessing the EU market, a stronger need will arise for legal and implementing solutions regarding the issue of insolvency, ensuring payments within 30 days, etc. These are the issues of crucial importance for a small economy which is most adaptable to changes, but, at the same time, most sensitive to the access to sources of financing and disturbances in settling mutual liabilities of business entities. Regional competitiveness, strengthening of entrepreneurship in regions and preparation of institutions supporting entrepreneurship to support entrepreneurship and implement the projects that will be financed from the structural funds will be given adequate priority and support. The projects will be prepared and implemented to build capacity, human resources and expertise for using the EU funds and financial instruments, which will take place in the conditions of state administration reform.

⁴⁰ On 30 June 2008, the Government of the Republic of Croatia adopted a Decision on strategic and institutional framework for the use of the EU structural instruments in the Republic of Croatia. The Decision determines the EU structural instruments, strategic documents of the Republic of Croatia for the use of structural instruments, competent authorities for co-ordination of structural instruments, certification of payments under structural elements and audit and authorities competent for preparation and management of individual strategic documents. The strategic documents for the use of the EU structural instruments and which the Republic of Croatia will co-ordinate with the European Commission are the following: the National Strategic Reference Framework and Operational Programmes. In the Republic of Croatia, 15 operational programmes were established for the purpose of using the structural instruments. The operational programme for competitiveness and innovations is one of the programmes within the competence of the Ministry of the Economy, Labour and Entrepreneurship, which will in the preparation and management of that programme co-operate with the Ministry of Science, Education and Sports, the Business Innovation Centre of Croatia (BICRO d.o.o.) and the Croatian Agency for Small Business (HAMAG).

⁴¹ HBOR implements the Credit Programme to Improve Liquidity, which is aimed at achieving, maintaining and improving liquidity of the credit beneficiaries in the period of general financial instability. Commercial banks may grant credits to credit beneficiaries for settling their liabilities to suppliers, financial institutions and settling other short-term liabilities. HBOR also has a credit programme for financial restructuring. The objective of that programme is to change maturity of sources of funds by favourable long-term crediting, establish a long-term financial balance for the economic entities, improve business stability and performance, create higher-quality preconditions for an entry of an economic entity into new investments. Credits are granted based on a business plan (balance sheet, profit and loss account and cash flow statement projections), assessment of market and economic justification of a change in maturity of sources of funds. Credits are intended for investments directed at changing maturity of sources of funds in the economic entities' balance sheets).

⁴² In December 2008, the Government of the Republic of Croatia adopted the Decision which determines the guarantee potential of the Croatian Agency for Small Business in the amount of HRK 1 billion. The aforementioned decision increased the guarantee potential of HAMAG by additional HRK 500 million. About 50% of the guarantee potential is used. Since 2005, HAMAG has allowed, through the guarantees, for more than HRK 2.3 billion worth investments in the economy.

4.1.7 Public Private Partnership

The Government of the Republic of Croatia, upon the proposal of the Agency for Public Private Partnerships (hereinafter: the Agency) adopted four regulations on 7 May 2009: Regulation on the criteria for assessment and approval of the public private partnership projects²⁴, Regulation on the content of public private partnership contracts⁴³, Regulation on the supervision of implementation of the public private partnership projects⁴⁴ and the Regulation on training of participants in procedures for the preparation and implementation of public private partnership projects⁴⁵. In addition, for the purpose of more efficient and higher-quality proposals and implementations of the public private partnership projects (hereinafter: PPP), on 22 July 2009, the Public Private Partnership Guide was published. The Guide is primarily intended for public sector and it contains instructions for potential contracting authorities for high quality preparation and successful implementation of the PPP projects, in accordance with the Act on Public Private Partnerships⁴⁶, Concessions Act⁴⁷ and Public Procurement Act⁴⁸.

The implementing acts, the Regulation on the criteria for assessment and approval of the public private partnership projects, Regulation on the supervision of implementation of the public private partnership projects and Regulation on the content of public private partnership contracts, apart from prescribing the criteria for assessing, establishing and implementing the PPP projects and the adequate preparation and supervision of implementation of the PPP projects, envisage the central management of the PPP projects approval process by the Agency for PPP in co-operation with the Ministry of Finance. Consequently, sustainable and positive projects, in fiscal terms, are being developed, which ensure a long-term value for money and protection of rights and interests of public partners, as well as attraction of new investments. Compliance of PPP projects with positive regulations, budget projections and plans and sectoral developmental plans and strategies of the Agency for PPP and the Ministry of Finance provides evidence to investors of the project quality, which improves safety and sustainability of their investments.

In accordance with the Regulation on training of participants in procedures for the preparation and implementation of public private partnership projects, the Agency initiates the procedure of concluding co-operation agreements with the respective partner institutions, for the purpose of implementation of the prescribed programmes for persons participating in the preparation and implementation of the PPP projects within public bodies and for personnel of professional associations. The implementation of the planned training programmes will begin in the second quarter of 2010. The goal of this training is to improve the existing level of knowledge in this field in order to prepare and implement appropriately the strategic projects that are being implemented under the PPP model and to manage them more efficiently.

By the end of 2010, the adoption of the Ordinance on establishing and keeping the register of public private partnership contracts is expected, on the basis of which the procedure of establishing the Register will be carried out, which will be followed by the entry into Register of all the PPP contracts, including those concluded before the entry into force of the Act on Public Private Partnership and for which it has been assessed that they have PPP characteristics. Further education, primarily for the Agency employees, will be provided, in the mid-term period, through the project under the IPA 2007 programme, the implementation of which started on 24 November 2009. In addition, for the purpose of strengthening administrative capacity of the Agency, carrying

⁴³ Official Gazette 56/09

⁴⁴ Official Gazette 56/09

⁴⁵ Official Gazette 56/09

⁴⁶ Official Gazette 129/08

⁴⁷ Official Gazette 125/08

⁴⁸ Official Gazette 110/07 and 125/08

out of training programmes and other forms of employee training is planned. The final goal of these measures is to improve quality of public infrastructure and public services by combining resources, efforts and the know-how of both private and public sectors.

The PPP will develop as a part of the national policy priorities and priorities established by the PPP strategic developmental framework in the Republic of Croatia. The adopted regulations govern the procedure of assessing and approving the PPP projects, which is, among other things, based on their compliance with the sectoral development plans and strategies at all levels. In this manner, the application of the PPP model is ensured in the sectors of strategic interest, primarily in transport, energy and urban infrastructure, environmental protection and in the realisation of other projects in accordance with the needs of citizens and other social entities, for the satisfaction of which the public authority is responsible.

Successful establishment, implementation and development of PPP in the Republic of Croatia requires a broad public support, as a result of which, in the forthcoming period, efforts will be made to improve administrative capacity and awareness of PPP, primarily through various forms of training and, on the other hand, efforts will be made to reach a consensus of all the participants in the preparation and implementation of the PPP projects through media activities. All the aforementioned activities will contribute to maximising the benefits of that partnership relationship between the public and private sector, with an aim of contributing to further economic growth and meeting the objectives of infrastructure development and providing higher-quality public service to citizens.

4.2 FINANCIAL SECTOR

At the end of September 2009, total bank assets accounted for 77.6% of total assets of all financial intermediaries. In terms of share in total assets of all financial intermediaries, housing savings banks follow with a 1.5% share. Such a structure indicates 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 and 2009 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.

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

	2005	2006	2007	2008	September 2009
Banks	78.9	76.7	73.9	77.7	76.6
Open-end investment funds, net assets	2.7	4	6.4	2.1	2.1
Closed-end investment funds, net assets	1.1	1.4	1.7	0.9	0.9
Insurance companies	5	4.9	5	5.6	5.9
Housing savings banks	1.9	1.6	1.4	1.5	1.4
Compulsory pension funds, net assets	3.6	4	4.5	4.7	5.6
Voluntary pension funds, net assets	0.1	0.1	0.2	0.2	0.3
Credit unions	0.5	0.5	0.4	0.1	0.1
Leasing companies	6.2	6.8	6.5	7.2	7.1
Total	100	100	100	100	100

Source: Croatian National Bank, Ministry of Finance, HANFA

4.2.1 Banking Sector

At the end of 2009, 33 banks and 5 housing savings banks operated in Croatia. Their share in total assets of all financial intermediaries was about 78%. At the same time, the banking system was highly concentrated, 10 largest banks accounting for about 93% of total assets of all banks. Banks in majority foreign ownership predominate in the ownership structure, representing 90.5% of total bank assets, compared to 4.6% of bank assets in domestic state ownership and 4.9% of total bank assets in domestic private ownership.

In order to influence the reduction of loan growth, which is for the most part based on foreign borrowing of banks from their parent banks, the Croatian National Bank (hereinafter: the CNB) introduced several measures of credit control. However, in the second half of 2008, the CNB adjusted all its measures to the context of global financial crisis, so that individual decisions were abolished (marginal reserve requirement) or mitigated (reduction of reserve requirement, minimum cover of bank's foreign currency liabilities with liquid foreign currency claims). This has provided the banking system with additional liquidity in the conditions of decelerated credit activity.

By the application of the Act on Amendments to the Banking Act⁴⁹, i.e. Credit Union Act⁵⁰, allowing for a transformation of savings and loan co-operatives into savings banks or credit unions, the following was realised by the end of 2009:

- 76 savings and loan co-operatives decided to wind up their business;
- 1 savings and loan co-operative transformed into a savings bank;
- 27 savings and loan co-operatives transformed into credit unions;

The Credit Institutions Act⁵¹, implementing the provisions of the Capital Requirement Directive⁵², 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

⁴⁹ Official Gazette 141/06

⁵⁰ Official gazette 141/06

⁵¹ Official Gazette 117/08

⁵² 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.

Credit Institutions Act⁵³. The Act prescribes that credit institutions must have minimum capital adequacy of 12%. The new capital adequacy calculation will apply as of 31 March 2010, since the CNB have transposed the amendments to the Capital Requirement Directive, adopted in 2009 at the EU level, into the relevant subordinate legislation at the beginning of 2010⁵⁴.

Furthermore, according to Directive 2009/110/EC the electronic money institutions are no longer considered credit institutions, so that in 2010 the new Act on Electronic Money Institutions will begin to be prepared.

For the purpose of defining closer co-operation between supervisory institutions, the Memorandum of understanding for financial crisis management was signed by the CNB, the Croatian Financial Services Supervisory Agency and the Ministry of Finance.

In early 2007, the members of the National Payment System Committee (hereinafter: the Committee): Ministry of Finance, Croatian National Bank, Croatian Chamber of the Economy and Croatian Banking Association (hereinafter: HUB), concluded that the Single Euro Payment Area (SEPA) adjustment project is of national interest and that the Committee will further debate, where necessary, on all the issues relevant for its implementation and successful functioning. For this purpose, an on-going exchange of all information and data regarding the establishment of SEPA has been agreed between the CNB and HUB. The Committee has also expanded its scope of activity, so that, in addition to the national payment system, in the course of its operation the Committee will also debate issues pertaining to the external payment system. Finally, in October 2009, the Payment System Act⁵⁵ was adopted, which transposed into the Croatian legislation Directive on payment services in the internal market⁵⁶ and which will enter into force in 2011.

4.2.2 Non-banking Sector

On 1 October 2009, the authorisation for conducting insurance business was issued to 27 insurance companies and 2 reinsurance companies in the Republic of Croatia. In addition, there was 25 insurance intermediation companies (insurance brokers), while 220 intermediaries conducted insurance intermediation business as natural persons. 186 insurance representation companies (insurance agents) and 168 crafts for insurance representation were engaged in insurance representation business (insurance agency), whereas 6,983 insurance agents conducted insurance representation business as natural persons (including insurance agents in the bank channel).

At the 44 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 Agency), while 26 banks obtained the authorisation by the Croatian National Bank for performing the tasks of representation in insurance, upon a prior approval by the Agency.

⁵³ Official Gazette 117/08, 74/09 and 153/09; In addition to the Capital Requirement Directive 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.

⁵⁴ Amendments to directives have been published in the Official Gazette, issue No. 2/10

⁵⁵ Official Gazette 133/09

⁵⁶ Directive 2007/64/EC on payment services in the internal market

As of 1 October 2009, 4 compulsory pension funds operated in Croatia, total net assets of which amounted to HRK 27.5 billion by late September 2009. An intervention fund, entitled the 'Stability Fund', has been operative since October 2008. That fund was established as a reaction to the proposal of compulsory pension funds and their management companies, in view of unfavourable trends on the global financial market, and it operates in a form of an open-end investment fund with a private offer into which compulsory pension funds and their management companies make contributions based on their market shares. A compulsory pension fund which would use the intervention fund assets may only use these assets for making payments to unit holders.

As of 1 October 2009, 6 open-end voluntary pension funds were active, with total assets of HRK 1.04 billion, and 15 closed-end voluntary pension funds with total assets of HRK 198.6 million. In addition to pension funds, 132 open-end investment funds were active on the capital market, with total net assets of HRK 10.4 billion, as well as 4 closed-end investment funds with HRK 1.4 billion in assets and 6 closed-end real estate investment funds with total assets of HRK 552.6 million⁵⁷.

In addition, two funds were established under the special law – the Fund of Croatian Homeland War Veterans and members of their Families with HRK 2.3 billion in assets and the Pensioners' Fund with assets of HRK 3.5 billion.

In the course of 2009, the Croatian legislation was aligned in the non-banking sector and for that purpose the following acts were adopted: Act on Amendments to the Insurance Act⁵⁸, the Act on Amendments to the Act on Compulsory Insurances within the Transport Sector⁵⁹ and Act on Amendments to the Capital Market Act⁶⁰, as well as the respective subordinate legislation.

The Agency, as a supervisory authority regarding the operation the capital market participants, revises and improves its approach to supervision, which will be based, in the forthcoming period, on risk management control and internal controls of the supervised entities. Furthermore, the preparation of methodology for the on-site supervision of investment companies is underway, which will be based on the risk assessment of individual companies.

The Agency plans to continue its work on the supervision methodology, consultations with the industry and training of participants in the capital market for the purpose of adjusting to the European standards and to monitor the adoption of regulations on the EU level, interpretations of the European Commission and the Committee of European Securities Regulators (CESR) and to update and adjust its activities accordingly.

In addition, the Agency plans to intensify its cooperation with other EU regulators and to implement activities pertaining to monitoring the dynamics of adopting regulations in the EU on an on-going basis and their timely implementation into the legislation of the Republic of Croatia. The Agency has signed several memoranda of understanding with regulators from other countries and after detailed assessment of the Agency's request for signing the Multilateral Memorandum of Understanding with the members of International Organisation of Securities Commissions (IOSCO) this document has been signed as well.

With the aim of stimulating confidence in the financial market and contributing to the smooth functioning of the financial market, the project for educating the general public and investors has been carried out, encompassing a wide range of the Agency's activities – educational activities intended for government institutions and professional public, a broad educational multimedia campaign called 'Right to Know', etc.

⁵⁷ Closed-end investment funds assets as at 31 August 2009.

⁵⁸ Official Gazette 82/09

⁵⁹ Official Gazette 36/09 and 75/09

⁶⁰ Official Gazette 74/09

4.3 LABOUR MARKET

In 2009, as a result of the global economic crisis, the economic activity in the Republic of Croatia decelerated, which was reflected in reduced employment, i.e. unemployment growth.

According to the data of the Central Bureau of Statistics, registered employment amounted to 1,472,217 at the end of November 2009, which is 3.8% less than at the end of the same month in the previous year. Unemployment registered with the Croatian Employment Service was 291,545 at the end of December 2009, a 21.2% growth relative to the end of the same month of the previous year.

For the purpose of preventing a further increase in unemployment, i.e. further termination of employment contracts, and avoiding incurrence of additional costs of workers' layoffs, it was necessary to introduce new flexibility measures, in order to allow business entities to adjust their business to the new circumstances, which would, at the same time, ensure for the largest number of workers to retain their labour-law status, thus preventing a sharp unemployment growth.

Accordingly, for the purpose of preserving jobs with those employers who were forced to reduce their economic activities due to economic and financial crisis, the Job Protection Act was adopted in July 2009⁶¹. In accordance with the aforementioned act, the aid is available to the employers who have shortened the working hours for all workers or for workers in individual organisational units, instead of terminating their employment contracts.

In addition, harmonisation of the Labour Act with the respective *acquis communautaire* was completed, by preparing the new Proposal of the Labour Act, which was approved by the Government of the Republic of Croatia at its session on 22 October 2009, following a positive evaluation by the European Commission, and was forwarded to the Croatian Parliament for adoption. The Labour Act was adopted by the Croatian Parliament on 4 December 2009 and entered into force on 1 January 2010.

4.3.1 Stimulating Employment

In May 2008, the Government of the Republic of Croatia and the European Commission signed the Joint Assessment of Employment Policy Priorities (JAP), on the basis of which a new cycle of active employment measures began in May 2009, with the preparation and implementation of the National Employment Promotion Plan 2009–2010. The recommendations for the improvement of existing measures and the preparation of new ones were presented to the working groups drawing-up the National Plan, which are a result of the component 2 of the PHARE 2005 project, and in the preparation of which, along with the state administration bodies, social partners on the national level and in four counties (the City of Zagreb, Šibenik-Knin, Međimurje and Osijek-Baranja) also participated. In addition, the European terminology and qualification of employment policy measures were also presented, according to the EUROSTAT database methodology. In the course of preparation of the National Plan two joint conferences were held, related to the implementation of JAP, where the first Report on the JAP implementation for the period from May 2008 to April 2009 was submitted.

The National Employment Promotion Plan (2009 – 2010) establishes the main principles of the state employment policy, as well as responsibilities and tasks of the competent state administration bodies and public institutions.

⁶¹ Official Gazette 94/09

The Croatian Employment Service is an institution responsible for the measures aimed at promoting employment, education while being employed, education based on work needs and co-financing of employment in 'socially useful' work for the long-term unemployed and other unemployed, who are faced with social exclusion and who have found themselves in an unfavourable position on the labour market. In 2009, 6,296 persons were encompassed by the measures, out of which 46.3% were women. Out of total encompassed persons, 692 persons were employed through employment aid, 644 were included in the training programme for a specific employer (training aid), 2,025 were included in the training programme for a non-specific employer, whereas 1,935 persons were employed under the Public Work Programme.

4.3.2 Social Security System

Legal Protection of Unemployed Persons

In the course of preparation and adoption of the Act on Employment Mediation and Unemployment Rights in 2008, it was justified to link the amount of financial compensation for unemployment to the level of previously earned employees' salaries, taking into account fiscal capacity of the state budget and a multi-year trend of a continuous decrease in the rate and number of the unemployed, i.e. the number of financial compensation beneficiaries. Accordingly, for the first three months the maximum amount of financial compensation amounted to 70% of the previous gross salary after deduction of contributions; for the remaining period until one year it amounted to 50%, whereas the permanent compensation until beginning of employment or pension amounted to 40%. On the other hand, the same Act determined the maximum amount of unemployment compensation relative to the average salary paid in the Republic of Croatia in the previous year (HRK 5,178 in 2008), i.e. any unemployed person that entered the records with the above-average salary was entitled to a compensation relative to the average, rather than his/her own salary. Accordingly, the maximum amount of financial compensation amounted to 70% (HRK 3,625) for the first three months, 50% (HRK 2,589) for the remaining period until one year, whereas the permanent compensation until beginning of employment or pension amounted to 40% (HRK 2,071).

However, as a result of the effects of the global crisis on the economy and labour market in the Republic of Croatia, the number of beneficiaries of financial compensation for unemployment increased significantly. In June 2009, the number of compensation beneficiaries in the records of the Croatian Employment Service rose by 22.4% compared to the same month in the previous year. Therefore, taking into account the overall macroeconomic developments, it was necessary to reduce temporarily the highest level of that compensation, for the purpose of restricting the fiscal consequences of the increased number of beneficiaries of financial compensation for unemployment.

For the purpose of maintaining the fiscally sustainable existential and socially acceptable minimum, the Act on Amendments to the Act on Employment Mediation and Unemployment Rights⁶² was adopted in July 2009, which linked the maximum amount of financial compensation to the movements in the amount of the prescribed minimum salary (about HRK 2 252), reflecting the previously mentioned socially acceptable and fiscally sustainable standard. By the application of these amendments to the Act, the maximum amount of financial compensation for the first three months now amounts to 100% of the prescribed minimum salary after deduction of contributions (HRK 2,251), 80% or HRK 1,801 for the remaining period until one year, whereas permanent compensation until beginning of employment or pension amounts to 60% or HRK 1,350. Due to those amendments by the end of 2009 budgetary savings in the amount of around HRK 15 million

⁶² Official Gazette 94/09

were realised, whereas in 2010 those savings will amount to HRK 30 million and will be directed at the employment incentives.

Pension Insurance

In the field of compulsory pension insurance based on generation solidarity (I pillar), since the beginning of the pension reform, i.e. 1 January 1999, the level of pension has been monitored on an on-going basis and especially the level of early retirement pension, disability pension due to professional incapacity for work in the course of beneficiary's employment and minimum pension, which were raised for the purpose of improving the financial and social security of their beneficiaries, starting from 1 January 2008, by the Amendments to the Pension Insurance Act⁶³. As of the date of application of the aforementioned Act, as well as the Act on the Supplement to a Pension Earned under the Pension Insurance Act⁶⁴, no significant increase in the share of pension expenditures in GDP has been observed relative to the previous period. More specifically, in 2008, the share of pension expenditure in GDP rose mildly to 9.8% from 9.7% recorded in 2007. 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 in costs of the application of the aforementioned acts of approximately 0.35% - 0.4% of GDP annually.

As regards the minimum pension, which is the basic instrument for realising the principle of solidarity and redistribution in the system of generation solidarity, although a fall in the number of minimum pension beneficiaries was recorded from 39.5% in 2007 to 21.8% in 2008, the possibilities are being considered for changing the method of its financing and achievement by reviewing the income and property status.

By the application of the Ordinance on the procedure of convalidating decisions and individual acts⁶⁵ from the field of pension insurance, the access to pension insurance rights was allowed by acknowledging the qualifying period completed on the territory of the Republic of Croatia which was under the UN protection. Further progress is expected in resolving that issue, since the applications for convalidation of decisions and individual acts can be submitted within an unlimited period of time.

In compulsory pension insurance based on generation solidarity a further financial consolidation is expected, i.e. a systematic improvement of financial position of the future pension beneficiaries, for whom, since 2009, pension is computed taking into account salaries earned in the entire period of working life, which stimulates prolonged work and exercising of pension rights at a later stage. A moderate increase in pension beneficiaries with a completed qualifying period of 40 years or more in the total number of pensioners has already been recorded, from 10.9% in 2006 to 11.5% in 2008. Further measures will be taken with an aim of improving fiscal and social sustainability of the pension system.

In view of unfavourable demographic movements, possibilities are being considered for providing equal conditions for acquiring rights to old-age pension and early retirement pension for both men and women, and for increasing the age limit for entitlement to old-age pension.

For the purpose of enhancing compulsory pension insurance based on capitalised savings (II pillar), i.e. ensuring adequate pensions for the future generation of pensioners, collection of the relevant

⁶³ Official Gazette 79/07

⁶⁴ Official Gazette 79/07

⁶⁵ Official Gazette 53/08

indicators is underway to create an analytical basis for considering possibilities within the pension insurance second pillar.

Since personal accounts management and capital market investments create high administrative costs, it should be noted that for the purpose of more rational operation of institutions, a centralised collection of contributions and unified administration of personal accounts in the second pillar are prescribed, as well as joining a pension fund in the offices of the Central Registry of Insured Persons (REGOS), which reduces operating costs of pension fund management companies, especially marketing costs, and ensures a reliable inflow of members and contributions. This, along with funds' assets growth, under the assumption of stable capital market, creates a possibility of a gradual reduction of fees in compulsory pension insurance based on capitalised savings. Activities will continue with an aim of enhancing the process of data compilation and transfer to all the entities in the business environment and improving the quality of electronic data exchange among institutions, since transparent and efficient management of pension system assets, availability and exchange of data also represent the priorities in the pension system reform implementation.

As regards voluntary pension insurance based on capitalised savings (III pillar), despite unfavourable economic conditions, both in Croatia and in the world, increased interest in participation in that form of additional source of income of citizens in the future has been recorded (6 open-end voluntary pension funds and 15 closed-end voluntary pension funds). Efforts will be made to find the appropriate solutions for promoting the participation in that form of pension insurance.

The pension system reform 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. 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

In accordance with the objectives of the Social Benefit Reform Strategy and the Amendments to the Social Welfare Act⁶⁶, the financial position of all the groups of beneficiaries has been improved (as of 1 November 2008, a new base, increased by 25%, for the calculation of all social contributions has been applied), procedures for exercising the rights have been simplified, a total number of rights has been reduced, whereas the rights have been introduced that are co-ordinated with respect to the beneficiary category and the rights' objectives.

Great efforts are still aimed at controlling and restricting the growth of expenses in the most important social protection systems. The Government of the Republic of Croatia has accepted the view that in the state budget, as in the local budgets, the level of funds should be maintained required for ensuring material rights of socially disadvantaged groups (social welfare recipients, unemployed, elderly persons without pension, low-pension pensioners, etc.). However, in view of the economic crisis and change in macroeconomic conditions, measures have been taken regarding better targeting of individual social benefits. More specifically, the measure of free transport for

⁶⁶ Act on Amendments to the Social Welfare Act (Official Gazette 79/07).

secondary school students and free textbooks for all students was abolished, except for those students of poorer financial status.

In statistical terms, in 2009, a slight fall in the number of permanent support recipients was recorded, in comparison with 2008 and 2007. Accordingly, in June 2007, 107,945 recipients were registered (2.43% of the Republic of Croatia population), in 2008, 97,878 recipients (2.21% of the Republic of Croatia population), compared to 93,754 recipients in June 2009 (2.11%). Although the statistical data in that period are more difficult to be compared due to the application of the new regulation, it can be concluded that an increase in the number of permanent support recipients in the social support system was curbed and that the number of those recipients actually dropped in that period. Nevertheless, at the same time, entitlement to assistance and care allowance increased, amounting to 73,748 recipients in June 2007, 75,738 in June 2008 and 78,136 in June 2009. This is a category right exercised on the basis of a physical or mental handicap or a permanent change in the health status, whereas the income census is higher than the one prescribed for exercising the right to permanent support.

As a result of the economic and financial situation, in mid-2010 a slight rise in the number of permanent support recipients can be expected, following a period of exercising the right to a cash benefit on the basis of employment termination, i.e. losing a job. Accordingly, ensuring a minimum living standard for the most disadvantaged part of the population and satisfying the needs of socially vulnerable groups represents the objective that will attempted to be fulfilled in the forthcoming period. The aforementioned objective arises from the Strategic Development Framework 2006 – 2013, Joint Memorandum on Social Inclusion of the Republic of Croatia and the National Strategy for Equalising Opportunities for Disabled Persons 2007 – 2015.

For the purpose of a further development of the social welfare system by improving the service quality through decentralisation and deinstitutionalisation, the Ministry of Health and Social Welfare takes further activities aimed at delegating powers to the units of local and regional self-government. The social services decentralisation requirement is based on the recommendation of the European Charter on Local Self-Government that public powers should be at a level as close as possible to citizens and on the Constitution of the Republic of Croatia, which classifies the welfare services within the terms of reference of the local self-government. The new Social Welfare Act, the adoption of which is planned in 2010, should promote decentralisation in the field of social welfare, guaranteeing that funds for ensuring the minimum living standard of the most disadvantaged part of the population will continue to be provided at the central level.

By introducing the mechanism of local social planning, expanding of the social service providers' network for all the population groups will be ensured, as well as a diverse offer of extra-institutional forms of care. In addition to network expansion, the minimum standards for social service quality are introduced for all the providers ensuring the uniform quality in providing the services.

The new work organisation of the social welfare centres, according to the 'one-stop-office' principle, which should be introduced into all the social welfare centres on the territory of the Republic of Croatia until 2012, will ensure a higher-quality approach for recipients of social welfare rights and services. The new organisation model should allow for a better provision of information to citizens and greater cohesion between service providers at the local level. IT networking of the social welfare system, along with statistics alignment with the EUROSTAT methodology will improve monitoring, facilitate control, as well as ensure cohesion and data exchange with other systems with which the social welfare system exchanges information.

As a part of the pre-accession and accession activities in the field of social inclusion, the Ministry of Health and Social Welfare co-ordinates the pre-accession activities based on JIM⁶⁷; participates in the preparation and implementation of the operational programmes under the IPA⁶⁸ programme within the sectoral competence and prepares and implements the projects financed under the IPA programme. Under Component IV - Human Resources Development of IPA programme, the project 'Establishing Support in Social Integration and Employment of Disadvantaged and Marginalized Groups'⁶⁹ is being implemented. The project's objective is to promote social inclusion of the long-term unemployed social welfare recipients by providing support to their access to the labour market in the Republic of Croatia. One part of the project implementation refers to allocation of non-refundable grants, in the total amount of EUR 1.5 million, while the other part refers to contracting the services, the purpose of which is to develop a user-oriented approach in the target group approach to the labour market, strengthening inter-sectoral co-operation between the participants and improving the quality of service provision of the social welfare centres. EUR 225,000 is earmarked in the state budget for the aforementioned purpose, or 15% of the total allocated non-refundable grants.

The systematic protection of rights and interests of children and vulnerable groups is an ongoing measure that is being implemented through the application of the adopted national plans, programmes, strategies and policies. In the course of 2008 and 2009 the following conventions were prepared for signing and ratification: Convention on Jurisdiction, Applicable Law, Recognition, Enforcement and Co-operation in Respect of Parental Responsibility and Measures for the Protection of Children (Hague, 1996), Convention on Contact Concerning Children (Strasbourg, 2003), Convention on the Legal Status of Children Born out of Wedlock (Strasbourg, 1975), Convention on Child Protection and Cooperation Regarding International Adoption (Hague, 1993) and European Convention on the Adoption of Children (revised) (Strasbourg, 2008). In 2010, the National Strategy for the Protection of Children from Abuse and Neglect, which is currently being prepared, is planned to be adopted and the Protocol on the procedure regarding serious neglect of a parent, adoptive parent, guardian or another person pertaining to the responsibility to provide for or care for a child and the National Plan against the sexual abuse of children are planned to be prepared and adopted.

Protection of Motherhood and Family Allowance

In the implementation of the 2006 National Population Policy⁷⁰ measures aimed at the improvement of the family aid system, the new Act on Maternity and Parental Benefits has been applied in the Republic of Croatia since 1 January 2009, payment of child support has been continuously ensured and the operation of family centres has continued.

Investments in the protection of motherhood and parenthood are a result of the implementation of the National Population Policy and application of the Act on Maternity and Parental Benefits which encompassed, in contrast to the previous legislative solutions, all mothers/parents, regardless of their labour law status: employed and self-employed, parents earning other income, farmers outside the profit or income tax system and unemployed parents and parents outside the labour system. More specifically, different regulations were applied to different categories of beneficiaries in the previous period. In accordance with the new legislative solution, payment of benefits to the employed parents in the course of using additional maternity or parental leave is linked to the budget base. In addition, new legal assumptions were created for a flexible use of parental leave

⁶⁷ Joint Memorandum on Social Inclusion of the Republic of Croatia (Joint Inclusion Memorandum /JIM/)

⁶⁸ Instrument for Pre-accession Assistance

⁶⁹ Establishing Support in Social Integration and Employment of Disadvantaged and Marginalized Groups

⁷⁰ Official Gazette 132/06

until a child has turned 8 years old, maternity and parental leave may be used as an entitlement to a part-time work, while parental leave may be used by both parents at the same time, alternatively and in parts. Furthermore, increased investments are also related to the fact that, for the purpose of harmonisation with the *acquis communautaire*, that Act has expanded the individual rights that used to be exercised only on the basis of paid employment to other potential beneficiaries, such as those entitled on the basis of child adoption or entitled to a leave or part-time work for the purpose of caring for a child with severely damaged health. The Ministry of Family Affairs, War Veterans and Intergenerational Solidarity supervises the implementation of the Act.

In contrast to maternity and parental benefits, the role of which is primarily procreative, a child support has a triple role: prevention of poverty, improving and maintaining quality of children's family and a procreative effect. A child support is linked to total income earned in the previous calendar year, i.e. income census of 50% of the budget base.

In 2009, the work of 17 county family centres continued for the purpose of improving family services, particularly those services focused on preventing the development of unwanted family relations, and providing advisory support in family planning, care and provision for children and in work with young people.

4.4 AGRICULTURAL SECTOR

Agricultural Land

Management of the state-owned agricultural land is regulated by the Agricultural Land Act⁷¹, adopted by the end of 2008. The types of management include: lease, long-term lease and sale of state-owned agricultural land and concession for fish ponds. Management is, to the largest extent, within the competence of the units of local self-government and is performed in two stages, as follows:

1. The units of local self-government, upon the approval by the Ministry of Agriculture, Fisheries and Rural Development, are obliged to develop and adopt programmes for state-owned agricultural land management (hereinafter: the programmes) which are based on the cadastral data, containing the information concerning the area of state-owned agricultural land designated for return, lease, long-term lease, sale, concession and other purposes. Management of the state-owned agricultural land is not possible if the units of local self-government have not adopted the programmes, upon the approval by the Ministry of Agriculture, Fisheries and Rural Development. A total of 349 units of local self-government have adopted the programmes so far, upon the approval by the Ministry of Agriculture, Fisheries and Rural Development, encompassing a total of 537,929 ha of agricultural land in state ownership, whereas 73 units of local self-government do not have a state-owned agricultural land on their territory.
2. Units of local self-government are obliged, upon the approval by the Ministry of Agriculture, Fisheries and Rural Development, to carry out public tenders for lease and sale of state-owned agricultural land, in accordance with the programmes, whereas the public tender for a long-term lease is carried out by the Long-Term Lease Committee. A total of 180,000 ha of state-owned agricultural land has so far been managed under the programme, whereas approximately 150,000 ha of agricultural land is being used on the basis of a one-year lease contract.

⁷¹ Official Gazette 152/08

Privately-owned agricultural land transactions are conducted in accordance with the general regulations governing the real estate transactions starting from 1 January 2010. As of the previously mentioned date, the part of the Agricultural Land Act⁷² entered into force, which regulates sale and lease of private agricultural land, for the purpose of providing support to the improvement of the agricultural farm structure (land area increase and clustering of cadastral plots of agricultural land into bigger parcels).

In early 2009, the Government of the Republic of Croatia adopted the Programme of Consolidation of Agricultural Land in the Republic of Croatia 2009 – 2021, containing a detailed elaboration of the following activities and measures that will be implemented in the aforementioned period:

- Legislative activities: preparation and adoption of the Land Consolidation Act and implementation of consolidation; alignment of tax legislation with the Agricultural Land Act and Land Consolidation Act; establishment and operation of the National Committee for monitoring the application and harmonisation of legislation governing the issue of agricultural land and land administration;
- Direct implementing measures: establishment and operation of the Agency for Agricultural Land and establishment and operation of the land fund instrument; establishment and maintenance of the 'Agricultural Land IT System'; adoption and application of the Operational Programme for agricultural land consolidation and development; implementation of the campaign of informing the public and land policy education;
- Indirect implementing measures consisting of active participation of the Ministry of Agriculture, Fisheries and Rural Development in the activities of bringing order in land registry and cadastral status of the agricultural land.

The objective of the 2009 – 2021 land policy is expected to be met by the implementation of the aforementioned activities and measures. The objective is to consolidate the average agricultural farm, i.e. agricultural land used by the agricultural farm, by increasing the area by 5 ha on average and by reducing the number of productive parcels (one or more clustered cadastral plots) by approximately 50%.

Privatisation of State-owned Companies

The last large agricultural and food-processing company in majority state ownership, agricultural and industrial conglomerate 'Vupik' d.d. (VUPIK d.d.) from Vukovar, has been privatised. In September 2009, the Croatian Privatisation Fund announced a public call for tenders to purchase 87.98% of shares of this company under special conditions.

The management board of the Croatian Privatisation Fund, out of four tenders received, selected the tender of 'Agrokor' d.d. company as successful. The Government of the Republic of Croatia, at its session held on 12 November 2009, accepted the Proposal of the Decision on accepting the tender of the tenderer 'Agrokor' d.d. for purchase of 1,251,163 shares of company 'VUPIK' d.d., Vukovar. Purchasing the shares, 'Agrokor' d.d. accepted an obligation to assume 20% of arrears of 'VUPIK' d.d. towards public creditors, to retain all of the 847 employed persons for the period of three years and to give over 25%-plus-one share to employees of 'VUPIK' d.d. without remuneration. In the period of five years 'Agrokor' d.d. will invest around HRK 430 million into 'VUPIK' d.d.

Regulation of the Agricultural and Food Products Market

⁷² Official Gazette 152/08

For the purpose of harmonising the market mechanisms for particular agricultural products with the market organisation in the EU, in December 2009 the Act on Regulation of the Agricultural Products Market was adopted⁷³. The Act lays down the manner and measures for regulation of the market for particular sectors of agricultural products, conditions for activation of particular market regulation measures, beneficiaries in implementation of those measures, controls of those measures, monitoring and inspection.

Activities concerning the creation of the vineyard cadastre, development of methodology guidelines for collection and entering data on vineyards, producers, vine production and vine stocks will continue in the framework of Land Parcel Identification System (LPIS)⁷⁴. The full functionality of the vineyard cadastre is expected by the end of 2010 at the same time as the setting up of LPIS.

In the cattle production area, activities related to implementation of the single system of compulsory animal identification have continued. In 2010 development of the legal framework for classification and assessment of sheep carcasses on the slaughter-line, as well as improvement of the beef tracking system which would enable monitoring products from farms to tables is planned.

State Aid in Agriculture

In the first half of 2009, the bulk of the state aid to agriculture was administered in accordance with the Act on State Aid to Agriculture and Fisheries⁷⁵. In July 2009, the new Act on State Aid to Agriculture and Rural Development⁷⁶ was adopted, which gradually aligns the domestic aid scheme with the aid regulated by the EU Common Agricultural Policy, aiming at a gradual transition to a system of a single farm payment. That Act regulates state aid to agriculture in a form of direct payments to agricultural farms and rural development measures. This act regulates state aid in agriculture in the form of direct payments to farms as well as rural development measure. In the first half of 2010 it is planned to adopt a new act which would regulate the means of direct payments during the entire pre-accession period. In addition, preparations and capacity building will be intensified (especially in the Agriculture, Fisheries and Rural Development Paying Agency) aiming at the implementation of the single payment scheme as of the date of Croatia's accession to the EU.

Since the beginning of 2010 the new Act on Excise Duties⁷⁷ 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 Agriculture⁷⁸ lays down the legal framework for formulation of right to use gas oils under privileged conditions, whereas the Ordinance on application of Act on Excise Duties Related to Gas Oil Coloured Blue for Use in Agriculture, Fisheries and Aquaculture⁷⁹ lays down detailed conditions for exercise of that right.

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. The total budget for market-pricing policy measures under the first pillar is planned to be decreased

⁷³ Official Gazette 149/09

⁷⁴ Land Parcel Identification System is being set up based on digital maps applying the Geographic information system method and represents the graphic records of all agricultural lands used for agricultural production

⁷⁵ Official Gazette 87/02, 117/03, 82/04, 12/05, 85/06, 141/06, 134/07, 85/08 and 4/09

⁷⁶ Official Gazette 83/09

⁷⁷ Official Gazette 83/09

⁷⁸ Official Gazette 149/09

⁷⁹ Official Gazette 1/10

gradually, while aids relating to measures for rural development under the second pillar are to be increased considerably.

Rural Development

Pursuant to the Act on State Aid to Agriculture and Rural Development⁸⁰, the Ministry of Agriculture, Fisheries and Rural Development will prepare the National Rural Development Programme. The Programme will encompass the national measures of rural development aiming at enhancing competitiveness of agricultural farms, preservation and improvement of the environment and biological diversity, as well as improvement of the living conditions in the rural area.

The use of the EU pre-accession programmes has continued. The duration period of the pre-accession programme SAPARD expired on 31 December 2009. Four tenders were carried out and 41 projects worth HRK 307,386,602.22 were contracted. Out of that amount, aid from the SAPARD programme amounts to HRK 135,616,059.30. All aid funds are financed by the Republic of Croatia and the EU in the 25% (Republic of Croatia) to 75% (EU) ratio. In 2010 monitoring of implementation of projects contracted under the SAPARD programme will continue.

The IPARD programme was prepared for the new programme period (2007 – 2013) and funds were earmarked in the total amount of EUR 184.4 million (HRK 1.3 billion).

The managing authority for SAPARD/IPARD programmes and Agriculture, Fisheries and Rural Development Paying Agency⁸¹, as managing and implementing body, have prepared documentation required for the implementation of the programmes, while delegation of authorities is soon expected, which creates the preconditions for inviting the first tender.

The measures accredited in the first accreditation cycle are the following: Investments in Agricultural Holdings for the Purpose of Restructuring and Achieving EU standards, Investment in Processing and Marketing Agricultural and Fish Products for the Purpose of Restructuring and Reaching EU Standards and Rural Infrastructure Improvement and Development.

The second accreditation package under the IPARD programme will comprise the following measures: Technical Assistance and Diversification and Development of Rural Economic Activities, whereas the following measures will constitute the third accreditation package: Preparation and Implementation of Local Rural Development Strategies (LEADER) and Activities for the Improvement of Agro-Environment.

Phytosanitary Area

In 2009, phytosanitary inspection continued supervising the establishment of the phytosanitary register and implementing the plant passport system in plant owners registered in the register (fruit and grapevine propagating material, seed potato), and these activities will continue parallel to the establishment of the phytosanitary register and introduction of the plant passport system for the remaining categories of plant owners that are subject to registration in the register. In the aforementioned period, further improvement of knowledge and skills of phytosanitary inspectors continued, as well as equipping of the phytosanitary office.

The general objectives in this field include: further improvement of quality of monitoring organisms harmful to plants and measures for their prevention; full establishment of the plant

⁸⁰ Official Gazette 83/09

⁸¹ The Agency was established by the Act on Establishing Agriculture, Fisheries and Rural Development Paying Agency.

passport system and continued supervision of the establishment of the phytosanitary register and the plant passport system; establishment of a single information and communication system of the entire phytosanitary office, which will allow for high-quality administration of phytosanitary register, data on performed inspections of the registered plant owners and other databases; improvement of communication with agricultural producers and other entities interested in phytosanitary area. In addition, the objective is to improve the infrastructure and equipment at phytosanitary border crossings which will remain operative following the Republic of Croatia's accession to the EU. In the forthcoming period, a further strengthening of phytosanitary inspection capacity is planned by increasing the number of phytosanitary inspectors, depending on the needs identified on-site, and by a further enhancement of knowledge and work conditions of phytosanitary inspectors, as well as providing the inspectors with IT equipment and cars.

In the field of plant protection products, the general objectives encompass a further development of the new system of plant protection products registration, as well as reassessment (reregistration) of plant protection products, enhancement of the plant protection product post-registration control programmes, supervision of proper application of plant protection products and pesticide residues in foodstuff, which will considerably improve the level of human and environmental safety from hazardous substances. A significant progress has been made in harmonisation and application of legislation.

In the 2010 – 2012 period, the activities are planned related to strengthening of administrative capacity of agricultural inspection which supervises sale and application of plant protection products. Employment of new inspectors, training and further providing of inspectors with IT equipment and cars are planned. In the course of 2010, training of agricultural inspectors under TAIEX programme is planned, for the purpose of enhancing knowledge and professional skills related to post-registration control of plant protection products and supervision of proper application of plant protection products.

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 and in particular the activities relating to official controls are as follows:

- The creation of a Multi-Annual Plan of Controls, which will be completed in the third quarter of 2010;
- The creation of annual plans of official controls, which are based on the analysis of risks relating to stipulated time limits and division of responsibilities;

The Annual plan of official controls of products of animal origin has been created in co-operation with the Veterinary Directorate of the MAFRD.

- The creation of documented procedures for carrying out official controls.

Procedures have been set up for carrying out official controls in the area of food and feed safety as follows:

- The Procedure for carrying out official controls in the area of food and feed safety;
- Operational instructions for inspections in the area of food and feed safety;
- Operational instructions for audits in the area of food and feed safety.

The procedures listed above will be posted on the MAFRD web site in January 2010.

- The Ordinance on the rapid alert system for food and feed⁸² has been created;
- The creation of a Plan of incident management and/or potential incident management relating to food and feed that will be implemented together with the Ordinance on the rapid alert system for food and feed, whose publication is planned for March 2010;
- The creation of a Guide on traceability, withdrawal and recall of food intended for entities in the food business, whose publication is planned for March 2010;
- The creation of the Ordinance on authorisation of official and reference laboratories for food and feed and animal health, whose publication is planned in 2010;
- The Ordinance on microbiological criteria for food has been created and posted on the MAFRD web site;
- The creation of the Ordinance on rules of establishment of the national network of institutions, conditions and criteria for inclusion on the institution list and financing rules, whose publication is planned for February 2010;
- The Ordinance on the issuing of scientific opinions and providing scientific and technical assistance has been created;⁸³

In 2009, the process of alignment with the relevant EU regulations continued. In accordance with the Food Act,⁸⁴ a regulation was adopted, governing the labelling of nutritional values of foodstuffs,⁸⁵ as well as a series of regulations governing the quality requirements for individual food categories, thus contributing to market liberalisation and ensuring free movement of goods⁸⁶. A Guide on nutritional value labelling of foodstuffs has been created and published on the MAFRD web site.

In addition, the Act on Designations of Origin, Geographical Indications and the Traditional Speciality Logo for Agricultural Products and Foodstuffs⁸⁷ has been adopted. The said Act lays down the responsibilities of the existing agricultural inspection and quality inspection in the segment of implementing laws and subordinate legislation which govern the area of registration and protection of agricultural products and foodstuffs with one of these labels. The Amendments to the Act on Designations of Origin, Geographical Indications and the Traditional Speciality Logo for Agricultural Products and Foodstuffs⁸⁸ amended the national procedure for registration and protection of agricultural products and foodstuffs with the traditional speciality logo and provided for a more efficient system of establishing compliance in accordance with the practice applied at the national level in the EU Member States. In addition, amendments to the procedure of applying

⁸² Official Gazette 134/09

⁸³ Official Gazette 130/09

⁸⁴ Official Gazette 46/07 and 155/08

⁸⁵ Ordinance on nutritional value labelling of foodstuffs (Official Gazette 29/09)

⁸⁶ Ordinance on fruit juices and similar products intended for human consumption (Official Gazette 20/09); Ordinance on milk and dairy products (Official Gazette 20/09); Ordinance on sugars and methods of analysis of sugars intended for human consumption (Official Gazette 39/09); Ordinance on methods for determining sugar quality during emergency sugar purchase (Official Gazette 39/09); Ordinance on the quality of tuna and Atlantic bonito products (Official Gazette 56/09); Ordinance on natural mineral and natural spring waters (Official Gazette 57/09, 85/09); Ordinance on sampling methods and analyses of edible casein and caseinates (Official Gazette 70/09); Ordinance on honey (Official Gazette 93/09); Ordinance on the quality of sardine products (Official Gazette 96/09); Ordinance on methods of sampling and analysis of partly or wholly dehydrated milk intended for human consumption (Official Gazette 112/09)

⁸⁷ Official Gazette 84/08, 75/09 and 107/09

⁸⁸ Official Gazette 75/09

for registration and submitting objections at the EU level have been adopted. Subordinate legislation has been adopted, regulating the said area in more detail⁸⁹.

Activities planned during the reference period are related to the strengthening of administrative capacity of the agricultural inspection and the food quality inspection, which includes employment of new inspectors, inspector training through projects financed under TAIEX and further procurement of new IT equipment and cars for inspectors.

Veterinary Area

The process of legislative alignment in the veterinary area continued in 2009 in accordance with the "Strategy for transfer, adoption and implementation of the *acquis communautaire* for Chapter 12 - Food Safety, Veterinary and Phytosanitary Policy.

The new system of control of the transport of animals was introduced on 1 September 2008 with the entry into force of the Ordinance on veterinary health checks of live animals in domestic transport and the certificate of animal health and place of origin⁹⁰, which stipulates that all farms holding cattle, swine, sheep, goats, equidae, poultry and rabbits have to be subject to veterinary checks.

The veterinary checks of farms continued through 2009 with their main objectives including the following: the entry of all farms in the register of farms, informing all animal owners of their obligations, harmonisation of data from the Single bovine registry with the actual situation on farms, the creation of a database that will be used for the purpose of more rational utilisation of resources in the application of comprehensive veterinary legislation and development of a high-quality infrastructure to be used in providing training to animal owners in relation to requirements of multisegmented harmonisation they will be required to comply with in order to be eligible for state subsidies.

As regards the establishment of the Central Veterinary Information System (CVIS) in accordance with the Veterinary Act⁹¹ as the unified system of registries and computer programmes aimed at ensuring efficient access to data and at providing timely decision-making support and efficient management in all segments of the veterinary services, an international tender for the best provider is under way. The databases are expected to become operational early in 2011.

Fisheries

The Act on Structural Support and Market Regulation in Fisheries⁹² created the legal framework for the adoption of the Operational programme for implementing structural policy measures and creating administrative capacity as the most important element of the implementation of structural measures in fisheries.

In order to establish a system of structural measures in fisheries in 2010 it is planned to adopt a National Strategic Plan and an Operational Plan which will, based on the situation, priorities and objectives identify measures to be financed in the fisheries sector, in accordance with the *acquis*

⁸⁹ Ordinance on traditional speciality guaranteed logos for agricultural and food (Official Gazette 82/09) and Ordinance on designations of origin, geographical indications and the traditional speciality logo for agricultural products and foodstuffs (Official Gazette 88/09)

⁹⁰ Official Gazette 87/08

⁹¹ Official Gazette 41/07

⁹² Official Gazette 153/09

communautaire. 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 will be created by using technical assistance under the IPA 2009.

In order to complete the establishment of the vessel monitoring system (VMS) it is planned to open a new public tender for the procurement of the complete system for monitoring vessels in the 15-18 meter category, thus completing the procedure of equipping all fishing vessels that are required to have the said system under the EU law.

In 2010, it is planned to create a National Plan of Data Collection, aiming at ensuring a single system of collecting data on sustainable management of marine bio-resources in accordance with the latest EU regulations. The said programme will be created under the IPA 2009.

The strengthening of monitoring and control 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 strengthening of the fisheries inspection. As part of the strengthening of monitoring and control at sea it envisaged to take important steps in the training of inspectors, procurement of equipment (vehicles, vessels, technical equipment) in the coming three year period as well as connecting different services that carry out control under the Marine Fisheries Act⁹³.

4.5 PUBLIC ADMINISTRATION REFORM

The public administration reform continued in 2009. The Ministry of Public Administration that was established in July 2009 is *inter alia* responsible for steering reforms and the modernisation process in the public administration, thus ensuring the preconditions for strengthening of management and administrative capacities of the body responsible for public administration reform.

The new General Administrative Procedure Act⁹⁴ was adopted in March 2009, entering into force on 1 January 2010.

Within the framework of the implementation of the new Administrative Inspection Act⁹⁵ thorough inspection has been carried out on an ongoing basis. In addition, the organisational structure of the administrative inspection has been strengthened through the establishment of a separate organisation within the Ministry of Public Administration.

In 2009, state administration bodies that participated in the project of functional analysis started implementing the recommendations received under the project. The majority of recommendations relating to organisational changes, professional education and training of employees, informatisation and strengthening of certain functions has been implemented.

At the end of December 2009 the Government of the Republic of Croatia adopted the Civil service human resources development strategy 2009 - 2012. The Strategy was prepared in co-operation of the Ministry of Public Administration and experts engaged in the project 'Support to Development of the Civil Service Human Resources Development Strategy' within the framework of Danish bilateral assistance. The Strategy presents the current situation related to human resources, general and specific objectives, means and indicators of its implementation.

⁹³ Official Gazette 74/94, 57/96, 46/97 – consolidated text and 48/05

⁹⁴ Official Gazette 47/09

⁹⁵ Official Gazette 63/08

Continued training of civil servants is provided by the Civil Servants Training Centre of the Ministry of Public Administration. Until October 2009, 4,643 civil servants attended different training programmes in the Centre.

A draft proposal of the Act on the Salaries of Civil Servants was sent to the Croatian Parliament for adoption at the beginning of 2009, while a draft proposal of the Act on Salaries in Local and Regional Self-government Units was sent to the Croatian Parliament for adoption in July 2009. Within the framework of the procedure of adoption of the Act on the Salaries of Civil Servants objections arose as regards the need to regulate the assessment criteria in more detail. Therefore SIGMA was required to prepare a comparative study on best assessment practices in the EU Member States, which was submitted to the Ministry of Public Administration in September 2009. Since the Final Proposal of the Act on the Salaries of Civil Servants was not sent to the adoption procedure in the Croatian Parliament by the expiry of the time limit for second reading, according to the Rulebook of the Croatian Parliament the adoption procedure is deemed to be suspended. However, the Government of the Republic of Croatia did not give up on the adoption of an act regulating the salaries of civil servants and it is considering the possibility of adopting a single act on salaries in the entire public sector (state administration, local self-government and public administration).

By adopting the Strategy for development of electronic administration in the period 2009-2012 and the plan of activities in 2009 and 2010 by the Government at its session held in January 2009 additional incentive was provided to the strengthening of the implementation of the appropriate information and communication technology (ICT) in supporting business processes and rationalising the operation of the state administration. In the course of 2009, the maintenance and further development of the central web portal of the public administration "My Administration" as well as the computer and communication network 'HITRO-net' continued and activities planned for 2009 were carried out. Project tasks have been completed, aiming at the creation of an interoperability framework, as well as the paperless office model (e-Office), the model of a central system for authorisation and authentication and the project for managing knowledge, projects and resources of ICT in state administration.

In the forthcoming period special attention will be given to the regulation of the system of salaries in the public sector and to training as regards the implementation of the new General Administrative Procedure Act. In November and December 2009 five one-day seminars were held in co-operation with SIGMA related to the application of the new General Administrative Procedure Act and preparations are underway for the provision of training under the IPA 2008 - Assistance in transition and institution building component. In addition, it is planned to provide regular training on the administrative procedure in the Civil Servants Training Centre of the Ministry of Public Administration.

Last but not least, special procedural acts will be harmonised with the new General Administrative Procedure Act, which will be carried out within the framework of Danish bilateral Assistance under the project "Preparation for implementation of the new General Administrative Procedure Act – alignment of the existing procedural acts" whose completion is planned in May 2010.

At the same time, measures will be taken aimed at further development of the human resource system, regulation of public agencies and continued training of state and local civil servants and employees, as well as creation of a more efficient system of local self-government.

In the area of application of ICT in state administration there are, at present, no proscribed norms, standards or frameworks to be adhered to by projects or services based on ICT. On one hand, this enables rational management of budgetary funds earmarked for investments in ICT, while on the

other it spurs the creation of unconnected IT islands and additional administrative hurdles in the provision of public services.

By the implementation of e-Administration Development Strategy in 2010 it is intended to solve the issue of mentioned imperfections by developing specific models which will, each in its own segment, enable the improvement of state administration efficiency. The final objective is to strengthen the use of ICT in state administration and its communication with Croatian citizens and the economy. This will set the framework for and the objectives of new and existing activities of e-Administration, putting the emphasis on user satisfaction, rationalisation of administrative procedures and provision of modern electronic services.

Based on completed project tasks the creation of technical specifications for individual parts of the e-Administration system will continue in order to enable further development and establishment of specific electronic administration models: the paperless office model (e-Office); the central system authorisation and authentication model and the model for managing knowledge, projects and ICT resources in state administration. In addition, documents will be drawn up, enabling the creation of a framework for interoperability in state administration and an analysis and adjustment of the legal framework will be carried out, aiming at further development and implementation of new models of the electronic administration system.

For the purpose of achieving the said objectives, the following measures are planned to be undertaken:

- Alignment of procedural law with the new General Administrative Procedure Act;
- Application of a human resources development strategy;
- Adjustment of the system of public agencies in accordance with the EU standards;
- Regulation of salaries in the public sector;
- Establishment of IT supported central register of civil servants;
- Analysis of the performance of local self-government units and the existing territorial organisation;
- Implementation of activities envisaged under the Implementing plan of the e-Administration Development Strategy 2009-2012 planned for 2010;
- Preparation of the first annual report on the implementation of the e-Administration Development Strategy 2009-2012 for 2009;
- Preparation of a semi-annual report on the implementation of the e-Administration Development Strategy 2009-2012.

The alignment of procedural law with the new General Administrative Procedure Act will ensure consistency and simplify administrative procedures, facilitate exercising of citizens' rights and reduce procedure costs. Further development of human resources, strengthening of responsibility, ethics, competences and motivation of civil servants in the provision of public services, regulation of the system of public agencies, and development of a more efficient system of local self-government will ensure further strengthening of the efficiency of public administration and reduce operating costs.

4.6 OTHER REFORMS

4.6.1 Development of a Knowledge-based Society

In accordance with the basic documents setting forth the educational and economic policies and strategies of the Republic of Croatia, their implementation continued in the previous period.

The objectives specified in the Education System Development Plan 2005-2010 have been realised, with a result that the trend of increased enrolment of children in pre-school educational programmes has continued, whereas the implementation of national pedagogical standards has systematically ensured the quality of education.

Special accent was put on the implementation of the Vocational Education Act⁹⁶ and the Vocational Education and Training System Development Strategy of the Republic of Croatia 2008-2013. In this connection, vocational programmes will be further updated and adjusted to the needs of the economy, labour market and society as a whole, and lifelong learning will be systematically promoted.

The creation of the Croatian Qualification Framework (CQF) is underway in line with the adopted Action Plan 2008-2012. Work on the CQF will continue at the national level and within the IPA programme in the forthcoming period. The qualification standards will be developed, together with curriculum examples related to these qualifications and expert instructions for various participants, and training sessions for work group members will be organised.

The quality of secondary education has been systematically maintained: national exams will continue to be carried out in the forthcoming period and the state secondary school-leaving exam will be conducted for the first time in the school year 2009/2010. In addition, self-evaluation has continued to be introduced into schools and electronic databases have been upgraded (VETIS, e-Matica).

In 2009, Croatia participated in the PISA examination of the knowledge and skills of students, and the PIRLS examination is planned to be conducted in the forthcoming period, aiming to enable a more realistic evaluation of Croatian students' achievements and learning outcomes and their comparison with those of their peers from other European systems.

The Education and Teacher Training Agency has adopted the Vocational Training Strategy 2009-2013 and will in this connection set up an information system for the reporting and processing of data on activities related to the improvement of human resources in education institutions. The Agency for Vocational Education and Training will also redefine the system of vocational education of teachers and their occupational promotion.

The Bologna process has been systematically implemented. The integration of the university will be continued, study programmes will be re-evaluated, external evaluation of higher education institutions will be organised and student and teacher mobility will be improved.

Following the adoption of the Act on the National Foundation for Science, Higher Education and Technological Development of the Republic of Croatia, the restructuring of the National Foundation commenced. In the forthcoming period, special efforts will be made to reform the financing system for scientific and research projects. In the previous period, several pilot projects for the establishment of centres of excellence were defined and the preparations for their launching will continue. Their aim will be to improve the usability of the existing scientific equipment for the scientific community and economy, promote excellence in research and the cooperation between science and the economy, while special efforts will be devoted to improving the cooperation with

⁹⁶ Official Gazette 30/09

the European Research Area. In 2009, the Council for the National Innovation System was intensively strengthening the National Innovation System in order to promote the transfer of knowledge to the economy and private sector. The Action Plan for the mobility of researchers will remove the obstacles to mobility and enable greater intersectoral and international mobility.

4.6.2 Health Care Reform

The package of reform measures implemented in 2009, aimed at introducing new sources of financing and improving the system of control of health care system expenditures, resulted in the financial stabilisation of the health care system. The debt of the health care system was reduced by HRK 700 million and the expenditures of the Croatian Health Insurance Institute (CHII) were brought into line with planned revenues. Expenditure control will be further strengthened by abolishing CHII's medical commissions and introducing an institute of authorised doctors as of 1 October 2009. Through continuous work in the field, in primary health care offices (at least twice a month), authorised doctors will be able to exercise better control of expenditures on medicines and sick leave. The ex-ante control of primary health care expenditures was thus established, in addition to the already existing ex-post control.

The number of employees absent from work on sick leave dropped from 58,238 to 54,636 a day. As a result, the debt of the CHII, which amounted to more than HRK 154 million in 2008, was completely settled in 2009. Therefore, the CHII has no outstanding debts towards economic entities. This trend is expected to continue in 2010.

The Ministry of Health and Social Welfare has signed a contract on completing the informatisation of primary health care, aiming at realising the 'paperless doctor' project and fully enabling the electronic operation of the health care system (e-health care).

The project of reorganising emergency medical assistance and investing in health care has been started. The total investment of the project, launched by the Government of the Republic of Croatia with the World Bank loan assistance, is EUR 90 million. The Croatian Institute of Emergency Medical Services has also been established. The final aim of the project is to establish an integrated system of emergency hospital admissions and increase the efficiency and speed of response of out-of-hospital emergency medical services (achieve the average time interval between receipt of an emergency call and arrival at the scene of 10 minutes in urban areas and 20 minutes in rural areas for 80% of the calls, and the average time interval between an emergency call and arrival to hospital of 75 minutes, and in 80% of the cases of less than 60 minutes).

The Agency for Quality and Accreditation in Health Care became operational in 2009. The aim of the Agency is to provide for quality and safety in the health care system through planning, implementing and evaluating measures to ensure, improve, promote and monitor health care quality at all levels of the health care system.

In addition, a project has been launched with an aim of developing a 'master plan' for health care institutions and a human resource strategy for the health care sector with a plan of investment in human resources in health care.

It is expected that the introduction of the requirement to establish a central appointment unit at all hospitals and the setting up of the department for the compilation and maintenance of national waiting lists at the Ministry of Health and Social Welfare will result in a significant rationalisation and better utilisation of hospital capacities. The procedure of procurement of medical equipment and refurbishment of hospital facilities has also started, which will considerably improve the accessibility of health care, especially in the treatment of malignant diseases.

4.6.3 Judicial Reform

A significant number of measures from the Action Plan associated with the Judicial System Reform Strategy aimed at the strengthening of independence, impartiality, professionalism and efficiency of the judicial system were implemented in 2009. In December 2009 the Judicial Academy Act was adopted along with the package of laws which introduce objective and transparent criteria for entering into the judicial profession. The average time needed for entry of ownership rights in the land registry was additionally reduced. The majority of procedural laws was amended aiming at reducing time limits for court procedure. In order to further enhance the efficiency of courts, the Strategic Study on Improving the Efficiency of Enforcement Proceedings and Introducing Public Enforcement Agents was adopted in July 2009. Aiming at the further development of the conciliation system as an alternative way of in-court and out-of-court resolution of disputes, the Act on Amendments to the Act on Conciliation⁹⁷ was adopted in July. In addition, the preparatory stage for the extension of the Integrated Court Case Management System (ICMS) to the remaining courts was completed. The Case Tracking System (CTS) for state attorney's offices was implemented at pilot locations of the state attorney's offices in Zagreb, Zlatar, Karlovac and Pula. The successful realisation of the e-company pilot project which has been implemented at all the commercial courts of the Republic of Croatia was further extended. The rationalisation of the municipal courts network has been carried out in accordance with the Ordinance⁹⁸. In 2009, 8 permanent offices were physically moved to the seats of municipal courts. The new Criminal Procedure Act, which significantly changes the criminal procedure in terms of efficiency and effectiveness, entered into force as of 1 July 2009 in relation to crimes within the jurisdiction of the Office for the Prevention of Corruption and Organised Crime (USKOK). Organisational and institutional changes were also effected by the establishment of special offices and bodies for the implementation of measures to fight against corruption and organised crime, the so-called USKOK vertical (the police, State Attorney's Office and courts). In 2009, the new Probation Act which improves the prison system was adopted and the Directorate for Probation was established within the Ministry of Justice⁹⁹.

The 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. In order for the stated goals to be attained, measures from the Action Plan associated with the Judicial System Reform Strategy will be revised in 2010.

Pursuant to the Judicial Academy Act¹⁰⁰ which entered into force on 1 January 2010, the Judicial Academy has become an independent institution, and the State School for Judicial Officials is being established. The Judicial Academy will conduct the initial training and preparation of candidates for autonomous, responsible, independent and impartial performance of judicial duties, professional training of trainees and court advisors, and continuous professional improvement of judicial officials. On 1 October 2010, the School will enrol the first generation of trainees for a two-year professional training period.

The most important segment of the judicial system reform relates to the efficiency improvement of the judiciary. One of the measures aimed at the judiciary efficiency improvement is the introduction of the ICMS at additional 60 courts in 2010. The rationalisation of the municipal and misdemeanour court network as well as the network of State Attorney's Offices will continue to be

⁹⁷ Official Gazette 79/09

⁹⁸ Ordinance on determining time limits for the provision of working, spatial, technical and other conditions at the seats of merged courts was enacted on 1 October 2008 (Official Gazette 112/08)

⁹⁹ Establishment of the Directorate for Probation is part of the Judicial System Reform Strategy and the Strategy of Establishment of the Croatian National Probation Service: Five Year Strategy, 2008-2012

¹⁰⁰ Official Gazette 153/09

implemented in the forthcoming period. In 2010 the rationalisation of county and commercial courts network will be implemented. In line with the strategic framework for the reform of the enforcement system¹⁰¹ a new Enforcement Act and a new Act on Public Enforcement Agents will be prepared in 2010. Thereby, the enforcement system of the Republic of Croatia will be thoroughly reformed.

The remaining provisions of the new Criminal Procedure Act, adopted in December 2008, which incorporate thorough changes and require considerable technical and organisational adjustments, will enter into effect on 1 September 2011.

Aiming at continued combating of corruption, the measures from the Action Plan of the Anti-Corruption Strategy will be revised.

The Directorate for Probation will establish a professional organisation capable of providing professional services in accordance with the law.

4.6.4 Environmental Protection

Aiming at the rationalisation and improving the efficiency and cost-effectiveness of the environmental impact assessment procedure, the Government of the Republic of Croatia adopted the Regulation on amendments to the Regulation on the environmental impact assessment¹⁰², thereby reducing time limits for the procedure, except for the part related to information and participation of the public. In 2009, guidelines on preparing studies on the environmental impact of the projects of exploitation of mineral raw materials were prepared and published. A proposal for guidelines on the projects of wind power plants was compiled and submitted for interdepartmental co-ordination. Guidelines on the participation of the public in environmental impact assessment procedures will be drafted in the first half of 2010. 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 and education for the employees of competent county bodies will continue to be organised. In 2009, the Croatian Environment Agency (CEA) drafted a proposal of the National List of Indicators comprising 266 indicators. Activities will continue on the implementation and coordination of the Environmental Protection Information System (EPIS) and its components, as well as on the integration of the existing information systems and databases on specific thematic areas and sub-areas within the EPIS. The CEA has been preparing a Report on the State of the Environment in the Republic of Croatia covering the period 2005-2008. The Report will be completed by the end of 2010. In 2010, work will also continue on defining and co-ordinating all the criteria for the selection and designation of reference centres for all thematic areas and on drafting a proposal of the decision on their establishment.

Activities will continue on the implementation of the Kyoto Protocol, both with regard to the obligations related to reducing greenhouse gas emission and those related to reporting on emissions. In late 2008, implementing regulations were adopted on greenhouse gas emission quotas and emission trading¹⁰³, as well as on the implementation of the Kyoto Protocol flexible mechanisms¹⁰⁴. In June 2009, the Government of the Republic of Croatia adopted the Plan for

¹⁰¹ Strategic Study on Improving the Efficiency of Enforcement Proceedings and Introducing Private Enforcement Agents

¹⁰² Official Gazette 67/09

¹⁰³ Regulation on greenhouse gas emission quotas and the method of emission allowance trading. (Official Gazette 142/08)

¹⁰⁴ Regulation on implementation of the Kyoto Protocol flexible mechanisms (Official Gazette 142/08)

allocation of greenhouse gas emission quotas in the Republic of Croatia¹⁰⁵ In December 2009, the Greenhouse Gas Register became operational as the procedure of connecting it with the International Transaction Log (ITL) was completed. The trading system will be established in two phases: in the first phase the entities subject to the requirement will obtain emission permits, and in the period 2010-2012 they will be monitoring emissions from their plants and submitting verified reports. Following Croatia's accession to the EU, the plants will be allocated quotas in the accounts in the Register and the Croatian Emission Trading System will be connected with the EU Emission Trading System. An implementation regulation on the conditions for performing the activities related to the verification of reports on plant emissions will be adopted in 2010.

As regards air quality, the implementation of the measures from the Air Quality Protection and Improvement Plan¹⁰⁶ will continue to be monitored. The remaining 12 stations for continuous air quality monitoring within the National Air Quality Monitoring Network were established in 2009, which was financed from the state budget. The stations' measuring equipment is procured under the PHARE 2006 project. The stations are expected to be put into operation in the first half of 2010. As of 1 January 2010, air quality will be monitored, and the stations within the National Network maintained and serviced, by the Meteorological and Hydrological Service. In December 2009, the Government of the Republic of Croatia adopted the Programme for gradual emission reduction of certain pollutants in the Republic of Croatia for the period until the end of 2010, with projections for the period 2010-2020¹⁰⁷. In early 2010, the Ministry will prepare the Action Plan for Reduction of Air Pollution by Ground-Level Ozone. The Action plan for Reduction of Air Pollution by Suspended Particles and Nitrogen Oxides in the Areas and Settled Areas of the Republic of Croatia in which Limit and Target Values are Exceeded will be prepared in 2010.

In the field of waste management, activities were continued on the rehabilitation and closing of waste disposal sites, with the rehabilitation of 63 waste disposal sites completed so far. 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. The public procurement procedure is underway for the construction of the Bikarac Waste Management Centre (WMC) in Šibenik-Knin County, co-financed under the ISPA programme in the amount of EUR 6.0 million. In 2009, agreements were concluded with the European Commission on the co-financing of two WMC construction projects, in Istria County and in Primorje-Gorski Kotar County. Additional WMC construction projects to be co-financed from the EU funds are in the preparatory phase. The implementation of the Phare 2006 project, aimed at improving hazardous waste management, is underway.

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. December 2009 saw the adoption of the new Water Act¹⁰⁸ and Water Management Financing Act¹⁰⁹, which will provide the basis for the adoption of subordinate legislation aimed at strengthening and reforming the existing water management financing system, as well as increasing the annual funding. The allocation of funds from the state budget, grants, loans and the EU assistance funds for the period 2010-2012 is envisaged for the following projects: the realisation of capital water supply projects; capital projects of the protection of water and sea against pollution; capital irrigation projects; regional project for the management of the Neretva and Trebišnjica rivers, implemented in cooperation with Bosnia and Herzegovina; the ISPA project 'Programme for

¹⁰⁵ Official Gazette 76/09

¹⁰⁶ Air Quality Protection and Improvement Plan in the Republic of Croatia for the period 2008-2011 (Official Gazette 61/08)

¹⁰⁷ Official Gazette 152/09

¹⁰⁸ Official Gazette 153/09

¹⁰⁹ Official Gazette 153/09

Water and Waste Water Karlovac' and the ISPA technical assistance for the preparation of projects under the IPA programme; Inland Waters Project and IPA projects Slavonski Brod and Knin-Drniš.

As regards sea quality, the Regulation on sea bathing water quality¹¹⁰, redefining standards for bathing water quality on sea beaches and establishing limit values for microbiological parameters and other characteristics of the sea, as well as management measures, has been in effect since 1 January 2009. A unified database for entering, processing and evaluating testing results, as well as for reporting and informing the public on sea bathing water quality has been developed. The database became operational at the beginning of the season of sea water quality assessment in 2009, during which the public had access to the sea water quality assessment results by means of a Google Maps browser, developed especially for that purpose. The sea bathing water quality profile, also planned to be entered into the database, is under preparation, as well as the annual report, leaflets and map on sea bathing water quality on the beaches of the Croatian Adriatic. Activities were continued on the implementation of the Project against Pollution of Water in the Coastal Area. Within its activities, the EPA will continue with the establishment and development of the Water Quality IT System and the IT System 'More' and establish a connection with other databases and the Water Information System for Europe (WISE).

In the field of nature protection, the priorities for the period 2010-2012 include completing the process of alignment of the legislation with the *acquis communautaire*, establishing the necessary implementing mechanisms and building up the administrative capacity at all levels by employing new experts and providing training to existing and new employees. Special attention will be given to completing the proposal for the EU ecological network NATURA 2000 and creating management plans for these areas, as well as to establishing monitoring systems. The project 'Institutional Strengthening and Implementation of the NATURA 2000 Ecological Network in Croatia' under the PHARE 2005 programme was completed in 2009. The project included conducting consultation activities with sectors and interested participants, drafting management plans for NATURA 2000 areas (2 pilot projects), conducting expert training programmes related to the appropriate assessment of effects on NATURA 2000 areas and implementing numerous activities aimed at raising public awareness of the proposal of NATURA 2000 areas. The plans for 2010 include continuing expert activities on defining the proposal for the NATURA 2000 Ecological Network. It is also envisaged to carry out part of the activities aiming at the establishment of the NATURA 2000 Ecological Network through the implementation of IPA projects in 2010. 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, by which time the Regulation on internationally important ecological areas will have been completed and the Regulation on ecological network declaration¹¹¹ amended. In the forthcoming period, work will continue on the establishment of a unified nature protection information system and protection of new areas pursuant to the Nature Protection Act¹¹².

As regards the control of industrial contamination, the Regulation on the procedure of establishing combined environmental conditions¹¹³ entered into force on 31 March 2009. The CARDS 2004 project, which contributed to the strengthening of administrative capacities for the implementation of the IPPC Directive¹¹⁴, was completed in June 2009. With an aim to further enhance the capacity of the industrial sector to implement the IPPC Directive, a project under the IPA I programme was proposed in 2009 to provide support to the operators of industrial plants required to obtain IPPC

¹¹⁰ Official Gazette 73/08

¹¹¹ Official Gazette 109/07

¹¹² Official Gazette 70/05 and 139/08

¹¹³ Official Gazette 114/08

¹¹⁴ Council Directive 96/61/EC concerning integrated pollution prevention and control

permits, and to other participants in the permit issuance procedure. The start of the project implementation is envisaged for the fourth quarter of 2010. In 2009, the EPA established four databases (the Environmental Pollution Register, Register of Installations in Which Dangerous Substances Have Been Identified, Inventory of Inquest Registers for Reported Major Accidents, Inventory of Inquest Registers for Operating Permits and Licences) within the Plant Emissions Information System (PEIS). The development and upgrading of these databases will be continued and reporting will be improved. Promotional activities will continue for the Eco-Management and Audit Scheme (EMAS) to be introduced into companies and organisations.

In the area of chemicals, plans for 2010 include the adoption of subordinate legislation to regulate the area of hazardous chemicals whose transportation has been forbidden or restricted and, in accordance with the REACH Regulation, the classification, labelling and packaging of hazardous chemicals. In the area of biocidal products, the Ordinance on amendments to the Ordinance on the list of existing active substances permitted in biocidal products and the Ordinance on amendments to the Ordinance on the list of existing active substances not permitted in biocidal products are planned to be enacted in 2010.

In the area of GMO, plans for 2010 include making amendments to existing 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 new Noise Protection Act¹¹⁵ was adopted in 2009, in accordance to which the production of strategic noise maps and action plans will be continued.

In the field of forestry, the compilation of the 'Conceptual and Operational Plan of National Forest Resources Inventory of the Republic of Croatia' has been completed. The finalisation and data presentation are planned for the beginning of 2010. The Register of Forestry Fires is established and has been in use since 1 January 2009. An analysis of the applicability of the Register will be made in the first quarter of 2010, possible deficiencies will be removed and improvements to the Registry made. The Register of Forest Ecosystems Damages will contain around ten sub-registers which are in the development stage. The basic database on the damage of forest ecosystems is established and it will be further developed in the form of registers. The project for improving the implementation of fire-prevention measures aimed at reducing the number of fires is expected to be launched in 2010. The existing National Forest Policy and Strategy will be revised in 2010 and 2011 and the National Forest Programme will be created afterwards.

¹¹⁵ Official Gazette 30/09

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 new Competition Act	<ul style="list-style-type: none"> Adoption of Regulation on block exemption in the transport sector Adoption of Regulation on the procedure and criteria for imposing and calculating penalties Adoption of Regulation on criteria for reducing penalties or acquittal from penalties 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 	IV quarter 2010
Efficient implementation of competition-related legislation	<ul style="list-style-type: none"> Training on the application of new legislation for employees of the Croatian Competition Agency, other regulatory bodies and the judiciary (through the IPA 2007 programme twinning project) Training on the application of new legislation for students, local business community, bodies of local authorities and the public in general (through the IPA 2007 programme service agreement) 	2010-2011
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 procedures prescribed by the Regulation on state aid 	Continuously
Efficient implementation of state aid legislation	<ul style="list-style-type: none"> Completion of state aid approval procedure for Croatian shipyards Professional training of employees of the Croatian Competition Agency and providers of state aid (on central and local levels) through a project in the framework of IPA 2007 programme 	2010-2011
5.1.2. Privatisation		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Privatisation of the largest share of the remaining portfolio of the Croatian Privatisation Fund	<ul style="list-style-type: none"> Transformation of the Croatian Privatisation Fund, introduction of new models of privatisation and preparation for sale of companies in majority ownership 	2010
Privatisation of five shipyards and one subsidiary	<ul style="list-style-type: none"> Announcement of the second round of tender procedure 	2010
Further privatisation of majority stakes in companies	<ul style="list-style-type: none"> Intensification of activities related to public tender announcements 	Until privatisation completion
Further privatisation of the Croatian Railways	<ul style="list-style-type: none"> Sale of subsidiary companies of the Croatian Railways 	Until privatisation completion
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 2010
Restructuring and modernisation of railway companies	<ul style="list-style-type: none"> Preparation and definition of restructuring monitoring indicators 	Continuously
Implementation of the Railway Infrastructure National Program	<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
Privatisation aimed at ensuring preconditions for successful functioning of shipyards in the future applying current measures of economic policy which are in line with the economic policy of the EU	<ul style="list-style-type: none"> Inviting a tender for privatisation of companies from the shipbuilding sector Implementation of restructuring programmes (depending on the privatisation results) 	2010 (the second round of tender procedure by 15 February 2010) Continuously
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 Adjustment of the infrastructure to the needs of the market Oil derivatives - increase the level of reserves in oil and oil derivatives so that they reach the EU levels and conduct fuel extraction in accordance with the EU standards 	Continuously
5.1.6. Small and medium-size enterprises		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Lifelong learning in entrepreneurship	<ul style="list-style-type: none"> Project of the national learning programme for entrepreneurship in formal and informal education Training in electronic business South East European Centre for Entrepreneurial Learning (SEECCEL) Co-financing of universities with specialist entrepreneurial programmes Pupils' co-operatives and pupils' firms Children's entrepreneurship week 	Continuously

Competition and innovation	<ul style="list-style-type: none"> • Training of exporters • Use of new technologies and technological procedures • Ecological protection of products • Innovation and new products • Introduction of the EU norms • Economic entities clustering (CLUSTERS) • Croatian export offensive (CEO Project) • Linking SMEs and R&D • Incentives to energy enterprises • Financial instruments for the development of entrepreneurial competitiveness • Marketing and promotion • Coordination of activities related to expansion of e-commerce and e-business • Establishment of scientific-technological parks 	Continuously
Improvement of entrepreneurship financing	<ul style="list-style-type: none"> • Credit financing • Risk fund • Business angels • Guarantees 	Continuously
Establishment and development of entrepreneurial and business structure, consulting services	<ul style="list-style-type: none"> • Incentives for development of the Croatian Agency for Small Business • Incentives for regional development agencies • Training and development of consultants' network • Support to development of entrepreneurial centres, technological parks and business incubators 	Continuously
Stimulate regional competitiveness	<ul style="list-style-type: none"> • Financial instruments for regional development of entrepreneurship • Incentives for crafts and co-operatives • Social cohesion projects • Promotion of entrepreneurship among target groups 	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 • Adoption of an ordinance on the organisation and maintenance of the Registry of Agreements on Public Private Partnerships • Scientific analysis of practical experiences 	Continuously 2010 Continuously
Improved control of fiscal risks	<ul style="list-style-type: none"> • Co-ordination between the Agency for Public Private Partnership and the Ministry of Finance in the activities of approval and implementation of projects of public private partnership 	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 projects of public private partnership 	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 Continuously
5.2. FINANCIAL SECTOR		
5.2.1. Banking sector		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further alignment with the <i>acquis communautaire</i>	<ul style="list-style-type: none"> • Electronic Money Institutions Act 	IV quarter 2010
Further development and improvement of prudential regulations and the banking sector	<ul style="list-style-type: none"> • EU legislation monitoring 	Continuously
Organisation of the supervisory body, human resource development	<ul style="list-style-type: none"> • Presentation for banks, credit unions and savings banks of new legislation to be adopted in 2009 and implemented as of 2010 • Training of supervisors in connection with new legislation and banking risks • Improving the system of prudential reporting of banks (FINREP, COREP) 	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"> • <i>Acquis communautaire</i> monitoring and alignment where necessary • Supervision of entities - risk-based supervision • Education of the public and investors 	Continuously 2010-2012 Continuously
5.3. LABOUR MARKET		
5.3.1. Employment stimulation		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Increase of 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
Reduce working hours to preserve jobs and achieve a degree of employment	<ul style="list-style-type: none"> • Job Protection Act 	2010
5.3.2. Social security system		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Application of the Ordinance on convalidation of decisions and individual acts in the field of pension insurance and pension payments	<ul style="list-style-type: none"> • Granting the possibility for submitting requests for convalidation without any time restrictions thereby enabling persons working in the territory of the Republic of Croatia under UN administration to exercise their pension insurance rights 	Continuously
Maintain a socially acceptable and fiscally sustainable level of material and legal protection of unemployed persons	<ul style="list-style-type: none"> • Act on Amendments to the Act on Employment Mediation and Unemployment Rights 	2010

Ensure a minimum standard of living for the most underprivileged population and meet the needs of socially vulnerable groups by improving the quality of service through decentralisation and deinstitutionalisation	<ul style="list-style-type: none"> • Ensure minimum living standards for the most underprivileged part of the population • Enactment of a new Social Welfare Act • IT networking of the social welfare system and statistical alignment with EUROSTAT methodology • Expansion of the social services network through the introduction of the mechanism of local social planning • Improve material position of the elderly and disabled without any income through the introduction of the institute of state pension • 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 the country. 	<p>2010</p> <p>2010-2012</p> <p>2010-2012</p> <p>2011-2012</p> <p>2010-2012</p>
Systematic protection of the rights and interests of children and vulnerable groups and alignment with international standards	<ul style="list-style-type: none"> • Preparation and ratification of international conventions and adoption of national documents relating to the protection of the rights of children and vulnerable groups 	2010-2012
Implementation of operational programmes under relevant IPA programmes and preparation and implementation of projects financed from the IPA	<ul style="list-style-type: none"> • Participation in the drawing up of operational plan for the future ESF • Supervision of the implementation of the projects financed from IPA 2007-2009 • Implementation of the project 'Establishment of Support for Social Inclusion and Employment for Socially Vulnerable and Marginalised Groups' 	2010-2012
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 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 allowance which is gained and paid depending on the total amount of household income and other conditions regulated under the Act on Child Support 	2010-2012
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 student and pupil hostels 	<p>Continuously</p> <p>Continuously</p>

5.4. AGRICULTURAL SECTOR

POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improve competitiveness and adjustment to EU market standards	<ul style="list-style-type: none"> • More efficient distribution of total budgetary funds earmarked for aid within the sector • Creation of the vineyard cadastre 	<p>Continuously</p> <p>2010</p>
Alignment and adjustment of the state aid system with the one of the EU	<ul style="list-style-type: none"> • Adoption of the new act which will regulate the forms of direct payments in the course of the entire pre-accession period 	2010
Introduction of the Central Veterinary Information System	<ul style="list-style-type: none"> • Analysis of the existing database • Developing a full database 	2010-2011
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 • Collection and harmless disposal of animal cadavers 	Continuously
Rural development	<ul style="list-style-type: none"> • Financing rural development measures from pre-accession assistance programme SAPARD • Financing rural development measures from IPA component V - IPARD programme 2009-2011 	<p>2010</p> <p>2010-2012</p>
Uniform animal marking system	<ul style="list-style-type: none"> • Implementation of animal marking • Ordinance on the quality of sheep carcasses - classification and assessment of sheep carcasses on the slaughter-line • Ordinance on the marking of beef - a system of marking of beef which ensures traceability control 	<p>Continuously</p> <p>2010</p> <p>2010</p>
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"> • Drawing up a national strategy plan • Drawing up an operational programme 	2010-2012
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 	2010-2012
Establishment of a vessel monitoring system (VMS)	<ul style="list-style-type: none"> • Acquisition of vessel monitoring devices 	2010-2012
Inspection service strengthening	<ul style="list-style-type: none"> • Inspection service strengthening 	2010-2012

5.5. PUBLIC ADMINISTRATION REFORM

POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Ensuring consistency in administrative procedure to facilitate exercise of citizens rights	<ul style="list-style-type: none"> • Alignment of special procedural legislation with the new General Administrative Procedure Act 	2010-2011
Improving human resources development to ensure more efficient provision of public services	<ul style="list-style-type: none"> • Application of the Human Resources Development Strategy 	2010-2012
Improving efficiency of public administration and development of a more efficient service for the provision of public services	<ul style="list-style-type: none"> • Adjustment of the system of public agencies with EU standards 	2010-2011
Ensuring consistency in remuneration throughout the public sector	<ul style="list-style-type: none"> • Regulation of the issue of salaries in the public sector 	2010-2011
Strengthening the role of e-administration in economic development	<ul style="list-style-type: none"> • Establishment of an IT-supported central registry of civil servants 	2010
Development of a more efficient system of local self-government and better functioning of the public administration at the service of citizens	<ul style="list-style-type: none"> • Analysis of the work of units of local self-government and the existing territorial organisation 	2012

Enabling further development and establishment of new models of the system of e-administration	<ul style="list-style-type: none"> Implementation of activities envisaged under the implementing plan for the e-administration Development Strategy for the 2009-2012 period, planned for 2010 Drawing up the first annual report on the implementation of the e-administration Development Strategy for the 2009-2012 period, in 2009 Drawing up a semi-annual report on the implementation of the e-administration Development Strategy for the 2009-2012 period 	<p>2010</p> <p>I quarter 2010</p> <p>III quarter 2010</p>
5.6. OTHER REFORMS		
5.6.1. Development of a knowledge-based society		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improving quality of primary and secondary education	<ul style="list-style-type: none"> Increase the number of children and young persons included in the system of education Draw up a national curriculum Implement the state school-leaving exam Achieve national pedagogical standards in accordance with the coefficient of feasibility Develop Croatian Qualification Framework Increase the number of persons included in adult education in accordance with the requirements of the economy Develop a quality assurance system 	<p>Continuously</p> <p>2010-2011</p> <p>2010 and continuously</p> <p>Continuously</p> <p>2010-2012</p> <p>Continuously</p> <p>Continuously</p>
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 Improve quality assurance in the system of higher education Improve co-operation 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 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2010-2011</p> <p>Continuously</p>
Strengthening of science and research and their connection with the economy	<ul style="list-style-type: none"> Start with the establishment of centres of excellence Improve the potentials of the National Foundation for Science, Higher Education and Technological Development Encourage commercialisation of research results and the transfer of knowledge and technologies, with a view to boosting long-term economic development 	<p>2010-2012</p> <p>Continuously</p> <p>Continuously</p>
5.6.2. Health care reform		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further financial stabilisation of the health care system	<ul style="list-style-type: none"> Drawing up a 'master plan' of health care institutions Reduce sick leave expenses 	2010-2011
Improvement of the system of control of health care system expenses	<ul style="list-style-type: none"> Abolition of medical commissions of the Croatian Institute for Health Insurance and appointment of authorised doctors for field work Informatisation of primary health care National waiting lists 	2010-2011
Improved availability of health care	<ul style="list-style-type: none"> Acquisition of medical equipment and refurbishment of hospitals Reorganisation of emergency medical service 	2010-2011
5.6.3. Judicial reform		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Reform of the judiciary	<ul style="list-style-type: none"> Revision of the Action Plan associated with the Judicial System Reform Strategy 	2010
Prevention of corruption and organised crime	<ul style="list-style-type: none"> Implementation of the Action Plan associated with the Corruption Prevention Strategy 	2010
Independence of the judiciary	<ul style="list-style-type: none"> Establishment of legislative and institutional structure for the beginning of work of the State School for Judicial Officials 	Beginning of the 2010
Rationalisation of the courts network	<ul style="list-style-type: none"> Rationalisation of municipal, misdemeanour, commercial and county court networks and State Attorney's offices network 	2010
Informatisation of the judiciary	<ul style="list-style-type: none"> Introduction of ICMS - ICMS is planned to be introduced in 60 courts (30 municipal, 19 county and 11 commercial courts) 	Continuously end 2010
Improvement of the efficiency of the judicial system	<ul style="list-style-type: none"> Entering into force of the new Criminal Procedure Act 	September 2011
Improvement of the prison system	<ul style="list-style-type: none"> Establishment of the probation system 	2010
5.6.4. Environmental protection		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
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"> Drawing up further guidelines and provide training for the implementation of the EIA and SEA procedures International reporting in accordance with the assumed obligations and reporting to the Republic of Croatia in accordance with national legislation and international obligations Establish and maintain the Environmental Protection Information System Draw up a report on the state of the environment in the Republic of Croatia in the 2005-2008 period 	<p>2010</p> <p>Continuously</p> <p>Continuously</p> <p>2010</p>
Improvement of the comprehensive system of air quality management and creation of conditions for systematic resolution of problems related to climate changes	<ul style="list-style-type: none"> Annual assessment of air quality at designated areas and in populated areas, and review of air quality categories Establishment of air quality information system (as part of the Environmental Protection Information System) Action plan for airborne particles and nitrogen dioxide (NO₂) in designated and populated areas of the Republic of Croatia where marginal values are exceeded Implementation of the Plan for the allocation of greenhouse gas emission quotas to legal entities Establishment of the greenhouse gas emission trading system Adoption of an implementing regulation on the conditions for the conduct of verification of facility emissions reports 	<p>2010-continuously</p> <p>2010-continuously</p> <p>2010</p> <p>2010-2012</p> <p>2010-2012</p> <p>2010</p>

Establishment of a comprehensive waste management system	<ul style="list-style-type: none"> • Construction of county/regional waste management centres • Restructuring of 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 • Development of hazardous waste management system including identification and management of 'hot spots' in Croatia - Phare 2006 • Further development of the Waste Management Information System by the Environment Protection Agency (as part of Environment Protection Information System) 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2010</p> <p>2010-continuously</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"> • 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) • Strengthening of water management planning - continuation of work on the adoption of water management plans in four water areas • 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 of 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 irrigation systems • Greater investments in the system of protection against damage caused by water • Development and establishment of an information system on the richness and quality of water and linking the water information system with the Environment Protection Information System • The establishment of the system of reporting on waste waters • Further work and adjustments and establishment of a system of reporting on the quality, quantity, and use of water and waste waters in accordance with WISA requirements 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2010-continuously</p> <p>2010-continuously</p> <p>2010-continuously</p>
Sea and marine environment protection	<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 • State of the Sea Report, including human activities, report on the good state of the marine environment, report on identification of a group of objectives of marine environment protection and associated indicators • Establishment and further development of the Information System 'More' • Strengthening control of the sea quality in the coastal area (Project on the protection against pollution in the coastal area) 	<p>Continuously</p> <p>Continuously</p> <p>2010-continuously</p> <p>2010-continuously</p> <p>2010-continuously</p>
Improvement of the nature protection system	<ul style="list-style-type: none"> • Administrative strengthening of nature protection institutions at state and regional level, including inspection service. • Development of a system of protected areas, review and digitalisation of the borders of protected areas and development of the monitoring system • 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 nature protection guidelines through co-operation between various sectors 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p>
Protection of natural values	<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 • Establishment of the NATURA 2000 network and monitoring • Implementation of wolf and lynx management plans • CITES implementation activities <p>International co-operation in the area of protection of nature (implementation of projects):</p> <ul style="list-style-type: none"> • World Bank loan for the project of investment in the protection of nature - preparatory phase • 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 a part of the Environment Protection Information System 	<p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2009-2010</p> <p>2010-2011</p> <p>2010-2011</p>
Establishment of industrial pollution control system	<ul style="list-style-type: none"> • Education of government bodies and economic entities as regards the implementation of the IPPC Directive (IPA I) • Promotional activities for the introduction of EMAS into companies and organisations in the Republic of Croatia • Further development and upgrading of the facilities and emissions information system 	<p>2010-2011</p> <p>2010-continuously</p> <p>2010</p>

Efficient and harmonised implementation of the national policy in the field of chemical safety	<ul style="list-style-type: none"> • Implementation of the National programme of chemical safety • Adoption of subordinate legislation to regulate the area of hazardous chemicals whose transportation is forbidden or restricted and classification, labelling and packaging of hazardous chemicals • 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 • 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 	Continuously 2010 2010 2010
Improvement of the comprehensive forestry system	<ul style="list-style-type: none"> • The Programme of Fire Prevention Measures • Revision of the National Forestry Policy and Strategy • The National Forestry Programme 	2010 2010-2011 2010-2011
Establishment of a system of continuous forest supervision	<ul style="list-style-type: none"> • Adoption of a 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 	Continuously Continuously

Annex I Matrix of Policy Commitments

	2009	2010	2011	2012
OVERALL ASSESSMENT OF FISCAL IMPACTS OF MAJOR IMPLEMENTING MEASURES				
A. Implementation				
B. Net direct impact on the budget	-34,997,122	223,933,004	-101,731,646	-412,755,355
B1. Direct impact on revenues	85,550,972	173,443,677	171,183,135	-99,048,539
B2. Direct impact on expenditures	120,548,094	-50,489,327	272,914,781	313,706,816
I. ENTERPRISE SECTOR				
Total (1+2+3+4+5)				
A. Implementation				
B. Net direct impact on the budget	750,061,682	205,881,465	222,986,270	-177,184,927
B1. Direct impact on revenues	-95,250,750	-37,208,315	108,049,548	33,343,761
B2. Direct impact on expenditures	-845,312,432	-243,089,780	-114,936,722	210,528,688
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	-1,163,342	279,612	-295,640	-114,430
B1. Direct impact on revenues				
B2. Direct impact on expenditures	1,163,342	-279,612	295,640	114,430
2. Railway Restructuring				
Total				
A. Implementation				
B. Net direct impact on the budget	647,957,850	62,536,930	168,957,110	-156,367,497
B1. Direct impact on revenues	-95,250,750	-37,208,315	108,049,548	33,343,761
B2. Direct impact on expenditures	-743,208,600	-99,745,245	-60,907,562	189,711,258
Subsidies				
A. Implementation				
B. Net direct impact on the budget	51,272,000	125,320,158	27,797,630	9,682,212
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-51,272,000	-125,320,158	-27,797,630	-9,682,212
Investment in Modernisation				
A. Implementation				
B. Net direct impact on the budget	583,325,850	-56,343,711	139,934,480	-175,824,709
B1. Direct impact on revenues	-107,080,750	-43,948,798	108,049,548	33,343,761
B2. Direct impact on expenditures	-690,406,600	12,394,913	-31,884,932	209,168,470
MSTI, Reforms, Development Studies, Alignment of Legislation				
A. Implementation				
B. Net direct impact on the budget	13,360,000	-6,439,517	1,225,000	9,775,000
B1. Direct impact on revenues	11,830,000	6,740,483		
B2. Direct impact on expenditures	-1,530,000	13,180,000	-1,225,000	-9,775,000
3. Restructuring of the Shipbuilding Industry				
Subsidies				
A. Implementation				
B. Net direct impact on the budget	103,000,000	183,000,000	100,000,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-103,000,000	-183,000,000	-100,000,000	
4. Small and Medium-Size Enterprises				
Total				
A. Implementation				
B. Net direct impact on the budget	632,174	-38,450,077	-45,327,200	-20,731,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-632,174	38,450,077	45,327,200	20,731,000
Lifelong Entrepreneurial Training				
A. Implementation				
B. Net direct impact on the budget	-1,591,000	-198,970	-1,040,800	-980,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	1,591,000	198,970	1,040,800	980,000
Competitiveness and Innovations				
A. Implementation				
B. Net direct impact on the budget	-33,128,018	-23,731,592	-28,686,400	-7,804,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	33,128,018	23,731,592	28,686,400	7,804,000

Improvements in Financing

A. Implementation				
B. Net direct impact on the budget	6,451,192	-6,699,515	-3,000,000	-3,500,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-6,451,192	6,699,515	3,000,000	3,500,000

Construction and Development of Entrepreneurial and Business Infrastructure, Consultancy Services

A. Implementation				
B. Net direct impact on the budget	-5,600,000	-120,000	-7,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	5,600,000	120,000	7,000	

Regional Competitiveness

A. Implementation				
B. Net direct impact on the budget	34,500,000	-7,700,000	-12,593,000	-8,447,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-34,500,000	7,700,000	12,593,000	8,447,000

5. Public-Private Partnership**Total**

A. Implementation				
B. Net direct impact on the budget	-365,000	-1,485,000	-348,000	28,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	365,000	1,485,000	348,000	-28,000

Training for Employees of the Agency for Public Private Partnership

A. Implementation	X			
B. Net direct impact on the budget	-45,000	-45,000	-10,000	-10,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	45,000	45,000	10,000	10,000

Adoption of the Ordinance on the structure and keeping of the Register of PPP Contracts

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

Scientific Analysis of Practical Experiences

A. Implementation				
B. Net direct impact on the budget	-70,000	-340,000	-338,000	38,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	70,000	340,000	338,000	-38,000

Coordination of Activities Between the Agency for Public Private Partnership and the Ministry of Finance Relating to the Approval and Implementation of PPP Projects

A. Implementation	X			
B. Net direct impact on the budget	-250,000			
B1. Direct impact on revenues				
B2. Direct impact on expenditures	250,000			

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		-500,000		
B1. Direct impact on revenues				
B2. Direct impact on expenditures		500,000		

Implementation of the Ordinance on the criteria for the assessment and approval of PPP projects

A. Implementation		X		
B. Net direct impact on the budget		-350,000		
B1. Direct impact on revenues				
B2. Direct impact on expenditures		350,000		

Implementation of the Ordinance on the monitoring of implementation of PPP contracts

A. Implementation		X		
B. Net direct impact on the budget		-150,000		
B1. Direct impact on revenues				
B2. Direct impact on expenditures		150,000		

II. LABOUR MARKET**Total (1+2+3+4+5+6+7+8+9+10+11+12+13)**

A. Implementation				
B. Net direct impact on the budget	-545,205,183	-146,343,094	-142,848,447	-65,421,967
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	545,205,183	146,343,094	142,848,447	65,421,967

1. Stimulating Employment

A. Implementation				
B. Net direct impact on the budget	41,873,570	-33,994,506	-108,383,177	-66,337,017
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-41,873,570	33,994,506	108,383,177	66,337,017

2. Job Preservation					
A. Implementation		X	X		
B. Net direct impact on the budget		-25,000	-104,975,000		
B1. Direct impact on revenues					
B2. Direct impact on expenditures		25,000	104,975,000		
Note: the Act is applicable until the end of 2010.					
3. Protection of Unemployed Persons Under Substantive Law					
A. Implementation					
B. Net direct impact on the budget		-431,760,556	65,464,556	-18,619,000	20,000,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures		431,760,556	-65,464,556	18,619,000	-20,000,000
Note: In the first and second year of application it is necessary to earmark HRK 15 million and HRK 30 million less, respectively, for the cost item 'unemployment benefits' (the total amount of funds under this item equalled HRK 1.200 million in 2009). Consequently, in 2011 it will again be necessary to secure the full amount of funding for the benefits in question.					
4. Convalidation of Pensions and Retirement Earnings and Convalidation of Working Years under the Convalidation Act and the Ordinance on the procedure for convalidation of decisions and individual acts in the field of pension					
A. Implementation					
B. Net direct impact on the budget		-35,880,500	-13,879,000	-21,162,700	-21,482,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures		35,880,500	13,879,000	21,162,700	21,482,000
5. Ensuring a Minimum Standard of Living for the Most Vulnerable Categories of the Population					
A. Implementation			X		
B. Net direct impact on the budget			-6,500,000	-9,790,000	-9,840,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures			6,500,000	9,790,000	9,840,000
6. IT Networking of the Social Welfare System					
A. Implementation			X		
B. Net direct impact on the budget			-5,250,000	-750,000	
B1. Direct impact on revenues					
B2. Direct impact on expenditures			5,250,000	750,000	
7. Extending the Network of Social Welfare Services Through the Introduction of the Mechanism of Local Social Planning					
A. Implementation			X		
B. Net direct impact on the budget			-11,223,000		-6,820,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures			11,223,000		6,820,000
8. Improving the Organisation of Work of the Social Services					
A. Implementation			X		
B. Net direct impact on the budget			-7,894,000	4,700,000	3,500,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures			7,894,000	-4,700,000	-3,500,000
9. Ratification of International Conventions and Adoption of National Documents Relating to the Protection of the Rights and Interests of Children and Vulnerable Groups					
A. Implementation			X		
B. Net direct impact on the budget			-725,000		
B1. Direct impact on revenues					
B2. Direct impact on expenditures			725,000		
10. Implementation of Regulations Aimed at Protecting Motherhood and Providing Support to Families					
A. Implementation		X			
B. Net direct impact on the budget		-120,318,553	-16,555,500	24,356,430	26,757,050
B1. Direct impact on revenues					
B2. Direct impact on expenditures		120,318,553	16,555,500	-24,356,430	-26,757,050
11. Scholarships for Full-Time Students					
A. Implementation					
B. Net direct impact on the budget		11,105,856	-611,644	-3,000,000	-1,000,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures		-11,105,856	611,644	3,000,000	1,000,000
12. Subsidizing Students' Accommodation and Meals					
A. Implementation					
B. Net direct impact on the budget		-10,000,000	-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	10,000,000
13. Transportation Services for Students and Students with Disabilities					
A. Implementation					
B. Net direct impact on the budget		-200,000	-200,000	-200,000	-200,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures		200,000	200,000	200,000	200,000

III. AGRICULTURE				
Total (1+2+3+4)				
A. Implementation				
B. Net direct impact on the budget	-270,181,631	497,161,150	83,283,154	32,141,868
B1. Direct impact on revenues	53,318,159	86,332,739	110,064,087	25,500,000
B2. Direct impact on expenditures	323,499,790	-410,828,411	26,780,933	-6,641,868
1. State Aid in Agriculture				
A. Implementation				
B. Net direct impact on the budget	-235,376,257	474,258,215	164,152,234	38,241,868
B1. Direct impact on revenues				
B2. Direct impact on expenditures	235,376,257	-474,258,215	-164,152,234	-38,241,868
2. SAPARD Implementation				
A. Implementation		X		
B. Net direct impact on the budget	45,204,000	-33,907,732		
B1. Direct impact on revenues	51,296,268	-35,000,000		
B2. Direct impact on expenditures	6,092,268	-1,092,268		
3. IPARD Implementation				
A. Implementation	X			
B. Net direct impact on the budget	-12,500,000	52,500,000	-97,160,000	-6,100,000
B1. Direct impact on revenues		120,000,000	110,800,000	25,500,000
B2. Direct impact on expenditures	12,500,000	67,500,000	207,960,000	31,600,000
4. Implementation of the World Bank Project for the Adjustment of Agricultural Legislation with the Acquis				
A. Implementation			X	
B. Net direct impact on the budget	-67,509,374	4,310,667	16,290,920	
B1. Direct impact on revenues	2,021,891	1,332,739	-735,913	
B2. Direct impact on expenditures	69,531,265	-2,977,928	-17,026,833	
IV. PUBLIC ADMINISTRATION REFORM				
Total (1+2+3)				
A. Implementation				
B. Net direct impact on the budget	-5,427,496	349,068	404,840	369,980
B1. Direct impact on revenues	964,742	5,550,000	-1,110,000	-3,330,000
B2. Direct impact on expenditures	6,392,238	5,200,932	-1,514,840	-3,699,980
1. Implementation of Activities Relating to e-Administration				
A. Implementation			X	
B. Net direct impact on the budget	-6,327,238	965,738	296,500	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	6,327,238	-965,738	-296,500	
2. Adoption of the Strategy for the Development of Human Resources in Public Administration				
A. Implementation	X			
B. Net direct impact on the budget	899,742		-15,000	
B1. Direct impact on revenues	964,742			
B2. Direct impact on expenditures	65,000		15,000	
3. Alignment of Special Procedural Acts with the New Act on the General Administrative Procedure				
A. Implementation		X		
B. Net direct impact on the budget		-616,670	123,340	369,980
B1. Direct impact on revenues		5,550,000	-1,110,000	-3,330,000
B2. Direct impact on expenditures		6,166,670	-1,233,340	-3,699,980
V. DEVELOPMENT OF A KNOWLEDGE-BASED SOCIETY				
Total (1+2+3+4+5+6+7+8+9+10)				
A. Implementation				
B. Net direct impact on the budget	-10,206,966	14,511,067	-4,989,839	-3,080,297
B1. Direct impact on revenues	8,139,576	49,797,224	-33,366,800	-4,359,000
B2. Direct impact on expenditures	18,346,542	35,286,157	-28,376,961	-1,278,703
1. Development of Pre-School Education				
A. Implementation				
B. Net direct impact on the budget	-2,828,380	-380,400	-1,633,190	-436,729
B1. Direct impact on revenues				
B2. Direct impact on expenditures	2,828,380	380,400	1,633,190	436,729
Note: Partial funding has been secured by a World Bank loan, while the remainder has been allocated from the budget.				
2. Development of the National Curriculum for Pre-School, Primary-School and Secondary-School Education				
A. Implementation				
B. Net direct impact on the budget	-1,438,744	238,984	-78,002	-6,654
B1. Direct impact on revenues				
B2. Direct impact on expenditures	1,438,744	-238,984	78,002	6,654
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	-3,947,432	7,627,650	-598,565	-142,853
B1. Direct impact on revenues				
B2. Direct impact on expenditures	3,947,432	-7,627,650	598,565	142,853
Note: Partial funding has been secured by a World Bank loan, while the remainder has been allocated from the budget.				
4. Application of National Pedagogical Standards in Accordance with the Feasibility Coefficient				
A. Implementation				
B. Net direct impact on the budget	3,835,060	8,507,620	-104,143	-14,657
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-3,835,060	-8,507,620	104,143	14,657
Note: Partial funding has been secured by a World Bank loan, while the remainder has been allocated from the budget.				
5. Development of the Croatian Qualifications Framework				
A. Implementation				
B. Net direct impact on the budget	-200,000	-320,000	-1,880,000	-28,560
B1. Direct impact on revenues	5,139,576	27,603,224	-17,556,800	-3,237,000
B2. Direct impact on expenditures	5,339,576	27,923,224	-15,676,800	-3,208,440
Note: Declared funds include donations within the framework of IPA projects.				
6. Strengthening the Quality of Adult Education				
A. Implementation				
B. Net direct impact on the budget	-3,600,000	-1,400,000	-485,000	-65,820
B1. Direct impact on revenues	3,000,000	22,194,000	-15,810,000	-1,122,000
B2. Direct impact on expenditures	6,600,000	23,594,000	-15,325,000	-1,056,180
Note: Declared funds include donations within the framework of IPA projects.				
7. Development of the Quality Assurance System				
A. Implementation	X			
B. Net direct impact on the budget	-310,508	-266,482	-55,968	-7,596
B1. Direct impact on revenues				
B2. Direct impact on expenditures	310,508	266,482	55,968	7,596
8. Continued Implementation of the Bologna Process				
A. Implementation				
B. Net direct impact on the budget	-716,962	1,106,516	-22,297	-2,759
B1. Direct impact on revenues				
B2. Direct impact on expenditures	716,962	-1,106,516	22,297	2,759
9. Strengthening the National Foundation for Science, Higher Education and Technological Development of the Republic of Croatia				
A. Implementation	X			
B. Net direct impact on the budget	-1,000,000	0	-97,000	-13,164
B1. Direct impact on revenues				
B2. Direct impact on expenditures	1,000,000		97,000	13,164
10. Start-up and Operation of Centres of Excellence				
A. Implementation		X		
B. Net direct impact on the budget		-602,821	-35,674	-2,361,505
B1. Direct impact on revenues				
B2. Direct impact on expenditures		602,821	35,674	2,361,505
Note: Declared funds include donations within the framework of IPA projects.				

VI. HEALTH CARE REFORM

Total (1+2+3+4)

A. Implementation				
B. Net direct impact on the budget	-117,235,287	8,622,349	-145,516,361	-96,311,179
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	117,235,287	-8,622,349	145,516,361	96,311,179

1. Reduction in Expenditures on Sick Leave

A. Implementation				
B. Net direct impact on the budget	-111,268,248	50,900,000		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	111,268,248	-50,900,000		

2. Informatisation of Primary Health Care

A. Implementation				
B. Net direct impact on the budget	-15,877,458	-22,824,623	40,325,438	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	15,877,458	22,824,623	-40,325,438	

3. Procurement of Medical Equipment and Refurbishment of Hospital Premises

A. Implementation				
B. Net direct impact on the budget	25,825,666	-17,054,737	-111,679,844	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-25,825,666	17,054,737	111,679,844	

4. Reorganisation of Emergency Medical Assistance

A. Implementation				
B. Net direct impact on the budget	-15,915,248	-2,398,291	-74,161,955	-96,311,179
B1. Direct impact on revenues				
B2. Direct impact on expenditures	15,915,248	2,398,291	74,161,955	96,311,179

VII. JUDICIAL REFORM**Total (1+2)**

A. Implementation				
B. Net direct impact on the budget	16,780,109	-49,185,200	-1,843,363	-36,184,033
B1. Direct impact on revenues	17,151,245	21,892,579	-30,560,250	-19,503,300
B2. Direct impact on expenditures	371,136	71,077,779	-28,716,887	16,680,733

1. Judicial Reform

A. Implementation				
B. Net direct impact on the budget	11,084,337	-57,427,400	-6,089,103	-38,586,813
B1. Direct impact on revenues	5,415,145	15,022,679	-19,767,500	-9,911,000
B2. Direct impact on expenditures	-5,669,192	72,450,079	-13,678,397	28,675,813

Note: The reform of the judiciary is partly financed by EU assistance funds, donations made by international organisations and a loan from the Council of Europe Development Bank.

2. Prevention of Corruption

A. Implementation				
B. Net direct impact on the budget	5,695,772	8,242,200	4,245,740	2,402,780
B1. Direct impact on revenues	11,736,100	6,869,900	-10,792,750	-9,592,300
B2. Direct impact on expenditures	6,040,328	-1,372,300	-15,038,490	-11,995,080

Note: The judicial reform in the part related to the prevention of corruption is partly financed by the EU assistance funds, donations made by international organisations and a loan from the Council of Europe Development Bank.

VIII. ENVIRONMENTAL PROTECTION**Total (1+2+3+4+5+6+7+8+9)**

A. Implementation				
B. Net direct impact on the budget	146,417,650	-307,063,801	-113,207,900	-67,084,800
B1. Direct impact on revenues	101,228,000	47,079,450	18,106,550	-130,700,000
B2. Direct impact on expenditures	-45,189,650	354,143,251	131,314,450	-63,615,200

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	-4,540,678	-451,622	-2,833,000	1,542,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	4,540,678	451,622	2,833,000	-1,542,000

2. Air Quality and Climate Protection (MEPPPC)

A. Implementation				
B. Net direct impact on the budget	204,400	5,075,600	840,000	
B1. Direct impact on revenues	9,811,000	-7,630,000	-5,825,000	
B2. Direct impact on expenditures	9,606,600	-12,705,600	-6,665,000	

Note: The measure 'Establishment of National Air Quality Monitoring Network' is partly financed through the EU Pre-Accession Aid: Phare 2006 'Air Quality Monitoring and Management System', which has been declared in the state budget for the years 2008, 2009 and 2010. Support for activities concerning the development of the greenhouse gas emissions trading system, including the Register of greenhouse gas emissions, has been received through one of the components of CARDS 2004 project 'Support for the Further Approximation of Croatian Legislation with the Environmental Acquis'.

3. Waste Management (MEPPPC)

A. Implementation				
B. Net direct impact on the budget	-375,000	-515,000	740,000	800,000
B1. Direct impact on revenues	11,739,000	30,491,000	22,220,000	-18,050,000
B2. Direct impact on expenditures	12,114,000	31,006,000	21,480,000	-18,850,000

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

4. Water Management (MAFWM)				
A. Implementation				
B. Net direct impact on the budget	137,742,598	-303,207,000	-114,673,000	-77,537,000
B1. Direct impact on revenues	79,720,000	22,280,000	6,250,000	-112,650,000
B2. Direct impact on expenditures	-58,022,598	325,487,000	120,923,000	-35,113,000
Note: The project Slavonski Brod and Knin – Drniš is co-financed through the IPA programme. The project 'Water and Waste Water Management Programme Karlovac' and the technical assistance project for the preparation of projects for IPA are co-financed through the ISPA programme. The project 'Inland waters' is co-financed by a loan. The regional project on the management of the Trebišnjica and Neretva rivers, which is being implemented in co-operation with Bosnia and Herzegovina, is co-financed by World Bank donations.				
5. Protection of the Sea and Marine Environment (MEPPPC)				
A. Implementation				
B. Net direct impact on the budget	5,625,660	7,683,840	-3,048,500	3,429,000
B1. Direct impact on revenues	-50,000			
B2. Direct impact on expenditures	-5,675,660	-7,683,840	3,048,500	-3,429,000
Note: Partial funding shown under B2 has been secured by an IBRD loan (50%), while the remainder will be financed from the state budget.				
6. Nature Protection (MC)				
A. Implementation				
B. Net direct impact on the budget	5,436,600	-6,322,600	506,000	620,000
B1. Direct impact on revenues		3,138,450	-3,138,450	
B2. Direct impact on expenditures	-5,436,600	9,461,050	-3,644,450	-620,000
Note: Declared funds include donations within the framework of the Phare 2005 project and IPA component I TAIB.				
7. Establishing Industrial Pollution Control System (MEPPPC)				
A. Implementation				
B. Net direct impact on the budget	759,219	-1,359,219	0	
B1. Direct impact on revenues	8,000	-1,200,000	-1,400,000	
B2. Direct impact on expenditures	-751,219	159,219	-1,400,000	
Note: Within the framework of the measure 'Training of Government Bodies and Economic Operators in the Application of the IPPC Directive' support was received through one of the components of CARDS 2004 project 'Support for the Further Approximation of Croatian Legislation with the Environmental Acquis'.				
8. Chemicals and GMOs (MHSW)				
A. Implementation				
B. Net direct impact on the budget	-741,517	-9,107,800	3,660,600	4,061,200
B1. Direct impact on revenues				
B2. Direct impact on expenditures	741,517	9,107,800	-3,660,600	-4,061,200
9. Forestry (MRDFWM):				
A. Implementation				
B. Net direct impact on the budget	2,306,368	1,140,000	1,600,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-2,306,368	-1,140,000	-1,600,000	

Annex II Statistical Appendix

Table 1a: Macroeconomic Prospects

Percentages unless otherwise indicated	ESA Code	2008	2008	2009	2010	2011	2012
		Level (bn EUR) ¹		Rate of change			
1. Real GDP at market prices	B1*g	34.5	2.4	-5.9	0.5	3.0	3.5
2. GDP at market prices	B1*g	47.4	8.9	-3.3	2.3	6.0	6.6
Components of real GDP							
3. Private consumption expenditure	P3	28.0	0.8	-8.5	0.4	3.6	3.7
4. Government consumption expenditure	P3	8.8	1.9	1.0	-1.0	-0.5	0.3
5. Gross fixed capital formation	P51	13.1	8.2	-11.3	0.9	4.2	5.2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	1.5	3.1	0.9	1.1	1.4	1.8
7. Exports of goods and services	P6	19.9	1.7	-17.6	3.2	4.8	5.9
8. Imports of goods and services	P7	23.8	3.6	-21.9	3.0	5.3	6.4
Contribution to real GDP growth ²							
9. Final domestic demand		49.8	3.1	-8.4	0.3	3.2	3.8
10. Change in inventories and net acquisition of valuables	P52+P53	1.5	0.4	-2.2	0.2	0.3	0.4
11. External balance of goods and services	B11	-4.0	-1.3	4.7	-0.1	-0.6	-0.7

Source: CBS, MFIN

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	2008	2009	2010	2011	2012
1. GDP deflator		6.4	2.8	1.8	3.0	3.0
2. Private consumption deflator		6.1	2.5	2.7	3.0	3.0
3. HICP		-	-	-	-	-
4. National CPI change		6.1	2.5	2.7	3.0	3.0
5. Public consumption deflator		7.0	2.8	1.2	2.6	2.8
6. Investment deflator		5.8	0.1	0.9	2.7	2.7
7. Export price deflator (goods & services)		4.8	1.3	2.4	2.5	2.5
8. Import price deflator (goods & services)		4.9	-0.6	2.6	2.2	2.3

Source: CBS, MFIN

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	2008	2009	2010	2011	2012
		Level/Rate of change				
1. Population (thousands)		4,435	4,435	4,435	4,435	4,435
2. Population (growth rate in %)		0.0	0.0	0.0	0.0	0.0
3. Working-age population (persons) ^[1]		2,742	2,752	2,758	2,765	2,772
4. Participation rate		65.1	64.1	64.0	64.1	64.4
5. Employment, persons ^[2]		1,636	1,591	1,582	1,596	1,621
6. Employment, hours worked ^[3]		n.a.	n.a.	n.a.	n.a.	n.a.
7. Employment (growth rate in %)		1.3	-2.7	-0.6	0.9	1.6
8. Public sector employment (persons); NCEA - O,P,Q categories		286.1	287.9	287.9	287.9	289.4
9. Public sector employment (growth in %)		2.8	0.6	0.0	0.0	0.5
10. Unemployment rate ^[4]		8.4	9.9	10.3	9.9	9.1
11. Labour productivity, persons ^[5]		1.0	-3.3	1.0	2.1	1.9
12. Labour productivity, hours worked ^[6]		n.a.	n.a.	n.a.	n.a.	n.a.
13. Compensation of employees ^[7]	D1	8.5	-0.5	0.7	4.6	6.2

Source: CBS, MFIN

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	2008	2009	2010	2011	2012
1. Net lending/borrowing vis-à-vis the rest of the world <i>of which:</i>	B.9	12.5	8.0	8.3	8.4	8.4
- Balance of goods and services		-8.1	-4.0	-4.2	-4.6	-4.9
- Balance of primary incomes and transfers		-1.1	-1.7	-1.8	-1.7	-1.6
- 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	13.9	11.4	11.5	11.5	10.7
3. Net lending/borrowing of general government		-1.4	-3.4	-3.3	-3.1	-2.3
4. Statistical discrepancy		-3.4	-	-	-	-

Source: CNB, MFIN

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	2008	2009	2010	2011	2012
GDP and investment						
GDP level at <i>current</i> market prices (in domestic	B1g	342.2	331.0	338.5	358.9	382.6
Investment ratio (% of GDP)		27.6	25.3	25.2	25.4	25.8
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		3.2	1.3	0.4	2.3	2.6
2. Industry (excluding construction)		1.4	-8.3	0.6	3.9	4.9
3. Construction		8.5	-5.0	0.1	2.4	3.7
4. Services		2.4	-2.7	0.3	2.9	3.2

Source: CBS, MFIN

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		2008	2009	2010	2011	2012
1. Current account balance (% of GDP)	% of GDP	-9.2	-5.7	-6.0	-6.3	-6.5
2. Export of goods	EUR million	9,814	7,664	8,081	8,897	10,080
3. Import of goods	EUR million	20,608	15,086	15,959	17,634	19,768
4. Trade balance	EUR million	-10,794	-7,422	-7,878	-8,737	-9,688
5. Export of services	EUR million	10,091	8,463	8,910	9,596	10,383
6. Import of services	EUR million	3,133	2,831	2,976	3,095	3,234
7. Service balance	EUR million	6,958	5,632	5,934	6,501	7,148
8. Net interest payments from abroad	EUR million	-1,162	-1,532	-1,590	-1,670	-1,737
9. Other net factor income from abroad	EUR million	-407	-224	-255	-298	-366
10. Current transfers	EUR million	1,036	998	1,024	1,116	1,244
11. <i>Of which</i> : from EU	EUR million	957	0	0	0	0
12. Current account balance	EUR million	-4,369	-2,548	-2,765	-3,088	-3,398
13. Foreign direct investment	EUR million	3,225	1,388	1,572	1,933	2,185
14. Foreign reserves	EUR million	9,121	9,950	9,528	9,623	9,894
15. Foreign debt	EUR million	39,125	42,031	44,426	47,378	50,730
16. <i>Of which</i> : public	EUR million	10,248	-	-	-	-
17. <i>O/w</i> : foreign currency denominated	EUR million	35,761	-	-	-	-
18. <i>O/w</i> : repayments due	EUR million	-	-	-	-	-
19. Exchange rate vis-à-vis EUR (end-year)	NCU/EUR	7.32	7.35	7.37	7.37	7.37
20. Exchange rate vis-à-vis EUR (annual average)	NCU/EUR	7.22	7.34	7.33	7.33	7.33
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, MFIN

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

Table 2: General Government Budgetary Prospects

	ESA code	2008 Level	2008	2009	2010 % of GDP	2011	2012
Net lending (B9) by sub-sectors							
1. General government	S13	-7.705	-1.4	-3.4	-3.3	-3.1	-2.3
2. Central government	S1311	-7.853	-1.4	-3.4	-3.2	-3.1	-2.3
3. State government	S1312	0.000	0.0	0.0	0.0	0.0	0.0
4. Local government	S1313	0.148	0.0	0.0	-0.1	-0.1	-0.1
5. Social security funds	S1314	0.000	0.0	0.0	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	126.647	39.4	38.8	38.4	36.8	35.8
7. Total expenditure ^[1]	TE	134.352	40.8	42.2	41.7	39.9	38.1
8. Net borrowing/lending	EDP.B9	-7.705	-1.4	-3.4	-3.3	-3.1	-2.3
9. Interest expenditure	EDP.D41 incl. FISIM	5.603	1.5	1.6	1.9	1.8	1.7
p.m. 9a. FISIM		0.000	0.0	0.0	0.0	0.0	0.0
10. Primary balance ^[2]		-2.103	0.1	-1.8	-1.4	-1.3	-0.7
Components of revenues							
11. Total taxes (11 = 11a+11b+11c)		71.933	23.0	22.0	22.2	21.1	20.7
11a. Taxes on production and imports	D2	52.303	16.5	15.5	15.8	15.6	15.3
11b. Current taxes on income and wealth	D5	19.630	6.5	6.5	6.4	5.6	5.4
11c. Capital taxes	D91	0.000	0.0	0.0	0.0	0.0	0.0
12. Social contributions	D61	37.669	12.0	12.5	12.1	11.7	11.4
13. Property income	D4	2.133	0.5	0.7	0.4	0.4	0.4
14. Other (14 = 15-(11+12+13))		14.912	3.9	3.6	3.6	3.5	3.3
15 = 6. Total revenue	TR	126.647	39.4	38.8	38.4	36.8	35.8
p.m.: Tax burden (D2+D5+D61+D91-D995) ^[3]		111.735	35.5	35.2	34.8	33.3	32.5

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

^[2] The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9).

^[3] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.

Table 2 (continued)

	ESA code	2008 Level	2008	2009	2010 % of GDP	2011	2012
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	48.242	15.6	17.1	16.9	16.0	15.3
17a. Social transfers in kind	P31 = D63	8.939	3.1	3.5	3.5	3.2	3.0
17b. Social transfers other than in kind	D62	39.303	12.5	13.6	13.4	12.8	12.3
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	5.603	1.5	1.6	1.9	1.8	1.7
19. Subsidies	D3	7.504	2.4	2.4	2.1	1.9	1.8
20. Gross fixed capital formation	P51	11.696	2.0	1.8	1.9	1.9	1.8
21. Other (21 = 22-(16+17+18+19+20))		61.307	19.3	19.3	18.9	18.2	17.5
22. Total expenditures ^[1]	TE	134.352	40.8	42.2	41.7	39.9	38.1
p.m. compensation of employees	D1	31.122046	9.8	10.3	10.4	10.0	9.7

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

Source: MFIN

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

Table 3: General Government Expenditure by Function

Percentages of GDP	COFOG Code	2008	2009	2010	2011	2012
1. General public services	1	4.6				
2. Defence	2	1.5				
3. Public order and safety	3	2.3				
4. Economic affairs	4	4.8				
5. Environmental protection	5	0.3				
6. Housing and community amenities	6	1.9				
7. Health	7	5.6				
8. Recreation, culture and religion	8	1.3				
9. Education	9	4.1				
10. Social protection	10	13.5				
11. Total expenditure (item 7 = 22 in Table 2)	TE	40.8				

Source: MFIN

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

Table 4: General Government Debt Developments

Percentages of GDP	ESA code	2008	2009	2010	2011	2012
1. Gross debt ^[1]		29.1	33.5	36.1	37.3	37.4
2. Change in gross debt ratio		-4.0	4.4	2.6	1.2	0.1
Contributions to change in gross debt						
3. GDP effect		-2.7	1.0	-0.7	-2.1	-2.3
4. Primary balance ^[2]		-0.1	1.8	1.4	1.3	0.7
5. Interest expenditure (incl. FISIM) ^[3]		1.5	1.6	1.9	1.8	1.7
6. Stock-flow adjustment		-2.7	0.0	0.1	0.1	0.1
<i>of which:</i>						
- Differences between cash and accruals ^[4]		-0.1	0.0	0.0	0.0	0.0
- Net accumulation of financial assets ^[5]		0.1	0.2	0.3	0.4	0.4
<i>of which:</i>						
- Privatisation proceeds		-0.3	-0.2	-0.1	-0.1	0.0
- Valuation effects and other ^[6]		0.0	0.0	0.0	0.0	0.0
p.m. implicit interest rate on debt ^[7]		4.8	5.3	5.8	5.4	4.8
Other relevant variables						
7. Liquid financial assets ^[8]		0.0	0.0	0.0	0.0	0.0
8. Net financial debt (8 = 1 - 7)		29.1	33.5	36.1	37.3	37.4

Source: MFIN

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

^[1] As defined in Regulation 3605/93 (not an ESA concept).

^[2] Cf. item 10 in Table 2.

^[3] Cf. item 9 in Table 2.

^[4] The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

^[5] Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

^[6] Changes due to exchange rate movement, and operation in secondary market could be distinguished when relevant.

^[7] Proxied by interest expenditure (incl. FISIM recorded as consumption) divided by the debt level of the previous year.

^[8] AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted at stock exchange; including mutual fund shares).

Table 5: Cyclical Developments

Percentages of GDP	ESA Code	2008	2009	2010	2011	2012
1. Real GDP growth (%)	B1g	2.4	-5.9	0.5	3.0	3.5
2. Net lending of general government	EDP.B.9	-1.4	-3.4	-3.3	-3.1	-2.3
3. Interest expenditure (incl. FISIM recorded as consumption)	EDP.D.4 1 + FISIM	1.5	1.6	1.9	1.8	1.7
4. Potential GDP growth (%) ^[1]		1.0	-0.5	-0.1	1.1	1.8
Contributions:						
- labour						
- capital						
- total factor productivity						
5. Output gap		3.1	-2.6	-2.0	-0.1	1.5
6. Cyclical budgetary component		1.1	-0.7	-0.7	-0.1	0.4
7. Cyclically-adjusted balance (2-6)		-2.5	-2.6	-2.6	-3.0	-2.8
8. Cyclically-adjusted primary balance (7-3)		-1.0	-1.1	-0.7	-1.2	-1.1

Source: MFIN**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

	2008	2009	2010	2011	2012
1. GDP growth (% points)					
Previous update	2.5	2.0	3.2	4.0	
Latest update	2.4	-5.9	0.5	3.0	3.5
Difference	0.1	7.9	2.7	1.0	
2. General government net lending (% of GDP)					
Previous update	-1.2	-0.9	-0.6	0.0	
Latest update	-1.4	-3.4	-3.3	-3.1	-2.3
Difference	0.2	2.5	2.6	3.1	
3. General government gross debt (% of GDP)					
Previous update	42.3	41.4	40.0	37.9	
Latest update	29.1	33.2	35.5	36.5	36.5
Difference	13.2	8.2	4.5	1.3	

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

Table 7: Long-term Sustainability of Public Finances

Percentages of GDP	2000	2005	2010	2020	2030	2040	2050
Total expenditure ^[1]	-	42.5	41.7	38.5	39.4	40.5	42.2
<i>of which:</i>							
- Age-related expenditures ^[2]	-	14.1	15.2	13.7	14.6	15.6	17.3
- Pension expenditure ^[3]	-	8.7	8.7	7.2	6.6	6.5	6.9
- Social security pension	-	-	-	-	-	-	-
- Old-age and early pensions	-	-	-	-	-	-	-
- Other pensions (disability, survivors)	-	-	-	-	-	-	-
- Occupational pensions (if in general government)	-	-	-	-	-	-	-
- Health care	-	5.5	6.5	6.6	8.0	9.1	10.5
- Long-term care (this was earlier included in the health care)	-	-	-	-	-	-	-
Education expenditure	-	-	-	-	-	-	-
Other age-related expenditures	-	-	-	-	-	-	-
Interest expenditure	-	1.9	1.9	1.9	2.2	2.5	2.7
Total revenues	-	39.0	38.4	35.5	35.5	35.5	35.5
<i>of which</i> : property income	-	-	-	-	-	-	-
<i>of which</i> : from pensions contributions (or social contributions, if appropriate)	-	5.9	5.9	5.3	5.3	5.3	5.3
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	1.0	4.1	2.4	1.2	1.1
Real GDP growth	2.9	4.2	0.5	3.5	1.4	0.4	0.2
Participation rate males (aged 20-64) ^[4]	67.8	69.6	70.8	71.9	71.9	71.2	71.9
Participation rates females (aged 20-64) ^[4]	55.5	56.8	57.3	58.1	58.2	57.6	58.2
Total participation rates (20-64) ^[4]	61.5	63.1	64.0	64.9	65.0	64.3	65.0
Unemployment rate	16.1	12.7	10.3	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, MFIN

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

^[1] Total expenditures according to ESA 95

^[2] Pension plus health care expenditures

^[3] Total public pension expenditures except pensions and permanent rights of war veterans

^[4] Aged (15 - 64)

Table 6: Basic Assumptions on the External Economic Environment

Variable (annual growth rates in %, if not otherwise stated)	Assumptions for								
	2008		2009		2010		2011		2012
		<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)	4.63	<i>0.1</i>	1.25	<i>-2.0</i>	1.62	<i>-2.2</i>	2.70	<i>-1.5</i>	3.09
- Long-term term interest rate ^[2] (annual average)	2.95	-	3.36	-	3.79	-	-	-	-
Exchange rates (annual average ^{“-“} : depreciation)									
Exchange rate vis-à-vis €	7.22	<i>-0.01</i>	7.34	<i>-0.03</i>	7.33	<i>-0.02</i>	7.33	<i>0.00</i>	7.33
USD / € **	1.46	<i>-0.02</i>	1.39	<i>0.04</i>	1.46	<i>0.08</i>	1.40	<i>0.02</i>	1.39
Nominal effective exchange rate	84.4	<i>-0.1</i>	87.0	<i>-1.3</i>	85.7	<i>-1.8</i>	86.6	<i>-0.4</i>	86.8
Real effective exchange rate ***	81.4	<i>1.4</i>	81.9	<i>-0.8</i>	79.3	<i>-1.9</i>	79.0	<i>-1.1</i>	78.2
GDP (in real terms)									
- World	3.0	<i>-0.9</i>	-1.3	<i>-4.3</i>	2.9	<i>-1.3</i>	4.2	<i>-0.5</i>	4.6
- Euro Area	0.7	<i>-0.6</i>	-4.2	<i>-4.4</i>	0.0	<i>-1.3</i>	1.4	<i>-0.6</i>	1.8
World trade (in real terms)									
Country export markets	2.4	<i>-3.9</i>	-14.1	<i>-16.5</i>	0.4	<i>-4.6</i>	3.5	<i>-2.1</i>	4.6
World volume of trade	3.0	<i>-2.0</i>	-12.4	<i>-16.5</i>	1.2	<i>-5.2</i>	5.2	<i>-1.9</i>	6.3
International prices									
World import prices (goods, in €)	9.1	<i>-4.9</i>	-11.1	<i>-11.0</i>	3.4	<i>2.2</i>	2.2	<i>1.1</i>	1.4
Oil Prices**** (USD per barrel)	97.0	<i>-2.8</i>	62.0	<i>-6.0</i>	82.1	<i>7.1</i>	79.5	<i>0.3</i>	81.0

Source: ECFIN, IMF, MFIN

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 2009 and 2010 are from Foreign Exchange Consensus Forecast (November, 2009), while for 2011 and 2012 are from IMF (GAS, August 2009).

*** Effective exchange rate is calculated as a weighted mean of bilateral exchange rates of HRK against EUR (weight 72.2%) and HRK against USD (27.8%).

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

**** Projected values of oil prices for 2009 and 2010 refer to Crude Oil Futures prices traded on the NYMEX, while for 2011 and 2012 refer to a simple average of UK Brent, Dubai, and West Texas Intermediate (IMF, August 2009).

^[1] IMF (GAS August 2009), euro 3m LIBOR. Change calculated compared to data and projections in GAS (October 2008).

^[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 2009 under the 2009-2011 PEP

MAIN MEASURES UNDER THE 2009-2011 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
ENTERPRISE SECTOR			
Competition and state aid			
Adoption of Regulation on block exemption in the transport sector Adoption of the Regulation on the method and criteria for imposition and calculation of penalties Adoption of the Regulation on the criteria for reduction in or exemption from penalties Adoption of the Regulation on the method of reporting and criteria for assessment of concentration of entrepreneurs	No	IV quarter 2010	As the new Competition Act was enacted on 24 June 2009 and its entering into force is envisaged for 1 October 2010, the adoption of subordinate legislation has been postponed from IV quarter 2009 to IV quarter 2010.
Training for application of new legislation for employees of the Croatian Competition Agency, other regulatory authorities and the judiciary (through the IPA 2007 project)	In progress	2010-2012	Twinning partners have been selected (Italy and Great Britain) and the beginning of implementation of the two-year project is expected in January 2010.
Issuance of state aid rules in accordance with the procedure prescribed by the Regulation on State Aid	Yes	Continuously	In 2009, 3 new decisions on the publishing of rules on state aid were adopted. A new Decision on the publishing of a list of rules on state aid was also adopted (OG 12/09).
Completion of the state aid granting procedure for five Croatian shipyards Professional training of Croatian Competition Agency employees and state aid providers (at central and local level) through the IPA 2007 project	In progress	2010-2012	The process of privatisation of Croatian shipyards was initiated, on the basis of a tender approved by the European Commission. The assessment of business plans of selected investors, to be conducted by the Croatian Competition Agency followed by the European Commission, is expected to take place in 2010, following completion of the process of privatisation. Professional training in the field of state aid is planned to be conducted through a twinning project and technical assistance project in the framework of the IPA 2007 programme, which is to be implemented in the 2010-2012 period.
Privatisation			
Privatisation of the largest share of the remaining portfolio of the Croatian Privatisation Fund	In progress	2010-2011	In 2009, a total of 86 companies were privatised of which three companies were privatised through a public tender sale, 48 companies through bankruptcy and winding up procedures and after the sale of minority stakes (up to 25%) was resumed on the Zagreb Stock Exchange following a one year break. 35 companies were fully privatised through this channel.
Privatisation and restructuring of five shipyards and one subsidiary	In progress	2010	The privatisation is planned to be carried out in the second round of the tender procedure which will be launched on 15 January 2010, at the latest.
Professionalisation of management of a part of the portfolio (mainly minority stakes)	No	2010	In 2010, the Government of the RoC will define a new model and an institutional framework for government asset management.
Continuation of privatisation of majority stakes	In progress	Until completion of privatisation	During the observed period, 25 public tenders were invited for the sale of 15 companies. 13 companies underwent bankruptcy proceedings and 2 companies underwent winding up proceedings. In 2009, bankruptcy proceedings were initiated for two more companies. Until the end of the year a tender for the sale of 6 more companies is planned.
Continuation of privatisation of Croatian Railways	In progress	Until the end of privatisation, and at the latest until 2010	Since the beginning of privatisation of subsidiaries (early 2007), 25 public tenders were invited for the sale of 8 subsidiaries of Croatian Railways. A sales contract was concluded for the sale of one company, one company underwent bankruptcy proceedings and one company was privatised on the basis of preemptive rights.
Railway restructuring			
Creation of subordinate legislation	Yes	2009	A larger number of Ordinances was drafted in 2009, while further work on their drafting will continue in 2010.
Preparation of network reports	Yes	2009	Each year, a new Network Report is drafted (legislative provision). The drafting of the Network Report for 2011 is currently being completed.
Allocation of routes to operators	Yes	2009	In accordance with the 2009 Network Report, routes are allocated to operators.
Establishment and full operability of the Security Agency	Yes	2009	The Agency was established in 2009 and its Governing Council and Acting Director were appointed. Full functioning is planned for 2010.
Fulfilment of conditions under PAL 2 loan	No	-	PAL 2 loan has been suspended.
Creation of annual maintenance and modernisation plans	No	2010-2012	These activities are planned in the context of annual business plans.
Restructuring of the shipbuilding industry			
Privatisation through invitation to tender for purchase of shares/a stake in shipyards and implementation of the restructuring programme	In progress	2010	The implementation of the measure was postponed from the end of 2009 to 2010. Restructuring programmes will be defined within public tender conditions and will be carried out upon the privatisation completion.

Energy			
Adjustment of the internal market to EU conditions	Yes	Continuously	In the context of gas market strengthening, the following subordinate legislation was adopted in 2009: General terms and conditions for natural gas supply (OG 43/09), Network rules for gas distribution system (OG 50/09), Rules for the gas storage system (OG 50/09), Ordinance on natural gas market organisation (OG 50/09), Network rules for the transmission system (OG 50/09).
Adjustment of the infrastructure to market needs	Yes	Continuously	Under the plan for the development, modernisation and construction of the gas transmission system in the RoC in the 2007-2011, the Croatian and the Hungarian operator of the gas transport system have entered into an agreement on the construction of a gas pipeline. Further activities have also been undertaken in the context of construction of a LNG terminal on the island of Krk. Market activities have been separated from the regulated activities and operators have been introduced for specific activities in the field of gas including operators for LNG terminals and natural gas storages. Further construction of a double 400 kV power-transmission line between Ernestinovo (CRO) and Pech (HU) is underway and its completion is expected in 2010. Further activities are also undertaken to establish connections with Bosnia and Herzegovina (a 220 kV power-transmission line between Mraclin and Prijedor was put into operation in April 2009).
Oil derivatives - monitoring oil and oil derivatives reserves on the EU level and fuel extraction in accordance with the EU standards	Yes	Continuously	As regards oil and oil derivatives, the Croatian Compulsory Oil Stocks Agency has drafted a Program of the Agency's activities with a view to ensuring compulsory 90 day reserves until 31 July 2012 in line with the Plan for Delivery, Dynamics of Formation and Replacement of Compulsory Stocks of Oil and Oil Derivatives, Storage Organisation and Regional Layout (OG 149/09). In addition, in 2009 the authorities adopted the Energy Development Strategy of the Republic of Croatia until 2020 (OG 130/09).
Small and medium-size enterprises			
Project of the national programme for entrepreneurial education in formal and informal education Training in relation to e-business South East European Centre for Entrepreneurial Learning (SEECLE) Children's entrepreneurship week Co-financing of universities with specialist entrepreneurial programmes Pupils' cooperatives and pupils' firms	Yes	Continuously	These measures were conducted in 2009 and will continue to be conducted 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 2009, the Operational plan was adopted based on a Conclusion of the Government of the RoC of 2 April 2009. The stimulating environment is based on the Act on Small Business Development Incentives (OG 29/02 and 63/07), the adopted budget plan and projection, legislation governing the establishment of small business entities (companies, crafts, cooperatives, profit institutions and other entities of small and medium-size enterprises), the State Aid Act (OG 140/05) and subordinate legislation governing state aid.
Education of exporters Application of new technologies and technological processes Environmental protection of products Innovations and new products Introduction of EU standards Association of economic entities (clusters) Program of internationalisation and strengthening of international competitiveness of the Croatian economy Integration of SMEs and R&D institutions Incentives to energy enterprises Financial instruments for development of entrepreneurial competitiveness Marketing and promotion Coordination of activities related to expansion of e-commerce and e-business Establishment of scientific-technological parks	Yes	Continuously	
Credit financing Risk fund Business angels Guarantees	Yes	Continuously	
Incentives for development of the Croatian Agency for Small Business Support to setting up regional development agencies Training and development of consultants' network Support to developing entrepreneurial centres, technological parks and incubators	Yes	Continuously	
Financial instruments for regional development of entrepreneurship Incentives to crafts and cooperatives Social cohesion projects Promotion of entrepreneurship among target groups	Yes	Continuously	
Public-private partnership			
Upgrading of legislative framework through creation of implementing legislation	Yes	May 2009	Upon Agency proposal, the Government adopted on 7 May 2009 subordinate legislation to the Act on Public Private Partnership: Regulation on the criteria for assessing and approving public private partnership projects, Regulation on the content of agreements on public private partnership, Regulation on the supervision of implementation of public private partnership projects and the Regulation on the training of participants in the procedures of preparing and implementing public private partnership projects. These regulations were published in the Official Gazette 56/09, and entered into force on 21 May 2009.

Institutional strengthening in the area of public private partnership (establishment of the Agency for Public Private Partnership)	Yes	January 2009	The Agency for Public Private Partnership was established pursuant to the Act on Public Private Partnership adopted in January 2009. As of 1 January 2009, the employees of the Trade and Investment Promotion Agency (Department for Public Private Partnership) became the employees of the Agency for Public Private Partnership. This Agency currently employs 14 persons who participate on an ongoing basis in specialist and other training programmes.
Continuous scientific analysis of practical experiences (analysis of PPP agreements entered into before entry into force of the Act on Public Private Partnership and analysis of international experiences in the area of PPP gained at workshops with SIGMA representatives)	Yes	Continuously	The Agency for Public Private Partnership has requested from 252 institutions (state administrative bodies, public bodies, bodies of local and regional self-government and state-owned companies) to submit PPP agreements entered into before the Act on Public Private Partnership came into force for the purpose of their registration and analysis of national experiences in this field so far.
Coordination between the Agency for Public Private Partnership and the Ministry of Finance in PPP projects approval and implementation	Yes	Continuously	Active cooperation between the Agency for Public Private Partnership and the Ministry of Finance, particularly on the tasks associated with the drafting of subordinate legislation and participation in training programmes.
FINANCIAL SECTOR			
Banking sector			
Adoption and implementation of subordinate legislation based on the Credit Institutions Act	Yes	December 2009	
Adoption and implementation of subordinate legislation based on the Electronic Money Institutions Act	No	2010	A new Electronic Money Institution Act will be drafted in 2010.
Adoption of the Payment Services Act	Yes	October 2009	The final title of the act is the Payment Operations Act
Adoption and implementation of subordinate legislation based on the Financial Conglomerates Act	Yes	June 2009	Ordinance on the manner of calculation of capital adequacy of financial conglomerates (OG 70/09)
Adoption of the Consumer Loan Act	Yes	June 2009	The final title of the act is the Consumer Lending Act
Non-banking sector			
Act on Amendments to the Act on Compulsory Insurances within the Transport Sector	Yes	13 March 2009 19 June 2009	Two amendments to the Act on Compulsory Insurances within the Transport Sector were made: - Act on Amendments to the Act on Compulsory Insurances within the Transport Sector (OG 36/09); and - Act on Amendments to the Act on Compulsory Insurances within the Transport Sector (OG 75/09)
Adoption of subordinate legislation based on the Capital Market Act	Yes	I quarter 2009	
Adoption of subordinate legislation based on the Act on Amendments to the Insurance Act	Yes	III quarter 2009	
LABOUR MARKET			
Employment stimulation			
Analysis and independent evaluation of annual employment incentive plans	Yes	May 2009	A Report on the implementation of the Joint Assessment of the Employment Policy Priorities for 2008 with recommended measures was adopted.
Development of national implementing plan for the Joint Memorandum on the employment policy priorities	Yes	May 2009	The National Employment Implementation Plan for 2009 and 2010 was adopted.
Social security system			
Through restructuring of unemployment benefit in the first year of unemployment encourage training and active job seeking and through reduction of unemployment compensation in the following period, encourage work activation.	Yes	January 2009	The new Act on Employment Mediation and Unemployment Rights came into force.
Granting the possibility for submitting requests for convalidation of pension insurance rights without any time restrictions to persons working in the territory of the Republic of Croatia under UN administration.	Yes	2009	The measure is conducted on the basis of the Ordinance on decision convalidation procedure and individual acts in the field of pension insurance.
Introduction of a personal identification number	Yes	2009	
Informatisation of the social welfare system	In progress	2011	Information system development conducted in the context of the Project of Social Welfare System Development is to be completed in June 2010. Full implementation will take place in 2010 and 2011.
Implementation and financing of approved innovative projects regarding the rendering of social services at local community level aimed at deinstitutionalisation and reintegration of beneficiaries into the society	Yes	2009	All project activities are completed and further implementation will be financed by units of local self-government.
Service quality improvement in social welfare facilities (reconstruction and adaptation of social welfare centres, construction of new centres and improvement of sanitary and hygienic conditions in social welfare homes)	Yes	2009	All activities are in the final phase (construction, extension, refurbishment, improvement of sanitary and hygienic conditions)
Adoption of a new act in the field of social welfare	In progress	2010	Preparations were made in 2009 for the drafting of a draft proposal of the act whose adoption is envisaged for 2010.
Development of a 'one-stop-office' concept	In progress	2011	'One stop office' model is currently being tested in 5 social welfare centres and preparations are underway for its implementation in other social welfare centres.

Drawing up and adopting a national strategy for the protection of children from abuse and neglect	No	2010	
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	2010	Due to MHSW reorganisation, the drawing up and adoption of the protocol on the procedure regarding serious neglect of a parent, adoptive parent, guardian or another person pertaining to the responsibility to provide for or care for a child and the national plan against sexual abuse of children have been postponed until 2010.
Drawing up a national plan against sexual abuse of children	No	2010	
Initiating the procedure for signing and ratification of the Convention on Protection of Children and Co-operation in Respect of Intercountry Adoption (Hague Adoption Convention, 1993)	Yes	2009	
Strengthening of capacities of social welfare centres for the purpose of providing support to groups that are in unfavourable position with regard to access to employment - IPA IV Operational programme for human resources development	In progress	2012	
Improvement of the system of family aid in accordance with the National Population Policy (drafting and application of the implementing regulations based on the National Population Policy)	Yes	2009	With a view to achieving the measures of the National Population Policy, the authorities adopted the Act on Maternity and Parental Benefits which entered into force on 1 January 2009. Also, under the Act on Child Support, the amount of child support paid depends on the amount of family income and procreation allowance is paid for each third and fourth child in the family. A foundation Croatia for Children was also founded which became operative in 2009.
Establishment of family centres and branches of family centres	Yes	2009	In 2009, 17 family centres were founded. No further investments are planned. The establishment of new centres will be considered after financial resources are ensured.
AGRICULTURAL SECTOR			
Privatisation of a large agricultural and food-processing company VUPIK d.d., Vukovar	Yes	12 November 2009	
Adoption of a new Act on State Aid to Agriculture	Yes	3 July 2009	
Recruitment of new employees in the Central Veterinary Information System of the Veterinary Inspectorate.	Yes	10 July 2009	
International tender 'Design, Development and Implementation of Veterinary Science Information System' for the establishment of an operational Central Veterinary Information System	Yes	7 September 2009	International tender was open until 23 October 2009. The selected company is expected to start operating in early 2010, while its full operability is expected in early 2001, following completion of the startup activities.
Financing of the measures of rural development from the pre-accession programme SAPARD	Yes	2009	The program was completed on 31 December 2009.
Financing of the measures of rural development from the funds of the pre-accession instrument - IPA, component V IPARD 2009-2012	Yes	2009-2012	EC accreditation and full implementation of the IPARD programme from 2009 to the date of accession are expected.
Financing of the measures of rural development from the state budget	Yes	2009	
Drawing up a Food Processing Industry Development Strategy	No	2010	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. As no sufficient funds had been envisaged under the 2009 budget, the appointed committee did not start working on the drafting of the strategy during that year. Funds earmarked for this purpose have been envisaged under the 2010 budget under a collective item of the Ministry - drawing up strategic documents.
Adoption of a national operational programme of support to the food processing sector	No	2010	The operational programme was not adopted in 2009 as its adoption is closely connected to the adoption of the Food Processing Industry Development Strategy and to budgetary funds planning for the 2010-2012 period. The aid planned for the development of the food-processing sector under the 2009 budget was reallocated under the revised budget.
Act on State Aid in Fisheries	Yes	11 December 2009	The Act was adopted at the session of the Croatian Parliament on 11 December 2009 (The Act on Structural Support to Fisheries and Regulation of the Fisheries Market, OG 153/09)
Operational Fisheries Programme	No	1 August 2010	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.
National Strategic Plan	No	1 April 2010	The legislative basis for the adoption of the National Strategic Plan is provided by the Act on Structural Support to Fisheries and Regulation of the Fisheries Market. The National Strategic Plan can be placed into the adoption procedure only after this Act has entered into force.

PUBLIC ADMINISTRATION REFORM			
Adoption of the Regulation on job classification and salaries of civil service employees	No	Upon enactment of the Act on the Salaries of Civil Servants	The Regulation on job classification and salaries of civil service employees is connected to the Act on Salaries of Civil Servants and it can be placed into the adoption procedure only after enactment of this Act.
Adoption of a Strategy for the development of human resources in state administration	Yes	December 2009	
The application of the Administrative Inspection Act and conduct of a thorough supervision of all bodies of state administration	Yes	November 2009	In the context of application of the new Administrative Inspection Act, between June 2008 when the Act entered into force and November 2009, thorough supervision was conducted in 8 bodies of government administration. Supervision will continue to be conducted on an ongoing basis in the context of regular activities of the Administrative Inspection, in accordance with the Work Plan.
Implementation of activities planned for 2009 under the Implementation Plan of the 2009-2012 Electronic Administration Development Strategy of the Republic of Croatia	Yes	December 2009	Since the adoption of the Strategy in January 2009, the central portal of the public administration ('Moja uprava') continued to be maintained and further developed and activities planned for 2009 were launched. Project tasks were defined for the preparation of the framework for interoperability, paperless office model (e-Office), central authorisation and authentication system model, and the model for the system of information-communication technology knowledge, projects and resources management in government administration.
Drawing up a semi-annual report on the implementation of the 2009-2012 Electronic Administration Development Strategy of the Republic of Croatia	No	January 2010	Semi-annual report will constitute a part of the annual report to be drawn up in January 2010.
Drawing up an annual report on the implementation of the 2009-2012 Electronic Administration Development Strategy of the Republic of Croatia	No	January 2010	Given that the 2009-2012 Electronic Administration Development Strategy was adopted in January 2009 and that the one year period elapses in January 2010, the first annual report will be drawn up accordingly.
OTHER REFORMS			
Development of a knowledge-based society			
Encourage the establishment of kindergartens and increase the number of preschool programmes, with a particular emphasis on increasing the number of children in preschool programmes	Yes	10 October 2009	In 2009, 22 new kindergartens and 38 regional kindergarten facilities were opened and approvals were given for 113 new programmes.
Conduct pre-testing of fourth and eighth grade students	No	School year 2009-2010	Teacher training was conducted and the foundations were laid for the preparation of mathematics tests for eighth grade students, reading literacy tests for fourth grade students and biology tests for eighth grade students.
Conduct national exams - external evaluation of educational programmes and student achievements	Yes	February - May 2009	Pre-testing and testing were conducted on a sample of 1,400 second grade secondary school students in mathematics and Croatian.
Continue with the project of introduction of the state school-leaving exam	Yes	March-June 2009	A trial state school-leaving exam was held.
Health care reform			
Stabilisation of financing of hospitals	Yes	January 2009	Hospital limits have been raised since 1 April 2008 to the level of funds necessary for balanced business activity and on 1 January 2009, health care system reform was initiated which created the conditions for increased income from alternative sources.
Introduction of the system of fixed and variable capitation rates instead of fixed capitation rate in primary health care	Yes	April 2009	In the period from January to March 2009, institutional conditions were created for the beginning of application of the mixed model of payment in primary health care, based on regulatory changes which entered into force on 1 January 2009. The mixed model of payment consists of a fixed amount which depends on the number of insured signed in persons and a variable amount which consists of the payment of the price for the service provided, agreed preventive programmes and indexation.
Introduction of other forms of financing (supplementary health insurance in the free market), and to ensure preventive action in the area of risky behaviour and risk factors, one of the measures is the introduction of special contributions in respect of known and recognised risks (a larger share of medical expenses arising from direct and indirect risk exposure is expected to be financed by source of risk)	Yes	January 2009	
Regulation of a part of the system of control (professional and financial)	Yes	January 2009	
Judicial reform			
Physical merger of 21 municipal courts to 9 courts	In progress	2010	So far, 15 municipal courts have been physically merged to 7 courts.
Implementation of the common information system for the land registry and the cadastre	In progress	June 2010	The project of the establishment of a common information system for the land registry and the cadastre is underway. It includes land registry and cadastre data harmonisation. The operative function of the common information system is planned for 1 June 2010 and it will contain data from 2 municipal courts, i.e. land registry departments, one in Požega and one in Zadar.
Entering into force of the provisions of the new Criminal Procedure Act	Yes	1 January 2009 1 July 2009	Some of the provisions of the Criminal Procedure Act entered into force on 1 January and 1 July 2009, while some of the provisions which involve radical changes and require significant technical and organisational adjustments will enter into force on 1 September 2011.
The establishment of the structure and the necessary preconditions for full application of the Free Legal Aid Act	Yes	2 February 2009	The implementation of the Free Legal Aid Act started on 2 February 2009. The institutional framework for its implementation had been provided until then.

Environmental protection			
Drawing up guidelines for the implementation of the EIA and SEA procedures	Yes	December 2009	Guidelines have been drawn up for the preparation of studies on the environmental impact of mineral resources exploitation. Draft guidelines on wind power plants have been prepared. The guideline on public participation in environmental impact assessment procedures will be drawn up in the first half of 2010.
The adoption of a Programme for emission reduction of specific pollutants causing acidification, eutrofication and ground ozone	Yes	December 2009	Official Gazette 152/09
The establishment of the remaining 12 stations for continuous air quality monitoring	Yes	December 2009	In 2009, the 12 remaining stations for continuous air quality monitoring were established, financed from the state budget. Measuring equipment for these stations was acquired in the context of the PHARE 2006 project programme. These stations are expected to be put into operation in the first half of 2010.
Operationalisation of the Registry of Greenhouse Gas Emissions	Yes	December 2009	The Operationalisation of the Registry of Greenhouse Gas Emissions took place in 2009 in terms of completion of the procedure of connecting to the International Transaction Log.
The establishment of the system of implementation of flexible mechanisms under the Kyoto Protocol	Yes	December 2008	Although the previous PEP, in the economic policy matrix, determined the year 2009 as the deadline for the implementation of this measure, the Regulation on implementation of the flexible mechanisms of the Kyoto Protocol was adopted already in December 2008 (OG 142/08).
Drafting and adoption of implementing legislation based on the Environmental Protection Act	Yes	September 2009	In 2009, 5 pieces of subordinate legislation were adopted. The drafting and adoption of new and revision of the existing implementing regulation based on the Environmental Protection Act will continue in the forthcoming period as stated in the economic policy matrix.
NATURA 2000 – PHARE	Yes	July 2009	The year 2009 saw the completion of the implementation of the PHARE 2005 programme Institutional Building and Implementation of NATURA 2000 in Croatia.
Development of protected areas management system and ecological network area management, establishment of an environmental protection information system	Yes	September 2009	The establishment of the Environmental Protection Information System has been launched in the context of PAMS project implementation.
Drawing up and implementation of the project 'National Forest Resources Inventory of the Republic of Croatia'	No	I quarter 2010	The drawing up of the Conceptual and Operational Plan of National Forest Resources Inventory of the Republic of Croatia has been completed. Finalisation and data presentation are planned for early 2010.