



REPUBLIC OF CROATIA



2007 PRE-ACCESSION ECONOMIC PROGRAMME

Zagreb, November 2007

TABLE OF CONTENTS

1 OVERALL POLICY FRAMEWORK AND OBJECTIVES.....	- 2 -
2 ECONOMIC OUTLOOK	- 3 -
2.1 RECENT ECONOMIC DEVELOPMENTS	- 3 -
2.2 MEDIUM-TERM ECONOMIC SCENARIO	- 8 -
2.2.1 Real sector	- 8 -
2.2.2 Inflation	- 11 -
2.2.3 Monetary and exchange rate policy	- 12 -
2.2.4 External sector	- 14 -
3 PUBLIC FINANCE	- 17 -
3.1 GENERAL GOVERNMENT BALANCE AND DEBT	- 17 -
3.1.1 Policy strategy and medium-term objectives	- 17 -
3.1.2 Actual balances and medium-term perspectives	- 18 -
3.1.3 Structural balance	- 23 -
3.1.4 Debt levels and developments.....	- 25 -
3.1.5 Budgetary implications of major structural reforms	- 26 -
3.2 SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS PROGRAMME	- 28 -
3.2.1 Fiscal risks and sensitivity analysis of deficit and public debt.....	- 28 -
3.2.2 Comparison with previous programme	- 32 -
3.3 QUALITY OF PUBLIC FINANCES	- 35 -
3.4 SUSTAINABILITY OF PUBLIC FINANCES	- 37 -
3.5 INSTITUTIONAL FEATURES OF PUBLIC FINANCES	- 39 -
4 STRUCTURAL REFORM OBJECTIVES.....	- 41 -
4.1 ENTERPRISE SECTOR.....	- 41 -
4.1.1 Privatisation.....	- 41 -
4.1.2 Railway restructuring	- 42 -
4.1.3 Restructuring of shipbuilding industry.....	- 43 -
4.1.4 Energy	- 44 -
4.1.5 Small and medium size enterprises	- 46 -
4.1.6 Public-private partnership	- 48 -
4.2 FINANCIAL SECTOR.....	- 50 -
4.2.1 Banking sector.....	- 50 -
4.2.2 Non-banking sector	- 52 -
4.3 LABOUR MARKET.....	- 54 -
4.3.1 Stimulating employment	- 54 -
4.3.2 Social security system	- 55 -
4.4 AGRICULTURAL SECTOR	- 59 -
4.5 ADMINISTRATIVE REFORM	- 65 -
4.6 ADDITIONAL REFORM AREAS	- 67 -
4.6.1 Knowledge-based society.....	- 67 -
4.6.2 Health care reform.....	- 68 -
4.6.3 Judicial reform.....	- 70 -
4.6.4 Environmental protection.....	- 74 -
5 ECONOMIC POLICY MATRIX	- 79 -
Annex I Matrix of policy commitments	- 86 -
Annex II Statistical appendix	- 91 -
Annex III Structural reforms agenda and achievements	- 102 -

1 OVERALL POLICY FRAMEWORK AND OBJECTIVES

The framework and goals of the economic policy of the Republic of Croatia are defined in a series of strategic documents of the Government of the Republic of Croatia, namely: the Strategic Development Framework for 2006-2013, the Economic and Fiscal Policy Guidelines for 2008-2010, and the Pre-accession Economic Programme (PEP). Those documents provide the basis for the implementation of the economic policy in the next medium-term period, and they are prepared through consultations between the state administration bodies and employers' and unions' representatives. The Strategic Development Framework for 2006-2013 is the main strategic document which defines the priority areas of action and the economic policy goals until 2013. The Economic and Fiscal Policy Guidelines provide a three-year fiscal framework for the implementation of the mentioned goals and measures. This year's PEP for 2008-2010 builds on these two documents and defines the macroeconomic and fiscal framework for the forthcoming three-year period, the priority areas of the policy of the Croatian Government, the order of those priorities, as well as the specific measures necessary for successful implementation of the structural economic reforms.

In the period until 2010, the main economic policy goal is to ensure stable and sustainable economic growth, while at the same time reducing unemployment and increasing employment, and to strengthen competitiveness of the Croatian economy. During this period, the acceleration of economic growth is planned to the level of seven percent, while the unemployment rate is expected to drop below seven percent.

The achievement of the main economic policy goal implies:

- maintenance of macroeconomic stability with the reduction of external imbalances;
- further fiscal consolidation with the reduction of the budget deficit and the balancing of the budget in order to ensure that the fiscal policy is in line with business cycle developments;
- strengthening of entrepreneurship and providing more opportunities for private sector as the main generator of economic growth;
- completion of reform processes with an emphasis on the reform of public administration and completion of the judicial reform;
- restructuring and privatisation of the economic sectors dependant on the state aid
- development of transport and energy infrastructure;
- improving the quality and the flexibility of labour force through providing adequate training in accordance with the labour market needs.

2 ECONOMIC OUTLOOK

2.1 RECENT ECONOMIC DEVELOPMENTS

According to the quarterly GDP calculation estimates, the annual growth of real GDP accelerated from 4.3% in 2005 to 4.8% in 2006¹. A large contribution to the growth of economic activity in 2006 came from the fixed capital formation (3.2 percentage points, which is 1.8 percentage points more than the year before). Besides stronger investment activity, private consumption was also an important driver of overall economic activity, its contribution to real GDP growth remaining at the previous year's level (2.1 percentage points). The growth of government consumption also accelerated in 2006, to 2.2%, thus contributing to the recovery of dynamics of overall final consumption. Net foreign demand had opposite effects, its negative contribution to real GDP growth being -1.1 percentage points, mainly as a result of the fact that in 2006 imports of goods and services grew faster than the exports. Actual GDP growth was 0.2 percentage points higher than the projected in the previous year's PEP, due primarily to faster-than-expected growth of fixed capital formation and private consumption, while the growth of exports and government consumption was slightly overestimated.

In the first half of 2007, real economic growth was 6.8%. The largest contribution to GDP growth in that period came from private consumption, which grew at the annual rate of 6.8%. The 8.3% real growth of fixed capital formation in the first half of 2007 was a result of the slowdown from 11.2% in the first quarter to 5.2% in the second. In the observed period, the real growth of exports of goods and services was 6.3%, whereas the real growth of imports of goods and services was 5.2%. Even though goods and services exports grew faster than the imports, net foreign demand contributed negatively to the real GDP growth. Government consumption grew evenly during the first and the second quarter, and its real y-o-y growth in the first half of the year was 2.7%.

The available monthly economic activity indicators for the beginning of the third quarter suggest that the positive trends observed in the first half of 2007 will continue. The notable recovery of foreign demand for investment and consumer goods alike has had a positive impact on the growth of industrial production. The available data on current production, merchandise trade and changes in the inventories of final industrial products suggest that investment consumption will continue to grow towards the end of the year, which is in line with strong acceleration of the annual growth of banks' loans to enterprises during the first eight months. In addition, data on planned acquisitions of non-financial assets by the general government are indicative of a recovery of public investment during 2007, accompanied by a growth of private capital investment, which is expected to be more moderate than last year. Furthermore, steady growth of real retail trade turnover during the first eight months of this year and improvement in consumer optimism compared to the beginning of the year – as the Consumer Confidence Survey conducted by the Croatian National Bank (CNB) in April and July showed – suggest that positive developments in private consumption will also continue. This is also confirmed by changes in regular and non-regular sources of financing of household consumption, and especially by a strong growth of citizens' disposable income stemming to some extent from pensioners' debt repayments. Moreover, bank loans to households grew during the second quarter of this year at a rate similar to that recorded in first quarter (above 17%, according to the average loan balance).

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

In the first half of 2007, an exceptionally high economic growth was achieved, and the available monthly economic activity indicators suggest that such strong economic dynamics will continue, so that real growth for the entire 2007 is likely to be much higher than projected in the PEP for 2006-2009.

The positive developments in the real sector in mid-2007 reflected on the labour market as well. Thus, the number of unemployed persons registered with the Croatian Employment Service (HZZ) at the end of August 2007 was 10.4% smaller than at the same time previous year. Furthermore, both the preliminary employment data of the Central Bureau of Statistics (CBS) and the data on the number of insured persons with the Croatian Pension Insurance Institute (HZMO), which are considered a more reliable short-term indicator of movements in employment levels, point to a continued annual growth of the total number of employed persons during the first eight months of this year. As a result of the positive developments in the labour market during the observed period, the rate of registered unemployment at the end of August was 1.5 percentage points below the level measured in the same month of the previous year. The registered unemployment rate fell to 13.8%, its lowest level since 1997. The results of the labour force survey for the first half of 2007 are expected to confirm the described developments².

The annual growth of the average real gross earnings paid in the first eight months of 2007 was 4.2%, much higher than in the same period of 2006. However, as a result of the strong growth of labour productivity during that period, nominal unit labour cost growth slowed down, thus easing the cost pressure on production and having a favourable impact on inflation.

In 2006, the average annual inflation rate was 3.2%, which is 0.3 percentage points less than estimated in the PEP for 2007-2009. Such departure of the actual figure from the estimate can largely be explained by the factors on the supply side present in the autumn of 2006, namely a decrease in the prices of crude oil in the world market and the unusually warm weather that resulted in lower prices of agricultural products in the domestic market.

The first seven months of 2007 saw a very mild acceleration of the annual consumer price inflation, from 2.0% in December 2006 to 2.1% in July 2007. In August, inflation grew faster and reached 2.6%. Faster growth of the consumer price index (CPI) in August can be attributed to a shock on the supply side caused by increased prices of agricultural and industrial food products due to unfavourable weather conditions, i.e. a drought. During the first eight months of the year, core inflation rose by 2.6% y-o-y, while the industrial producer price index went up by 2.5% in the same period.

The stable exchange rate of the kuna against the euro helped to keep the inflation at a comparatively low level during the first eight months of the year. The nominal exchange rate of the kuna against the euro appreciated by 0.3% during the first eight months. In July and August, the kuna exchange rate was exposed to appreciation pressures stemming primarily from the usual seasonal stronger inflow of foreign currencies during the top tourist season. Besides, the month of July also witnessed a strong inflow of foreign currencies due to enterprises' continued borrowing abroad. In this context, note should be made of the borrowing of Zagrebački holding (the Zagreb City Holding) through the EUR 300 million Eurobond issue. In order to ease the appreciation pressures, the central bank intervened in the foreign exchange market in July, for the first time this year, by purchasing a total of EUR

² The Labour force Survey is the most comprehensive survey of the labour market characteristics, and is carried out on a sample of Croatian households in accordance with the methodological rules and principles of the International Labour Organization (ILO). In 2007 the CBS has started processing and publishing the results on a quarterly basis. The latest available survey reported the 11.2% unemployment rate for the first quarter of 2007.

139.0 million from commercial banks in two auctions. During the first eight months of 2007, the indicator of exporters' price competitiveness slightly deteriorated, as suggested by the movements in the index of the real effective exchange rate of the kuna which appreciated during the period by 1.5% deflated by consumer prices and by 1.2% deflated by producer prices.

Monetary developments in 2007 were characterised by the adoption of the Decision on the Purchase of Compulsory CNB Bills, which supplemented the CNB's existing set of monetary policy instruments aimed at slowing down the growth of banks' placements and reducing external imbalances, the current account deficit and foreign debt in particular. Pursuant to the Decision, banks' placements in 2007 may grow by 12% at the most without being subject to the purchase of the compulsory CNB bills bearing a very low interest rate, while placements growth above the 12% limit is the basis for the purchase of the CNB bills, with the rate of purchase being 50%. While bank placements did grow more slowly than in 2006, commercial banks already exhausted much of the credit growth limit during the first half of the year, which prompted the CNB to further tighten the measures prescribed in the Decision in June. In the amendments to the Decision, the CNB introduced the monthly 0.5% limit for the growth of bank placements during the second half of the year, which means that in the second half of the current year bank placements may grow by 3%.

The developments during the first eight months of 2007 are indicative of slower credit activity of commercial banks. Thus, bank placements to the non-banking sector grew by 9.3%, which is 3.9 percentage points less than in the same period last year. Such developments reflected on the annual growth rate of bank placements, which dropped from 22.9% at the end of 2006 to 18.7% at the end of August 2007. Corporate loans recorded an annual growth rate of 17.0% at the end of August, while household loans grew somewhat faster, i.e. by 20.2%.

Slower growth of bank placements during 2007 reflected also on banks' needs for foreign funding. Taking into account the effects of the marginal reserve requirement, according to which commercial banks are obliged to make a deposit with the central bank equalling 55% of their new foreign borrowings, as well as the increased interest rates in the Eurozone, commercial banks switched from foreign to cheaper domestic sources of financing. In the first eight months of 2007, foreign liabilities of commercial banks fell by EUR 1.9 billion or 18.2%. On the other hand, strong growth of domestic sources of funds continued, so that at the end of August 2007 total liquid assets (M4) grew by 19.0%, due primarily to the growth of deposits during the summer months as a result of a successful tourist season. The strongest growth was recorded by foreign currency deposits, which are traditionally the most common type of bank deposits (accounting for over 65% of total deposits). Their annual growth rate at the end of August was 21.6%, while kuna deposits grew at the rate of 16.3%. Money (M1) recorded the annual growth rate of 19.4%, with currency outside banks and demand deposits contributing evenly to such growth.

International economic relations in 2006 were marked by the widening of the current account deficit to 7.7% of GDP. This was mostly a result of the increased negative balance (deficit) in merchandise trade, which was only partly offset by favourable results in international services trade. When it comes to foreign debt, its share in GDP grew by 3 percentage points during 2006 compared to the year before and reached 85.3% of GDP. Such growth is mainly attributable to enterprises' direct foreign borrowing which largely substituted slower growth of banks' borrowing abroad, while the Government, on the other hand, reduced its external debt. The 2006 figures differ slightly from the expectations incorporated in the previous PEP (the relative indicators of the current account deficit and foreign debt are higher by 0.2 percentage points and 0.9 percentage points, respectively). On the current account side, the divergence is mainly a result of larger imports of goods, whereas the results in exports of

goods and services are better. The fact that the growth of foreign debt in 2006 was higher than forecasted in the previous PEP can mostly be attributed to higher-than-expected growth of foreign borrowing on the part of enterprises.

After its strong growth during 2006, the current account deficit continued to widen during the first two quarters of 2007 to reach EUR 3.4 million, which is 3.6% more than in the same period last year. Its growth is mainly a result of a growing imbalance in international merchandise trade, which was only partly neutralised by good results in international service trade and favourable movements in the factor income account. Still, it should be noted that the current account deficit grew more slowly in the first half of 2007 than in the corresponding period previous year, when its annual growth rate reached 23.7%.

As for exports of goods, their annual growth rate fell from 16.1% in the first eight months of 2006 to 11.4% in the corresponding period in 2007. To the largest extent, such slowdown is a result of reduced exports of energy products (natural and industrial gas, and electricity) and certain food products, such as coffee, tea, cocoa and spices, as well as fish and fish products. At the same time, exports of other transport equipment (mainly ships), electrical machinery, apparatus and appliances, along with exports of crude oil and petroleum products performed very well.

In the first eight months of 2007, the value of total imports of goods increased by 10.8% at the annual level, which is 4.4 percentage points less than in the same period last year. Such slower annual growth can largely be explained by reduced imports of natural and industrial gas, sugar, sugar and honey products, as well as leather and fur products. By contrast, imports of road vehicles, iron and steel have continued to grow fast, with increased imports of general industrial machinery and equipment making a strong contribution to the growth of overall imports as well. Imports of capital goods have also continued to grow, yet at a lower rate than in the first eight months of 2006 (13.6% compared to 14.2%). Speaking about other Sections of the Standard International Trade Classification (SITC), the growth of imports of crude oil and petroleum derivatives should not be disregarded, even though it was much slower compared to the last year's corresponding period thanks to the fact that the growth of the prices of crude oil in the world market stabilised.

In terms of geographical structure of foreign trade in the first eight months of 2007, as compared to the entire last year, the share of the EU countries (excluding Bulgaria and Romania) in Croatia's total goods exports decreased, primarily as a result of a reduced share of exports to the old Member States, Italy and Sweden in particular. On the other hand, the share of exports to the new Member States in Central and East Europe went up thanks mainly to a greater share of exports to Malta and Hungary. The share of developing countries in Croatia's total goods exports grew moderately during the first eight months of 2007, which can largely be attributed to an increase in the share of exports to the countries in the region, primarily Bosnia and Herzegovina, Serbia and Montenegro. On the imports side, the share of developed countries increased slightly, due mainly to larger imports from the old EU Member States, Italy in particular. As for imports from developing countries, the share of imports from Bulgaria decreased the most.

In the first half of 2007, there was a net inflow of EUR 2.6 billion into capital and financial account. Compared with the first half of 2006, a much stronger net inflow was recorded in respect of foreign direct investment (FDI), whereas net outflow associated with portfolio investment, as well as net inflow in respect of other investment were smaller than last year. Larger amounts of FDI relate mainly to equity investment, with recapitalisation in certain banks accounting for a predominant portion. Apart from that, considerable equity investments were made in the trade sector, and also in the extraction of crude oil and natural gas sector.

During the first half of 2007, EUR 371 million net outflow was recorded in the portfolio investment account because the growth of foreign assets of domestic sectors outpaced the growth of their foreign liabilities in the same period. The growth of foreign assets can mainly be attributed to increased investment by domestic investment funds into equity securities in the international market, while the increase in liabilities results largely from the new EUR 250 million bond issue by the Croatian Bank for Reconstruction and Development (HBOR).

EUR 1.4 billion net inflow in the other investment account which was recorded in the first half of 2007 is to the largest extent attributable to further increase in liabilities of the domestic sectors, enterprises in particular. However, as the banks' and government's liabilities were reduced during the same period, total growth of liabilities in respect of other investment was less than a half of the growth measured in the last year's corresponding period. At the same time, the amount of the domestic sectors' foreign assets declined, due mainly to the withdrawal of cash and bank deposits even though the extent of such withdrawals was much smaller than in the first half of last year.

According to balance of payments data excluding cross-currency changes, international reserves went up by EUR 472 million during the first half of 2007, which is almost three times less than in the comparable period last year. Such considerably smaller growth of international reserves can mainly be explained by commercial banks' reduced allocations of the foreign currency reserve requirement, including the marginal reserve requirement, but also by reduced central bank's interventions. According to monetary statistics data which include cross-currency changes, international reserves grew by 5.1% during the first six months of 2007 to reach EUR 9.2 billion at the end of June. Slower annual growth of international reserves continued into the months of July and August due also to commercial banks' reduced foreign liabilities, i.e. reduced allocations of the foreign currency reserve requirement, including the marginal reserve requirement.

In the first eight months of 2007, gross external debt widened by EUR 1.2 billion (4.2%), reaching EUR 30.4 billion at the end of August, according to preliminary data. In terms of individual economic sectors, the growth of external debt in the period reviewed is attributable exclusively to enterprises (which account for the largest share of other domestic sectors) in that their foreign liabilities, including liabilities to associated companies abroad (on the basis direct investment into enterprises) went up by EUR 3.2 billion. As a consequence, the annual growth of corporate external debt accelerated to 34.9%, its share in total external debt increasing to the level of 50.5%. During the first eight months of 2007, the government sector reduced its external debt by EUR 0.1 billion, while the liabilities of commercial banks went down by EUR 1.9 billion in the same period, so their portion of external debt, including hybrid and subordinate debt instruments (direct investment into banks), amounted to EUR 8.5 billion at the end of August, down 18.1% from the end of 2006.

2.2 MEDIUM-TERM ECONOMIC SCENARIO

The medium-term macroeconomic projections are based on the released GDP and balance of payments data for the first two quarters and other high-frequency indicators of economic activity available for the first eight months of 2007. The forecasts for the real and external sectors have been aligned with the fiscal projections contained in the medium-term fiscal programme. The programme assumes continuation of the implementation of the structural reforms set out in this year's PEP, as well as Croatia's accession to the EU in 2009.

The macroeconomic policy mix on which the programme is based is characterised by fiscal consolidation and preserved stability of the kuna exchange rate. The monetary policy is focused on maintaining the exchange rate stability in order to keep inflationary expectations under control. In the situation of substantial foreign capital inflows, strong appreciation pressures are present, while aggregate demand grows, thus impacting negatively on current account deficit. With a view to narrowing the existing gap between savings and investment, the fiscal policy is focused on reducing further the fiscal deficit, which will allow the external debt as a share of GDP to stabilise and decrease over the medium term.

2.2.1 Real sector

The quarterly GDP calculation indicates real y-o-y economic growth of 7.0% in this year's first quarter and 6.6% in the second, or 6.8% in the first half of the year. The projection for the whole 2007 assumes a 6% real GDP growth, which is 1.2 percentage points more than in 2006. Real economic growth of 6%, with the anticipated 3.1% growth of implicit GDP deflator in the current year, would result in an increase of the kuna value of GDP of an estimated HRK 23.2 billion, i.e. GDP at current prices would stand at HRK 273.8 billion at the end of the year.

Positive developments in the real sector are expected to continue in the next several years, with economic growth being expected to reach 6.1%, 6.5% 7.0% in 2008, 2009 and 2010, respectively. To some extent, such positive expectations rest on the assumption of Croatia's EU accession in 2009. Based on the experiences of the new EU member states from the 2004 enlargement, EU membership is expected to give a strong impetus to economic growth. A positive contribution is also expected to come from continued structural reforms and the resulting improvement of the business climate, which will help strengthen the private sector, while the narrowing of fiscal deficit will open up new opportunities for the private sector.

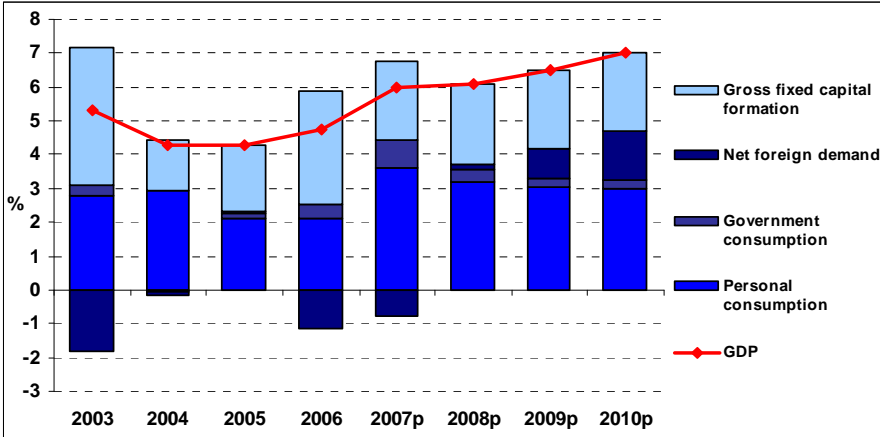
According to estimates, y-o-y growth of the implicit GDP deflator should fall from 3.9% in 2008, to 3.3% in 2009, and 3.2% in 2010. The implicit deflator movements follow the movements in the consumer price index, but the rates of change of the implicit deflator are higher in all the periods under review. The difference is a result of higher estimates for the government consumption deflator, which results from the method of its calculation assuming constant productivity. It means that in the segment of the government consumption relating to the compensation of employees, real growth represents only the growth of the number of employees, while the increased deflator accounts for the rest.

Throughout 2007, private consumption has recorded strong recovery, as shown by its real y-o-y growth of 6.8% in the first half of the year. For the entire 2007, private consumption is expected to grow at a rate of 6.0% in real terms. The recovery of private consumption can be explained by the 1.3% y-o-y employment increase and the 3.1% real growth of net wages in the first eight months. This, along with the compensation paid to pensioners (i.e. pensioners' debt repayments), has had a positive impact on the growth of households' real disposable

income. The growth of private consumption has also been supported by the growth of household loans even though their y-o-y growth is anticipated to slow down towards the end of the year. While the average y-o-y real growth of household loans (excluding housing loans) has been slowing down during the past several months, in the first eight months of the year, it was still higher than in the same period last year.

Private consumption is expected to contribute strongly to real GDP growth in the remaining years of the projection period as well. Real growth of private consumption is estimated at 5.4%, followed by 5.1% in 2009 and 2010. Such growth of private consumption will be a result of the projected growth of wage bill arising from faster growth of employment and wages which follows intensified economic activity. Besides the increase in disposable personal income, consumer optimism could be additionally boosted by anticipated further increase in the value of household assets. This refers not only to real estate prices, but also to the value of financial assets such as shares and investment funds assets. At the end of 2006, Croatian individuals held shares with total market value of almost HRK 28 billion, not including the value of their shares in investment funds. This effect should be taken into account particularly in the context of Croatia’s accession to the EU as optimistic expectations will continue to grow.

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



Source: CBS, MF

After a very strong 10.9% real growth of fixed capital formation in 2006, the first half of 2007 saw a slowdown to 8.3% y-o-y. For the entire 2007, real growth of this aggregate demand category is expected to be at 7.5%. Public investment in road construction is expected to make an important contribution to investment growth in 2007. While a positive contribution of the government investment is expected in the period after 2007, the private sector will still be the main generator of investment. For each year during the period 2008-2010, real investment growth of 7.2% is projected, as a result of improved business and investment climate.

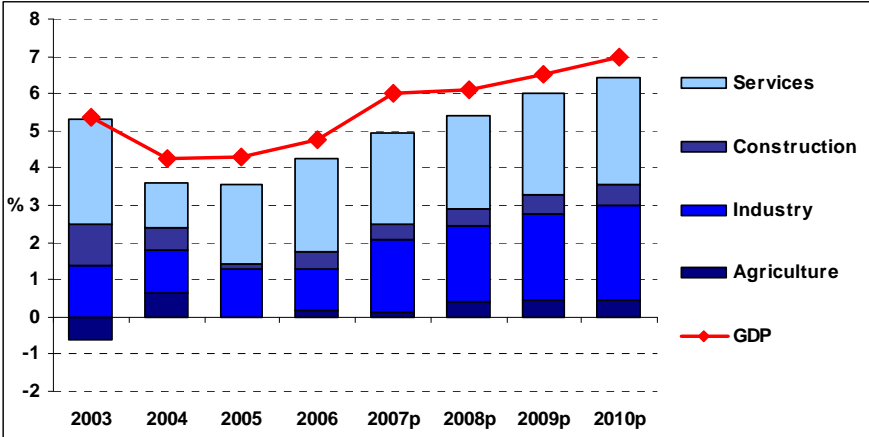
The government consumption projection is based on the nominal general government budget data. Real growth of the government consumption in the relevant period is determined by expenditures for the use of goods and services, since no increase in the number of public service employees is expected. The projection for 2007 shows a 4.2% real growth of the government consumption, as a result of faster growth of expenditures for the use of goods and services. Slower growth of this expenditure category will reduce the real growth rates of the government consumption to 1.8%, 1.4% and 1.6% in 2008, 2009 and 2010, respectively. It is therefore realistic to expect somewhat stronger contribution of the government consumption

to real GDP growth in 2007, with moderate positive contribution in the subsequent years until 2010.

Real y-o-y growth of goods and services exports accelerated from 3.0% in the first to 8.9% in the second quarter of 2007, while cumulative growth in the entire first half of the year stood at 6.3%. In view of the 13.6% y-o-y growth of the exports of goods in the months of July and August, and considering also the y-o-y increase in the number of nights spent by foreign tourists in the same period, real growth of goods and services exports for the entire 2007 is expected to be 8.0%. In the upcoming period, goods and services exports are expected to grow even faster, i.e. by 9.3%, 10.0% and 10.5% in 2008, 2009 and 2010, respectively. Faster growth of exports will be spurred by favourable economic growth prospects in the Croatian main export markets (Italy, Germany, Austria and Slovenia), by further strengthening of integration processes, productivity growth, as well as the anticipated implementation of export promotion projects by the Ministry of Economy, Labour and Entrepreneurship. While real growth of goods and services imports is expected to accelerate in 2007 to 7.5%, in the years to come, their growth is expected to slow down in parallel with slower growth trends in personal consumption and investment. Thus, real growth of goods and services imports is projected at 7.1%, 6.8% and 6.6% for 2008, 2009 and 2010, respectively. It follows from the above projections that net exports of goods and services will make a negative contribution to real GDP growth in 2007, whereas their contribution in the subsequent years is expected to be positive.

A medium-term projection of gross value added (GVA) is based on the full compliance between GDP calculations according to the expenditure and the production method i.e. it is assumed that there is no statistical discrepancy in the projection period. In the medium term, indirect tax revenues reduced by subsidies at current prices are expected to grow faster, which largely follows the projected economic growth. It is further assumed that the structure of the economy will not change significantly over the medium term. Industry and construction are expected to be the fastest growing economic activities in the medium term, while the growth of value added in the services sector is likely to lag slightly behind the growth in those sectors. However, the services sector is still expected to be the largest contributor to overall economic growth. As regards agriculture, unfavourable weather conditions in 2007 are expected to have negative effects, however the dynamics of value added is likely to recover in the years to come, partly as a result of the utilisation of the pre-accession SAPARD funds intended for agriculture and rural development.

Figure 2: Sectoral contributions (in percentage points) to real GDP growth



Source: CBS, MF

Favourable developments in the labour market present during 2006 continued into 2007, so the average number of registered unemployed persons in the first eight months of 2007 was reduced by 7.9% y-o-y. In line with such developments, the ILO survey unemployment rate is expected to fall in 2007 to 10.2%. Furthermore, it is anticipated that the employment rate will continue to rise until the end of the projection period as a result of faster economic activity, while the unemployment rate will fall to 9.2%, 8.1% and 6.9% in 2008, 2009 and 2010, respectively. The projected economic growth will not be fully reflected in increased employment, which will result in higher productivity in all the years during the projection period. The projection further assumes that throughout the relevant projection period wages will not grow as fast as productivity, so real unit labour costs will decline further.

2.2.2 Inflation

The average annual rate of inflation in 2006 was 3.2%, which is 0.3 percentage point lower than projected in the previous PEP. The difference is a consequence of favourable factors on the supply side which were present in the autumn of 2006. Namely, the decrease in crude oil prices in the world market and the unusually warm weather that brought down the prices of agricultural products in the domestic market.

As the price increase in the period from September to December 2006 was smaller than expected, the carry-over effect on the 2007 average inflation was weaker than originally projected. As a result, the projection for the average annual consumer price inflation rate in 2007 was downward revised to 2.5% (0.7 percentage points down compared to the previous PEP).

Table 1: Consumer price index, %

	2006.	2007.p	2008.p	2009.p	2010.p
CPI, PEP 2007.-2009.	3.5	3.2	2.8	2.6	-
CPI, PEP 2008.-2010.	3.2	2.5	3.1	2.6	2.5

Source: MFIN

As noted above, there was a modest increase in the annual consumer price inflation rate during the first seven months of 2007, from 2.0% recorded in December 2006 to 2.1% in July 2007. However, August saw somewhat faster rise in the inflation, which reached 2.6%. This was a consequence of a shock on the supply side, with prices of agricultural and industrial products rising due to poor weather conditions, i.e. a drought, which reduced crops in Croatia.

In the remainder of the year, there will be a risk that increased prices of agricultural products may spill over into prices of certain food products. The risk is even more prominent in view of the fact that food products and non-alcoholic beverages account for 30.5% of the consumer basket used to calculate the consumer price index. Oil price movements in the world market pose another risk for achieving the projected inflation level in 2007. After a drop in August, crude oil prices began to rise again in the first half of September.

On the other hand, it is also possible that – given the stiff competition among them – retailers will relinquish some of their margins on food products. Also, it is expected that long-term agreements binding on producers and retailers will ease pressures for price increase in the remainder of this year. Besides, as part of its efforts to ease the present price pressures, the Government passed a decision introducing export duties on wheat in September. As regards oil prices, positive effects are expected from the OPEC decision to increase the official production level of crude oil by 500 000 barrels a day as of 1 November 2007. Furthermore,

in order to mitigate the effects of higher oil prices in the world market, the Croatian Government reduced the excises on all types of unleaded petrol last April.

The consumer price index is projected to grow by 3.1% y-o-y in 2008. The increase in the average annual rate of consumer price inflation from 2.5% in 2007 to 3.1% in 2008 is a result of a higher inflation level carried over from the previous year. The forecast of consumer price movements in 2008 rests on the assumption that the kuna to euro exchange rate will remain relatively stable. In accordance with the anticipated movements of the US dollar against the euro in the international foreign exchange markets, the year 2008 should see a moderate appreciation of the average nominal kuna to US dollar exchange rate. The strong exchange rate of the kuna against the US dollar eases the inflationary pressures stemming from the rising prices of crude oil and certain other raw materials in the world market.

The 2007 drought, as well as a potential further rise in oil prices are likely to impact negatively on the inflationary developments in 2008. The drought has reduced crops thus causing the prices of corn – being the most important fodder – to rise, which in turn could lead to higher prices of meat on account of increased production costs. The described effects will be mitigated by the Government's decision from August 2007 introducing export duties on corn and providing for its duty-free imports. On the other hand, assuming that the drought will not occur again in 2008, it is realistic to expect a decrease in the prices of agricultural products in the second half of the year, as well as a positive base period effect on the reduction of the annual rate of change in the prices of agricultural products.

According to a report released by Barclays Capital on 12 September 2007, the average price³ of crude oil in 2008 is estimated at USD 73.8 per barrel, which is 10.4% more than the estimated price for 2007. The IMF analysts are optimistic as regards movements in the prices of other raw materials (excluding energy products) during 2008. They have forecast an average 7.8% price decrease compared to 2007, with metal prices falling by a strong 13.9%. Apart from that, there is uncertainty as to electricity price developments once the Croatian market is fully liberalised in mid-2008. As of 1 July 2008, household consumers will also have the right to choose their electricity supplier.

Lower inflation rates are forecasted for 2009 and 2010 as the negative impacts of the shock on the supply side (i.e. the drought) will gradually disappear. So, consumer prices are expected to grow at the average annual rate of 2.6% in 2009, their growth slowing down to 2.5% in 2010.

2.2.3 Monetary and exchange rate policy

The main goal of the monetary policy, which is implemented by the CNB, is to achieve and maintain price stability. In pursuing that goal, the CNB uses – as an indirect goal – an anchor in the form of a stable nominal kuna to euro exchange rate. The choice of the nominal anchor reflects the circumstances in which the monetary policy is implemented in Croatia, primarily the openness of the Croatian economy and a high degree of its euroisation, due to which exchange rate movements have a strong effect on inflationary expectations, the financial system stability and economic activity at large.

The CNB applies a managed float regime, which means that the exchange rate of the national currency against the euro is formed freely in the foreign exchange market depending on movements in supply and demand, while the central banks tries to prevent excessive exchange rate volatility through occasional interventions in the foreign exchange market (auctions). In view of increased capital inflow from abroad, the CNB has most often been faced with kuna

³ Average price of crude oil of WTI and Brent types.

appreciation pressures over the past several years, so its interventions have mainly involved foreign currency purchases from banks. Increased foreign currency supply is primarily a result of significant inflows from tourism, intensive foreign borrowing, privatisation revenues, expectations on the part of market participants and, lately, of banks' recapitalisation.

Despite the described circumstances and pressures on the kuna exchange rate, the current exchange rate policy has proven successful in maintaining the stable exchange rate and low inflation. During 2007, the monetary policy measures have produced a stable monetary environment, thus easing the pressures on the kuna to euro exchange rate, so the interventions in the foreign exchange market were much less frequent than in previous years. At the same time, the inflation has remained low.

In the circumstance of free movement of capital, the importance of a stable exchange rate lies in the fact that it limits the functioning of the transmission mechanism through the interest rate channel. Thus, instead of determining the interest rates in the domestic market by extending loans to commercial banks, the CNB sterilises kuna liquidity surplus resulting from the conversion of capital inflows. The CNB operations in the open market, which were successfully introduced in 2005, have therefore mainly been used for liquidity management rather than conducting the interest rate policy. The reserve requirement remains the main sterilisation instrument and is calculated at the rate of 17%. On account of its EU approximation, Croatia will gradually lower the reserve requirement rate.

The CNB continues to implement the measures aimed at mitigating external imbalances, primarily the high level of commercial banks' foreign borrowing, mainly used to finance domestic consumption and therefore causing further widening of the current account deficit. The marginal reserve requirement, which was introduced in mid-2004 and tightened in 2005 and 2006, has increased the cost of foreign financing for commercial banks, with higher interest rates in the eurozone adding to the efficiency of the instrument. Faced with the requirement to allocate 55% of the growth of their foreign liabilities, commercial banks have intensified their efforts to attract domestic sources of funding. To this end, the banks have particularly strongly encouraged foreign-currency indexed savings because the minimum foreign exchange liquidity requirement did not apply to this type of deposits. However, in September 2006 the CNB made amendments to the Decision on Minimum Required Foreign Exchange Claims to the effect that kuna liabilities indexed to a foreign currency were also included in total foreign exchange liabilities with the aim of ensuring the minimum foreign exchange liquidity within the system and slowing down bank credit growth.

It should be noted that a number of prudential regulations have also been amended as regards the classification of bank placements and contingent liabilities, as well as capital adequacy, with the aim of reinforcing the existing monetary policy instruments. The most important of those amendments requires from commercial banks to take currency-induced credit risk into account when determining overall credit risk. In the circumstances of faster credit growth, the banks have tried to offset the monetary policy instruments applied and the amendments to the prudential measures by substantial bank recapitalisation. Thus, commercial banks' capital was increased by an aggregate HRK 5.1 billion (EUR 0.7 billion) during 2006, and the trend continued into 2007, with fresh bank recapitalisation amounting to HRK 7.3 billion (EUR 1 billion) in the first eight months alone. Since the domestic banks are predominantly foreign-owned, bank recapitalisation has resulted in additional inflows of foreign capital and further kuna appreciation pressures, while at the same time improving the system's financial stability.

In spite of all the measures implemented by the CNB, bank placements grew by 22.9% in 2006. This prompted the CNB to adopt the Decision on the Purchase of Compulsory CNB Bills at the end of 2006 with a view to slowing down the growth of bank placements. Under

the Decision, all banks whose placements grow above the limit of 12% annually during 2007 are required to make a cash deposit with the central bank at a very low interest rate. While the banks are allowed to distribute freely their credit growth of up to 12% throughout the year, a substantial part of that permitted growth already took place by June. Therefore, the provisions of the Decision were tightened and the monthly 0.5% sub-limits introduced applicable to the opening balances as at 30 June 2007. In the initial version of the Decision, the portion of the annual credit growth not subject to the requirement referred to entire bank assets, including balance and off-balance sheet items likewise. Some banks took advantage of those provisions and found additional room for credit growth by reducing their off-balance sheet items, current account overdraft facilities in particular. It was exactly for that reason that the tightening of the Decision in June 2007 included also provisions on separate monitoring of on-balance sheet and off-balance sheet items. The aim is to ensure consistent pursuance of the monetary policy goals.

In the first eight months of 2007, bank placements grew by 9.3%, compared to 13.2% in the corresponding period of 2006. The CNB projections suggest that the growth of placements is likely to slow down to 12.8% by the end of 2007. The Decision on the Purchase of Compulsory CNB Bills will remain in effect throughout 2008, and the credit growth limit will be determined shortly at a level that will allow sustainable economic growth to continue. On the other hand, as kuna savings continue to grow and the monetary policy instruments remain in force, particularly those concerning the restrictions on commercial banks' credit growth and foreign borrowing, it is realistic to expect further reduction of banks' external debt and, consequently, the assets allocated under the marginal reserve requirement. Continuation of such trend will facilitate the abolishment of the marginal reserve requirement – as a measure of capital control – which the CNB is required to do before its EU accession. The amount of assets thus released will not be substantial and should not result in excessive liquidity. Besides, some instruments to mitigate potential pressures will be available to the CNB as part of its operations in the open market.

2.2.4 External sector

After the share of the current account deficit in GDP has grown during 2007 as anticipated, the next three years should see its gradual decline. Thus, after the anticipated 8.1% of GDP in 2007, the current account deficit could fall gradually to the level of 6.5% of GDP in 2010. Besides, the relative external debt indicator is expected to improve, so the share of external debt in GDP could decrease from 85.3% in 2006 to 84.1% in 2010.

Compared to the previous PEP, the expectations regarding international economic relations are less optimistic (the projected relative indicator of current account deficit is higher by 0.2 percentage points on average). This can largely be attributed to the fact that the performance in 2006 and in the first half of 2007 was below the expectations set out in the previous PEP. Besides, in comparison to the previous year's PEP, the projected figures are now more under the impact of the expected strengthening of overall economic activity, and private consumption in particular.

In the period from 2008 to 2010, a gradual increase in exports of goods is expected as a result of solid foreign demand in the EU countries and further growth of exports to the countries within the region, which should also be spurred by the CEFTA enlargement. Besides, exporters' business operations should be facilitated by stronger support coming from the HBOR and the Ministry of Economy, Labour and Entrepreneurship, as well as general improvement of the business climate and operating conditions.

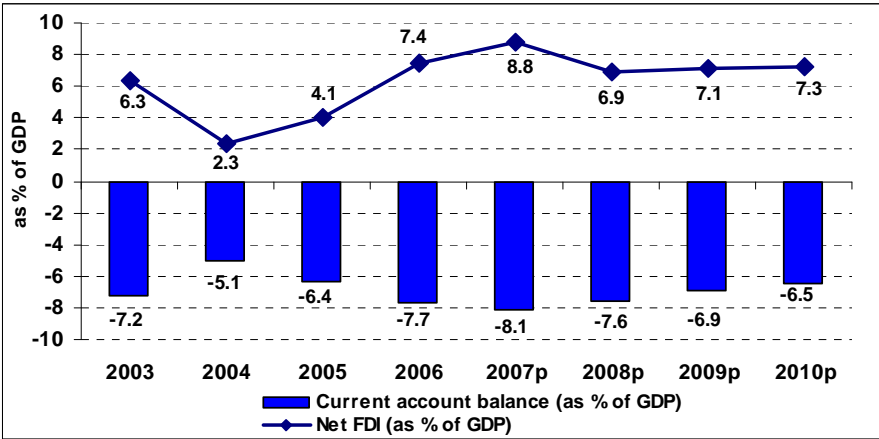
As regards merchandise imports, the growth is expected to slow down in 2008, largely as a consequence of slower growth of private consumption, as intended by the tightened CNB measures, and slower investment growth. Nevertheless, the growth of imports will remain at a relatively high level in the context of anticipated intensification of economic activity. Some projections suggest that crude oil prices in the world market will stay high, thus increasing the value of imported crude oil and petroleum products and, consequently, total goods imported.

The anticipated steady growth of net income from international service trade reflects continued growth of tourist revenues. The factors contributing to such growth include investments into accommodation facilities, their improved structure (larger number of hotels) and better quality (higher-category facilities), higher occupancy rates and more foreign visitors. Besides, improvement and diversification of tourist offer in general can be expected, as well as the prolongation of tourist season.

After the projected narrowing of the deficit in the factor income account during 2007, partly as a result of a notable increase in revenues from compensation of employees and the CNB revenues stemming from investments of international reserves, the years that follow will see the factor income account deficit widening again. On the one hand, it could be a result of the anticipated slower growth of revenues in respect of compensation of employees and smaller CNB revenues. On the other hand, taking into account intensified economic activity, business results of local enterprises are likely to improve, and this, along with increased equity FDI, should result in increased expenditures for equity investment.

The surplus in the current transfer account is expected to continue decreasing in the projection period. On the revenue side, a moderate annual growth is expected, mainly as a consequence of economic growth in the EU countries, from which a substantial part of total transfers originate.

Figure 3: Current account balance and net foreign direct investment



Source: CNB, MF

The very high FDI inflow into Croatia during 2007 is mainly a result of substantial banks' recapitalisation, and note should also be made of the initial public offering (IPO) of the shares of T-HT (Croatian telecom) in October, which made a strong contribution as well. During 2008, equity investment not associated with privatisation or bank recapitalisation is expected to grow further thanks, among other things, to Croatia's attractive geographic position, stable macroeconomic conditions, developed infrastructure, and relatively well-educated labour force, as well as the efforts made by the Agency for the Promotion of Exports and Investment (APIU) in promoting Croatia as an attractive destination for foreign investors. The alignment of legislation with the *acquis communautaire*, the implementation of necessary reforms, the

regulation of land registers, and the simplification of company formation procedures, along with the prevention of corruption, all these are expected to have a positive impact on future FDI into Croatia.

With regard to foreign assets of the domestic sectors, it is expected that investments by mutual funds into foreign securities will continue to grow throughout the projection period. International reserves are also expected to increase, yet at a lower rate than in previous years because the foreign exchange reserve requirement, including the marginal reserve requirement, will be lowered. In the projection period, the reserves are expected to suffice for more than five months of imports of goods and services.

In 2007, the share of external debt in GDP could decrease by 0.7 percentage points compared to the year before which will be partly result of anticipated reduction of banks' foreign liabilities despite of direct foreign borrowing of enterprises. Following a reduction during the previous two years, the government's external debt is likely to grow in 2007, due mainly to foreign borrowing by the HBOR. In the years ahead, the relative indicators of external debt are expected to decrease gradually, primarily as a result of further reduction of commercial banks' foreign liabilities. The consolidated general government will rely predominantly on the domestic sources of funds, so new foreign borrowing will be smaller than repayments of debt due. In this context, it should be mentioned that samurai bonds worth JPY 25 billion will mature in 2008, with samurai bonds in the nominal amount of JPY 25 billion and eurobonds in the amount of EUR 500 million maturing in 2009, while eurobond issue in the same amount falls due in 2010. Enterprises' external debt is expected to grow during the projection period, but the growth will slow down towards the end of the projection period. Such expectation rests on anticipated deepening of the domestic capital market, which should give new impetus to domestic borrowing. As a result, the share of external debt in GDP will fall to 84.4%, 84.2% and 84.1% in 2008, 2009 and 2010, respectively.

In the framework of capital account liberalization and in line with last years PEP, Republic of Croatia continued with liberalization of capital transactions during 2007. Cash transactions of non residents by their accounts in domestic banks are fully liberalized and full liberalization of portfolio investments in and from the Republic of Croatia is achieved. Beside the mentioned, Act on the Amendments to the Foreign Exchange Act regulates precise deadlines to abolish remaining restrictions that concern depositary transactions of non residents, approval of short term financial loans to non residents and cash transactions. Also, Republic of Croatia removed restrictive provisions from other laws which restricted cross-border investments in or from the Republic of Croatia. Removed are the provisions which forbid to brokers executions of clients orders for investments in the countries which are not member of EU or OECD and provision according to which individual shareholders of Central Depository Agency weren't allowed to own more than 10% voting shares while the same wasn't the case for the Republic of Croatia which was allowed to have higher percentage of shares. The provisions according to which state had privileged access to the funds of savings and loan associations were removed.

The goal of the Republic of Croatia is full liberalization of capital transactions as of January 1st 2009. This will be accomplished by coming into force of particular provisions of Foreign Exchange Act which precisely determine further pace of liberalization. From January 1st 2008 additional liberalization of cash transactions in kunas between residents and non residents will be carried out. Also, obligation of statistical reporting of credit transactions with foreign countries will cease to be condition for realization of credit transactions. From January 1st 2009, deposit transactions, approval of short term financial loans, cash transactions between residents and non residents and taking in and out of cash in kunas and foreign currency will be performed freely.

3 PUBLIC FINANCE

3.1 GENERAL GOVERNMENT BALANCE AND DEBT

3.1.1 Policy strategy and medium-term objectives

The fiscal policy for the next medium-term period will be based on the Economic and Fiscal Policy Guidelines for 2008-2010 adopted by the Government in August 2007, which define the goals and direction of the fiscal policy in the next period. Fiscal policy is part of the overall economic policy aimed at achieving long-term sustainable economic growth and reducing unemployment, while simultaneously increasing the competitiveness of the Croatian knowledge-based economy. Accordingly, the fiscal strategy will be oriented towards further fiscal adjustment and creation of additional opportunities for the private sector so as to enable faster economic growth, the reduction of unemployment and the increase of employment, balancing of the budget, cutting of the public debt, and the stabilisation and reduction of the external debt.

The fiscal policy will build on the current policy of strong fiscal adjustment by which net lending/borrowing (fiscal deficit according to the ESA 95 methodology) was more than halved: from -5.5% of GDP in 2003, to -2.2% of GDP in 2006, to an estimated -1.6% of GDP in 2007. Such reduction of the fiscal deficit was a result of the improvement and regulation of the system of public finance through the strengthening of budget management, introduction and expansion of the Treasury single account, introduction of budgetary analyses and measurement of fiscal effects, as well as the strengthening of tax administration with a view to combating grey (unofficial) economy. Since the focus will remain on efficient use of budgetary resources, while fiscal adjustment will continue, the forthcoming period is expected to see further reduction of net lending/borrowing from -1.6% of GDP in 2007, to -1.5% of GDP in 2008 and -0.6% of GDP in 2009, with surplus being recorded in 2010, i.e. net lending/borrowing will stand at 0.2% of GDP. It should be pointed out that the downward movement in net lending/borrowing will exclusively be a result of the structural measures and fiscal adjustment, rather than increases in the existing taxes or introduction of new ones, which would impose additional burden on the economy.

In keeping with the above, and in view of the need to maintain the present direction of the fiscal policy over the medium term and to ensure further development of a functioning market economy, while at the same time increasing competitiveness and employment in Croatia, the implementation of the following policies and measures is of utmost importance:

- Ensuring even economic growth in all Croatian regions;
- Channelling resources into education, science, further training for all age groups and encouraging the development of a knowledge-based society;
- Encouraging employment and development of entrepreneurship;
- Completing the transition process by implementing restructuring plans in the shipbuilding sector, restructuring and modernisation plans in the railway sector and by completing the privatisation process;
- Continuing the judicial reform;
- Continuing the reform of the health care system, which will ensure good quality and cost-effective medical care for all citizens;
- Guaranteeing fair treatment within the pension insurance system, while at the same time ensuring long-term sustainability of its fiscal position and improvement in pensioners' social position;

- Continuing the policy of granting rights to all socially vulnerable groups of the society;
- Continuing investments in the road and railway infrastructures, as well as the water and gas supply systems;
- Improving energy efficiency and energy stability;
- Completing the process of reconstruction and return of displaced persons;
- Maintaining the tax system stability;
- Completing the process of alignment of Croatian legislation with the *acquis communautaire*.

In conclusion, it is important to note that the fiscal policy focused on fiscal adjustment and reduction of deficit has a positive impact on reducing the share of public debt in GDP. After the share of public debt in GDP was reduced by 2.7 percentage points at the annual level in 2006, it is expected to fall further, from 44.9% in 2007 to 37.0% in 2010. By reducing the deficit and by choosing to finance the deficit in the domestic market the Government has made a positive contribution to total external debt. Over the past two years, the Government has been the only sector to reduce in nominal terms the level of its external debt. In view of such policy and taking into account developments in the macroeconomic environment, it is planned that the share of external debt in GDP will be reduced from the projected 86.0% in 2007 to 85.2% in 2010.

3.1.2 Actual balances and medium-term perspectives

Recent movements in the consolidated general government budget

According to 2006 fiscal data, the consolidated general government deficit stood at 2.2% of GDP, which shows that the trend of strong fiscal consolidation begun in 2004 went on. In only three years, the deficit was more than halved. The adjustment was particularly strong in 2006, when the deficit narrowed by 1.6 percentage points. The consolidated general government revenues rose by 8.4% y-o-y and were compliant with the plan. Expenditures were also in accordance with the plan, and they grew by 6.9% y-o-y. It is important to note that the share of expenditures in GDP has been shrinking steadily.

Table 2: Revenues, expenditures and net lending/borrowing of the general government 2003-2006

% of GDP	2003	2004	2005	2006
Net lending/borrowing	-5.5	-4.1	-3.8	-2.2
Total revenue	45.2	44.8	44.5	44.8
Total expenditure	50.7	48.9	48.4	47.0

Source: MF

The Act on Amendments to the Act on Financing Local and Regional Self-government Units has been in effect since 1 January 2007. The amendments provide for a more balanced and fairer distribution of tax revenues in all regions of Croatia, a special emphasis being on the areas of special state concern, and for better liquidity of the financing system at the local level. Thus, the entire amount of corporate income tax revenues is paid into the central government budget, whereas personal income tax revenues are assigned to the units of local and regional self-government, partly directly and partly through a settlement fund.

Besides the described amendments, another change in the tax system took place during 2007: a differentiated 10% VAT rate has been in effect since 1 August 2007, and it applies to daily

and periodical newspapers and magazines, with the exception of those that mainly or only contain advertisements and serve advertising purposes.

In the next medium-term period, there will be no major changes to the tax system, which means that no new taxes will be introduced, nor will the existing ones be increased. All changes will be aimed at simplifying the tax system, while the process of aligning the tax system with the EU legislation will continue.

The favourable fiscal trends present in 2006 continued into the first half of 2007 as a result of solid revenue collection and savings made on the expenditure side. In the first half of 2007, the consolidated general government revenues were higher than planned, with VAT revenues, social contributions and corporate income tax revenues being the strongest contributor to such revenue growth.

Total expenditures of the consolidated general government in the first half of 2007 were compliant with the plan, the most significant items being expenditures for social benefits and compensation of employees. As regards purchases of non-financial assets, they related mostly to purchases of buildings and other constructions effected primarily by extra-budgetary users and the local and regional self-government units. In the first half of the year, borrowings of the consolidated general government budget took place mostly in the domestic financial market.

Taking into account the outturn of the first six months of the year, the 2007 Budget was revised in July to provide for the adjustments of planned revenues, expenditures and total deficit. Under the revised budget, the consolidated general government deficit, i.e. net lending/borrowing, for 2007 is planned at the level of -1.6% of GDP. Compared to the initial 2007 Budget, this is a reduction by 0.2 percentage points. The revenue and expenditure outturn in the remainder of the year is in line with the revised budget, so it is safe to conclude that stronger fiscal adjustment will be achieved as planned.

Medium-term fiscal projections

Consolidated general government revenues

Total revenues of the consolidated general government for the period 2008-2010 are planned according to the projections of macroeconomic variables and expected movements in certain revenue categories during 2007. The medium-term projections show a downward trend in revenues as a proportion of GDP. For 2008, total revenues are planned at the level of 43.7% of GDP, but their share will drop to 41.8% of GDP by the end of 2010. In the period under review, VAT revenues, social contributions and corporate income tax revenues will remain the strongest contributors to the growth of the consolidated general government revenue.

VAT revenues are planned at the level of 13.7%, 13.4% and 13.0% of GDP in 2008, 2009 and 2010, respectively. Social contributions are the second largest source of revenue within the general government budget. For 2008, they are planned to stand at 13.3% of GDP, and by 2010 their share will slightly decrease, to 12.9% of GDP.

Excise revenues in the next medium-term are planned on the basis of projected GDP growth and in combination with the measures aimed at better collection of special taxes. This revenue category is planned at the level of 4.3%, 4.1% and 4.0% of GDP in 2008, 2009 and 2010, respectively. Excises on petroleum derivatives continue to account for the largest portion of total excises, followed by excises on tobacco products and excises on cars.

In the next medium-term period, personal income tax revenues will be around 3.5% of GDP on average. Movements in this revenue category follow the movements in nominal gross

wages and in employment. Corporate income tax revenue will hover at an average level of 3.0% of GDP in the next three years, based on the expected growth of economic activity.

Consolidated general government expenditures

In the period 2008-2010, fiscal adjustment on the expenditure side is planned to continue, supported by further implementation of the structural reforms and continued control of the execution of expenditure. Movements in expenditures during the next medium-term period will be determined by the implementation of the key policies and measures aimed at promoting entrepreneurship, education, protection of socially vulnerable groups, as well as maintaining sustainable economic growth and development. Accordingly, it is expected that total expenditures of the consolidated general government in 2008 will be at the level of 45.2% of GDP and will continue to decrease in subsequent years to the projected 41.6% of GDP in 2010.

Expenditure for social benefits accounts for the largest share of total expenditure of the consolidated general government. It is planned to stand at 17.4% of GDP in 2008, its share falling to the level of 15.9% of GDP by 2010. In the next medium-term period, the dynamics of expenditure for social benefits will be closely associated with meeting the needs of the pension insurance and health care systems.

Compensation of employees is the second largest expenditure item. In the next medium-term period, the share of this expenditure category should be reduced: it is planned to be at the level of 10.9% of GDP in 2008, falling to 10.4% of GDP by the end of 2010.

Expenditures for intermediary consumption relate mostly to expenditures for the use of goods and services. In the next medium-term period, this expenditure item will hover at an average 5.4% of GDP, its share declining steadily. In the period 2008-2010, the share of expenditures for subsidies is also expected to decrease. These expenditures are planned at the level of 2.1% of GDP in the relevant period.

Expenditures for property income refer mainly to interest payments, and their amount will depend primarily on the dynamics of borrowing in the previous years. The expenditures for property income are planned to account for 2.0% of GDP in 2008, and their share shrink to 1.8% of GDP by end-2010.

Other current transfers comprise mainly current grants and current donations. In 2008, other current transfers will amount to 1.6% of GDP, but in 2009 and 2010 their share will decrease to 1.5% of GDP. Capital transfers are comprised of capital grants and capital donations. In the next medium-term period, these expenditure items are planned to stand at 2.0% of GDP on average.

Expenditures for gross fixed capital formation comprise net expenditures for the acquisition of fixed assets, strategic inventories and valuables. Gradual reduction of the share of these expenditures in GDP will primarily depend on the dynamics of road and motorway construction during the next medium-term period. Expenditures for gross fixed capital formation are projected at 3.3% of GDP in 2008, while their share is expected to decline in the subsequent years, to the level of 2.8% of GDP by the end of 2010.

Table 3: Revenues, expenditures and net lending/borrowing of the general government 2008-2010

ESA 95	% of GDP	2006	2007p	2008p	2009p	2010p
TR	Total revenue	44.8	46.2	43.7	42.8	41.8
	<i>Main components of total revenue:</i>					
P.1	Output	3.8	4.8	3.8	3.6	3.5
D.211	Value-added tax	13.9	14.0	13.7	13.4	13.0
D.61R	Social contributions, receivable	13.7	13.6	13.3	13.1	12.9
	Current taxes on income, wealth etc., receivable	6.7	7.0	6.9	6.8	6.7
D.51A	- of which: personal income tax	3.5	3.6	3.5	3.5	3.4
D.51B	corporate income tax	2.9	3.1	3.1	3.0	3.0
D.212	Taxes and duties on imports excluding VAT	0.6	0.6	0.5	0.5	0.4
	Taxes on products, except VAT and import taxes	5.3	5.1	4.9	4.8	4.6
D.214	- of which: excises	4.6	4.5	4.3	4.1	4.0
D.4R	Property income, receivable	0.5	0.7	0.3	0.3	0.3
TE	Total expenditure	47.0	47.8	45.2	43.4	41.6
	<i>Main components of total expenditure:</i>					
P.2	Intermediate consumption	5.4	5.8	5.6	5.4	5.2
D1.P	Compensation of employees	11.3	11.4	10.9	10.7	10.4
D.3P	Subsidies, payable	2.6	2.5	2.2	2.1	2.0
D.4P	Property income, payable	2.2	2.0	2.0	1.9	1.8
	Social benefits other than social transfers in kind, payable	14.9	14.9	14.4	13.8	12.9
D.62P	Social transfers in kind	3.3	2.8	3.0	2.8	3.1
D.7P	Other current transfers, payable	1.5	1.7	1.6	1.5	1.5
D.9P	Capital transfers, payable	2.0	2.1	2.1	2.1	2.0
P.5	Gross capital formation	3.4	4.3	3.3	3.0	2.8
	Assumption of guarantees	0.3				
B.9	Net lending/net borrowing	-2.2	-1.6	-1.5	-0.6	0.2

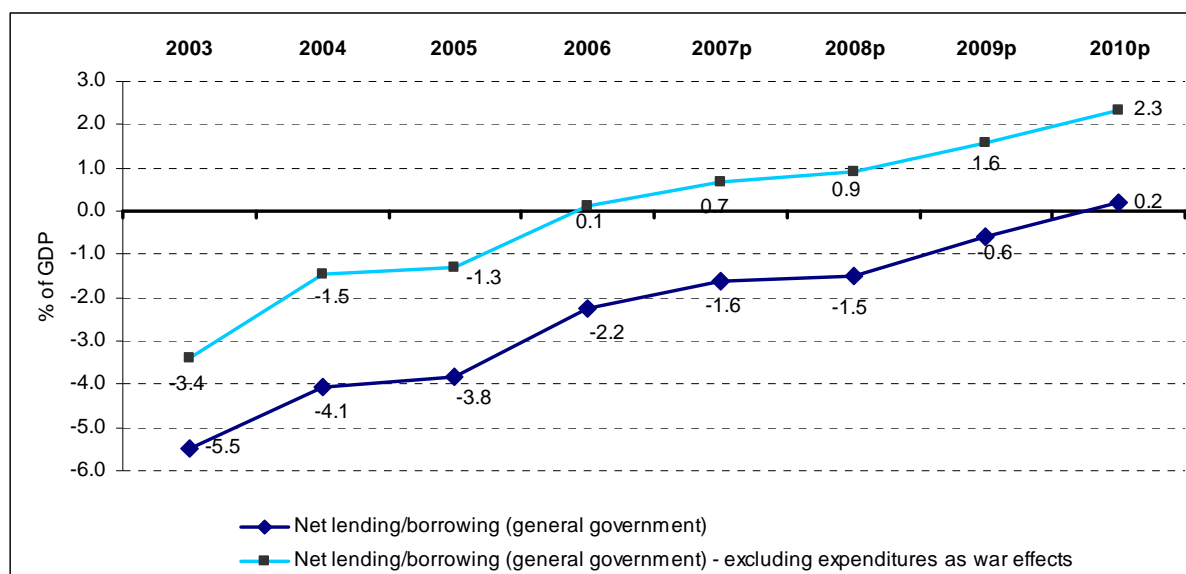
Source: MF

Expenditures – War effects

In this chapter, the expenditure caused by war in Croatia are dealt with separately because those are specific expenditures not known to other European economies, they are unavoidable and present major fiscal burden for many years ahead. Fiscal consolidation implemented since 2004 has even greater significance considering the amount and character of the expenditures caused by war. The graph below shows the reduction of fiscal deficit in the period 2003-2010, along with a comparable fiscal deficit level if the expenditure directly or indirectly caused by the war did not exist.

Total expenditures caused by war are projected at the level of 2.4%, 2.2% and 2.1% of GDP in 2008, 2009 and 2010, respectively. It should be noted that indirect expenditures caused by war are much higher than direct expenditures, and the share of the former is gradually increasing over the years, so in 2010 the share of indirect expenditures caused by war will account for 95.4% of total expenditures caused by war.

Figure 4: Fiscal deficit and expenditures – War effects



Source: MF

Net lending/borrowing

Net lending/borrowing at the consolidated general government level in 2008-2010 is expected from -1.5% of GDP in 2008 to 0.2% of GDP in 2010. Looking at different government levels, the central government budget will account for the largest portion of the projected net lending/borrowing in 2008, i.e. -0.8% of GDP, while net lending/borrowing of extrabudgetary users and local government units will amount to -0.6% and -0.1% of GDP, respectively. Towards the end of the projection period, revenues of the central government budget will exceed expenditures, the budget of the local government units will be balanced, while a deficit will be recorded only in respect of extrabudgetary users.

Table 4: Revenues, expenditures and net lending/borrowing of the general government 2008-2010, according to government level

% of GDP	2006	2007p	2008p	2009p	2010p
Budgetary central government - unconsolidated					
Total revenue	38.5	39.6	37.6	36.9	36.1
Total expenditure	39.8	40.4	38.4	37.1	35.7
Net lending/net borrowing	-1.3	-0.8	-0.8	-0.2	0.4
Extrabudgetary funds - unconsolidated					
Total revenue	3.0	3.8	2.8	2.7	2.5
Total expenditure	3.9	4.6	3.5	3.0	2.6
Net lending/net borrowing	-0.9	-0.8	-0.6	-0.4	-0.2
Local government - unconsolidated					
Total revenue	5.4	5.4	5.3	5.2	5.1
Total expenditure	5.4	5.5	5.4	5.2	5.1
Net lending/net borrowing	0.0	-0.1	-0.1	-0.1	0.0
Consolidated general government					
Total revenue	44.8	46.2	43.7	42.8	41.8
Total expenditure	47.0	47.8	45.2	43.4	41.6
Net lending/net borrowing	-2.2	-1.6	-1.5	-0.6	0.2

Source: MF

Financing of the general government budget

As the total level of net lending/borrowing in the period under review moves from –1.5% of GDP in 2008 to 0.2% of GDP in 2010, the needs for financing of the general government budget will change significantly.

Table 5: Financing of general government budget in 2008-2010

ESA 95	% of GDP	2006	2007p	2008p	2009p	2010p
B.9F	Net lending/borrowing	-2.2	-1.6	-1.5	-0.6	0.2
B.9F (-)	Financing	2.2	1.6	1.5	0.6	-0.2
F.A	Net acquisition of financial assets	-1.0	0.1	0.1	0.3	0.5
F.2A	Currency and deposits - assets	-0.4	0.2	0.2	0.1	0.1
F.4A	Loans - assets	0.4	0.3	0.3	0.4	0.3
F.5A	Shares and other equity - assets	-1.0	-0.4	-0.4	-0.1	0.0
F.L	Net incurrence of liabilities	1.2	1.7	1.6	0.9	0.3
F.3LR	Securities other than shares - liabilities - repayments	5.2	2.0	1.4	1.6	1.9
F.3LI	Securities other than shares - liabilities - incurrences	6.1	3.3	2.6	3.2	2.6
F.4LR	Loans - liabilities - repayments	2.7	1.7	1.4	1.8	1.5
F.4LI	Zajmovi - obveze - zaduživanje	2.6	2.3	1.8	1.2	1.0

Source: MF

On the financial asset side, the next medium-term period will see a gradual reduction in privatisation revenues as the privatisation process approaches completion. Primarily for this reason, net acquisition of financial assets will gradually grow in the period under review.

On the liabilities side, domestic sources of financing will have predominance over foreign sources, and stronger emphasis will be on longer-maturity instruments, especially five-year and/or ten-year bonds. Particular attention will be paid to the smoothing of the maturity structure of liabilities and balanced distribution of refinancing burden.

As regards bond repayments, three domestic bond issues in an aggregate amount of HRK 4bn and EUR 20m will mature in the relevant period, along with four international bond issues totalling JPY 50bn and EUR1bn.

Table 6: Overview of bonds maturing in 2008 – 2010

Bond	Date of issue	Currency	Amount (million)	Interest rate	Maturity
DOMESTIC BONDS					
Series 04 D-08	28.05.2003.	HRK	1,000	6.13%	28.05.2008.
Series 02 D-08	14.12.2001.	EUR	200	6.88%	14.12.2008.
Series 08 D-10	08.03.2005.	HRK	3,000	6.75%	08.03.2010.
INTERNATIONAL BONDS					
Samurai IV 2008.	26.06.2002.	JPY	25,000	2.15%	26.06.2008.
Euro - EUR IV 2009.	11.02.2002.	EUR	500	6.25%	11.02.2009.
Samurai V 2009.	26.06.2003.	JPY	25,000	1.23%	26.06.2009.
Euro - EUR V 2010.	24.02.2003.	EUR	500	4.63%	24.02.2010.

Source: MF

3.1.3 Structural balance

The method of the European Central Bank (ECB)⁴ was used to calculate the cyclically adjusted primary deficit of the consolidated general government in the period 1995-2010. It was assumed that cycle-sensitive items of the central government budget on the revenue side are personal income tax, corporate income tax, VAT, excises and social contributions, with

⁴ Bouthevillain et al., 2001, "Cyclically Adjusted Budget Balances: An Alternative Approach", Working paper br. 77, European Central Bank.

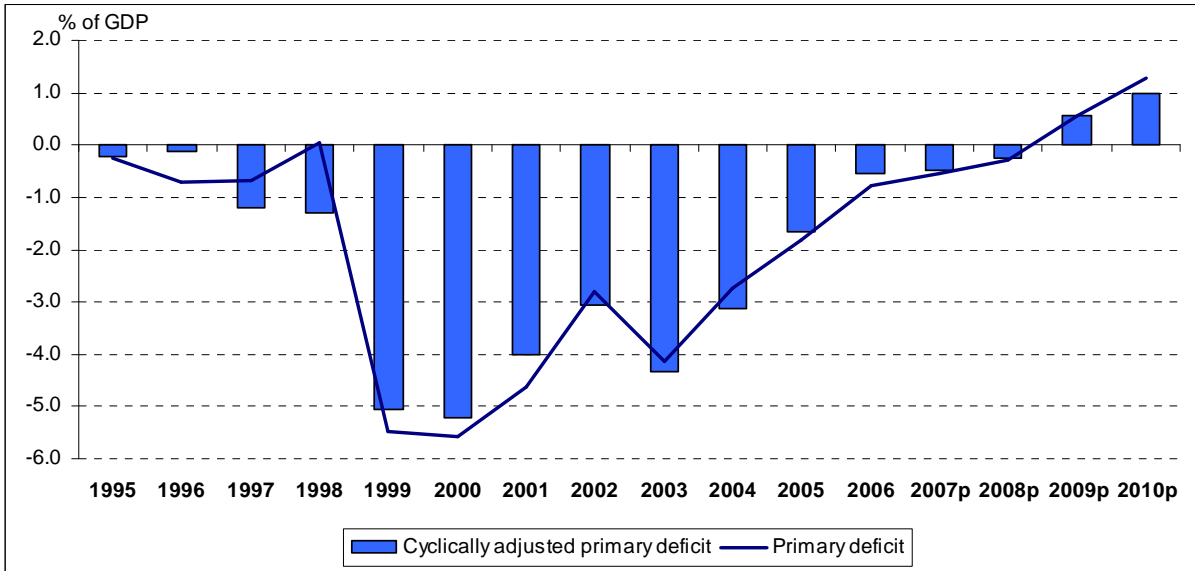
unemployment benefits on the expenditure side. The corresponding macroeconomic basis for the calculation of personal income tax and social security contributions is the wage bill, gross operating surplus for the calculation of corporate income tax, private consumption for VAT and excises, and the number of the unemployed for the calculation of unemployment benefits.

The elasticity of the cycle-sensitive components of the budget in relation to their respective macroeconomic bases is calculated by estimating the error correction model on quarterly data. According to the model estimate results, the elasticity of personal income tax is 2.62, and that of corporate income tax 2.25, while the elasticity of VAT is 1.19, of unemployment benefits 1.67, social contributions have elasticity of 0.54, whereas the elasticity of excises is calibrated and amounts to 1.⁵

In order to determine the gap between potential and actual values of the macroeconomic bases and the GDP gap, potential values were calculated by using the Hodrick–Prescott filter, with the smoothing parameter λ of 300. Quarterly data for the period from the third quarter of 2007 to the fourth quarter of 2010 were calculated on the basis of projections described in this PEP which assume that economic activity will speed up in the period from 2007 to 2010.

The results have shown that the structural primary deficit has been on decline since 2003, when it was measured at the level of -4.4% of GDP. According to projections, it should continue to decrease by 2010. In 2007, the structural primary deficit should amount to -0.5% of GDP, and to -0.2% in 2008, whereas – according to the methodology used and the projections – the structural primary surplus of 0.6% and 1.0% of GDP should be recorded in 2009 and 2010, respectively. The fiscal policy in the period 2004-2010 can be described as moderately restrictive (with the exception of the years 2004 and 2010) and procyclical at the same time. In the period from 1996 to 2004, however, when the fluctuations of economic activity were more pronounced, the fiscal policy did not have a uniform effect on the business cycle.

Figure 5: Primary deficit and cyclically adjusted primary deficit 1995-2010



Source: MF

⁵ It was not possible to make a significant assessment of the elasticity of excises through econometric analysis.

3.1.4 Debt levels and developments

The process of fiscal adjustment which began in 2004 has enabled the level of the general government deficit to be significantly reduced, and it has had a positive impact on public debt movements. During 2006, public debt as a proportion of GDP was reduced by as much as 2.7 percentage points, i.e. from 49.1% of GDP at end-2005 to 46.4% of GDP at end-2006. Of the total amount of public debt recorded at end-2006, 87.9% was attributable to direct borrowing of the various general government levels, while the rest referred to the Government guarantees.

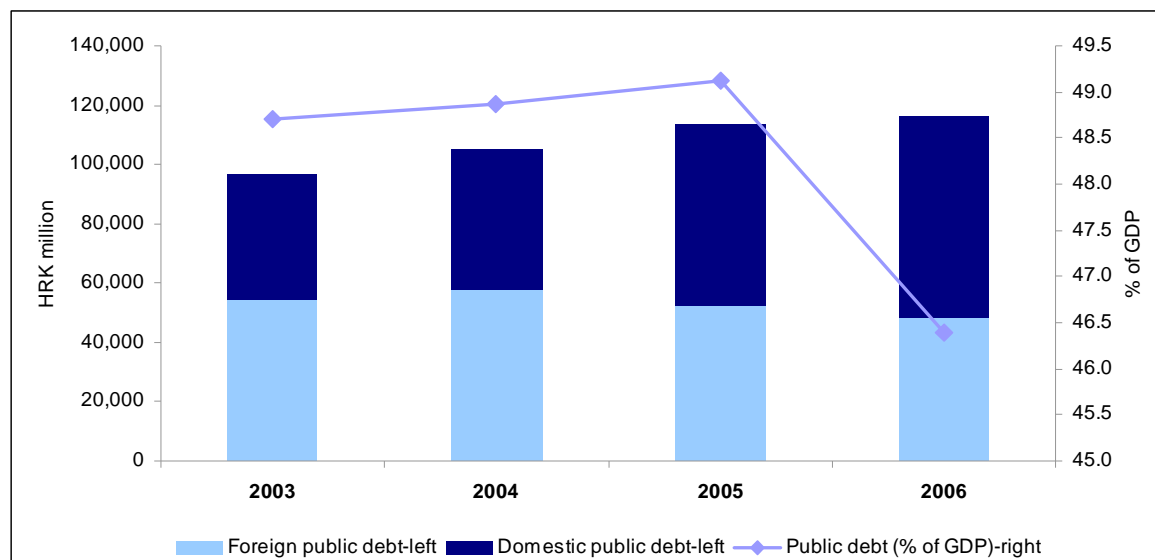
Table 7: Public debt 2003–2006

<i>HRK million</i>	2003	2004	2005	2006
Public debt (% of GDP)	48.7	48.9	49.1	46.4
General government debt	81,222	92,795	101,185	102,168
Foreign	45,676	50,241	45,364	41,619
Domestic	35,545	42,554	55,822	60,549
Public debt	96,641	105,057	113,640	116,268
Foreign	54,299	57,951	52,550	48,466
Domestic	42,342	47,106	61,090	67,801

Source: MF

The nominal growth of public debt was even during the past several years (until the end of 2005) and amounted to about 8% on average. However, thanks to the reduction of the general government deficit and the outturn of privatisation revenue, the y-o-y growth of public debt was reduced to only 2.3% in 2006. As regards changes in the international and domestic components of public debt, it can be seen that the share of the domestic component has increased in recent years, with the international component decreasing in the same period. In 2003, the international component accounted for 56.2% of total public debt, its share falling to 41.7% by the end of 2006 as a result of the substitution of international by domestic sources of funds, which has also contributed significantly to the development of the domestic financial market.

Figure 6: Public debt in 2003-2006



Source: MF

As regards the structure of the general government debt according to instruments, it is important to note that a majority of debt is associated with bond issues and loan borrowings. The past several years have been characterised by the Government's orientation towards securing financing through issues of short-term and long-term bonds in the domestic market, which has not only helped reduce the dependence on international capital markets, but has had a positive impact on the country's external debt. In order to stimulate deepening of the domestic financial market, long-term kuna denominated bonds have been launched as an additional instrument to attract institutional investors, but participation of the household segment is also expected. In this way, the investor base for the Government bonds in the domestic financial market has been significantly deepened.

Most of the general government debt related (84.9% at the end of 2006) to the central government budget debt, while the remaining part (13.8%) referred to the debt of extrabudgetary users and local government (1.3%). In terms of currency structure, it should be stressed that about 80% of the debt is denominated in foreign currency, mostly in euros. As some liabilities fall due for payment in the forthcoming period, debt denominated in yens and US dollars will decrease significantly, whereas kuna denominated debt will grow further as a result of the Government's growing orientation towards domestic borrowing sources.

With regard to public debt management in general, it is of great importance to define adequate plans and direction of public debt management. Those are formulated in the long-term Strategy of Public Debt Management, which builds on previous years' public debt management policies and is closely associated with the fiscal policy plan.

According to the public debt strategy, public debt will closely follow and reflect changes in the fiscal policy and the narrowing of budgetary deficit, so it will continue to decline as a proportion of GDP in the next medium-term period. By the end of 2010, public debt will fall to the level of 37% of GDP. The orientation to domestic sources for the purpose of financing the general government's needs will also continue, which will have additional positive impacts on the deepening of the domestic financial market.

Table 8: Projections of net lending/borrowing, general government debt and public debt

<i>% of GDP</i>	2006	2007p	2008p	2009p	2010p
Net lending/borrowing	-2.2	-1.6	-1.5	-0.6	0.2
General government debt	40.8	39.3	37.3	34.8	31.8
Foreign	16.6	15.2	13.2	10.8	9.0
Domestic	24.2	24.0	24.0	24.0	22.8
Public debt	46.4	44.9	42.7	40.1	37.0
Foreign	19.8	18.4	16.3	13.9	12.0
Domestic	26.6	26.4	26.4	26.2	25.0

Source: MF

3.1.5 Budgetary implications of major structural reforms

The economic policy is focused on encouraging long-term sustainable rates of economic growth, reducing unemployment and strengthening the competitiveness of the Croatian knowledge-based economy. In accordance with those goals, substantial funds are set aside for the reforms in the enterprise sector, labour market, agriculture, public administration, education and science, health care, 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: Assessment of Fiscal Effects of

Structural Reforms. Those fiscal effects include allocations of budgetary funds for the purpose of implementing certain measures, and they provide information as to how those measures are financed from loans and EU aid funds.

In the next medium-term period (2008-2010), net budgetary allocations for the purpose of implementing certain structural measures will be increased by an average HRK 1.5bn annually (0.4% of GDP). Budgetary revenues relating to those measures will be increased (through the use of EU aid funds and the like) by HRK 44.0m a year (0.01% of GDP) on average.

At this point, it is important to stress the most important measures having fiscal effects in the forthcoming period. The subsidies to Hrvatske željeznice (Croatian State Railways) will be gradually reduced in the next period, their strongest reduction (0.1% of GDP) taking place in 2008. Subsidies to shipyards, on the other hand, will be increasing until 2009 by an average 0.01% of GDP a year. In 2010, after the restructuring process has been completed, subsidies to shipbuilding will be reduced by the same amount. With regard to the policy of agricultural state aid, an increase corresponding to 0.08% of GDP is planned for 2008, and in the two subsequent years agricultural state aid will grow by 0.03% of GDP.

In this context, note should also be made of fiscal effects produced by the measures in the social security system. The recent legal amendments aimed at eliminating differences between the pensions of the so-called “old” and “new” pensioners will produce a total fiscal effect on the expenditure side amounting to 0.35%-0.40% of GDP in the next medium-term period. Besides, as part of the population and family policy, a new measure has been introduced providing for new mothers to receive full compensation during the first six months of their maternity leave, which will have an effect on expenditures of around 0.04% of GDP annually.

Other measures in the enterprise sector, labour market, agriculture, public administration, education and science, health care, judicial system and environment protection will also produce fiscal effects on the expenditure side, most of which will exceed the revenues resulting from the utilisation of various EU aid programmes.

3.2 SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS PROGRAMME

3.2.1 Fiscal risks and sensitivity analysis of deficit and public debt

The presented fiscal programme for the next medium-term period is based on the macroeconomic assumptions described above. However, in order to obtain a complete picture of movements in the area of public finance, it is necessary to consider certain fiscal risks and to test the sensitivity of deficit and public debt to those risks.

Fiscal risks

Changes in macroeconomic variables certainly have an impact on fiscal developments. The most important macroeconomic indicator is GDP, and its changes have a direct impact on the collection of budgetary revenues, and tax revenues in particular. Thus, if GDP growth rates were smaller than planned, it would result in increased net lending/borrowing in the next period, which would in turn lead to higher levels of public debt. Lower rates of economic growth could be a result of lower GDP growth rates in the neighbouring countries and in the countries which are Croatia's main trade partners or major tourist-originating countries.

With regard to macroeconomic developments, note should be made of the kuna exchange rate movements which have an impact on public debt movements over the medium-term. In view of the fact that about 80% of public debt is denominated in foreign currencies, kuna depreciation would lead to faster growth of public debt. Therefore, the reliance on the domestic debt market contributes positively to mitigating the risk in the future.

Debt servicing (principal repayments and interest payments) also presents a fiscal risk because when larger amounts of debt fall due for payment they create pressure on current business operations in that refinancing risk increases, while at the same time posing greater burden on the budget. Public debt management should therefore ensure that debt servicing burden is evenly distributed throughout the relevant period. According to the present liabilities balance, in the period 2008-2010, the largest debt servicing burden will be in 2009 and 2010. The projections of repayment of the central government budget debt over a longer-term period show that the repayment burden will be gradually decreasing, with refinancing risk being more pronounced in 2011, 2014 and 2015 when liabilities associated with bond issues fall due for payment.

Changes in revenues and expenditures have a direct impact on net lending/borrowing and, eventually, public debt. On the revenue side, the outturn could be less than planned either as a consequence of slower economic growth, as noted earlier, or as a result of growing unofficial (grey) economy. With respect to the latter, the controls of tax revenue collections will be tightened as part of the measures to stimulate and increase the efficiency of tax administration.

On the expenditure side, it is necessary to emphasise the risk of not implementing the main structural reforms in the enterprise sector, which could have a twofold effect on expenditures: on the one hand, further growth of subsidies instead of their decrease and, on the other hand, an increase in guarantees issued because unless business operations are improved, the main reasons for the issuance of government guarantees are not eliminated, and there is a likelihood that new guarantees will have to be assumed in the future. Similarly, changes in the social insurance policy aimed at increasing expenditures for social benefits above the levels originally planned, rather than their rationalisation and better targeting, would result in higher expenditures of the central government budget and, eventually, higher net lending/borrowing.

Finally, stronger expenditure pressures could be a result of implementation of investment projects without adequate controls. The investment projects are carried out in accordance with the adopted plans, namely the Plan for Road and Motorway Construction and the National Programme of Railway Infrastructure, which provide for distribution of the investment burden in accordance with general developments and assumptions of the fiscal and economic policies. Any upward variance from the infrastructure investment budget would lead to increased expenditures and net lending/borrowing.

The analysis of fiscal deficit and public debt sensitivity to the most significant risks are described below.

Deficit sensitivity analysis

In this chapter, an overview is given of the results of sensitivity analysis of net lending/borrowing (fiscal deficit) to changed basic assumptions. The main assumptions of the movements in total net lending/borrowing, i.e. the factors whose changes are monitored, could be of an economic (fiscal) nature, or they can have an external character, as is the case with changes in the areas of demography, social welfare, etc.

Sensitivity analysis of net lending/borrowing was carried out on the assumption of a shock of real GDP growth in 2008 and 2009, a shock of reduced revenue in those years, and a shock involving a one-off increase in expenditures (subsidies/social benefits) in 2008. All those analysis and their results were then compared to the baseline scenario which is based on medium-term macroeconomic forecasts. While those analysis were carried out on arbitrary assumptions, they still clearly show what effects on net lending/borrowing could be expected in the next medium-term period if the main assumptions moved in an unwanted direction. Furthermore, an analysis like this gives a clearer picture as to what should be done in such hypothetical situations in order to avoid or minimize undesired consequences.

The of a lower level of real GDP is carried out by reducing the estimated real GDP growth to twice lower levels in 2008 and 2009. The lower level of GDP could be, e.g., a consequence of substantially reduced levels of economic activity in the countries which are Croatia's main trade partners, or it could be a result of lower growth rates in the neighbouring countries or the main tourist-originating countries. Analysis results have shown that, as a consequence of slower real economic growth in 2009, net lending/borrowing would be as much as 2.2 percentage points of BDP higher than the level projected under the baseline scenario. After the period of shock, a very moderate recovery follows.

On the other hand, if the revenue growth rate in 2008 and 2009 were twice lower than the one foreseen under the baseline scenario, it would have considerable negative effects on movements in net lending/borrowing, and those adverse effects would accumulate during the two years of lower growth causing the negative balance of net lending/borrowing in 2009 to be as much as 2.4 percentage points of GDP higher than the level projected under the baseline scenario. Furthermore, as another drawback of lower revenue growth it should be pointed out that after a period of shock, the recovery is relatively slow so the negative effects of reduced revenue growth extend over a very long period.

The analysis of the growth of expenditures (subsidies/social benefits) implies the possibility of certain social rights being increased or the non-implementation of the main structural reforms based on which certain savings have been projected in the baseline scenario or guarantees have been assumed that – under the baseline scenario - should have only been contingent liabilities. For the purpose of this analysis, we have arbitrarily assumed a one-off increase in expenditures of HRK 1bn.

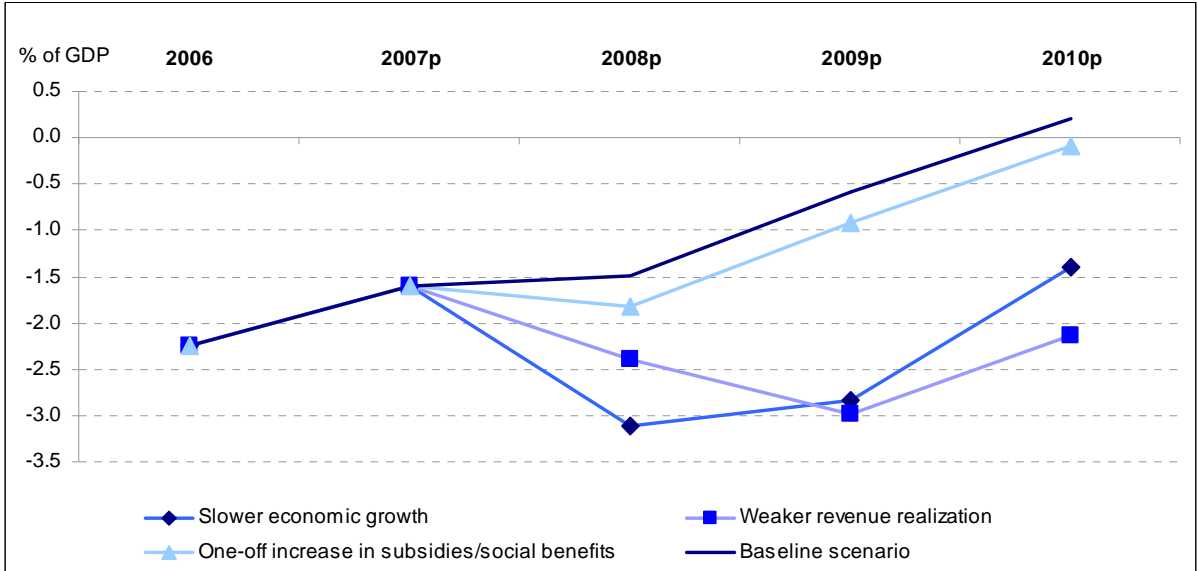
The effects of such increase show that the increase in total net borrowing is carried over to the entire period under review.

Table 9: Assumptions of the baseline scenario and results of the sensitivity analysis

	2006	2007p	2008p	2009p	2010p
Assumptions (baseline scenario)					
Real GDP, growth rate	4.8	6.0	6.1	6.5	7.0
Inflation (deflator BDP-a)	3.4	3.1	3.9	3.3	3.2
Revenue, growth rate	8.9	12.7	4.3	7.7	7.8
Expenditure, growth rate	5.9	8.9	6.5	6.1	6.1
Subsidies, growth rate	9.4	6.1	-2.7	4.7	2.4
Social benefits, growth rate	5.6	9.9	6.7	4.9	5.7
Net lending/borrowing					
Baseline scenario	-2.2	-1.6	-1.5	-0.6	0.2
Slower economic growth	-2.2	-1.6	-3.1	-2.8	-1.4
Weaker revenue realization	-2.2	-1.6	-2.4	-3.0	-2.1
One-off increase in subsidies	-2.2	-1.6	-1.8	-0.9	-0.1
One-off increase in social benefits	-2.2	-1.6	-1.8	-0.9	-0.1

Source: MF

Figure 7: Results of sensitivity analysis



Source: MF

Public debt sensitivity analysis

Movements in overall public debt are closely related to macroeconomic assumptions, as well as the assumptions and results of the implementation of the fiscal policy. Therefore, it is of great importance that the impact of various changes in the assumptions that determine public debt movements is continuously analyzed so as to enable timely and realistic understanding of various implications of those changes in the basic macroeconomic and fiscal assumptions. Furthermore, sensitivity analysis makes it possible to measure the intensity of public debt reactions to changes in certain determining factors and, finally, it enables realistic consideration of potential measures which would mitigate negative developments caused by changes in the main determining factors. The analysis is based on the baseline scenario which rests on medium-term macroeconomic projections and assumptions. A series of alternative

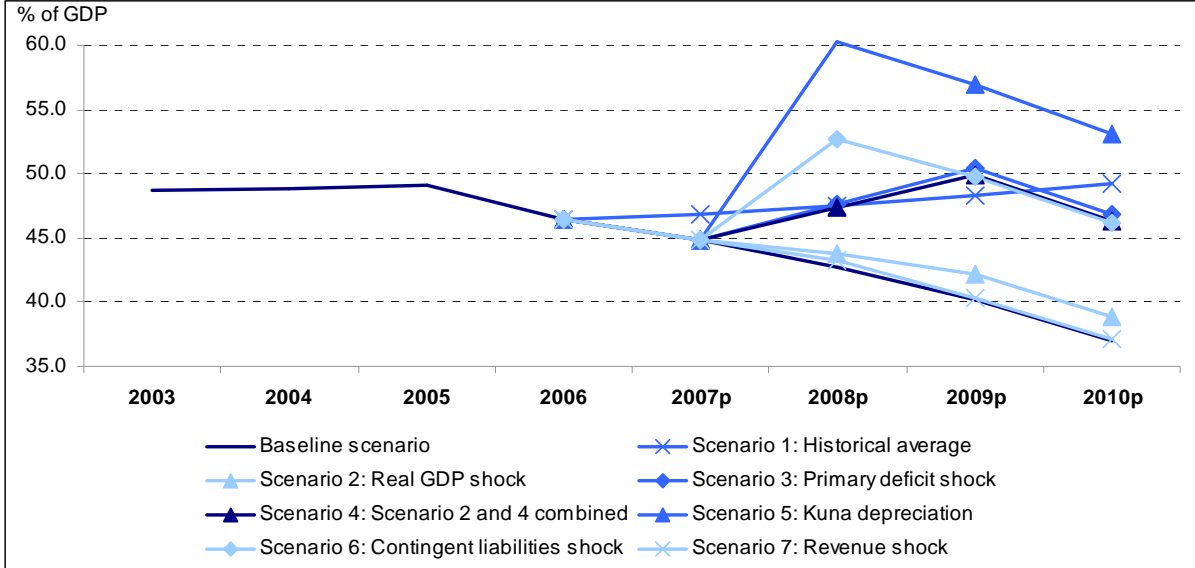
scenarios are then applied with the assumed values being kept at a certain (historical) level or subjected to various shocks.

After the above described sensitivity analysis have been carried out, it is apparent that depreciation of the kuna, especially against the euro, would have the strongest impact on public debt movements in the next several years. The reason for such reaction of the public debt to the kuna depreciation lies primarily in the fact that about 80% of total public debt is denominated in foreign currencies, of which 60% in euros. For the purpose of this, a 30-percent depreciation of the kuna in 2008 is assumed, which would result in the public debt rising to a relatively high level of around 60% of GDP. Considering the effects of depreciation on the level of public debt, it is necessary to take care to reduce the proportion of debt denominated in foreign currencies.

Besides, the analysis conducted have shown a strong reaction of the public debt to changes in contingent liabilities (guarantees), thus suggesting the need to curb their growth, i.e. to restructure certain economic sectors in order to eliminate the need for guarantee issuance. A shock of the primary deficit, as the main debt generator, has shown adverse public debt developments over the medium term, especially because of the fact that the effects of the primary deficit shock subside very slowly and extend until the end of the relevant period.

On the other hand, the scenarios in which the assumptions are kept at their historical (average) values have shown a gradual growth of public debt as a share in GDP towards the end of the period observed. It clearly suggests the need to continue with fiscal adjustment because it reduces the level of necessary new borrowings. Obviously, it needs to be accompanied with the implementation of the key structural reforms.

Figure 8: Public debt as a share in GDP under different scenarios (in %)



Source: MF

Table 10: Results of public debt sensitivity analysis

	2006	2007p	2008p	2009p	2010p
I. Baseline medium-term projection					
Public debt	46.4	44.9	42.7	40.1	37.0
o/w: foreign-currency denominated	37.1	35.9	34.2	32.1	29.6
Change in public debt	-2.7	-1.5	-2.1	-2.6	-3.2
Identified debt-creating flows	-2.5	-1.9	-2.4	-2.8	-3.3
Primary deficit	0.6	0.8	0.3	-0.4	-1.2
Revenue and grants	44.8	46.2	43.7	42.8	41.8
Primary (non interest) expenditure	45.4	47.0	44.1	42.4	40.6
Automatic debt dynamics	-1.5	-1.6	-2.0	-1.8	-1.8
Contribution from interest rate/growth differential	-1.3	-1.6	-2.0	-1.8	-1.8
o/w: contribution from real interest rate	0.8	0.9	0.5	0.7	0.7
o/w: contribution from real GDP growth	-2.2	-2.5	-2.5	-2.5	-2.5
Contribution from exchange rate depreciation	-0.2	0.0	0.0	0.0	0.0
Other identified debt-creating flows	-1.6	-1.1	-0.8	-0.5	-0.3
Privatization receipts (negative)	-1.6	-1.1	-0.8	-0.5	-0.3
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0
Other (e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0
Residual, including asset change	-0.2	0.3	0.3	0.2	0.1
Key macroeconomic and fiscal assumptions					
Nominal GDP (HRK million)	250,590	273,763	301,751	331,959	366,388
Real GDP growth (%)	4.8	6.0	6.1	6.5	7.0
Average nominal interest rate on public debt (%)	5.4	5.5	5.3	5.3	5.4
Average real interest rate (nominal rate minus change in GDP deflator, %)	2.0	2.4	1.4	2.0	2.3
Nominal appreciation (increase of euro value of domestic currency, %)	0.4	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, %)	3.4	3.1	3.9	3.3	3.2
Growth of real primary spending (deflated by GDP deflator, %)	3.2	9.9	-0.6	2.4	2.6
II. Debt-to-GDP ratio sensitivity analysis					
1. Real GDP growth, real interest rate and primary deficit in 2008-2010 at historical average level	46.4	46.8	47.5	48.3	49.3
2. Real interest rate in 2008 and 2009 at historical average level plus two standard deviations	46.4	44.6	42.9	40.5	37.3
3. Real GDP growth in 2008 and 2009 at historical average level minus two standard deviations	46.4	44.9	43.7	42.2	38.8
4. Primary deficit in 2008 and 2009 at historical average level minus two standard deviations	46.4	44.9	47.6	50.5	46.9
5. Scenario 2 and 5 combined using one standard deviation shocks in 2008 and 2009	46.4	44.9	47.3	49.9	46.2
6. One-off depreciation of 30% in 2008	46.4	44.9	60.3	57.0	53.0
7. Increase of other debt-creating flows (guarantees) by 10% of GDP in 2008	46.4	44.9	52.7	49.7	46.1
8. Revenue-to-GDP ratio in 2008 and 2009 at historical average level minus two standard deviations	46.4	44.9	43.3	40.3	37.1
Historical values of key variables (past six years)					
	Historical average		Standard deviation		
Primary deficit	2.4		1.4		
Real GDP growth (%)	4.8		0.6		
Nominal interest rate (%)	5.6		0.2		
Real interest rate (%)	2.0		0.2		
Inflation rate (GDP deflator, %)	3.6		0.3		
Public revenue in GDP	45.5		1.1		

Source: MF

3.2.2 Comparison with previous programme

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

One of the most important changes that has taken place during the previous year and has led to changes in revenues, expenditures and net lending/borrowing as a share in GDP is the change in nominal GDP. The difference is a result of the revised calculation of nominal GDP for 2004 and for subsequent years, of stronger economic activity and also of higher inflation projections for the medium-term period. Thanks to higher levels of nominal GDP, the categories under review (revenues, expenditures and net lending/borrowing), expressed as a share in GDP, have been reduced.

However, the differences between certain fiscal values for the same years in last year's PEP and this year's PEP can also be accounted for by other reasons, which are all very characteristic for revenues and expenditures. The outturn of the general government revenues in 2006 was above the projection included in the last year's PEP, and the contribution of that surplus to revenues outturn in the subsequent years has been calculated by reference to the baseline effect. Furthermore, in 2007 one-off revenues (concession and dividend revenues) are estimated to be higher than those projected under the last year's PEP, which to a certain extent explains the change in revenues' share in GDP during 2007. The rest of the 2007

revenue surplus compared to the last year's PEP can be attributed to stronger economy activity, which is carried over into the subsequent years through the baseline effect. The changed macroeconomic assumptions used in the revenue projection lead to an increase in the anticipated general government revenues throughout the medium term-period.

Table 11: Comparison of revenues, expenditures and net lending/borrowing of the general government for period 2006-2009, according to 2006 PEP and 2007 PEP

	2006	2007p	2008p	2009p	2010p
2007 PEP (% of GDP)					
Total revenue	44.8	46.2	43.7	42.8	41.8
Total expenditure	47.0	47.8	45.2	43.4	41.6
Net lending/borrowing	-2.2	-1.6	-1.5	-0.6	0.2
2006 PEP (% of GDP)					
Total revenue	45.0	44.8	44.0	43.3	
Total expenditure	47.2	46.6	45.7	44.7	
Net lending/borrowing	-2.2	-1.8	-1.7	-1.5	
Difference: 2007 PEP and 2006 PEP (percentage points)					
Total revenue	-0.2	1.4	-0.3	-0.4	
Explained by:					
Revision of GDP	-0.5	-0.9	-1.7	-2.4	
Difference due to final outturn of 2006	0.3	0.2	0.2	0.2	
Increase in one-off revenues in 2007		0.9			
Difference due to projection for 2007		1.2	1.2	1.1	
Difference due to projection for 2008			0.0	0.0	
Difference in projection for 2009				0.5	
Total expenditure	-0.1	1.2	-0.5	-1.3	
Explained by:					
Revision of GDP	-0.5	-1.0	-1.8	-2.5	
Assumption of guarantees in 2006	0.3				
One-off expenditure associated with court rulings		0.1			
Subsidies		0.1			
Clearance of arrears		0.1			
Increase in motorway construction expenditures		0.8			
Compensation of employees		0.2	0.3	0.5	
Increase in health expenditure		0.2	0.2	0.2	
Increase in expenditure for pensions		0.1	0.4	0.4	
Increase in material cost			0.3	0.3	
Increase in expenditure for interest			0.1	0.1	
Other	0.1	0.5	0.0	-0.3	
Net lending/borrowing	-0.1	0.2	0.2	0.9	

Source: MF

In 2006 the level of expenditure was higher than projected in the last year's PEP. The reason for this lies in the guarantees assumed during 2006 and accounting for 0.3% of GDP.

A number of effects during 2007 have caused the levels of expenditure to change between the two PEPs. Note should be made of one-off expenditures for enforcement of judgements regarding compensation of employees. Also, the level of subsidies has risen, particularly as a result of larger amounts allocated to agricultural subsidies. A substantial portion of the increase in expenditures during 2007 can be attributed to intensified motorway construction works, and there has also been a one-off increase related to the payment of arrears in the health care system.

For all the years during the period 2007-2009, this year's PEP foresees higher expenditures for compensation of employees, which is mainly associated with the increase in projected expenditures for compensation of employees at the local government level. It should be pointed out that the local government expenditure projections have been revised compared with the last year's PEP mainly because of the fact that the 2006 budget execution by the local government units at end-2006 was much above the relatively pessimistic projections from the last year's PEP.

In addition to the above mentioned one-off expenditures in 2007 aimed at eliminating the accumulated arrears in the health care system, the 2007 budget includes also higher health expenditures which should prevent further build-up of arrears, and the effect of the increase in this expenditure category will be felt in subsequent years.

Expenditures for the pensions of war veterans are moderately growing during 2007 as a result of the payment of dues from previous years. The pension expenditures will grow somewhat faster in the years ahead due to the equalising of pensions of the so-called „old” and „new” pensioners, i.e. reducing of existing differences in pension amounts paid to persons who retired at different times.

Increased material expenditures in 2008 and 2009 can be explained by two factors. Firstly, the level of utilisation of EU aid funds is expected to be higher, and those are largely channelled into material expenditures. The other reason is the revision of expenditure projections at the local government level, as described above. According to their revised projections, interest expenditures are expected to be somewhat higher in 2008 and 2009 than projected in the last year's PEP.

Under the new projections for total revenues and expenditures at the general government level, an improvement is foreseen with the regard to the level of net lending/borrowing, from 0.2 percentage points in 2007 to 0.9 percentage points in 2009.

3.3 QUALITY OF PUBLIC FINANCES

In the next medium-term period, the measures aimed at improving the quality of public finance will be continued. In the previous period, a number of measures were implemented to improve the quality of budget management: the State Treasury and the single treasury account were introduced; the scope of the single treasury account was broadened to include social security funds; budgetary analyses were improved and the system was introduced for measuring fiscal effects of all legislative proposals; the system for monitoring and reporting public finance statistics by using internationally accepted methodologies was improved; the system of internal financial controls of budgetary resources was introduced and enhanced, while the budgetary revenue collection system was improved. Furthermore, the current liquidity planning and maintenance system is being systematically improved, and to this end quarterly, monthly, weekly and daily plans of inflows and outflows are prepared.

As regards the revenue side of the budget, the activities aimed at strengthening controls of budgetary revenue collection through systematic supervision will continue with the aim of combating the grey economy and ensuring that all taxpayers honour their tax liabilities. In the forthcoming period, the existing taxes will not be increased, and no new taxes will be introduced, so there will be no additional tax burden on the economy. The focus of the tax policy over the medium-term will be on the alignment of the Croatian tax legislation with the *acquis* and introduction of the measures aimed at simplifying the tax system.

Furthermore, the efficiency of controls of budgetary spending and timely execution of budgetary expenditures will be improved so as to ensure that budgetary resources are channelled into the areas of strategic importance.

In this context, it is appropriate to underline the progress made in the full alignment of the national legislation in the area of public procurement with the *acquis*. The new Act on Public Procurement⁶ has been drafted, a result of systematic work of the Office for Public Procurement of the Government of the Republic of Croatia, supported by SIGMA and the experts of the CARDS 2002 twinning project „Strengthening the Croatian Public Procurement System”. This Act is an important step towards the alignment of the Croatian legislation with the *acquis* and with general principles of public procurement which should ensure free competition in the public procurement market. Conceptually, the new Act on Public Procurement defines the procedures of the public procurement for public clients, clients in the area of water supply, energy, transportation and postal services, including the legal protection. The new Act on Public Procurement was passed by the Croatian Parliament on 3 October 2007. Its main goals include improved management of public finance, establishment of the optimum proportion of invested public resources to create new value, encouragement of free market competition, reduction of administrative burden, environment protection, promotion of excellence and efficient legal protection.

As regards implementation of the structural reforms aimed at improving the quality of public finance in Croatia, it should be pointed out that the economic policy in general and, consequently, fiscal policy is focused on promoting knowledge and excellence, i.e. on creating a knowledge-based society⁷. The Croatian economic policy is based on increased competitiveness of a learning economy and on investment in human resources, in accordance with the Lisbon Strategy goals. To this end, numerous measures are being undertaken in the field of reform of education and science with the objective of building up adequate and

⁶ The new Act on Public Procurement was adopted by the Croatian Parliament on 3 October 2007.

⁷ The measures aimed at developing a knowledge-based society are set out in Chapter 4.6.1.

competent human resources and ensuring labour force mobility, as well as balancing supply and demand in the labour market. Lifelong learning and higher levels of education are encouraged among Croatian citizens in view of the fact that a substantial number of young people between the age of 16 and 18 are unemployed; policies are in place to stimulate secondary-level education by providing free textbooks and transportation to students. Over the past four years, i.e. from 2003 to 2007, investment in education and science grew by HRK 2.6bn or 33.7%.

It is also important to stress the orientation of the budgetary policy towards more balanced development of Croatia and continued construction of infrastructure facilities. The Act on Amendments to the Act on Financing Units of Local and Regional Self-government, which entered into force in 2007, provides for more balanced and fairer distribution of tax revenues among all regions of Croatia, especially in the areas of special state interest, and for better liquidity of the overall financing system at the local level. The new system has thus given fresh impetus to stronger and more balanced development of all parts of Croatia. Also, the Government is allocating considerable resources to many development and infrastructure projects aimed at encouraging stronger regional growth and creation of good quality infrastructure network in Croatia. Investment in reconstruction, as well as capital, infrastructure and economic projects at the level of local units is a precondition for stronger economic activity and a higher standard of living. In the period 2003-2007, investment in development projects at the regional level went up almost three times. In the next period, investment in harbour and air transport facilities will continue, and it is also important to note that the construction of certain road sections will proceed in accordance with the Road and Motorway Construction Plan, while special attention will be paid to investment in railway infrastructure according to the National Programme of Railway Infrastructure.

Eventually, the fact that budgetary funds are channelled into the creation of a stimulating business environment demonstrates the alignment of the fiscal policy with the overall economic policy which is focused on encouraging stronger participation of the private sector in achieving long-term sustainable high rates of economic growth. The budget supports gradual withdrawal of the government sector from the economy, so further decrease in the general government expenditure is planned: from 46.2% of GDP in 2007 to 41.8% of GDP in 2010. Furthermore, the Government plays an active role in encouraging entrepreneurship, as demonstrated by a series of projects designed to stimulate business activity in crafts, medium and small enterprises, tourism, agriculture and fishing. When speaking about the creation of an advantageous business climate, the state resources are allocated to the implementation of the key measures in the area of public administration and the judiciary with the aim of lifting all the existing administrative barriers and establishing a modern, efficient and professional system of public administration at service to all entrepreneurs and citizens. Another goal is to set up an efficient judicial system and promote the rule of law through systematic fight against corruption, as manifested in budgetary allocations for that purpose.

Systematic implementation of the measures aimed at improving the public finance system through better control of budgetary revenue collection and efficient use of budgetary resources by channelling those into areas of strategic importance will help improve the quality of public finance in Croatia. The public expenditure policy which is focused on investments intended to stimulate entrepreneurship, education and science, as well as capital projects, will ensure long-term sustainability of high economic growth rates, which will in turn spur faster growth of budgetary revenues and, eventually, provide new opportunities for investment in knowledge and infrastructure and thus add to the quality and sustainability of the public finance system and economic growth.

3.4 SUSTAINABILITY OF PUBLIC FINANCES

The analysis of long-term sustainability of public finance in this year's PEP is based on the same long-term population projections as last year (a scenario with medium fertility and medium migration). Compared to the previous PEP, certain assumptions have changed, and this refers primarily to more optimistic real GDP growth rates in the initial period, faster reduction of the unemployment rate to 7%, the inclusion of expected effects of equalisation of the pensions of "new" and "old" pensioners into expenditure for pensions, and the new fiscal projections for the period until 2010.

It is assumed that there will be no changes in the regulations and policies governing public pension and health expenditures and that the manner of calculating and collecting social security contributions will remain unchanged. It is further assumed that all other public revenues, with the exception of social security contributions, as a share of GDP will stay the same, and all other expenditures, except for pension, health and interest expenditures, will retain their current share in GDP. As regards participation rates, it is assumed that behaviour patterns of individual economic agents will stay unchanged, with participation rates according to the characteristic age groups (15-24, 25-49, and 50-64) and gender remaining the same. On such assumption, it can be seen that after the year 2010 the overall participation rate will fall as a result of a growing share of the population in older age groups.

At the beginning of the period, real GDP growth is expected to be 7%, converging in the subsequent years towards the projected average potential GDP growth for EU10 (new member states after the 2004 enlargement).⁸ Unemployment rate is expected to fall until 2010 to reach the level of 7%, which is considered to be the structural unemployment rate, and it will remain unchanged until 2050. The growth of productivity per employee is derived from the assumptions on real GDP growth and changes in the number of employed people, which is determined by long-term demographic projections and assumed participation rates.

On the basis of the assumptions described above, a moderate decrease in revenues from pension insurance contributions is estimated: from 6.9% of GDP in 2005 to 5.9% of GDP in 2015, stabilising in subsequent years. Such decline in the first years can be explained by a gradual increase in the share of employees claiming their pension insurance under both mandatory pillars of pension insurance, with a proportion of their contributions (5% of the calculation basis) being paid into mandatory private pension funds. Older employees, on the other hand, are largely covered only by the first pillar of pension insurance, with total amount of their contributions (20% of the calculation basis) being paid into the public fund. As older employees retire, the number of employees who pay only a portion of their total contribution (15% of the calculation basis) into the public fund will grow. The share of revenues from pension contributions is expected to stabilise at the level of 5.9% of GDP after 2015, as a result of the assumption that real growth of wage per employee is equal to labour productivity and of the contribution rate definition as a constant portion of wages, where higher first-pillar contributions for older employees are taken into account for the purpose of pension insurance contributions.

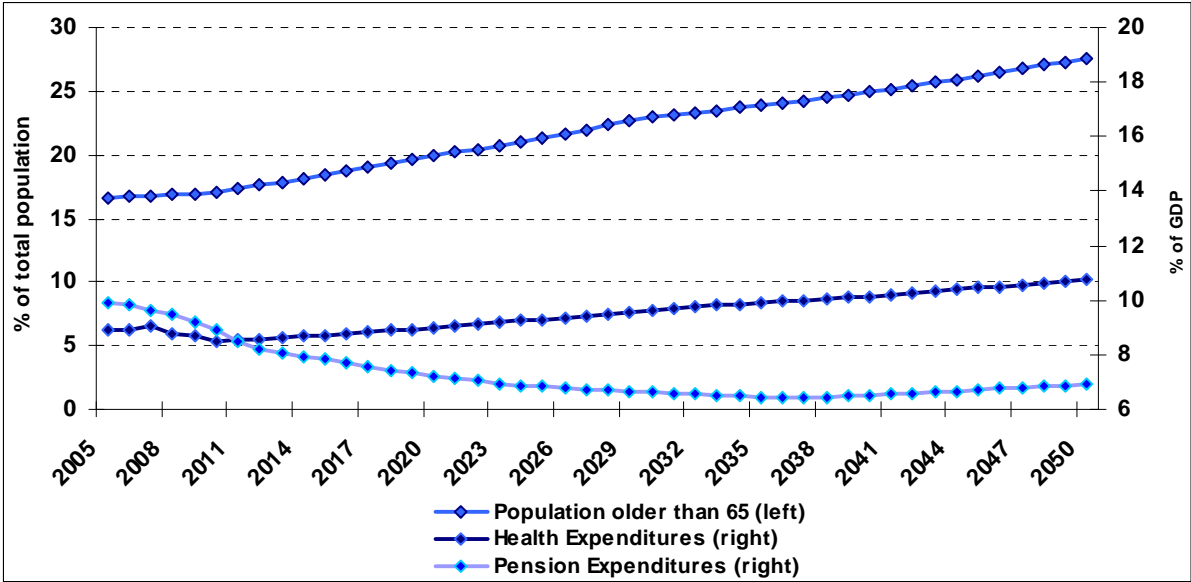
The projection results show a significant decrease in public pension expenditures, from 9.9% of GDP in 2005 to 6.9% of GDP in 2050, with the pensions and permanent rights of war veterans being excluded from the analysis. The share of pension expenditures in GDP is smaller than projected in the previous PEP despite the inclusion of expenditures for equalisation of "old" and "new" pensions because more optimistic rates of real GDP growth

⁸ The assumption and the level of rates are derived from the projections of the Economic Policy Committee of the EU (2006).

are projected this year. Public pension expenditures include only the expenditures of the Croatian Pension Insurance Institute (HZMO), and not the expenditures under private pension insurance schemes (whether mandatory or voluntary). Such decrease in public expenditures is primarily a result of the decrease in relative pensions (pension-wage ratio) paid from the first pillar. This result is certain to high extent if the current parameters of pension calculation are maintained, i.e. pension indexation is made according to the formula which takes into account 50% of wage growth and 50% of the inflation. It is expected that payments from the second pillar will partially or completely compensate for the decrease in relative pensions. It should be noted that the projections take into account a gradual decrease in the share of those pensioners whose pensions are paid entirely from the first pillar, and the growing share of those who are paid part of their pensions from the first pillar and the other part from the second.

Public expenditures in the health care system are projected to grow from 6.2% of GDP in 2005 to 10.2% of GDP in 2050. Such growth is a result of the estimated pure effect of aging population and rising health expenditures in line with productivity growth. The expenditure growth arising from the pure aging effect is a result of a growing share of the population in older age groups who absorb relatively large amounts of health expenditures. In addition to the effect of aging population, it is also assumed that health expenditures for each age and gender group will grow in line with GDP per employee. Since salaries of medical personnel are one of the major expenditure items of the health care system, it can be assumed that health expenditures will grow at the same rate as compensation of medical personnel, which in turn is expected to grow at the same rate as average wages in the economy in general. Health expenditures as a proportion of GDP will grow by around 2 percentage points in 2050 a result of a more optimistic projection of GDP growth resulting in faster growth of productivity and, consequently, health expenditures.

Figure 9: Aging of population, health and pension expenditures



Source: MF

3.5 INSTITUTIONAL FEATURES OF PUBLIC FINANCES

The legal framework regulating the area of public finance has several levels: the Constitution of the Republic of Croatia, the Budget Act and its implementing regulations, the annual budget of the Republic of Croatia, as well as ordinances and instructions. The principal legal act governing budgetary processes and relations between institutions within the system is the Budget Act.

The Budget Act from 2003 defines in detail the instruments for public expenditure management and regulates the process of planning, preparation, adoption and execution of the budget, asset management and debt management, public debt management, borrowing and issuance of guarantees by the central government and the units of local and regional self-government, budgetary relations in the public sector, accounting, as well as internal and external budgetary supervision. The Act determines also mutual relations and respective rights and responsibilities of the institutions concerned (the Croatian Parliament, the Government of the Republic of Croatia, the Ministry of Finance and budgetary users) and functions within the budgetary system.

The Budget Act acknowledges the need of introducing standard classifications serving as a framework for reporting and systematic monitoring of revenues and receipts, on the one hand, and expenditure and expenses, on the other hand, broken down by the competent authority, goal, purpose, type and location. However, the Ordinance on Budgetary Classifications, which entered into force in the second half of 2007, defines in more detail the contents of those classifications in that it determines the structure of their code numbers and names, the application of classifications to all budgets and budgetary user, and connections between those classifications. Besides, the Ordinance has introduced a special classification of financing sources.

The requirement to apply the budgetary classifications (and the system of code numbers and names) to all budgets and budgetary users in the process of planning, execution, accounting and reporting provides, *inter alia*, the basis for consistent monitoring of transactions, for spending controls, as well as for economic and statistical analyses.

It follows from the above that the area of public finance is regulated in institutional terms, and the Strategy for Improvement and Modernisation of the Processes within the State Treasury for 2007-2011, adopted by the Government of the Republic of Croatia on 12 October 2007, is the basic development document for this area.

The goals and contents of the Strategy are strongly determined by the period of its application, which coincides with the period of Croatia's EU accession negotiations and the first years of its EU membership.

Since the State Treasury incorporates, in terms of organisation and information technology processes, all key budgetary processes, namely budget preparation and execution, accounting and reporting, as well as public debt management, the Strategy defines the goals of modernisation of the State Treasury system, along with short-term and medium-term measures which should ensure that those goals are achieved.

The Strategy for Improvement and Modernisation of Processes in the State Treasury builds on the main strategic document of the Croatian Government, namely the Strategic Development Framework for 2006-2013, and the Government's other documents that cover, from various aspects, the area of public finance, and in particular the National Programme of the Republic

of Croatia for Association with the European Union, the Pre-accession Economic Programme for 2007-2009, and the National Programme for Prevention of Corruption for 2006-2008.

The Strategy consists of a large number of measures and defines reasonable timeframes for their implementation. The application of a medium-term programme budget and establishment of a single IT system for financial management within the State Treasury are the key activities which will be carried out during the medium-term period.

Furthermore, the Strategy foresees the implementation of the following measures:

- Introducing the practice of preparing a three-year strategy of the Government policies (Financial Strategy) in parallel with the fiscal plan, where such strategy should clearly define the priorities, goals and policies, its strategic choices reflecting on the budgets for each year within the three-year period. The Financial Strategy should be prepared on the basis of strategic plans of individual line ministries for the relevant three-year period and should be adopted by the Croatian Parliament;
- Preparation of the Medium-term Fiscal Framework to define medium-term fiscal goals of the Croatian Government in respect of the key indicators such as total revenues, total expenditures, budgetary deficit, public debt and debt servicing costs, including also the identification and quantification of potential risks, as well as a medium-term expenditure projection aligned with the goals in respect of revenues and budgetary deficit, and their breakdown at the level of liabilities arising from the Government's current and planned activities;
- Integrating budgetary planning with other budgetary processes, primarily budgetary accounting and budget execution;
- Defining the procedures for programme monitoring and evaluation;
- Establishing an automated system of supervision over liabilities incurrence, including multi-year liabilities;
- Modernisation of business with banks and introduction of e-business so as to ensure that information on the status of payment orders issued and account balances is available on time;
- Improvement of cash flow and cash needs planning, developing procedures for monitoring payment liabilities and preparing cash flow plans and borrowing plans;
- Proceeding with internal audit of the State Treasury system/business processes according to risk assessment, management requirements and results of risk assessments in the Treasury;
- Establishing a comprehensive accounting system, integrating the general ledgers of budgetary users with the general ledger of the State Treasury in order to ensure availability of data on the liabilities incurred and their maturity.

4 STRUCTURAL REFORM OBJECTIVES

4.1 ENTERPRISE SECTOR

4.1.1 Privatisation

Completion of privatisation of companies in the state portfolio, as well as exit from the market of companies with no future, making adequate provision for the employees through labour market institutions and social policy, completion of privatisation process of the shipbuilding industry and transformation of the Croatian Privatisation Fund (CPF) into an institution which will efficiently and actively manage the state assets remain the main objectives in the area of privatisation.

During the previous year, in accordance with the objectives set by the strategic documents, a total of 20 companies in majority ownership of the CPF were privatised (4 through a public tender and 16 companies in bankruptcy and winding-up proceedings), as well as a total of 171 companies in minority ownership (132 companies through a stock exchange sale and 39 companies through bankruptcy and winding-up proceedings).

Table 12: Privatisation of companies in the CPF portfolio¹⁰ through a public tender and stock exchange in the September 2006 – September 2007 period

	No. of privatised companies	Nominal value of stakes sold (million HRK)	Price achieved (million HRK)
Stock exchanges	132	88.7	152.6
Public tenders	4	549.6	50.6
Ukupno	136	638.3	203.2

Source: CPF

A relatively more modest result compared to the previous years is primarily a consequence of the portfolio structure, dominated by the companies that are facing operating difficulties and are as such not attractive to the investors on the market, as a result of which their sale, in accordance with the determined legal procedure, is time-consuming and performed in several stages (as much as 44 tenders were invited to sell 23 companies in the observed period).

However, a great progress was made in the area of black metallurgy, where the set objectives were met in entirety. Accordingly, Željezara Split and Valjaonica cijevi Sisak were privatised at the beginning of the second semester of 2007, while privatisation of aluminium company TLM is the final stage of contract signing with the selected strategic partner. It should be noted that terms and conditions of the privatisation tender were determined in co-operation with the recommended consultants from the EC and the Croatian Competition Agency and that privatisation of the black metallurgy sector was performed in line with the criteria set under the Stabilisation and Association Agreement concerning the market competition rules and Protocol 2 concerning the steel products.

By inviting a tender for sale of 5 subsidiaries of the company Croatian Railways, the planned privatisation of the national railway company has also commenced and one subsidiary has been privatised so far (in the case of a company RVR Services, the contract with the strategic partner was signed in October this year).

In early September 2007, the portfolio of CPF encompassed 880 companies of which 665 were available for sale (the remaining 215 companies are those that are not available for sale

¹⁰ The portfolio of the Croatian Privatisation Fund includes only a part of the central government ownership, so that the share relates to the privatisation status of that portfolio.

on account of legal disputes or are either dormant or subject to bankruptcy or winding-up proceedings).

Nominal value of the total state portfolio of the CPF amounts to HRK 18.8bn, while the value of CPF's equity portfolio amounts to HRK 10.0bn. The difference of HRK 8.8bn can be accounted for by the value of shares/stakes managed by the CPF on behalf of the actual owners (State Agency for Deposit Insurance and Bank Rehabilitation, Croatian Institute for Pension Insurance, Croatian Health Insurance Institute), to whom sale receipts are disbursed proportionate to their equity stake.

On the basis of the actions taken so far concerning the preparation of companies for privatisation, more intense efforts will be made in the forthcoming months concerning the invitation of public tenders (tenders for 25 companies have been prepared so far). In addition, the adoption of the National Shipbuilding Restructuring Programme is also expected (draft proposals of the selected consultants are completed and are subject to review by the government institutions) along with continued activities aimed at final definition of the amount of equity capital of the shipyard Uljanik, privatisation of which should begin in 2008.

4.1.2 Railway restructuring

The objective of the railway restructuring process implies the establishment of the railway sector which will be sustainable in fiscal terms and competitive, with a tendency of a reduced need for financial subsidies of the government.

A continued reform of the railway sector in 2007 refers to a further alignment of the national legislation with the *acquis communautaire* in the segment of the railway transport, as well as to preparations for liberalisation and enabling of a free access to the railway network. The majority of the activities undertaken are determined by the application of the Act on the Division of Croatian Railways (HŽ- Hrvatske željeznice d.o.o.).

In December 2006, four new railway companies – legal successors of the former HŽ were established by a decision of the Commercial Court in Zagreb from December 2006. These include: HŽ-Infrastruktura d.o.o., HŽ-Putnički promet d.o.o., HŽ-Cargo d.o.o and HŽ-Vuča vlakova d.o.o. Company HŽ-Holding d.o.o. was established by a special decision of the Government of the Republic of Croatia, with a primary objective of co-ordination and implementation of the restructuring process.

Business results from end-2006 point to an increase in natural business indicators. Accordingly, passenger transport amounted to 46 million passengers in 2006 (16% growth) while freight transport amounted to 17 million tons (7.1% growth), with heavy co-financing still being provided by the state budget (accounting for around 60% of total income of Croatian Railways).

As a part of co-operation with the World Bank, the implementation of the agreed objectives continued for the improvement of the operating ratio, reduction in the number of employees and privatisation of HŽ subsidiaries (non-core business). The targeted amounts for 2006 were realised, so that operating ratio for 2006 stood at 190%, number of employees was reduced by a net of 501, and preparatory activities for privatisation of subsidiaries (first five companies) were also successfully completed.

Liberalisation of the railway sector and opening of the network primarily imply further legislative alignment and creation of an institutional framework which will enable and provide a smooth market competition. A considerable progress has been made in the area of legislative alignment, so that in 2007, the Railway Transport Safety Act and Act on the

Agency for Railway Services Market Regulation were adopted. By adopting these and previously aligned acts (the Railway Act and the Act on the Division of Croatian Railways) the first and the largest part of the second package of the EU Rail Directives was transposed into the domestic legislation. The activities of adopting implementing regulations and establishing new administrative bodies are planned for the forthcoming period: Agency for Railway Services Market Regulation (*regulatory body*), Agency for Railway Transport Safety Supervision (*safety authority*).

For the purpose of introducing a systematic approach to the railway network development and management, and in order to achieve the objective of improving technical and technological characteristics of the network of railway lines to a higher or more competitive level, the final proposal of the National Railway Infrastructure Programme was completed. The Programme sets the criteria for management and modernisation of the existing network of lines, plans development and construction of new lines and proposes solutions to problem of local railway lines and the issue of railway-road crossings.

In the forthcoming three-year period, implementation of the measures aimed at reducing non-profitable services in the public passenger transport will continue, as well as at resolving of the issue of non-profitable local railway lines, resolving of the problem of railway-road crossings, issue of status and treatment of real estates with a status of public goods in general use, at improving technical and technological level of the railway network and at preparing the sector for the railway network liberalisation.

The restructuring objectives for 2007 relate to the railway sector in entirety. By end-2007, the following indicators should be realised:

1. improvement of financial efficacy through a further reduction of operating ratios to 170%;
2. reduction in the number of employees by 530;
3. carrying out privatisation of subsidiaries.

4.1.3 Restructuring of shipbuilding industry

The objective of the Government of the Republic of Croatia is to increase productivity and rationalisation of operation through a restructuring process and to achieve a long-term sustainability of shipyards' operation, in view of the fact that shipbuilding represents a strategically important sector of the Croatian industry. By implementing the measures under the restructuring programme, the shipyards are intended to be prepared for an autonomous successful operation on the world market, at the same time creating prerequisites for a successful privatisation.

Croatian shipyards sell their products almost in entirety on the open world market. Croatian shipyards account for 1% to 2% of total world orders (expressed in deadweight tonnage). The value of the book of orders amounted to around USD 3bn (for construction of 68 ships) at the end of the first half of 2007, which ensures full employment of the majority of shipyards until 2010. The Croatian shipyards still operate at a loss (in the first semester HRK 137.0m), which points to a need for adopting individual plans and implementing the restructuring process.

On the basis of the Decision of the Croatian Competition Agency from September 2006, which was adopted in accordance with Article 17 of the State Aid Regulation, the Government of the Republic of Croatia enacted the Decisions on granting state aid for maintaining business of shipyards in the period until the preparation of individual

restructuring plans (the so-called rehabilitation aid), pursuant to the Rules on state aid for rehabilitation and restructuring.

By the previously mentioned Decisions, state aid was granted to shipyards in the total amount of HRK 2.5bn until end-2006, of which HRK 1.0bn related to guarantees for advance payments of customers and HRK 1.5bn to guarantees for liquidity loans of shipyards.

Pursuant to the same Decision, the Government of the Republic of Croatia in the first quarter of 2007 adopted the Decisions on granting state aid in the total amount of HRK 1.7bn, of which HRK 733.0m accounts for guarantees for advance payments of customers and HRK 922.6m for liquidity loans of shipyards (bridging manufacturing financing). The Croatian Competition Agency (CCA) supervises the use of the granted funds on the basis of the report by the Ministry of Economy, Labour and Entrepreneurship.

In the first quarter of 2007 individual shipyards (Uljanik, 3. Maj, Kraljevica d.d., Brodotrogir d.d., Brodosplit) prepared their own draft proposals of individual restructuring programmes, which were, after the adoption by the Government Committee for Restructuring of Shipbuilding Industry, forwarded to the CCA for their review and assessment and to the European Commission. The CCA carries out review and assessment of the submitted programmes in co-operation with the external consultant. The approval of individual restructuring programmes by the Government of the Republic of Croatia is envisaged for end-2007 or for the first quarter of 2008. Those will be then officially forwarded to the European Commission for evaluation, after the prior evaluation by the CCA.

Draft proposals of individual shipyard restructuring programmes represent a constituent part of the Draft Proposal of the National Shipbuilding Restructuring Programme. The objectives defined by the aforementioned restructuring programme imply a successful rehabilitation, long-term sustainability and international competitiveness of shipbuilding industry in the Republic of Croatia. The measures and activities that are planned to be undertaken in the mid-term period and positive effects of which are expected by 2012, imply, in general, measures aimed at financial consolidation of shipyards, cost rationalisation, shipyard modernisation and more efficient use of internal resources.

Parallel to the implementation of the Croatian shipyards' restructuring, activities will be performed aimed at creating conditions for shipyard privatisation, which need not necessarily be connected to the end of the restructuring period of the Croatian shipbuilding industry.

Taking into account quality of construction and tradition of the Croatian shipbuilding industry foreign investors' interest in privatisation can be expected. This is confirmed by the enquiries of international investors who have clearly, on several occasions, expressed interest in participation in the privatisation process of the Croatian shipyards. Accordingly, a continuation of more intense discussions with potential investors can be expected, which could enable privatisation even prior to the completion of the restructuring process itself.

4.1.4 Energy

In 1997, Croatia launched structural reforms in the energy sector, with an aim of creating a new legal framework (completely aligned with the *acquis communautaire*), liberalisation of the energy markets, restructuring of the main energy companies and their privatisation. An adequate legal framework was established, allowing for the fulfillment of the set objectives.

Restructuring of the main energy companies was completed: Hrvatska elektroprivreda (HEP) and INA-Industrije nafte. A special company in charge with the natural gas transport has been

established - PLINACRO. Privatisation of the petroleum company INA-Industrija nafte began on the basis of a special act.

A complete opening of the electricity market was envisaged for 1 July 2008 and of the gas market for 1 August 2008. All institutions important for non-discriminatory and safe market operations have been established: Croatian Energy Regulatory Agency, Croatian Energy Market Operator, HEP-Transmission System Operator d.o.o. and HEP-Distribution System Operator d.o.o. (electricity) and Gas Transportation System Operator (a task entrusted to PLINACRO).

A model of bilateral market was selected for the initial opening of the electricity market in Croatia, which is based on electricity trading through bilateral contracts. A customer and a supplier are the parties to a bilateral electricity supply contract, whereas bilateral electricity purchase and sale contracts are concluded between a supplier, trader or manufacturer. As regards the allocation of cross-border transmission capacity, the appropriate rules on allocation and use of cross-border transmission capacity are applied.

The legal framework and strategic documents concerning the energy sector development determine the efficient energy use and cogeneration, as well as the use of renewable energy sources, to be of a special interest to the Republic of Croatia. The Environmental Protection and Energy Efficiency Fund (co-)finances programmes, projects and activities in the field of environmental protection, renewable energy sources and energy efficiency. In the field of renewable sources, incentives for electricity production from renewable sources were introduced (*feed-in tariffs*).

As regards the issue of energy supply safety, the Agency for Compulsory Stock Reserves of Oil and Oil Products has been established.

The biofuel quality regulation determined the indicative objective of 5.75% share of biofuel in total annual consumption of petrol and diesel fuels, which should be realised by 31 December 2010. The biofuels act and the respective subordinate legislation will be adopted by end- 2008 and will completely regulate this area.

The Government of the Republic of Croatia has accepted the Plan for development, modernisation and construction of the gas transport system in the Republic of Croatia from 2007 to 2011, in which supply and mounting of equipment is envisaged which will enable functioning of the secondary market and development of gas network in the south of Croatia, as a result of which obligations arising from the *acquis communautaire* relating to transport system will be fulfilled. It is estimated that the existing supply capacity will not be sufficient in the period after 2009 due to a significant consumption growth. A further development of supply capacity for natural gas is thus planned by means of:

- an increase in pipeline capacity of the gas supply line from the Russian Federation through Slovenia by 500 million space metres – in 2010;
- construction of supply line through Hungary – in 2012;
- construction of LNG terminal in north Adriatic – in 2012;
- construction of additional storage for Croatia's needs – in 2010.

In the field of energy, the Republic of Croatia is a party to several international agreements affecting regional co-operation in South-Eastern Europe: Energy Charter Treaty, Umbrella Agreement on the Institutional Framework for the Establishment of Interstate Oil and Gas Transportation to Europe – INOGATE and Energy Community Treaty.

As regards the Energy Community Treaty, the Republic of Croatia has completely opened its electricity and gas market considerably earlier than envisaged by that Treaty. Croatia participates actively in the creation of an efficient environment for the establishment of a

regional electricity and gas market in South-Eastern Europe. The Croatian electricity transmission system is extremely well connected with the neighbouring systems and it enabled in 1999, after putting into operation 400 kV of line between Croatia and Hungary, the first connection of the former CENTREL system with UCTE system. Construction of 400 kV transformer station Ernestinovo in south-eastern part of Croatia and reconstruction of the respective cables allowed for a reconnection of the UCTE electric synchronous zones 1 and 2. Successful connections represent a key condition for the establishment of the electric energy market in South-Eastern Europe and its connection with the EU market.

In the field of natural gas and in terms of the Energy Community Treaty, the Republic of Croatia has proposed several projects. This primarily refers to a construction of underground storage Beničanci with a capacity of 2 million space metres, which will have regional importance, and construction of a LNG terminal in the northern part of the Adriatic Sea, with a final capacity of 14 billion space metres per year. In addition, Croatia participates actively in negotiations concerning the gas transportation from the Caspian Sea region further to the EU territory. One of the projects includes a South-European Gas Ring Pipeline from Turkey to Slovenia, which is indicated by the EU as a priority line for gas supply. Another project relates to the Ionic-Adriatic Pipeline as a branch of the Trans Adriatic Pipeline which goes to Italy and which should pass through Albania, Montenegro, Bosnia and Herzegovina and Croatia to Italy.

For the purpose of implementation of the measures envisaged under the Energy Community Treaty, the Republic of Croatia has formed a working group consisting of the representatives of the Ministry of Economy, Labour and Entrepreneurship, Ministry of Environmental Protection, Physical Planning and Construction, Ministry of Culture, Croatian Energy Regulatory Agency, Hrvatska elektroprivreda, INA-Industrija nafte and company PLINACRO, which monitors the implementation of provisions and prepares documentation for the implementation of the Treaty provisions. The working group has accepted the report on the energy supply safety in the Republic of Croatia, which has been submitted to the Secretary of the Energy Community Treaty. As regards the Treaty, in the 2008-2010 period, additional measures concerning supply safety will be defined and measures will be adopted in the event of force majeure. One of the important tasks is also an obligation to transpose the *acquis communautaire* in the field of environmental protection under Annex II of the Energy Community Treaty, which will be realised in the 2008-2010 period.

4.1.5 Small and medium size enterprises

Data on growth in small and medium size enterprises (SMEs)¹¹, as well as on an upward trend of investment¹² in long-term assets indicate that the economic policy objectives have been fulfilled. In 2006, small and medium size enterprises in the Republic of Croatia retained the same place with respect to their share in total economy, accounting for 99% of the registered business entities (above the EU average), 55% of the total number of employees in Croatia, 44% of total GDP and 24% of exports (it is assessed that the share of small enterprises in exports amounts up to 60% of total exports of the Republic of Croatia, through various forms of business association and co-operation). The above indicators clearly show the purpose of

¹¹ In comparison with the previous business year, the number of medium size and large entrepreneurs was reduced since the Amendments to the Accounting Act changed the criteria for determining the entrepreneurs' size. 76 588 entities are small entrepreneurs (97.6%), 1 480 medium-size entrepreneurs (1.9%) and 441 large entrepreneurs (0.6%).

¹² With respect to the size of entrepreneurs, the largest investment growth rate was recorded by small entrepreneurs (41.4%), while large and medium size entrepreneurs recorded lower growth rates compared to the Croatia's average (20.9% and 12.9%, respectively).

the intention of the Government of the Republic of Croatia to provide incentives to the development of small and medium size enterprises as the key trigger of economic growth.

According to the global competitiveness index, Croatia made progress in moving up by 13 places in 2006 compared to 2005, to 51st place out of 125 countries on the list of global competitiveness. By climbing from 64th to 51st place, Croatia came closer to Slovakia in 37th, Hungary in 41st and Poland in 48th place, whereas Romania (in 68th place) and Bulgaria (in 72nd place) are ranked lower.

According to the results of the Global Entrepreneurship Monitor (GEM), Croatia made a huge progress - from 32nd place out of total 37 countries in 2002 it advanced to 18th place out of 42 countries in 2006.

The incentives and aid system for small and medium size enterprises in the Republic of Croatia is regulated and implemented on the basis of the two Government programmes - Programme of Incentives to Small and Medium Size Enterprises 2004-2008 and Programme of Entrepreneurial Zone Development 2004–2007. The instruments and measures are aimed at providing incentives to entrepreneurs with growth potential, increase in the number of business entities and employment, improved quality of business infrastructure and institutions supporting entrepreneurship, application of new technologies and innovations, facilitating financing, training and target groups (women, youth, war veterans, disabled), as well as at preserving traditional economic values and adjustment to the EU market. Aid is aimed at strengthening competitiveness, employment growth, export growth and a more balanced development of Croatia.

As a result of a wide range of measures of the Government of the Republic of Croatia (HITRO.HR, HITROREZ etc.), the community as well has changed its attitude towards entrepreneurship, thus creating an improved business environment and a more favourable climate for entrepreneurship development.

In that regard, several projects have been launched for the purpose of providing incentives to entrepreneurship, of which the most important are the following:

- Training in entrepreneurship;
- e-training in entrepreneurship;
- Competitiveness promotion projects;
- Favourable financing of small and medium size enterprises (interest subsidies, issuing of guarantees by the Croatian Agency for Small Business, launching of regional guarantee instruments as financial centres at the level of counties (regionally focused incentives), etc.);
- Entrepreneurial zone development projects;
- Projects aimed at development of crafts and crafts system.

Incentives to small business have increased over the years. This is a result of the alignment of legal solutions for SMSs with the *acquis communautaire*¹³, including the legislation regulating the issue of state aid and the overall economic policy of the Government.

The fundamental areas of providing incentives to the development of small and medium size enterprises in the forthcoming period are the following: (i) training in entrepreneurship, (ii) competitiveness, (iii) entrepreneurship financing and (iv) entrepreneurial infrastructure, adjusted to the strategic economic guidelines and (v) development of knowledge-based society and economy.

¹³ Act on Amendments to the Act on Promoting Small Business Development was adopted by the Parliament on 1 June 2007 and it simplifies the small business environment and aligns it with the EU recommendations.

4.1.6 Public-private partnership

During 2006, the Government of the Republic of Croatia adopted a decision on creating legal and administrative conditions for the introduction of the public-private partnership (PPP) model, with an aim of stimulating/promoting larger private investments in the construction of public goods and provision of public services.

The existing legal framework for PPP consists of the Guidelines for the use of contractual forms of PPP models, the provisions of which were described in detail in the last year's PEP, and the Regulation on granting the prior approval for the conclusion of the PPP contract under the private financial initiative model.

In accordance with the previously mentioned Regulation, there are three legal preconditions that have to be met for a public partner to be able to conclude a PPP contract:

- positive opinion of the PPP Sector concerning the submitted documentation, proposed diversification of risk and other elements of the contract;
- approval of the ministry competent for the contract that is to be concluded;
- prior approval of the Budget Preparation Sector of the Ministry of Finance as regards the ceiling for the annual fee to be disbursed by the public partner to the private partner under the PPP project.

In the process of approval of the PPP project, the PPP Sector also participates in the risk assessment with respect to the budget, which is in accordance with the Regulation on granting the prior approval for the conclusion of the PPP contract under the private financial initiative (PFI) model, within the competence of the Ministry of Finance. In that regard, the objective of the Government of the Republic of Croatia is to achieve identification and realisation of all PPP projects, in the context of the overall state investment and development strategy, among other things, through the improvement of co-operation between the PPP Sector and the Ministry of Finance. One of the key measures to achieve that objective is to improve the existing legal framework for PPP.

The new legal framework would regulate the basic concepts, competent bodies and general principles concerning concessions and PPP. The future structure of the legal framework would ensure the establishment of incentives for private sector investments in public infrastructure through PPP, along with a clearly defined system of approvals of the PPP projects and supervision of the same. Improvement of the legal framework for PPP also implies the role of co-ordination as a part of the government activities in the field of PPP, as well as the PPP projects assessment procedure, in accordance with the adopted development strategies and priorities at the national, regional and local level, under the condition of minimising fiscal risks in co-operation with the Ministry of Finance.

Following the adoption of the Guidelines for the use of contractual forms of PPP models, a more significant development and implementation of the PPP model has started in the Republic of Croatia, which, at the time, represented a relatively new form of public project financing in the Republic of Croatia. For that purpose, PPP Sector has organised several workshops aiming at making a closer acquaintance of public bodies and private sector with this model of financing. Since the problem of a lack of administrative capacity and knowledge of PPP represents the main shortcoming in implementing the PPP in the Republic of Croatia, a number of new educational activities has been planned, aimed at training the public and private sector participants, for the purpose of strengthening administrative capacity.

During 2007, PPP Sector and SIGMA (a consultant approved by the European Commission) organised three workshops for public sector participants and at least two more are planned to be held by the end of 2007. In addition, in cooperation with SIGMA, PPP Sector plans to prepare a detailed guide intended for the public sector participants and focused on the project contracting procedures under the PPP model. In 2008, further institutional strengthening of PPP Sector is planned.

4.2 FINANCIAL SECTOR

Banks predominate in the financial system of the Republic of Croatia, accounting for 73.9% of total assets of all financial intermediaries. Nevertheless, the said share has continuously been reducing in favour of other financial intermediaries, primarily leasing companies (6.9%), open-end investment funds (6.3%) and compulsory pension funds (4.4%).

Table 13: Financial sector structure (% of total assets, end of period)

	2002	2003	2004	2005	2006	June 2007
Banks, consolidated assets, in gross terms	85.8	83.4	81.5	78.7	76.4	73.9
Open-end investment funds, net assets	1.3	1.3	1.6	2.7	4.1	6.3
Closed-end investment funds, net assets	0.6	0.4	0.4	1.1	1.4	1.7
Insurance companies	5.7	5.4	5.2	5.1	5.0	4.9
Housing savings banks, consolidated assets, gross	1.1	1.5	1.8	1.8	1.6	1.4
Compulsory pension funds, net assets	1.1	2.0	2.9	3.6	4.1	4.4
Voluntary pension funds, net assets	0.0	0.0	0.0	0.1	0.1	0.1
Savings and loan co-operatives	0.6	0.6	0.5	0.5	0.5	0.5
Leasing companies	3.8	5.4	6.0	6.3	6.9	6.9
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: CNB, MFIN, HANFA

4.2.1 Banking sector

In mid-2007, 33 banks and 5 housing savings banks operated in the Republic of Croatia. In comparison with 2006, the number of banks was reduced by one institution as a result of its take-over by another bank. At the same time, the banking system was highly concentrated, so that 10 largest banks accounted for around 92% of total assets of all banks. Banks in majority foreign ownership predominated in the ownership structure, accounting for 91% of banks' total assets, whereas banks in domestic state and private ownership accounted for 4.5% of total assets of all banks each.

In order to contribute to a loan growth reduction, which is mostly based on foreign borrowing of banks from their parent banks, at the end of 2006, the CNB introduced a credit control measure, which obligates banks with the annual placement growth in 2007 exceeding 12% to purchase CNB bills in the amount of 50% of the excess amount. The same measure was made more stringent in July 2007, by setting the penalising limit on placement growth at 0.5% at the monthly level, starting from July 2007, relative to the balance of placements as at 30 June 2007.¹⁴

The Croatian Registry of Credit Obligations (HROK) will allow for a better insight into credit risk when banks grant their new placements. In May 2007, almost all founding banks of HROK began to use the reports on credit obligations of their customers. As regards the credit risk, it should be noted that in 2006 the CNB adopted a regulation¹⁵ according to which higher weights are applied to credit risk when calculating banks' capital adequacy for exposures to those customers whose foreign exchange position is not matched, in terms of currency in which they earn their income with the currency in which the placement was granted to them, for the purpose of an improved management of currency induced credit risk, in view of a large euroisation of banks' assets. The implementation of the provisions concerning currency induced credit risk is assessed during on-sight supervision of banks' operations. According to the data for end June 2007, 56% of banks' net placements was exposed to currency induced credit risk, i.e. around HRK 207bn. 75% of these placements was defined as unprotected, implying that in the case of that portion of placements exposed to currency induced credit risk

¹⁴ Decision on the Purchase of Compulsory CNB Bills

¹⁵ Currency Induced Credit Risk Management Guidelines

a change would occur in their credit risk in the event of an exchange rate change of a currency in which they are placed relative to the exchange rate of the currency in which they are repaid.

In the process of alignment of the existing savings and loan co-operatives with the *acquis communautaire* relating to the operation of credit institutions, in December 2006 Act on Amendments to the Banking Act was adopted, which introduced a possibility of establishing savings banks, as well as the Act on Credit Unions. In April and July 2007, the CNB adopted the respective subordinate legislation governing credit unions. According to the preliminary data, 43 savings and loan co-operatives have chosen to transform its business into savings banks, 36 into credit unions, whereas 19 of them have opted for voluntary winding-up. In addition to the above indicated acts, the Financial Collateral Act was adopted for the purpose of alignment with Directive 2002/47/EC on financial collateral.

Draft Proposal of an Act on Credit Institutions, transposing the provisions of Capital Requirement Directive in the part relating to credit institutions, was presented for public discussion in July 2007 and the same is expected for the drafts of subordinate legislation regulating in detail the capital adequacy calculation for credit institutions. Preparation of the draft acts relating to deposit insurance, electronic money institutions, reorganisation and liquidation of financial institutions and financial conglomerates is underway and they should be adopted by the end of 2008. For the purpose of a better coordination in the preparation of the aforementioned regulations, the working group heads meet regularly in order to discuss and co-ordinate individual legal solutions.

In addition to the above indicated alignments, the CNB has invited a public discussion concerning the CNB's Banking corporate governance guidelines (January 2007) and Anti-money laundering and anti-terrorism financing guidelines for credit institutions and credit unions (July 2007). At the same time, in relation to the Information system management guidelines aimed to reduce operational risk (March 2006), the Decision on adequate information system management was adopted in August 2007.

The CNB co-operates closely with domestic and foreign supervisory authorities in the area of alignment of domestic regulation with the EU requirements, but also in the operational part of bank operation supervision. In accordance with a mutual agreement concluded in September 2006, the CNB and HANFA thus established the Financial Sector Operational Supervision Committee. An Agreement on co-operation and exchange of information in the area of anti-money laundering and combating of terrorism financing (August 2006) was also concluded between the CNB and the Ministry of Finance. Finally, a preparation of an agreement on co-operation with Banque de France is underway.

An on-going exchange of information was agreed between the CNB and banks, concerning the Single Euro Payment Area (SEPA). In addition, at the latest meeting of the National Payment System Committee in early 2007, its terms of reference were amended, so that except domestic payment system, it also encompasses international payment system as of March 2007.

The objective of the Republic of Croatia is to improve the payment system in order to regulate more adequately the area of providing payment services by non-banking institutions and their licensing and supervision, transparency of conditions for providing payment services, rights and obligations of payment service providers and users, out-of-court settlement of disputes, etc., which is also necessary for the functioning of the single EU market. The system regulation will be achieved primarily by adopting the new act regulating payment systems and the appropriate subordinate legislation until end-2008.

In June 2007, the CNB published the Framework for the detection of counterfeits and fitness sorting by credit institutions and other professional cash handlers, which is, in terms of its contents, harmonised with the measures of the European Central Bank for euro banknotes redistribution. In this manner, the CNB also promotes the application of best practice in banknote handling and creates preconditions, in the long-run, for the future handling of euro banknotes as a domestic currency, in accordance with the European Central Bank standards. The application of the framework is set for end-2009 at the latest.

4.2.2 Non-banking sector

As at 31 December 2006, 78 open-end investment funds were registered in the Republic of Croatia, 7 closed-end investment funds, 1 Fund of Croatian Homeland War Veterans and their Family Members and 1 Pensioners' Fund. Total assets managed, at the moment, by all investment funds amount to HRK 38.3m. 22 investment fund management companies are also registered.

As at 31 December 2006, contracted active leasing contracts totalled HRK 32.5bn, of which HRK 12.0bn related to operative leasing, HRK 12.4bn to financial leasing and HRK 8.1bn to loans.

Total net assets of compulsory pension funds at end-April 2007 stood at HRK 18.1bn.

The insurance business development dynamics is pronounced in the Republic of Croatia. In 2006, insurance companies earned a total underwritten gross premium of HRK 8.19bn, of which HRK 6.0bn accounted for non-life insurance premium and HRK 2.18bn for life insurance premium. Owing to large growth rates recorded in the recent years in life insurance, the share of this insurance segment in the total portfolio has been constantly on the increase, amounting to 27.0% in 2006, whereas the share of non-life insurance in the total portfolio has been gradually reduced, amounting to 73.0% in 2006.

On 21 December 2006 Zagreb and Varaždin Stock Exchange merged. A merger of the two stock exchanges is expected to facilitate trading, increase the number of transaction and improve liquidity. In addition, a more dynamic development of the domestic market is expected, as well as strengthening of the competitive position in the European market and an increased offer to investors. Brokers' savings will be instantaneous, since they will pay for services of only one stock exchange instead of paying several double costs.

The following acts were adopted in 2006: Leasing Act, Act on Credit Unions, Act on Amendments to the Securities Market Act and Act on Croatian Bank for Reconstruction and Development, Act on Amendments to the Foreign Exchange Act, Act on Amendments to the Banking Act, Act on Amendments to the Croatian National Bank Act.

As envisaged by the plan, in 2007 the following acts were adopted:

- Financial Collateral Act – by adopting this act, formal barriers to the performance of operations concerning collateralisation of monetary obligations by financial instruments are eliminated, legal certainty is increased, credit risk is mitigated, cross-border transactions are facilitated and capital market and financial system as a whole are strengthened;
- Act on Amendments to the Voluntary and Compulsory Pension Funds Act – the act is aligned with the *acquis communautaire* and legal documents of the Council of Europe;
- Accounting Act – the act defined a new framework and financial reporting standards by adopting International Financial Reporting Standards;
- Act on the Take-Over of Joint Stock Companies – legal framework was created for carrying out the takeover procedure, which will be aligned with the provisions of

Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids.

In 2008, the following acts are planned to be adopted:

- Payment System Act – payment system will be aligned with the EU Directives;
- Securitisation Act – legal introduction of structured financing. The act is important for promoting market financing;
- Act on Reorganisation, Winding-up and Bankruptcy of Insurance Companies – alignment with the EU Directive on the reorganisation and winding-up of insurance undertakings;
- Financial Conglomerates Act – in the process of legislative alignment with the EU the Financial Conglomerates Act is planned to be adopted. It would regulate business of financial groups providing services and products in various financial sectors, the so-called financial conglomerates;
- Act on Amendments to the Audit Act – alignment with the EU Directives will be achieved, especially regulation of an independent oversight of auditors' work.

4.3 LABOUR MARKET

As a part of the EU pre-accession activities, on 30 August 2007, the Government of the Republic of Croatia adopted the Action Plan for legislative alignment and creation of the required administrative capacity for transposition and implementation of the *acquis communautaire* in the negotiating area of Chapter 19: Social Policy and Employment, for the purpose of a complete fulfilment of an additional benchmark for opening negotiations on this Chapter. In that regard, the Action Plan contains, apart from the dynamics of a gradual transposition of *acquis communautaire* into the national legislation, detailed information concerning the institutions and human resources for each individual task and determines the accompanying actions for strengthening administrative capacity and the required financial resources allocated for this purpose from the budget.

All the activities encompassed by the Action Plan should be completed until the end of 2008, which also implies a functional creation of the required administrative capacity for which additional HRK 40m should be allocated in the state budget in 2007 and HRK 50m in 2008. The funds will be planned as an increase in budget positions of the entities responsible for the measures under the Action Plan. These funds also include the amounts of the national participation in the use of pre-accession EU funds, of which the most important is the IPA programme in which the entities responsible for the activities under this Action Plan will participate with EUR 40m through I and IV component, relating to strengthening of administrative capacity and human resource development.

4.3.1 Stimulating employment

Labour market key indicators for the period continue to indicate a continuous rise in employment and a decline in unemployment. According to the preliminary data of the Central Bureau of Statistics, total registered employment increased from 1,498,515 in August 2006 to 1,511,007 in August 2007. In the same period, registered unemployment in the Croatian Employment Service records fell from 271,051 to 242,851, a 10.4% decrease. According to the Labour Force Survey, the employment rate for the population aged 15 to 64 years rose from 54.2% in the first half of 2006 to 55.2% in the first quarter of 2007, whereas the unemployment rate of the population aged over 15 years was reduced in the same period from 11.8% to 11.2%.

On the basis of the guidelines adopted under the National Action Plan for Employment 2005-2008 and the analysis of the implemented 2006 Annual Plan for Employment Promotion, a total of HRK 430m was allocated for the implementation of active employment policy measures under the 2007 Annual Plan. It is envisaged that in the forthcoming mid-term period, the planned funds will be increased, at least proportionate to the level of the expected economic growth rates. It should be noted that the implemented active employment policy measures will surely have a positive impact on the budget revenues due to an increase in employment and a reduction in unregistered employment. However, it is presently very difficult to assess since such impact depends on the rise in economic power of each individual as well as of economy as a whole.

The characteristics of the Croatian labour market, from the point of flexibility of the legal framework, do not depart significantly from the EU standards, but in order to examine this issue, the key question is whether Croatia wants to build its competitiveness on the global market on low labour costs or it wishes to base its development on knowledge and investment in human resources. In that regard, Croatia has launched the educational system reforms, which will be completed by a reform of the national qualification framework and a creation of

the system of acquiring universal skills, allowing for a faster transition from one profession to another, implying a greater degree of employability. For the purpose of ensuring a better flow of information from the labour market to the educational system, decentralisation of the Croatian Employment Service is performed, as well as establishment of local partnership, by connecting the local employment offices with the regional developmental agencies in order to respond more adequately to the local and regional developmental needs, through the educational system and the measures such as a change of qualification and additional qualification.

As regards the tax system related to the employment policy, it should be noted that in the forthcoming period there will be neither increases nor introduction of new taxes which would burden the economy and increase labour costs. However, the tax policy, including the contribution system will be focused in the forthcoming period on the alignment with the *acquis communautaire* and on the simplification of the entire system in order to diminish the motives for grey economy. Finally, it should be stressed that new jobs are created as a consequence of the economic growth which arises from strengthening of private investments, stimulated by a further improvement of the investment and entrepreneurial climate.

4.3.2 Social security system

Systematic changes which were launched by the Government of the Republic of Croatia in 2005 are still aimed at an improvement of social services work organisation, system informatisation and improvement of social service quality. In accordance with the reform objectives, new regulations in the field of social welfare¹⁶ were adopted in July 2007, which simplified the procedure of exercising rights, reduced the total number of rights and introduced the rights which are adjusted in view of the beneficiary category and the objective of rights. Additional HRK 148m is planned to be allocated for implementing the new regulations in 2008, which will be used for covering:

- exemption of child allowance from the family's total income, which has improved financial status of families with several members (six and more members),
- introduction of the new right – right to a status of a nursing parent,
- introduction of new remuneration – personal remuneration to a foster parent,
- obligation arising from a right to a temporary support, in accordance with a new regulation¹⁷ under the family law protection,
- costs of employment of new 41 employees in 18 social welfare centres, who will be engaged in foster care activities.

The reform activities under the SWDP¹⁸ continued to be carried out in three components. The overall reform is performed in co-operation with the World Bank. The objective of the first component is to improve the quality of social services and reduce the scope of institutional welfare. The activities based on pilot projects under the first component are carried out in three counties: initial financing of innovative programmes in providing social services at the community level and of new approaches in social work; support to financially profitable high-quality service aimed at prevention of social problems; deinstitutionalisation and reintegration of beneficiaries into the community; broadening of services provided at the local community level and modification of accommodation services to prevent institutionalisation, within the extended scope of provided services, and improve welfare quality.

¹⁶ Act on Amendments to the Social Welfare Act and Foster Care Act.

¹⁷ Proposal of the Act on Amendments to the Family Act is in the adoption procedure.

¹⁸ Social Welfare Development Project

The second component is aimed at the development of the IT management system for the purpose of: facilitating work of employees in social welfare institutions, simplifying the application filing procedure, increasing transparency of filing the application, ensuring greater control as a result of a possibility to check the information within other systems and reducing the fraud risk. In 2007, the preparation of the second project task of software supply and development was completed in three pilot counties. In 2008, development of the entire software and installation and training of employees are envisaged in the pilot counties and subsequently in the overall social welfare system.

The objective of the third component encompasses the improvement of the social welfare infrastructure by improving the accommodation conditions for beneficiaries in social welfare homes and constructing, i.e. renovating social welfare centres in accordance with the administrative reorganisation of these institutions (ensuring the conditions for a *one-stop-office*, installing information and network equipment, smooth operation).

In accordance with the signed Joint memorandum on social inclusion of the Republic of Croatia¹⁹, it has been determined that the persons who are most exposed to the poverty risk and social exclusion are the following: long-term unemployed persons and economically inactive persons, older persons without pension income, disabled persons, single-parent families and families with a larger number of children, a portion of displaced persons, minorities, homeless and former addicts. The activities and measures through which the set objectives will be realised will be performed in accordance with the National implementing plan for social inclusion (2007-2008). The planned activities are the following: increasing the level of employability of less employable persons, extending the coverage of secondary and higher education, vocational education reform and investment in a systematic promotion of life-long learning, extending the network of social services for children, the elderly and disabled persons, preventing disease or disability, ensuring equal access to health care institutions, developing a concept of social housing, reducing regional differences and a long-term elimination of poverty of older population.

The competent ministries, state institutes and agencies and other bodies responsible for the implementation of specific activities set by the implementing plan participate in the implementation of the measures, as well as representatives of local authorities, social partners, non-governmental organisations and providers of social services. The implementing plan also defines the indicators on the basis of which a degree of performance of activities will be measured and identifies the institutions responsible for the performance of the activities. The first performance report will be presented by summer 2008. The financial resources required for the implementation of individual activities will be provided by the responsible and implementing institutions.

During 2006 and 2007, representatives of the Ministry of Health and Social Welfare participated in the preparation of the Operational Programme for Human Resource Development 2007 – 2009²⁰, under IPA, including drafting of the proposal of the concept of the project: Establishing Network of Support in Social Integration and Employment of Disadvantaged and Marginalised groups²¹, which should be implemented by end-2009. The project's objective is to increase employment of those groups that are mostly affected by

¹⁹ JIM – Joint memorandum on social inclusion of the Republic of Croatia (signed on 5 March 2007) between the Government of the Republic of Croatia and the European Union.

²⁰ Operational Programme for Human Resource Development 2007 – 2009

²¹ Establishing Network of Support in Social Integration and Employment of Disadvantaged and Marginalised groups

long-term unemployment. The proposal of the project concept relates to social employment in organisations that are providers of social services in the community.

Protection of families and children

A systematic protection of rights and interest of children and disadvantaged group has continued to be implemented by the application of the adopted national programmes, strategies and policies. In accordance with the provisions of the European Convention on the Protection of Human Rights and Basic Freedoms, which transferred certain authorities of the social care centres to courts in the procedures of family relation regulation, i.e. in limiting or abolishing parents' rights to parental care, a more efficient protection of children was achieved.

It should be stressed that population policy measures, aimed at demographic recovery, have continued to be implemented. In addition to the measures already taken in that field, as of 1 January 2008, women on maternity leave will have a right to full salary compensation in the first six months, for which around 0.04% of GDP will have to be provided annually.

With the effort to ensure more effective protection of children of divorced parents, new provisions of the Family Act will come in force starting 1 January 2008 which will enable children of divorced parents, to which other parent is denying the right for support, to claim the right for the temporary support from the authorized social care centre. This temporary support can last no more than three years. Given that the resources for this measure are secured by the state, the Act obliges the social care centre to legally file a claim upon the irresponsible parent, to compensate the state budget for the cost incurred concerning the matter. In the 2008 budget, a total of HRK 93 million will be secured for these temporary allowances.

Pension insurance

Within the pension system, which represents one of the components of the overall social security system of the Republic of Croatia, two new acts relating to the pay-as-you-go system were adopted in 2007. More specifically, the Act on Allowance on Pensions Earned under the Pension Insurance Act was adopted, on the basis of which differences will be reduced in the amount of pensions earned for equal years of employment for pension purposes, i.e. under same conditions for the "old" and "new" pensioners. In addition, the Act on Amendments to the Pension Insurance Act was adopted, which will, starting from early 2008, increase the level of early old-age pensions, disability pensions, as well as the level of the lowest pensions by changing the method of its determination. As a result of the application of both acts a total fiscal cost of 0.35% - 0.4% of GDP per year will be incurred in the forthcoming mid-term period.

The Act on Amendments to the Compulsory and Voluntary Pension Funds Act was also adopted, which complements and improves the pension insurance system based on individual capitalised savings and adjusts it to the conditions of a social and economic development of the country.

In view of all the mentioned changes in the pay-as-you-go pension system, a systematic improvement of a financial position of future pension beneficiaries is expected from the beginning of 2008, whereas retaining of the so-called Swiss model for pension adjustment (50%:50%) allows for a long-term maintenance of financial sustainability of the system. Changes in the capitalised system, in view of increased possibilities of assets investment by pension funds in the prescribed types of assets beyond the borders of the Republic of Croatia following the EU accession and creation of a possibility of entry of the European institutions in the field of voluntary pension insurance in the Republic of Croatia will contribute to a

faster development of that type pension insurance. One of the previously set objectives of the pension reform is thus met in the long-run, which is a transfer of a part of responsibility for ensuring funds for old-age, regardless of the pay-as-you-go system, to an insurer himself, which will, in the long-run, contribute to a decrease in the share of funds for pension consumption.

4.4 AGRICULTURAL SECTOR

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

Land market

Management of the state-owned agricultural land has continued to be performed in accordance with the Agricultural Land Act and a subordinate application of by-laws regulating real-estate transactions. The types of management through a public tender include: lease, sale and concession. In the January 2006 – September 2007 period, 74 120.14 ha of land was under management (lease: 33 634.40 ha, sale: 10 678.85 ha, concession: 29 806.89 ha), and income (state, county and local budget) of HRK 136.0m was earned (HRK 66.4m from lease, HRK 58.9m from sale and HRK 10.7m from concessions). The state-owned land management plans envisage a total sale of 222 454.78 ha of agricultural land, of which 13% has been sold so far. The objective in the 2008-2010 period is to accelerate the sale dynamics of agricultural land.

One of the important priorities in changing the structure of agricultural farms is consolidation of agricultural land areas. In that regard, the implementation of the project 'Consolidation of agricultural land' continues. In the 2008-2009 period, the adoption of the regulation is planned as a part of the project, which will regulate consolidation of agricultural land for the purpose of improving the structure of agricultural farms, and continue with the elimination of the remaining obstacles to the efficient agricultural land market.

Privatisation of state-owned companies

In the forthcoming period, privatisation of the remaining companies engaged in agricultural and food-processing industry will continue. On account of reaching an agreement with the trade unions in the implementation of the ESOP programme, privatisation of large agricultural and food-processing company VUPIK, which is in majority state ownership, has not yet been completed and is now planned to be finalised in 2008. In 2007, a public tender was invited for the sale of company KIM d.d., Karlovac, fourth milk industry by its size, but the tender was annulled due to unsatisfactory bids. Continuation of privatisation of company KIM d.d. and company Sladorana d.d. Županja is envisaged in 2008.

Regulation of the agricultural and food products market

Activities on the harmonization of market mechanisms for particular agricultural products with the market organisation in the EU have continued. The most sensitive product in this segment is wheat and the application of the EU model elements continued in 2007. The state guarantees the intervention price of 101.3 euro/ton, which is the European intervention price. In 2007, the state did not participate in the purchase and trading was completely determined by the market. The prices of other cereals (barley, rye, oats), for which the framework of intervention price can subsequently be expanded, as it is the case in the EU, have gradually been adjusted to the set intervention price. Maize, as predominant cereals in Croatia, does not yet follow these parities, and this level of intervention price cannot be applied to it.

For the purpose of regulating the fruit and vegetable market, in 2006 and 2007, efforts were made to organise the logistic centres for purchase and processing of fruit and vegetables. The issue of apples was successfully resolved, where, by constructing 8 ULO cold storages

(capacity 21,000 tons) and the accompanying equipment, the logistics was provided for the market of apples which are the most important fruit in terms of consumption and production volume. In 2008, these activities on the fruit market are planned to be continued and in the forthcoming years, the vegetable market is planned to be regulated by a similar support for the construction of logistic centres. In 2008, the adoption of the regulations is planned which would transpose all the EU quality standards for fruit and vegetable into the Croatian legislation, whereas the application would start in 2009.

Activities concerning the creation of the vineyard cadastre were completed in 2007 as regards the technical part (all the required photographs were acquired, cadastre was digitalised in these areas), and designing of the digital database and a gradual performance of field activities to verify and enter all other vineyard data are planned for 2008. These activities will continue into 2009 as well.

In the cattle production area, activities aimed at harmonising market mechanisms have continued, with an aim of combating grey market and increasing the food safety. A single system of compulsory animal identification was established, which was implemented in entirety for bovine animals in 2007. The classification mechanism for bovine and swine carcasses on the slaughter-line was fully established. The regulations on identification of swine and horses were prepared and beginning and completion of identification and registration of swine and horses is planned in 2008. The regulations on cattle passport have been prepared and the passport system will become fully operative in early 2008. In 2007, regulations were prepared concerning identification and classification of eggs, whereas in 2008 and in the following years a phased-in introduction of the new classification and identification system is planned.

State aid in agriculture

The bulk of the state aid to agriculture is administered pursuant to the Act on State Aid to Agriculture, Fisheries and Forestry. In 2007, about HRK 2.3bn from the state budget was earmarked for aid covered by that Act, which is an increase of around 10% compared to 2006. The largest portion of the funds (86%) is still intended for a direct support to manufacturing, but that share has been gradually decreasing. The share of investment aids and aids to rural development increased to about 10%, while the share of income support to non-commercial farmers stands at about 4%.

The objective of agricultural policy is to increase total aid funds in the sector for the purpose of improving the competitiveness level and adjustment to the developed market of agricultural and foodstuff products in the EU, as well as a gradual increase in the share of funds for rural development. The rural development measures should be directed at diversification of activities which would allow for a larger employment and a better standard of living of the population in rural areas.

Rural development

The national measures for rural development have so far been primarily aimed at education of the rural population, support to agricultural schools, establishment and development of agricultural co-operatives and vocational associations, sale promotion of agricultural products, support to keeping traditional cattle breeds, reconstruction and development of the rural area and development of rural tourism. In 2007, HRK 101.4m from the state budget was earmarked for the implementation of these measures.

Within the EU pre-accession assistance for the rural area development, activities related to the implementation of the SAPRAD programme have continued. Following a review by the European Commission, a "Decision on transfer of assistance management authority to the

implementing Agency for pre-accession measures in agriculture and rural development in the Republic of Croatia in the pre-accession period” was adopted in September 2006. The said Decision confirmed that the SAPARD Agency has met the main criteria for the beginning of implementation of that programme in a satisfactory manner, and tenders were invited for the implementation of Measure 1 „Investment in agricultural farms“ and Measure 2 „Improvement of agricultural and fish product processing and trading“.

Two tenders have been invited so far and 146 applications have been received of which 21 applications have been approved and contracted, the total investment value of which slightly exceeds HRK 135m, i.e. for which total aid amounts to HRK 63.5m. The third round of tenders is expected to be invited by the end of 2007. All the funds are financed by the Republic of Croatia and the EU in the 25% (Republic of Croatia) to 75% (EU) ratio. The IPARD plan was prepared under the Instrument of pre-accession assistance, containing the proposed measures the adoption of which is expected by the end of 2007, which will be followed by the invitation of tender for the accredited measures.

Phytosanitary area

During 2007 the alignment of regulations governing phytosanitary area with the relevant EU legislation and their implementation has continued. Under the projects CARDS 2002 and CARDS 2003 knowledge was acquired concerning the implementation of these regulations in practice, trainings of phytosanitary inspectors and experts from the authorised institutions were organised and a part of the laboratory equipment for analysing the pesticide residues in food was acquired, as well as the equipment for analysing physical and chemical properties of plant protection products.

In the forthcoming period, activities will be aimed at a further alignment of regulations, improvement of the quality level of monitoring organisms harmful to plants, introduction of the plant passport system, application of the new system of plant protection products registration and continued training of employees in plant protection, phytosanitary inspectors and experts from the authorised institutions in order to reach the level required by the EU.

A phased-in establishment will begin of a phytosanitary register of importers, producers and distributors of the reproduction material of specific types of plants, which represents the basis for the application of the plant passport system. That system will allow for a systematic monitoring of the health status of plants during production, while the plant passport which will accompany the plant will represent a guarantee for customers of health safety of reproduction material, which is one of the main conditions for a successful agricultural production.

By the establishment of a uniform information system, high-quality will be ensured of keeping the phytosanitary registry and other databases and communication with agricultural producers and other entities interested in phytosanitary area will be improved. In the field of plant protection products, the application of the new plant protection products registration system will begin, as well as the reassessment (reregistration) of plant protection products, improvement of the plant protection product postregistration control programme and monitoring of pesticide residues in food, which will significantly improve the level of human and environmental safety against hazardous substances. In the segment of seed husbandry and planting material, the overall legislative alignment will be completed by end-2007, which will allow for the implementation of the new system in 2008.

Food quality and safety

In order to ensure preconditions for competitiveness strengthening of domestic food producers in terms of alignment of their operations with the EU standards in the area of food safety and

quality it is necessary to harmonise the domestic regulations with the EU legislation. Accordingly, several regulations were adopted which transposed the EU regulations governing this area into the legislation of the Republic of Croatia. The Strategy for transposing and implementing the legislation in the area of food safety, animal health and phytosanitary policy was also prepared. The Strategy contains the action plan, relating to a further legislative alignment and institutional strengthening for the purpose of legislation implementation, which should be implemented in order to establish an integrated approach to food safety.

In 2007, the quality requirements continued to be harmonised, which will improve market liberalisation and facilitate movements of goods. The alignment has started concerning the foodstuff identification system with geographical indication, authenticity labels and foodstuff traditional reputation labels. The need for institutional strengthening was also identified, especially in the part concerning conformity and control of foodstuffs with respect to the labels, in order for this form of protection to be fully implemented. In addition, the project CARDS 2004 was launched in 2007, under the title "Further capacity strengthening in the area of live animals and foodstuffs", within which further legislative alignment will be carried out, as well as strengthening of capacity of state administration bodies and inspections competent for the legislation implementation.

During 2007, Ministry of Health and Social Welfare continued with the activities concerning the implied responsibility in the area of food safety. In that sense, the reorganization of the Office for sanitary inspection has been performed and the Division for food safety and the Division for GMO control have been established. Also, activities concerning the organization of the border sanitary inspection have been planned. In 2008, it is planned to continue with the alignment of the legal framework and adoption of the implementing regulations in the area of food safety. With the aim of acceptance and the implementation of the EU legislation following projects are planned for 2008: PHARE 2005 "Support to the sanitary inspection in the preparation, implementation and the maintenance of the HACCP system" and the MPAP project "Capacity building for the implementation of the HACCP principles in institutional kitchens".

In the 2008-2013 period, for the purpose of structural reforms in the food-processing industry, sector support is planned under the pre-accession programmes SAPARD and IPARD, as well as the adoption of the national operative programme which would contain horizontal measures of support to food-processing industry, especially to small and medium-size enterprises, and which will be in line with state aid aimed at: improving competitiveness of EU industries and creation of sustainable jobs (e.g. aid to research and development, innovation and venture capital for small enterprises), ensuring social and regional cohesion and improvement of public services.

Veterinary area

During 2007, the process of legislative alignment continued and the new Veterinary Act was thus adopted as a strategic document in a further alignment of the Croatian legislation with the EU legislation. An accelerated and more efficient implementation of the new Veterinary Act in practice is a precondition for fulfilling extremely demanding benchmarks for the opening of negotiations in Chapter 12 Food safety, veterinary and phytosanitary policy.

In accordance with the Veterinary Act, there is an obligation of establishment of the Central Veterinary Information Centre which would encompass the system of registry, register and computer programmes, for the purpose of animal health and welfare protection and implementation of measures of veterinary public health. The new Veterinary Act also

provides for the reorganisation of the system of veterinary service and inspection and employment of official veterinarians and veterinary inspectors accordingly.

In accordance with the European Commission's 2006 Progress Report for the Republic of Croatia, in which a need is stressed for investments in infrastructure and construction of permanent veterinary border stations and a need for rationalisation of the number of veterinary border stations, the Government of the Republic of Croatia adopted a Decision on 8 permanent veterinary border stations on 7 September 2007, which will remain after Croatia's EU accession. During 2007, Sector of veterinary border inspection and international traffic, in accordance with the aforementioned, prepared the application for financing of permanent veterinary border stations under various EU pre-accession funds (IPA, PHARE), through which the same are planned to be constructed and aligned with the EU legislation.

Fisheries

The alignment of the Croatian legislation in the fisheries sector with the EU Common Fisheries Policy, especially in the area of fish and fishery product market continued during 2007 (the Ordinance on the conditions and manner of putting into circulation fish and other marine organisms was prepared and the preparation of the Ordinance on standards for putting into circulation fish and other water organisms is currently underway). Furthermore, a uniform register of fishing vessels over 24 metres in length was established and a review process was carried out for the benefits for vessels of the same length, which allowed for a direct connection of the benefit with the vessel. The implementation of PHARE project "Support to the Republic of Croatia in the preparation and implementation of the strategy to develop the fisheries sector within the context of alignment and enforcement of the *acquis communautaire* comprising the Common Fisheries Policy" is underway. In the 2008-2010 period a continuation of the legislative alignment is planned, as well as completion of the benefits review, continued registration of vessels in the electronic fleet register, further implementation of the satellite-based vessel monitoring system (VMS) and establishment of the Fisheries Monitoring Centre.

The objective is to create the fish and fishery product market in compliance with the EU requirements, which primarily relates to the establishment of the fish trading system (construction on ports of discharge and wholesale markets, definition of discharge measures, introduction of producer organisations, adoption of the relevant regulations).

Wood industry

On the basis of the Republic of Croatia's Operative Programme for the Development of Industrial Processing of Wood, 2006-2010, in 2007 a public tender was invited for granting state aid for promoting development and sustainability of industrial processing of wood in the Republic of Croatia in 2007, in the total amount of HRK 41.1m of non-refundable aid. With an aim of starting structural changes and creating high-quality and market-adjusted economic entities, the Act on Wood and Wood Product Processing and Use is being prepared. For the purpose of developing competitiveness of the wood sector on the domestic and foreign market, it is necessary to create identity through a recognisable Croatian design. In that segment, the National Strategy of Design in the Republic of Croatia is being prepared, which will create conditions for increasing life quality and improving Croatian economy and community culture by the application of design, using the Croatian potential for creating recognisable values in the global exchange. The Strategy is in the adoption procedure.

In the recent years, in the global industrial wood processing, design development, construction, technology and knowledge, as well as the use of innovative, the-so called smart materials, in the construction of final products have made such progress that many unprepared

countries cannot keep pace with that rising trend. Lack of orientation of production so far or attempts to realise greater short-term effects (e.g. exports of sawn material) actually lead to a devastation of the natural potential.

In that context, the wood sector in the Republic of Croatia must carry out all the preparations, from the legal ones to the strategic ones, in a timely manner. Accordingly, the developmental document „Republic of Croatia's Operative Programme for the Development of Industrial Processing of Wood, 2006-2010“, along with the Act on Wood and Wood Product Processing and Use and the National Strategy of Design in the Republic of Croatia, provided the framework for actions, which will gradually, but permanently, reduce weaknesses and eliminate threats on the one hand and develop strengths and make use of opportunities on the other hand. The priorities of development are the following:

- Improvement of the existing and development of new products, procedures and services;
- Rational use of raw wood;
- Creating wood sector brand;
- Developing technology and technological processes;
- Preparing the Croatian wood technological platform.

4.5 ADMINISTRATIVE REFORM

During 2007, as a part of the public administration reform, activities were completed relating to the reform of the civil service system. The remaining implementing acts for the Civil Servants Act were adopted, relating to the forms, method and conditions of civil servants' training, job classification, and methods of and conditions for promotion of civil servants, as well as the remaining acts ensuring depoliticisation and professionalisation in civil service²². An efficient system of permanent professional training of civil servants was established through the Centre for Improvement and Training of Civil Servants, and education of civil servants is performed continuously in accordance with the Training Programme.

The Proposal of the Act on the Salaries of Civil Servants was prepared and was submitted in the procedure to the Government of the Republic of Croatia. However, in view of a need for performing a detailed assessment of impact on the budget and preparation of the fiscal impact, as well as a dismissal of the Croatian Parliament, the adoption of this Act is postponed to 2008. The measures planned for 2007 relating to the adoption of the Act on the General Administrative Procedure and the Regulation on office transactions, adjusted to the electronic functioning of administration, are also postponed to 2008, in accordance with a change of the deadline in the National Programme for the Integration of the Republic of Croatia into the European Union and the deadline envisaged in the Proposal of the Strategy of State Administration Reform. This is assessed as a realistic and objective deadline for adoption. The realisation of the service relating to the electronic filing of income tax return for citizens is currently underway under the Programme HITRO.HR, the finalisation of which is postponed, relative to the initially planned deadline, due to technical problems.

Further reform of the state administration will be aimed at the deficiencies which are planned to be eliminated and which relate to the size and costs of state administration, complexity of administrative procedure, quality of providing public services to citizens, insufficient oversight of the work of state administration bodies and inadequately regulated labour-law status of civil servants and civil service employees in the units of local and regional self-government.

In view of the identified deficiencies, in the 2008-2010 period, a special attention will be paid to the fulfilment of the following objectives: improvement of the organisational efficiency and reduction of state administration costs (state administration rationalisation); simplification of administrative procedures to make it easier for citizens to exercise their rights; continued development of a more efficient system of providing public services to citizens and improvement of quality of providing public services; improvement of oversight of the work of state administration bodies and regulation of the labour-law relations for civil servants and civil service employees in the units of local and regional self-government.

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

1. performance of functional analysis in state administration bodies (including the adoption of the rationalisation programme in the state administration bodies in which functional analysis has been performed);
2. adoption of the Act on the General Administrative Procedure;
3. continued implementation of administrative decentralisation of state administration operations;
4. adoption of the Act on Labour Relations in Local and Regional Self-Government;

²² Act on Amendments to the Transfer of Power Act and Act on Amendments to the State Administration System.

5. adoption of the new Regulation on office transactions (adjusted to the electronic functioning of administration);
6. establishment of the electronically-supported register (files) of civil servants;
7. adoption and implementation of the Administrative Inspection Act;²³
8. continued professional improvement and training of civil servants in accordance with the training programmes through the Centre for Improvement and Training of Civil Servants

Since good administration in state and public service represents one of the preconditions for the private sector growth, as well as for the implementation of the policy of promoting fiscally responsible private sector, on the basis of the concluded Loan Agreement (programmatic adjustment loan) between the Republic of Croatia and International Bank for Reconstruction and Development, activities are being currently performed of analysing and reforming the state administration and civil service salary system. The first stage of the project is almost completed, relating to the analysis of the salary system and remuneration in civil service and the second stage of the project is expected to begin by the end of this year, i.e. the activities aimed at preparing the new act on salaries in civil service. The new Act, which will also contain the provisions on the centralised collective bargaining, should be adopted in 2008, with an aim of decompressing salaries and introducing the performance-based reward system, as well as reducing the wage bill in the public sector from about 11% of GDP at present to 10% of GDP in 2008.

²³ Measures from 1 to 7 are planned in the 2007-2009 PEP.

4.6 ADDITIONAL REFORM AREAS

4.6.1 Knowledge-based society

Continuing with the development of a knowledge-based society, and in accordance with the Lisbon strategy objectives and the objectives set by the Education System Development Plan 2005-2010, Scientific and Technological Policy of the Republic of Croatia 2006-2010 and the Strategic Development Framework 2006-2013, significant changes were made in the field of preschool education, primary school, secondary school and higher education, as well as in science and technology, in order to systematically improve quality and create high-quality human capital.

In the pedagogical year 2006/2007, 59 new kindergartens were opened and by the adoption of the Pedagogical Standard (end-2007) and the National Preschool Education Curriculum, which is expected in the pedagogical year 2008/2009, the preschool education quality will be additionally improved. The new Programme and Curriculum was introduced in all primary schools, based on the guidelines of the Croatian National Educational Standard (CNES), and its implementation is systematically monitored and evaluated. The first external evaluation of achievements of 8th-grade students was carried out and external evaluation of students' achievements and programmes for 4th and 8th grade students will be carried out in the school year 2007/2008.

In June 2007, the National Programme of Measures for the Introduction of Compulsory Secondary Education was adopted, which stimulates, primarily by incentives – free textbooks, free intercity transportation and free accommodation in student homes, students to enrol and complete secondary education programmes. These incentives are planned to be continued. In addition to general secondary school programmes, the national exams were organised in vocational schools and pre-examinations, in the case of final year students, were carried out with respect to a part of the assignments, as a part of the preparations for the state school-leaving exam. In the school year 2007/2008, conducting of the «trial» state secondary school leaving exam is planned for all 3rd grade students of general secondary schools. As regards the quality assurance in secondary schools, the proposal of the Ordinance on school self-assessment was prepared. In vocational secondary education, reduction of vocational areas and programmes continued and programmes for five new specialisations were developed. At the same time, 46 programmes were adopted, which last either for two years or for one year, for acquiring primary school qualification. The system of data collection, monitoring and analysis (VETIS) began to be used. At the beginning of the school year, the integrated system for standardised data set management (e-Matica) was put into trial operation, representing the basis for the development of the education management information system (EMIS). The basic elements of the Croatian Qualification Framework were adopted at the session of the Government of the Republic of Croatia on 5 July 2007.

As regards the implementation of the Bologna process, the implementation was assessed by a mark 4.1 at the European Ministerial Conference held in London in May 2007, which represents a great progress relative to the Conference held in Bergen in May 2005 when the successfulness of the implementation was assessed as “good”. The implementation of the project Development of Vocational Higher Education Studies for the Purpose of Promoting Employment in Smaller Urban Areas in the Republic of Croatia has continued in co-operation with the Development and Employment Fund. At the beginning of the academic year 2007/2008, several higher education institutions, public scientific institutes and a part of the

state institutions carrying on activities in the field of education, science and technology will be relocated to the scientific and university campus Borongaj.

As regards the field of science and technology, the criteria for evaluation of scientific projects and programmes were raised. The Second congress of Croatian scientists from the country and from abroad was held and the initiative for their mutual association and returning to Croatia has continued. The interstate agreement on the Seventh Framework Programme was concluded, which has been operative since 1 January 2007, and it is planned to continue with the establishment of the excellence centres and with several projects and programmes through which knowledge and technology will be transferred into economy. The establishment and launching of the Science and Innovation Investment Fund is planned under the IPA programme for the 2008-2010 period, which will have a role of strengthening technology and innovation capacity at higher education institutions and public organisations for research and marketing of innovations in order to contribute to sustainable regional development and industrial competitiveness of the sector with a high value-added in the economy and small and medium-size enterprises based on knowledge. Constructing and equipping of the Bio-Centre was also envisaged in this period, which will ensure the required space, equipment and services for the early developmental cycle and product development.

The Adult Education Act was adopted in February 2007 and the Mobility and EU Programme Centre was established within the Adult Education Agency. In accordance with the EC requirements, the Centre will be separated from the Adult Education Agency and will become an independent agency which will carry out the Life-Long Learning Programme and Youth in Action Programme. Participation of the Republic of Croatia in these programmes is planned from 2009. Adult Education Council, an expert body of the Government of the Republic of Croatia, was established on 30 August 2007.

4.6.2 Health care reform

A comprehensive health care reform encompasses a health care system reform, reform of health care system financing and public health system reform. For the purpose of meeting the reform objective, the National Health Care Development Strategy was adopted by the Croatian Parliament on 30 June 2006, which defines the guidelines, entities responsible for the health care policy implementation and the reform of the health system. The primary objective of the strategy is to improve the health care system by 2011, so to enhance and to secure even better quality health care to the citizens of the Republic of Croatia.

Health care system reform

An extensive restructuring and reform of health care, as a public sector, is based on the principles defined by the National Health Care Development Strategy: centralised policy, standards and norms, implementation planning and control; establishment of an integrated health care; management and responsibility decentralisation; strengthening of primary health care as the basic element of an integrated care, establishment of the optimal allocation of all capacities on the secondary and tertiary level of the health protection and the establishment of the control over general health care spending; compulsory informatisation, as the basis for the general spending and quality control; provision and rationalisation of funds and their allocation according to the basic principles (equality, solidarity, accessibility, rationality and quality) and special needs.

Aimed at improving organisation and functioning of the primary health care in 2007, privatisation of primary health care offices has continued, as well as completion and extension of the primary health care network by increasing the number of contractual teams and

informatisation of the primary health care for the purpose of its linking with hospitals. In order to monitor spending of monetary funds for prescription drugs, the average annual amount is determined of funds for drugs which may be prescribed per insured person, whereas the health care contract under mandatory health insurance determines the contracted amount of monetary funds for drugs which may be prescribed by a selected physician. The new system of outpatient emergency medical care is provided for the area of 3 counties (Varaždin, Osijek and Baranja, and Split and Dalmatia) and for the area of the City of Zagreb.

With an aim of enhancing organisation and functioning of secondary and tertiary health care, during 2007, informatisation of hospitals and their networking with the central information system have been conducted, efforts have been made to establish the register of hospitals and continuation of activities aimed at introducing the integrated hospital database is planned. The Health Care Quality Act is adopted by the Croatian Parliament on its session on 3 October 2007, providing for the adoption of the plan and programme of measures for ensuring, improving, promoting and monitoring health care quality and measures for introducing the uniform health care quality standard system and clinical quality indicators, as well as establishing of the Health Care Quality and Accreditation Agency.

Reform of health care system financing

In 2007, activities have continued aimed at implementing measures to stabilise the health care and health insurance system, as well as to improve fiscal discipline in the health care and health insurance system, which is expected to result in a reduction of the share of total health care spending in GDP, settlement of debts in the health care sector and maintenance of a high level of health care quality.

Provision of primary health care in the activities of general/family medicine, health care of pre-school children and health care of women, is financed, except according to the “per capita” principle, according to the principle “price per service”.

The pilot project was implemented of the application of payment by diagnosis related groups (DRGs) in hospital health care of patients suffering from acute diseases. The introduction of the DRG system is aimed at reducing the duration of hospitalisation, increasing quality and reducing costs.

By classifying drugs into therapeutic groups for the same indication areas and by setting the reference price for drugs from each of the therapeutic groups, a pre-condition was created for dividing the uniform drug list of the Croatian Health Insurance Institute into the basic drug list (drugs applied in hospitals and drugs the prices of which are adjusted to the reference prices) and supplementary list of drugs (drugs for which the insured persons pay the difference in price in pharmacies) by the application of which rationalisation in drug spending will be achieved.

Public health system reform

The objective of the public health system reform is reorganisation of the public health system, as the main authority responsible for the preventive activities, prescribed by the *acquis communautaire* in the field of human health care, as well as the authority responsible for development and systematic implementation of the preventive programmes, aimed at reducing the number of preventable diseases.

The preparation of the public health strategy is underway and its adoption is expected in 2008. Following its adoption the implementation of other implementing measures envisaged for the area of public health system reform will begin.

On the basis of the Blood Supply Act, all the implementing regulations were adopted in line with the requirements of the EU Directives. The basic network for secondary and tertiary level for carrying on transfusion activity is also in the adoption procedure.

Pursuant to the Act on Explantation and Transplantation of Human Body Parts for the Treatment Purposes, subordinate legislation was prepared on the minimum conditions which must be met by tissue and cell banks for the beginning of their operation, in accordance with the requirements of the EU Directive.

The National Programme for Early Breast Cancer Detection was successfully implemented in 2007.

The National Programme for Early Detection of Colon Cancer has been adopted, and its beginning of implementation is envisaged for early November 2007.

The Draft National Action Plan for prevention and reduction of excess body weight 2007-2011 was prepared, and its adoption is expected by the end of 2007.

As a part of alignment of the public health regulation with the EU and complying with the recommendations and guidelines of the European Union, the new act on the protection of the population from the contagious diseases was adopted.

The Republic of Croatia has started a procedure for joining the “Second Programme of Community Action in the Field of Health (2008- 2013)”, and its adoption is expected by the European Commission by end-November 2007. This is a framework programme, consisting of several chapters, i.e. public health fields (contagious diseases, malignant diseases, blood and blood supply safety, organ, tissue and cell transplantation, tobacco, alcohol, addictions). By signing the memorandum of understanding on the participation in the aforementioned Programme, Croatia may compete, in any of these fields, for participation in and co-financing of specific projects and programmes.

4.6.3 Judicial reform

In 2007, the Ministry of Justice realised the measures and activities determined by the Judicial System Reform Strategy, as follows:

Land registry reform: Total number of unsolved land registry cases in all municipal courts in Croatia was 130,299 on 31 October 2007. In the period 31 October 2006 – 31 October 2007 the number of unsolved land registry cases was reduced by 21.04%, i.e. by 34,721 cases. In the same time, a total of 647,318 of land registry cases were solved, 604,164 received and 1,910,624 land registry certificates were issued. Furthermore, 97.74% (4,053,999) of the land registry files have been transferred into the electronic form and 38.32% (1,589,250) have been verified.

Creditor protection and claim collection: A trend of reduction in the number of unsolved enforcement cases in all courts in Croatia continued into 2007, so that as at 1 November 2007 it amounts to 116,783, which represents a reduction of 80.51% since the onset of the application of the Action plan for reducing the backlog in enforcement cases, when the number of unsolved enforcement cases was 599,334. In the period 1 January 2006 – 1 November 2007, public notaries received a total of 627,071 enforcement cases and issued 619,033 decisions on enforcement, while in the period 1 November 2006 – 1 November 2007 they received a total of 57,006 probate cases, and solved 52,665 of them. In this way, public notaries have lifted the burden from the courts by the same number of cases.

The Committee for the appointment of public commissioners has appointed public commissioners who have fulfilled strict conditions prescribed by the Enforcement Act and

subordinate legislation. The Croatian Chamber of Economy has established the Register of immovables and movables which are sold in the enforcement procedure. From 2005 to 30 August 2007, 1,710 immovables and 66 movables, worth over HRK 50 000 and sold in the enforcement procedure, were entered in the register. Bankruptcy trustees are obliged to enter data in the second public and official register kept by the Croatian Chamber of Economy. Since 2006, 216 sales of immovables and 33 sales of movables in bankruptcy proceedings were entered in the register. The Ministry of Justice has adopted all the subordinate legislation in the bankruptcy proceedings; Ordinance on taking professional examination for a bankruptcy trustee, Ordinance on determining a list of bankruptcy trustees and the List of bankruptcy trustees were published in the Official Gazette. This has increased transparency of courts in bankruptcy proceedings and especially of the work of bankruptcy trustees, since the records on bankruptcy trustees are now kept by the Ministry of Justice and the Minister of Justice determines the list of bankruptcy trustees in accordance with the conditions required for bankruptcy trustees.

Modernisation and more efficient operation of courts: As at 1 November 2007, the total number of unsolved cases in all courts in Croatia stood at 1,014,646, which is a reduction of 38%, i.e. 623,052 cases, compared to December 2004, when the number of unsolved cases stood at 1,637,698. With the same objective to reduce the number of unsolved cases, until 31 July 2007, the President of the Supreme Court of the Republic of Croatia issued a decision on delegating the cases to another court with a subject matter jurisdiction in 8,693 cases. This measure has contributed to the fulfilment of the objective, i.e. it allows for a more expeditious deciding on the cases when courts at which the procedures have started, are not in a position to hear and decide these cases within a reasonable period of time. The measure of a temporary referral of judges to another court of the same or different instance, upon a request of the president of the court to which he/she is referred, has continued to apply. At the same time, there are efforts to find alternative methods of dispute resolution. Mediation in the Republic of Croatia is practiced at 8 municipal courts and at Commercial Court in Zagreb. In November 2006, the Alternative Dispute Resolution Committee was appointed and the Croatian Bar Association adopted a Decision on the Mediation Centre Establishment in July 2007. Supervision of court administration has also continued in order to achieve high-quality and efficient operation of courts. Until October 2007, supervision of proper performance of tasks by the judicial administration was carried out at a total of 38 courts. Since 1 July 2007 the new Framework Standards for the work of judges, adopted by the Ministry of Justice, is being applied. These framework standards determine the number of cases, from each judicial area, which a judge has to solve in average on an annual basis, taking into account the difficulties of particular types of cases and the ways in which certain cases can be solved. A new model of statistical monitoring of the work of the judges according to the framework standards was prepared in August 2007. Forms for the statistical monitoring were submitted to all courts and are being applied since 1 September 2007. New framework standards will enable the presidents of the courts and the judges' councils to determine and assess more objectively the quantitative results of the judges' work. At the same time, a Methodology for preparing the assessment of the judges has been prepared. The methodology has been adopted so that the judges' councils, which are obliged to carry out the assessment of the judges in accordance to the Law on Courts, would have unified criteria for the preparation of the assessment of a newly appointed judge after his second year of working as a judge, also in the process of the appointment of a judge to another court or when one is being appointed a judge permanently as well as when one is putting forward his/her candidature for the president of the court. The methodology implies the scoring of all elements which, according to the Act on Courts, are to be taken into account in the preparation of the assessment of discharging judge's duty and prescribes that these elements are to be assessed for the period of three

calendar years prior to the time of the assessment, except if the assessment is being prepared after the judge has been working for two years.

The Ministry of Justice has launched through several projects an extensive programme of carrying out informatisation for the purpose of a more efficient functioning of the judicial system. Development and introduction of the integrated case information management system (ICMS) at Croatian courts is one of the most important and largest projects, which, by itself, represents one of the most complex information projects in the country. ICMS (eSPIS) was introduced at Municipal Court in Pula, Commercial Court in Split and partly at Commercial Court in Zagreb.

Rationalisation of the courts network: On 9 March 2007, the Government of the Republic of Croatia, in accordance with the adopted Judicial System Reform Strategy and on the proposal of the Ministry of Justice, adopted the Conclusion according to which the rationalisation of the court network, as one of the most important strategic goals, will be carried out by a merger of the courts of the same type. The Government has submitted to the Parliament a proposal of the Act on the amendments to the Act on areas and headquarters of courts, which proposes a merger of 5 municipal and 5 misdemeanour courts. Since the Parliament suggested that the rationalisation should be carried out in a single proposal of the rationalisation of all courts which are planned to be merged, the Ministry of Justice decided to take a new approach to this issue. In October 2007, in agreement with the Austrian experts from the project CARDS 2002, it has been agreed that a new proposal of the Act on areas and headquarters of courts will be drafted and it will encompass all courts which are to be merged (according to the adopted criteria, i.e. courts with less than 5 judges, courts distanced from each other less than 50km, except the courts on the islands and in the areas of the special state concern). The dynamics of merging the courts will be determined in the transitory and final provisions of the Act, having in mind that the working group took a position that the merging of courts will be carried out in the period of 15 years. Merging of the courts for which a small amount of funds for the extension of the existing buildings is necessary will be carried out in the short term of 5 years, merging of the courts for which larger investments for the extension of the existing buildings is necessary will be carried out in the medium term of 10 years, while merging of the courts for which a construction of new buildings is necessary will be carried out in the long term of 15 years. The working group concluded that the implementing regulations should be prepared simultaneously with drafting of the proposal of the new Act, and they would be applied in the merger processes of all courts. The proposal of the Act on the merger of courts will be presented to all presidents of the high courts in the Republic of Croatia, as well as to the presidents of the county courts in December 2007 so that they could give their opinion. In order to obtain the support of the public for the rationalisation process, the public will be presented with all the benefits of the rationalisation on a conference scheduled for 13 December 2007, within the CARDS 2003 project.

The following EU projects are currently being implemented:

- CARDS 2003 - «Support to the Reform of the Croatian Court System – phase II»
- CARDS 2003 - «Combating Money Laundering»
- CARDS 2004 TW Light - «Support to Probation System Development»
- CARDS 2004 - «Support to More Efficient, Effective and Modern Operation and Functioning of the Administrative Court of the Republic of Croatia»
- CARDS 2004 – «Improving Court and Case Management at the High Misdemeanour Court and Selected Misdemeanour Courts»

Penal legislation reform and implementation of the anticorruption strategy: At its session held on 9 March 2007, the Government of the Republic of Croatia adopted a platform for the adoption of the new Penal Procedure Act and a working group for its preparation was formed.

In October 2007, the Act on Amendments to the Penal Act and the Act on Amendments to the Act on the Accountability of Legal Persons for Penal Act were adopted for the purpose of alignment of the national legislation with the *acquis communautaire*. The Act on Amendments to the Act on the Office for the Prevention of Corruption and Organized Crime (USKOK) entered into force on 23 July 2007. These amendments extended USKOK's competence to a possibility of taking actions against all official persons who have committed a crime of abuse of position and power with the intention of gaining pecuniary interest. By adopting these amendments to the Act on USKOK, along with the existing USKOK's capacity, legal preconditions will be created for a successful prosecution of large-scale corruption by USKOK as well. The measures envisaged by the National Anticorruption Programme 2006-2008 have been continuously implemented; the entities responsible for the activities regularly submit reports on the implementation of measures to the Ministry of Justice, as a co-ordinator of implementation.

Concerning the judicial system reform implementation, in the period 2008-2010 special attention will be given to the following areas:

Modernisation and more efficient operation of courts: The Ministry of Justice will perform an on-going supervision over the operation of the court administration and will take measures to eliminate the irregularities identified by the supervision. In accordance with the amendments to the Act on the State Attorney's Office, adopted in January 2007, the judicial inspection of the Ministry of Justice will also perform supervision of the work of the judicial administration in state attorney's offices. By the end of 2007, the CARDS 2004 project "Support to More Efficient, Effective and Modern Operation and Functioning of the Administrative Court of the Republic of Croatia" will be launched, also implying the beginning of the administrative court practice reform, which will follow after the adoption of the new Act on the General Administrative Procedure. The Ministry of Justice has started the development of the integrated case information management system (ICMS), which will, at a stage when it becomes fully operational at all courts in the Republic of Croatia, cover all business processes and needs of the judicial system. The objective of this project is to create an automated system at the national level which will assist judges and court officials in applying the rule of law and providing court services to citizens, as well as increase efficiency of judiciary in Croatia. In November 2007, eSPIS will be introduced at the Supreme Court of the Republic of Croatia, High Commercial Court of the Republic of Croatia, County Court in Zagreb and County Court in Pula. Funds have been granted under pre-accession fund PHARE 2005 "Mediation as an Alternative Dispute Resolution Method" and the project is expected to be launched in the second half of 2007. Under this PHARE 2005 project, mediation is planned to be expanded to other municipal and commercial courts. In the course of the project, amendments to the Mediation Act will be prepared, as well as the Draft Code of Ethics which will be used by the mediators, the Plan and programme of mediators' training and a campaign for the mediation promotion in the Republic of Croatia will be organised.

Land registry reform: In co-operation with the consortium headed by the company Ericsson Nikola Tesla, the realisation of one of the most important steps in the implementation of the project "Regulated Land", worth HRK 22.5m, begins. The contract was signed on 29 May 2007. The contracted time limit for establishing the common information system for land registry and the cadastre is 2 years and the system will provide a faster, more simple and safe registration of real estates and real estate rights. The Act on Amendments to the Land Registry Act is in the final stage of adoption under urgent procedure. These amendments are aimed at shortening time limits in the procedures of land registry establishment and renewal, adjusting land-registry and cadastre status, implementing safety in real estate legal

transactions and a faster ownership registration in land registry. Legal assistance is planned to be introduced to citizens in the ownership right registration procedure and exercising all other real rights at municipal courts in the Republic of Croatia.

Creditor protection and claim collection: The Ministry of Justice will continue to implement the action plan for reducing the number of unsolved enforcement cases. The enforcement procedure manual/guide is currently being prepared, which will contain a list of rights and obligations of all the participants in the procedure enforcement of movables, with practical examples and draft acts, as well as a brochure with the most frequent questions and answers. The Ministry of Finance prepares a professional training of public commissioners and other participants in the procedure, relating to accounting and finance. For the purpose of increasing transparency of the work of commercial courts, the registry of cases of the High Commercial Court of the Republic of Croatia has been made available to the public on its website (a party may at any time check the status of his/her case); a special website entitled «web bankruptcy» is under construction, where the overall domestic and foreign public may obtain all data concerning the sale of bankruptcy assets in all bankruptcy cases at all commercial courts, the value of which exceeds HRK 50,000, and all other necessary information related to bankruptcy cases. During 2008, introduction into practice of the new system of keeping court registers is planned to be completed, in accordance with the provisions of the amended Court Register Act. This implies the application of the new court register central database programme, equipping court registers with computers and appropriate office equipment, completion of the programme for scanning the document collection, new website of the court register and training of staff.

Penal legislation reform and implementation of the anticorruption strategy: The working group for drafting of the new Penal Procedure Act will continue with its work and will, on the basis of the adopted platform, discuss the key issues relating to the reform of the said procedure and introduction of new forms of accelerated procedures. In view of the existing experience of investigative judges, the investigation should be taken over by the state attorney's office in close cooperation with the police, which will necessarily include additional training of staff of both bodies. The National Anticorruption Programme will be implemented continuously, while the Ministry of Justice will continue to supervise the implementation of individual measures through the mechanism of regular reports and meetings with the entities responsible for the measures. In the forthcoming period, the National Anticorruption Programme and its related action plans with time frames, responsible bodies and the budget required for the implementation will be revised.

4.6.4 Environmental protection

In 2007, transposition of the *acquis communautaire* in the field of environmental protection was intensified and it will be fully completed by the end of 2008. The new Environmental Protection Act was adopted on 3 October 2007 by the Croatian Parliament. As regards the environmental impact study and a strategic environmental impact study, implementing regulations are being prepared which will be aligned with the *acquis communautaire*. For the purpose of implementation of these regulations, training for all the involved parties will be organised and guidelines for performing the impact study and a strategic environmental impact study will be prepared.

The Environmental Protection Agency prepared the Report on the State of Nature for the period 1997-2005, which was adopted by the Croatian Parliament in May 2007. The Environmental Protection Agency has continued development and upgrading of the Environmental Protection Information System, which includes the activities aimed at the

introduction of IT system for soil (supported by LIFE programme) and upgrading of the IT system for monitoring the state of the Adriatic Sea. In the 2008-2010 period the basic parts of the Environmental Protection Information System will be established and the National list of indicators will be prepared and published. The Environmental Protection Agency will establish its reference centres.

The assessment of air quality in the territory of the Republic of Croatia was completed in early 2007 and the proposal was made for a classification of the state territory into areas (zones) and inhabited areas (agglomerations), in accordance with Directive 96/62/EC. The Air Quality Protection and Improvement Plan was developed and its adoption is expected in the first quarter of 2008. In 2007, the activities started aimed at establishing the air quality IT system, as an integral part of the Environmental Protection Information System. A complete state air quality monitoring network is expected to be established in 2009, under PHARE 2006 project²⁵. In 2007, the Ministry of Environmental Protection, Physical Planning and Construction allocated around HRK 1.56m for creating preconditions for the implementation of this project (preparation of the project documentation, construction and other work, connecting to electric energy network).

In April 2007, the Croatian Parliament ratified the Kyoto Protocol. In July 2007, a CO₂ emission fee was introduced, which, in addition to earning income, aims at stimulating the liable entities to invest in reducing CO₂ emissions. The annual percentage of biofuel in total fuel was set at 0.9% for 2007, which amounts to 22 000 tons for biodiesel²⁶. By the adoption of the Regulation on Monitoring the Emissions of Greenhouse Gases in the Republic of Croatia in January 2007, the National System for Monitoring the Emissions of Greenhouse Gases was established and a legal framework was created for the introduction of the Register of Greenhouse Gas Emissions (in 2008), which are the preconditions for the functioning of the emission quota trading system. By the adoption of the appropriate Regulation (whose preparation is underway) the system of greenhouse gas emission trading will be established in the Republic of Croatia in accordance with Directive 2003/87/EC. The National Plan for the Emission Quota Allocation (to be adopted in the third quarter of 2008) will determine the total quantity of emissions for the allocation to plants carrying on specific activities. In accordance with the Plan, the emission quotas will be allocated to individual plants.

In the field of waste management, the application of the new ordinances started in 2007, relating to waste vehicles collection and processing, medical waste, waste lubricants, batteries, accumulators and electrical and electronic devices and equipment. In July 2007, the Government of the Republic of Croatia adopted the Waste Management Plan of the Republic of Croatia which provides for the method of organisation of the future integrated waste management system in the Republic of Croatia. The waste management centres at the county/regional level will be the main pillars of that system, which will be constructed within the determined timeframe. The estimated investments required for the establishment of the centres range from EUR 350m to EUR 397m and will be allocated from the Environmental Protection and Energy Efficiency Fund, the EU pre-accession funds, units of local/regional self-government and partly (for certain devices within the centres) through public-private partnership. The Operative Programme for Environmental Protection under IPA component III – Regional Development has been prepared. One of the priorities of the Operative Programme is the area of waste management, including the investments in waste management centres and preparatory activities for the rehabilitation of highly contaminated locations – «black spots». Rehabilitation of 292 waste disposal sites is currently co-financed by the

²⁵ PHARE 2006 "Air Quality Monitoring and Management System"

²⁶ The indicative target of biofuel share is 5.75% until 2010.

Environmental Protection and Energy Efficiency Fund and by the units of local self-government, total value of investments amounting to HRK 2.8bn (48% of which accounts for non-refundable resources from the Environmental Protection and Energy Efficiency Fund). Rehabilitation of all disposal sites is planned the end of 2011. The implementation of measures for the improvement of hazardous waste management will also continue, as well as the improvement of the IT system for the area of waste²⁷ (PHARE 2006 project), rehabilitation of «black spots» (the Environmental Protection and Energy Efficiency Fund has allocated HRK 162m for that purpose) and other measures for the establishment of the integrated waste management system.

In the field of water management, the activities indicated in the 2007-2009 PEP have continued for the purpose of strengthening and establishing the integrated water management system and increased investment in water management infrastructure. CARDS 2003²⁸ project has continued and CARDS 2004 project Capacity Building and Development of Guidelines for the Implementation of the Water Framework Directive has started. The adoption of the *Water Management Strategy* is in the legal procedure. As regards the reform of the existing system of water management financing, subordinate legislation should be amended/adopted in line with the implementation of the Water Management Financing Act. As regards the irrigation system, in the first phase, until 2010, irrigation of the area of up to 35 000 ha is planned, while in the second phase, until 2020, a total irrigation of 65 000 ha is planned. Funds totalling HRK 6.1m are planned to be allocated from the state budget for the alignment of water management legislation in the 2008-2010 period. For the same period, a total of HRK 240m is planned to be allocated from the state budget for capital projects of water supply. A total amount of HRK 360m is planned to be allocated from the state budget, in the 2008-2010 period, for capital projects of water and sea protection against pollution. A total of HRK 18 m is planned to be earmarked in the state budget for capital projects of protection against damage caused by water. For capital projects of irrigation, a total of HRK 581m is planned to be allocated from the state budget in the 2008-2010 period. The field of water management is one of the priorities of the aforementioned IPA Operative Programme for Environmental Protection, which implies investments in water supply systems and networks, as well as in drainage systems and purification of waste water.

The implementation of the Project against the pollution of water in the coastal area of the Republic of Croatia has continued at the envisaged pace (the implementation of the next phase of the project is being prepared, which will encompass the area of south Adriatic with the islands). A similar project, relating to the inland waters, was approved by the World Bank. Subordinate legislation will be prepared relating to the quality standards of the sea water on the beaches.

In the field of nature protection, in 2007, Nature Protection Directorate at the Ministry of Culture was reorganised, which allowed for administrative strengthening. An intense review is performed of the protected areas registry; in addition to other newly-protected areas and areas under preventive protection, Lastovo Islands were proclaimed a nature park and public institution for managing Lastovo Islands nature park was established. The development of the Geographic Information System (GIS) for nature protection in national parks and cultural goods within national parks has continued and co-operation has extended to public institutions for nature parks and public institutions for the protected natural values management at the county level (Ministry of Culture, State Geodetic Directorate supported by the Global

²⁷ The Environmental Protection Agency developed new databases in the previous period, such as the Register of Waste Management Licenses, etc.

²⁸ CARDS 2003 Approximation of the Croatian water management legislation with the EU water acquis (expected to be completed in March 2008).

Environment Fond (GEF) and the Government of the Kingdom of Norway and Environmental Protection and Energy Efficiency Fund). The inventorisation process of components of biological diversity has continued, which has resulted in the publication of red lists and red books for individual groups of plants and animals, preparation of detailed maps of habitats, development of the central nature protection IT system, drafting of the proposal of the National Ecological Network, etc. The priorities in the forthcoming period are related to the process of the Republic of Croatia's EU accession. In nature protection, this refers to a complete legislative alignment, including the establishment of the implementation mechanisms and strengthening of administrative capacity/institutional framework at all levels, especially at a local and regional level, which has proven to be the largest deficiency in the implementation and development of the nature protection system, as well as to the contribution of the Republic of Croatia to the ecological network NATURA 2000. The preliminary calculation of the required financial resources for the nature protection sector is more than EUR 75m for the 2006-2010 period. In the 2008-2010 period, the greatest results are expected through the projects PHARE/NATURA 2000, PPA/V – Implementation of the environmental *acquis* concerning the protection of species of wild fauna and flora by regulating trade therein and the System of the protected area management in Croatia – Phase II- Development of the county public institutions system for managing the protected areas, investments in which total around EUR 4.3m.

As regards the control of industrial contamination, the implementing regulations for the establishment of the system for the application of IPPC²⁹ and SEVESO II³⁰ Directives will be adopted in 2008. For the purpose of strengthening the capacity for the implementation of the IPPC Directive, CARDS 2004 project «Support for the further approximation of Croatian legislation with environmental *acquis*» was launched in September 2007. For the purpose of the system preparation for the application of Regulation 761/2001 allowing voluntary participation by organisations in a Community eco-management and audit scheme (EMAS), the promotional activities aimed at introducing EMAS in companies and organisations began in 2007. The Register of Risk-Exposed and Potentially Risk-Exposed Facilities has been systematically upgraded and the Register of Establishments Where Dangerous Substances are Present will be developed until 2010 (adjustment to the SEVESO II Directive).

In the field of chemical safety, the adoption of the National Chemical Safety Programme is planned in the first part of 2008. As regards the field of genetically modified organisms (GMO), transposition of the *acquis communautaire* into national legislation has continued. Two new employees were hired at the Nature Protection Directorate of the Ministry of Culture. The final version of the First Report on the Implementation of the Cartagena Protocol was completed and submitted to the Secretary of the Convention on Biological Diversity. The required amendments to the GMO Act itself will be adopted by the end of 2008.

In the field of civil protection, SEVESO II Directive³¹ was transposed in the part relating to the interventions after major accidents (competence of the National Protection and Rescue Directorate). In the field of forestry, the implementation of the Conceptual and Operative Plan of the National Inventory of Forest Resources of the Republic of Croatia is currently underway (2007-2008). The supervision of the forest plants health status and status monitoring will be carried out by the Forestry Institute Jastrebarsko. The establishment of the register of forest damages and forest fires is also anticipated for the purpose of performing an intensive and on-going supervision of forest ecological systems. Pursuant to the Forest Reproductive Material Act, the establishment of the gene bank and preservation is planned.

²⁹ Council Directive 96/61/EC concerning integrated pollution prevention and control

³⁰ Council Directive 96/82/EC on the control of major-accident hazards involving dangerous substances.

³¹ The amendments to the Protection and Rescue Act

The action of all inspection services responsible in the area of environment as well as their mutual coordination is a key issue for the efficient implementation of the environment protection system. Based upon the proposal of the Ministry of Environmental Protection, Physical Planning and Construction the Agreement on the cooperation of the inspection services in the area of environment protection has been signed on 2 August 2007 by the Ministry of Environmental Protection, Physical Planning and Construction, Ministry of Agriculture, Forestry and Water Management, Ministry of Health and Social Welfare, Ministry of Culture, Ministry of Interior, Ministry of Sea, Tourism, Transport and Development and the State Inspectorate.

In 2007, The Division for the GMO control has been established within the Office for sanitary inspection of the Ministry of Health and Social Welfare. The establishment of the Council for genetically modified organisms is underway.

The beginning of the project “Chemical safety-enhancement of the legal and administrative framework for the protection from dangerous chemicals” is expected in 2008 within which further alignment of the national regulations from the area of chemicals and the strengthening of institutional and administrative capacities are planned. The leading party in this project is the Ministry of Health and Social Welfare while the Ministry of Environmental Protection, Physical Planning and Construction is the project partner.

5 ECONOMIC POLICY MATRIX

5.1. ENTERPRISE SECTOR		
5.1.1. Privatisation		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Privatisation of companies in majority ownership (sale via public tender)		
Completion of the privatisation of agro-conglomerates	<ul style="list-style-type: none"> Announcement of the third round of invitations for tenders for the company Vupik, Vukovar 	during 2008
Continuation of privatisation of remaining sectors in majority ownership	<ul style="list-style-type: none"> Intensive preparation and announcement of tenders paired with bankruptcy and winding up proceedings over companies which are eligible for such procedures 	until the privatisation is completed
Privatisation of companies in minority ownership (via the stock exchange)		
Continued privatisation of minority shares	<ul style="list-style-type: none"> Sale of minority share packages at the Zagreb shares at the planned frequency of some forty companies per month 	until the privatisation is completed
Other goals		
Privatisation of subsidiary companies of Croatian Railways	<ul style="list-style-type: none"> Further signing of agreements between Croatian Railways and CPF, aiming at preparing subsidiary companies for privatisation Preparation of dependent companies for privatisation, in case of required recapitalisation of subsidiary companies through increase of initial capital of dependent companies Announcement of the sale tender 	until the sale of all subsidiary companies, by end-2010
Preparation for privatisation of shipyards	<ul style="list-style-type: none"> Privatisation of one shipyard (Uljanik) and preparation for privatisation of one more pursuant to the obligations assumed under the PAL and the adopt Strategic Development Framework 2006-2013 and the future National Restructuring Programme . 	during 2008
Transformation of the CPF into a new institution for the management of remaining state assets	<ul style="list-style-type: none"> Creation of the model for managing the remaining state assets including the definition of new organisational structure 	during 2008
5.1.2 Railway restructuring		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Harmonisation of legislation	<ul style="list-style-type: none"> Creation of subordinate legislation 	by 2009
Liberalisation of railway transport market	<ul style="list-style-type: none"> Establishment of regulatory bodies Creation of network reports Allocation of routes to operators Establishment of security bodies 	2007 2008 2009 2010
Restructuring and modernisation of railway company	<ul style="list-style-type: none"> Fulfilment of conditions under PAL 2 loan 	2007
Adoption of the National Railway Infrastructure Programme	<ul style="list-style-type: none"> Entry into agreements with Infrastructure manager Creation of annual modernisation plans 	2007 continuous
5.1.3 Restructuring of shipbuilding industry		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Restructuring aimed at achieving self-sustained profitable operation of individual shipyards	<ul style="list-style-type: none"> Implementation of the restructuring programme 	2005 - continuous
Privatisation with a view to ensuring the preconditions for their further successful operation through the implementation of economic policy measures compatible with the economic policy of the EU	<ul style="list-style-type: none"> Choice of the privatisation model shall depend on the Privatisation Act and Employee Stock Ownership Act (ESOP), and shall be carried out via public tenders and defined ToR 	2006 - continuous
Increase product sophistication in the shipbuilding industry in order to increase value added	<ul style="list-style-type: none"> Selection of market niche, domestic and international integration and production specialisation, implementation of IMO regulations etc. 	continuous
Create a new shipbuilding market on a commercially sustainable basis	<ul style="list-style-type: none"> Offering ships designed pursuant to the Leadership 2015 project 	continuous
Transfer to designing and constructing more complex vessels in order to increase value added	<ul style="list-style-type: none"> Entering agreements on the construction of more complicated 	continuous
Increase efficiency and cost competitiveness	<ul style="list-style-type: none"> Implementation of the Restructuring and rationalisation programme, cost control etc. 	2005 - continuous
Exploit synergy effects in order to reduce costs and achieve a more efficient access to the shipbuilding market	<ul style="list-style-type: none"> Centralisation of procurement, design and marketing and production specialisation 	continuous
5.1.4 Energy		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Implementation of envisaged plans regarding the use of renewable energy sources	<ul style="list-style-type: none"> The implementation of envisaged plans will enable incentives to privileged energy producers (so-called feed-in tariffs), defined by the Government of RC in subordinate legislation 	2008- 2010
Implementation of plans regarding energy efficiency	<ul style="list-style-type: none"> Establishment of local energy agencies and creation of specific programmes in cooperation with the Environment Protection and Energy Efficiency Fund 	continuous
Strengthening of the energy market in south-east Europe within the meaning of the Energy Community Agreement	<ul style="list-style-type: none"> Connecting the electricity and gas system with the neighbouring countries. 	continuous
5.1.5 Small and medium-size enterprises		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Whole-life entrepreneurial education	<ul style="list-style-type: none"> Project of the National Programme for Entrepreneurial Education with defined implementing programmes in formal and informal education Monitoring 	continuous

POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Competitiveness	<ul style="list-style-type: none"> • Education of exporters • Application of new technologies and technological processes • Environmental protection of products • Innovations and new products • Introduction of EU standards • Association of economic entities (clusters) • Incentives to crafts and cooperatives • Integration of SMEs and R&D institutions • Marketing and promotion • Coordination of activities related to e-commerce and e-business 	continuous
Strengthening of entrepreneurship financing	<ul style="list-style-type: none"> • Credit financing • Venture capital • Guarantees 	continuous
Quality improvement and development of business and entrepreneurial infrastructure	<ul style="list-style-type: none"> • Incentives for development of of the Croatian Agency for Small Business • Support to setting up regional development agencies • Support to developing entrepreneurial zones, technological parks and incubators 	continuous
5.1.6 Public-private partnership		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improvement of the regulatory framework	<ul style="list-style-type: none"> • Compliance with EU legislation and harmonisation with the acquis EU 	continuous
Strengthening of administrative capacities	<ul style="list-style-type: none"> • Holding workshops and seminars for the public and private sector • Systematic professional and administrative strengthening of the sector 	continuous
5.2 FINANCIAL SECTOR		
5.2.1 Banking sector		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further development and improvement of prudential regulations and the banking system	<ul style="list-style-type: none"> • Adoption of the Act on reorganisation, winding up and bankruptcy of credit institutions • Adoption of Credit Institutions Act • Adoption of the Electronic Money Institutions Act • Adoption of the Deposit Insurance Act • Adoption of the Payment System Act • Adoption of the Financial Institutions Act • Compliance with EU legislation • Authorisation of credit unions and savings banks 	2008 2008 2008 2008 2008 continuous continuous
Establishment of a supervisory body, human resource development	<ul style="list-style-type: none"> • Presentation for banks, credit unions and savings banks on new regulations to be adopted in 2008 • Training of supervisors in relation to new regulations and banking risks • Improvement of the banks' prudential reporting system 	continuous continuous 2008
5.2.2 Non-banking sector		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further development and improvement of the non-banking sector	<ul style="list-style-type: none"> • Adoption of the Act on the Reorganisation and Winding Up of Credit Institutions and Insurance Companies • Adoption of the Financial Conglomerates Act • Adoption of the Securitisation Act • Adoption of the Act on Amendments to the Audit Act • Compliance with EU legislation 	2008 2008 2008 2008 continuous
Establishment of a supervisory body, human resource development	<ul style="list-style-type: none"> • Further development of the organisational structure • Education for brokers, investment advisors and pension fund managers 	continuous 2007 continuous
5.3 LABOUR MARKET		
5.3.1 Stimulating employment		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Increase employment and employability by aligning labour market supply with demand	<ul style="list-style-type: none"> • Analysis and evaluation of annual employment incentive plans 	continuous
Better alignment of labour market needs with the education system	<ul style="list-style-type: none"> • Establishment of local partnerships for employment through cooperation between the regional offices of the Croatian Employment Bureau and regional development agencies. 	2008 and 2009
5.3.2 Social security system		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Social contributions reform		
Create a beneficiary -oriented system by improving service quality through decentralisation and deinstitutionalisation	<ul style="list-style-type: none"> • Implementation and financing of approved innovative projects regarding the rendering of social services at local community level aimed at deinstitutionalisation and reintegration of beneficiaries • Service quality improvement in social welfare facilities (reconstruction and adaptation of 13 welfare centres, construction of 12 new welfare centres and improvement of sanitary and hygienic conditions in 57 social welfare homes) • Development of the One-Stop-Office - invitations for tenders 	2008 2008 - 2009 2008
Children and families' protection - systematic protection of rights and interests of children and vulnerable groups and harmonisation with international standards	<ul style="list-style-type: none"> • Fulfilment of obligations under: National Youth Programme of Action, National Strategy on Drug Abuse Prevention National Trafficking Prevention Plan National Population Policy National Strategy of Unique Policy for Handicapped Persons National Policy for the Promotion of Gender Equality National Strategy for the Protection Against Family Violence and in the Family Violence Protocol National Programme for the Roma 	continuous 2008 - 2010
Increase in employment of less employable population groups	<ul style="list-style-type: none"> • Social employment with organisations which are social services providers in the community (IPA - Operational programme - human resources development) - envisaged employment of 10 - 12 persons and training of 20 social integration mentors) 	2008 - 2009

5.4 AGRICULTURAL SECTOR		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Efficient agricultural land market	<ul style="list-style-type: none"> Incentives for the purchase of agricultural land through a capital investment model "Enlargement of the Agricultural Land" Project Creation of the Agricultural Land Study regulating the enlargement of agricultural land 	<p>continuous</p> <p>2008-2009</p> <p>2008-2009</p>
Completion of the privatisation of agro-conglomerates	<ul style="list-style-type: none"> Hold invitations for privatisation tenders 	2008
Alignment of the Croatian agricultural policy with the common agricultural policy of the EU	<ul style="list-style-type: none"> Regulation of the agricultural products and foodstuffs market in line with the changes in market organisation in the EU Harmonisation of state aid to agriculture with EU directives Financing rural development measures from funds obtained under the pre-accession assistance programme-SAPARD Financing rural development measures from funds obtained under the Instrument for pre-accession assistance - IPA Establishment of a fully digitalised Wine Cadastre and entry and collection of the remaining data Introduction of EU phytosanitary standards and strengthening of the plant protection service Introduction of EU veterinary standards: regulations amendment, capacity strengthening Establishment of the Central Veterinary Information System Introduction of EU food quality and safety standards 	<p>continuous</p> <p>continuous</p> <p>2008</p> <p>2008-2010</p> <p>2008-2009</p> <p>continuous</p> <p>continuous</p> <p>continuous</p>
Alignment of fisheries policy with the Common Fisheries Policy of the EU	<ul style="list-style-type: none"> Harmonisation of legislation Introduction of the satellite vessel monitoring system (VMS) Establishment of a Fisheries monitoring centre 	<p>continuous</p> <p>2008-2010</p> <p>2008-2010</p>
Enhance the competitiveness of wood processing industry	<ul style="list-style-type: none"> Implementation of the Operative programme of wood processing industry development Establishment of the Wood exchange d.o.o. Establishment of the Centre for research of wood products and furniture development Establishment of an inspection office Creation and implementation of Action/Operative programmes for the implementation of the National Design Strategy of the Republic of Croatia 	<p>2008-2010</p> <p>2008-2010</p> <p>2008-2010</p> <p>2008-2010</p> <p>2008-2011</p>
5.5 ADMINISTRATIVE REFORM		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Ensure consistency in remuneration of government employees, transparency of the wage bill and remuneration and introduction of more elements based on achievement and work	<ul style="list-style-type: none"> Adopt an act on salaries of government employees 	2008
Rationalisation of government administration	<ul style="list-style-type: none"> Carrying out a functional analysis in government administration bodies (including the implementation of the rationalisation programme in the government administration bodies where a functional analysis has been carried out) 	2008
Streamline administrative procedure, facilitate the realisation of citizens' rights	<ul style="list-style-type: none"> Adopt a new General Administrative Procedure Act 	2008
Strengthen the role of electronic administration in the development of the economy	<ul style="list-style-type: none"> Adopting a new decree on office operations (aligned with electronic functioning of administration) Establishing an IT-supported register of civil servants 	<p>2008</p> <p>2008</p>
Regulation of the legal status of civil servants and employees in government administration in local and regional self-government units	<ul style="list-style-type: none"> Adopting Local and Regional Self-Government Employment Act 	2008
Improved supervision of the work of government administration bodies	<ul style="list-style-type: none"> Adopting amendments the Administrative Inspection Act Implementing the Administrative Inspection Act and conducting thorough inspection supervision in all government administration bodies 	<p>2008</p> <p>2009</p>
Set up a more efficient system for the provision of public services to citizens	<ul style="list-style-type: none"> Administrative decentralisation of government administration operations Professional improvement of local and regional government employees through the Academy of Local Democracy 	<p>2008</p> <p>continuous</p>
Improvement of the quality of public services	<ul style="list-style-type: none"> Professional training and development of government employees under educational programmes of the Centre for professional training and development of government employees 	continuous
5.6 ADDITIONAL REFORM AREAS		
5.6.1 Knowledge-based society		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Increase the number of children participating in pre-school programmes	<ul style="list-style-type: none"> Encouraging the establishment of a number of kindergartens aimed at involving rising numbers of children (especially of talented children, children with developmental difficulties and children from minorities) in pre-school programmes - as preparation for primary school Creation of the National curriculum for pre-school education 	<p>2008-2010</p> <p>continuous</p> <p>2008-2010</p>
Improve learning and teaching quality	<ul style="list-style-type: none"> Develop information and communication skills, foreign language learning, mathematical and scientific literacy, promote technical culture, entrepreneurship and social skills and carry out school self-evaluation Carry out experimental external assessment of educational programmes and student achievements - national exams for fourth grade pupils Carry out external assessment of educational programmes and student achievements - national exams for eight grade students 	<p>2009-2010</p> <p>continuous</p> <p>2008</p> <p>2008</p>
	<ul style="list-style-type: none"> Realisation of the Pedagogical standard in accordance with the feasibility coefficient National curriculum for primary education Develop primary school information system 	<p>2008-2010</p> <p>continuous</p> <p>2008-2010</p> <p>2008-2010</p> <p>continuous</p>

POLICY GOAL	IMPLEMENTING MEASURES	PERIOD	
Improve the quality of secondary education	<ul style="list-style-type: none"> Continue with the project of introducing the state school leaving exam by conducting national exams and implement school self-evaluation 	2008-2009	
	<ul style="list-style-type: none"> Create National Curriculum and implement the Pedagogical Standard 	2008-2010	
	<ul style="list-style-type: none"> Continue redefining professional areas and professions and develop the Croatian Qualification Framework 	2008-2009	
	<ul style="list-style-type: none"> Strengthen co-operation with economic and social partners 	2008-2010 continuous	
	<ul style="list-style-type: none"> Systematically improve the quality of adult education, primarily through recertification of programmes and application of standards and norms at institutions for adult education 	2008-2010 continuous	
Implementation of the Bologna Process	<ul style="list-style-type: none"> Establish new higher education colleges 	2008-2010 continuous	
	<ul style="list-style-type: none"> Continue with improvements aimed at achieving better quality of the higher education system; raise the quality of university programmes; provide support to the Office for quality assurance 	2008-2010 continuous	
	<ul style="list-style-type: none"> Carrying out external quality evaluation of higher education programmes and institutions simultaneously with the development of quality assurance units at institutions of higher education, and in connection with the mobility of professors and students 	2008-2010 continuous	
	<ul style="list-style-type: none"> Develop a system of providing scholarships and student loans 	2008-2009	
	<ul style="list-style-type: none"> Establishment of the Croatian Qualification Framework 	2008-2009	
	<ul style="list-style-type: none"> Encourage university integration processes and continue with the implementation of the lump sum financing model, adjusting the mechanisms of investment and control over spending of budgetary funds and encouraging private initiatives 	2008-2010	
	<ul style="list-style-type: none"> Systematically increase inflow of information on labour market need into the higher education system and strengthen the cooperation between the higher education system and the private sector 	2008-2010	
Strengthen research and development	<ul style="list-style-type: none"> Continue increasing funds for basic research and improving criteria for selection of scientific projects and programmes 	2008	
	<ul style="list-style-type: none"> Initiate new projects stimulating co-operation between the academic community and the economy and create centres of excellence, paired with systematic strengthening of the capacities of scientific organisations in relation to EU 	2008-2010	
	<ul style="list-style-type: none"> Ensure quality technological infrastructure and improve financing/monitoring procedures for technological projects 	2008-2010	
	<ul style="list-style-type: none"> Build and equip the BioCentre - Bio-science incubation centre 	2009-2010	
	<ul style="list-style-type: none"> Establish an Investment fund for science and innovation 	2009-2010	
	<ul style="list-style-type: none"> Harmonise the areas of interest and research aimed at greater degree of transfer of knowledge and technologies in the development of the economy and entrepreneurial endeavours. 	2008-2010	
5.6.2 Health care reform			
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD	
Health care system reform			
Improvement of the organisation and operation of primary health care	<ul style="list-style-type: none"> Expansion and extension of the primary health care network 	continuous	
	<ul style="list-style-type: none"> Changing the conditions for and the manner of providing specialist health care 	2008-2009	
	<ul style="list-style-type: none"> Renewing medical equipment 	continuous	
	<ul style="list-style-type: none"> Expanding the telemedicine system to primary health care and introducing telemedicine standards 	2008	
	<ul style="list-style-type: none"> Promotional activities related to raising awareness of healthy lifestyle 	continuous	
	<ul style="list-style-type: none"> Informatization of primary health care and its networking with hospital informatization 	continuous	
	<ul style="list-style-type: none"> Changing the relationship between community health centres and lease-holders with the introduction of a lease ordinance 	2008	
	<ul style="list-style-type: none"> Changing the calculation of funding for primary health care teams with the introduction of the "Fund Holding" for part of the services 	2008-2009	
	<ul style="list-style-type: none"> Defining primary health care teams and introducing additional types of specialist teams 	continuous	
	<ul style="list-style-type: none"> Establishing community health centres on islands and in areas of special state concern 	2007 - 2008	
	<ul style="list-style-type: none"> Ensuring joint assistance provision by the health care system, social security system and civil society system to the most vulnerable population groups 	continuous	
	<ul style="list-style-type: none"> Transforming the selected doctor into the selected family doctor 	continuous	
	<ul style="list-style-type: none"> Start of operations of the Croatian Mental Health Institute 	2007-2008	
	<ul style="list-style-type: none"> Harmonising laboratory check-ups and general and specialised medical and biochemical laboratories with those in the EU 	2008-2009	
Improvement of the organisation and operation of secondary and tertiary health care	<ul style="list-style-type: none"> Establishing a register of hospital health care institutions 	2008-2009	
	<ul style="list-style-type: none"> Accreditation of health care institutions according to their activities 	2008-2010 continuous	
	<ul style="list-style-type: none"> Categorisation of health care institutions based on the accreditation 	2008-2010 continuous	
	<ul style="list-style-type: none"> Plan to expand hospital capacities according to needs after the categorization 	2008-2010 continuous	
	<ul style="list-style-type: none"> Hospital system informatization 	2008-2010	
	<ul style="list-style-type: none"> Efforts to maintain high quality standards at hospital institutions accredited as clinics or clinical hospitals 	continuous	
	<ul style="list-style-type: none"> Managing consumption of medicines and introducing the concept of "pharmaceutical care" 	continuous	
	<ul style="list-style-type: none"> Setting up a new system of out-of-hospital emergency medical aid 	2008-2009	
	<ul style="list-style-type: none"> Establishing an integrated system of pre-hospital, hospital and inter-hospital emergency medical care based on the concept of integrated medical care 	2008-2009	

POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Reform of health care system financing		
Stabilisation of the health care and health insurance systems	<ul style="list-style-type: none"> Reducing the share of public spending on health care Regulating supplementary and additional health insurance Defining a negative list of the compulsory health insurance package (procedures which are not covered by compulsory health insurance) Improving the existing system of direct beneficiary payments Reducing the share of income of primary health care doctors generated by head tax in favour of payment mechanism of price per service and payment per case Categorisation of hospital accreditations with a possible effect on cost reduction Preparing algorithms of diagnostic and therapeutic procedures and standardising medical procedures Introducing hospital payments through the DTS system Rationalising procurement and the use of diagnostic equipment in line with the accreditation and categorisation of hospitals and defined clinical guidelines Introducing smart cards to monitor financial and physical indicators on patients and doctors Rationalising medicine consumption through basic and supplementary medicine lists 	<p>2008-2010</p> <p>2008-2009</p> <p>2008-2010</p> <p>2008-2009</p> <p>2008-2009</p> <p>2008-2010 continuous</p> <p>2008-2009</p> <p>2008-2009</p> <p>2008-2010 continuous</p> <p>2008-2009</p> <p>2008-2009</p>
Public health system reform		
Reorganisation of the public health system	<ul style="list-style-type: none"> Creation of a new public health strategy Creation of a National Public Health Programme and specific institutions' programmes Harmonisation of relevant legislation and secondary legislation with the regulations and practices of the EU Establishment the Public Health Fund Establishing a system of education and accreditation for the institutions and firms which are to implement public health programmes Establishment of a public health research fund Health care prevention (promotional activities aimed at preventive health protection comprised within the so-called "lifestyle" category (e.g. prevention of addiction to alcohol, nicotine, narcotics, fight against obesity)) 	<p>2008.</p> <p>2008-2009</p> <p>2007- 2008</p> <p>2009 -2010</p> <p>2008-2009</p> <p>2009 -2010</p> <p>continuous</p>
5.6.3 Judicial reform		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Modernisation and increase in efficiency of Croatian courts		
Increase the efficiency of the courts - reduce case backlogs	<ul style="list-style-type: none"> Redistribution of cases, from overburdened to less burdened courts. Implementation of the project of monitoring the resolution of «old» and unsolved cases (both civil and criminal). Supervision over the work of judiciary network (by Judiciary Inspectorate of the Ministry of Justice) 	<p>2008-2009 continuous</p> <p>2008-2009</p> <p>continuous</p>
Alternative resolution of court disputes	<ul style="list-style-type: none"> The project of strengthening the Conciliation procedures as an alternative way of resolving disputes 	2007-2009
Rationalisation of the court network	<ul style="list-style-type: none"> Merger of 5 municipal and 5 minor offence courts 	2008
Reform of administrative court proceedings	<ul style="list-style-type: none"> The project Support to more modern and functional operation of the Administrative court of the Republic of Croatia 	2007-2008
Development of the Integral Court Cases Management System (ICMS)	<ul style="list-style-type: none"> The project Support to court management and improvement of the court cases management – ICMS 	2008-2010
Land registry reform		
The project of putting land registry in order	<ul style="list-style-type: none"> Creation of the joint land registry and cadastral data information system Introduction of the legal assistance system for citizens in registering their ownership rights and other real rights at municipal courts in the Republic of Croatia. Adoption of the Act on Amendments to the Land Registry Act 	<p>2007-2009</p> <p>2008-2009</p> <p>2008</p>
Increase the efficiency of creditor protection and claim collection		
Increasing the efficiency of the execution procedure	<ul style="list-style-type: none"> Implementation of the Action plan in connection with the reduction of the number of execution cases at courts Professional education of public commissioners 	<p>2007-2008</p> <p>continuous</p>
Creditor protection and claim collection in execution proceedings	<ul style="list-style-type: none"> Introduction of the new court registries management system pursuant to the provisions of the amended Court Registry Act 	2008
Reform of criminal legislation		
Modernisation of the criminal procedure	<ul style="list-style-type: none"> Adoption of the new Criminal Procedure Act 	2008
Prevention of corruption and organised crime	<ul style="list-style-type: none"> Implementation of the National programme for prevention of corruption 2006 - 2008 Systematic monitoring of the implementation of the National programme for prevention of corruption and action plans 	<p>2007-2008</p> <p>continuous</p>

5.6.4 Environmental protection		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Integration of environment protection goals into planning and implementation of other sector policies, aiming at promoting sustainable development.	<ul style="list-style-type: none"> Adoption of subordinate Legislation pursuant to the Environment Protection Act relating to the assessment of the impact on the environment and strategic assessment of the impact on the environment. 	2008
	<ul style="list-style-type: none"> Creation of guidelines and training for the implementation of the PUO, assessment of influence on the environment, and SPUO, strategic assessment of influence on the environment, procedures 	2008
	<ul style="list-style-type: none"> Creation of the Sustainable Development Strategy 	2008
	<ul style="list-style-type: none"> Establishment and management of the Environment Protection Information System (ISZO) 	2008- continuous
Further development 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"> Air quality assessment at designated areas and in populated areas and the review of air quality categories. 	2008-continuous
	<ul style="list-style-type: none"> Construction of the remaining 12 centres for continuous monitoring of air quality. 	2008-2009
	<ul style="list-style-type: none"> Establishment of the Air Quality Information System 	2008-2009
	<ul style="list-style-type: none"> National programme of reduction of emissions of polluting substances in the air from existing stationary sources 	2008
	<ul style="list-style-type: none"> Creation of the National implementing plan for the implementation of the Stockholm Convention on organic pollutants. 	2008
	<ul style="list-style-type: none"> Establishment of the Greenhouse Gas Register 	2008
	<ul style="list-style-type: none"> Implementation of the Greenhouse gas allocation plan 	2008
	<ul style="list-style-type: none"> Establishment of the Greenhouse gas trading system 	2008-2010
	<ul style="list-style-type: none"> Establishment of the implementation system of flexible mechanisms from the Kvoto protocol. 	2009
Establishment of the comprehensive waste management system	<ul style="list-style-type: none"> Construction of county/regional waste management centres. 	2008-continuous
	<ul style="list-style-type: none"> Restructuring of the waste dumping sites by changing their purpose, continued use or by closing them. 	2008-continuous
	<ul style="list-style-type: none"> Further development of the system for the management of special waste categories. 	2008-continuous
	<ul style="list-style-type: none"> Implementation of restructuring programmes for former industrial locations polluted by dangerous substances and wild dumping sights of hazardous waste 	2008-continuous
	<ul style="list-style-type: none"> Development of the dangerous waste management system including the identification and management of the so-called "black holes" in the Republic of Croatia - Phare 2006 	2008-2009
	<ul style="list-style-type: none"> Further development of the Waste Management Information System by the Environment Protection Agency (as part of Environment Protection Information System) 	2008.-2009.
	<ul style="list-style-type: none"> Preparation of strategic documents and projects for financing from EU funds. 	2008-continuous
Strengthening and establishment the system of integrated water management with more intensive investments in the water management infrastructure	<ul style="list-style-type: none"> Strengthening/reform of the existing system of financing water management and ensuring more funds per year (amendments to/adoption of new subordinate legislation arising from the Act on Water Management Financing). 	continuous
	<ul style="list-style-type: none"> Strengthening of water management planning - adoption of the Water Management Strategy and continuation of work on the second phase of development of water management plans in certain areas. 	continuous
	<ul style="list-style-type: none"> More intensive implementation of water protection measures, especially with respect to the preparation and implementation of infrastructural water protection projects; recovery and completion of the existing and building of new water 	continuous
	<ul style="list-style-type: none"> Reduction of losses in the existing water supply systems and more connections to the public water supply systems (regional water supply systems), recovery and completion of the existing and building of new water supply systems. 	continuous
	<ul style="list-style-type: none"> Establishment of zones of sanitary protection of drinking water at source. 	continuous
	<ul style="list-style-type: none"> Improvement of existing and development of new irrigation systems. 	continuous
Sea and marine environment protection	<ul style="list-style-type: none"> Greater investments in the system of protection from damage caused by water. 	continuous
	<ul style="list-style-type: none"> Creation of the annual National Adriatic Sea Monitoring Report 	2008-continuous
	<ul style="list-style-type: none"> Creation of annual reports, leaflets and maps of sea water quality on beaches 	2008-continuous
	<ul style="list-style-type: none"> Creation and development of IT system for the monitoring of the Adriatic Sea. 	2008-continuous
Further development of the nature protection system	<ul style="list-style-type: none"> Strengthening of supervision of the sea quality in the costal area (Project of protection from pollution in the costal area). 	2008-2009
	<ul style="list-style-type: none"> Administrative strengthening of nature protection institutions at state and local level, including an inspection office. 	continuous
	<ul style="list-style-type: none"> Development of public institution GIS, national parks GIS, nature park GIS and public institutions for the management of protected areas at regional and local level 	2008
	<ul style="list-style-type: none"> Development of a system of protected areas, review and digitalisation of the borders of protected areas and development of the monitoring system 	continuous
	<ul style="list-style-type: none"> Revision and the adoption of the revized National Strategy for the Protection of Biological and Landscape Diversity. 	2008
	<ul style="list-style-type: none"> Development and implementation of regulations based on the Nature Protection Act 	2008-2009
	<ul style="list-style-type: none"> Revision of sector legislation and development of mechanisms to incorporate nature protection guidelines through co-operation between various sectors. 	continuous

Protection of natural values	<ul style="list-style-type: none"> • Establishment of the National Eco-Network (providing funds for protection in the area of the eco-network). • Protection of new areas, follow-up on the existing ones. • Establishment of the „NATURA 2000“ network. • Implementation of wolf and lynx management plans (revision after 2007) • Activities relating to the implementation of the CITES <p>International co-operation (implementation of international projects):</p> <ul style="list-style-type: none"> • NATURA 2000 – PHARE • INTERREG IIA "Cross-border co-operation in the management, protection and research of the Dinara population of lynx". 	<p>2007-continuous</p> <p>continuous</p> <p>2008-2009</p> <p>continuous</p> <p>continuous</p> <p>2007-2009</p> <p>2007-2008</p>
Establishment of industrial pollution control system	<ul style="list-style-type: none"> • Adopt implementing regulations of the Environmental Protection Act for the application of provisions on the eco-licence (IPPC Directive). • Education of government bodies and economic entities as regards the implementation of the IPPC Directive • Promotional activities as regards the introduction of EMAS to companies and organisations in the Republic of Croatia. • Establishment of the system and education of government bodies and economic entities as regards the prevention of major accidents involving hazardous substances. • Adoption of implementing regulations of the Environment Protection Act for the implementation of the provisions of Seveso II Directive. • Further development of the register of dangerous and potentially hazardous installations into the Register of installations with hazardous substances 	<p>2008</p> <p>2008-2010</p> <p>2008-2010</p> <p>2008-continuous</p> <p>2008</p> <p>2008- 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 	<p>2008-continuous</p>
Further development of the comprehensive forestry system	<ul style="list-style-type: none"> • Development and implementation of the project "National Inventory of Forestry Resources of the Republic of Croatia • Establishment of the Forestry Advisory Service • Adoption of subordinate legislation • Creation of the Croatian FSC standard for forest management. 	<p>2008</p> <p>continuous</p>
Establishment of a system of continuous forest supervision	<ul style="list-style-type: none"> • Adoption of a programme of measures for data collection and establishment of a register on the level of damage to forests. • Establishment and running of a comprehensive information system and register on forest fires. 	<p>continuous</p> <p>continuous</p>

Annex I Matrix of policy commitments

	2007	2008	2009	2010
OVERALL ASSESSMENT OF FISCAL IMPACTS OF MAJOR IMPLEMENTING MEASURES				
A. Implementation				
B. Net direct impact on the budget	-780,611,014	-3,265,944,435	-703,685,748	-397,377,340
B1. Direct impact on revenues	268,607,871	112,840,674	16,657,730	699,722
B2. Direct impact on expenditures	1,049,218,884	3,378,785,109	720,343,478	398,077,062
I. ENTERPRISE SECTOR				
Total (1+2+3)				
A. Implementation				
B. Net direct impact on the budget	-74,314,949	-553,975,504	-424,692,815	93,557,413
B1. Direct impact on revenues			20,734,977	0
B2. Direct impact on expenditures	74,314,949	553,975,504	445,427,792	-93,557,413
1. Railway restructuring				
Total				
A. Implementation				
B. Net direct impact on the budget	-118,488,119	-353,005,388	-249,743,115	66,088,529
B1. Direct impact on revenues				
B2. Direct impact on expenditures	118,488,119	353,005,388	249,743,115	-66,088,529
Subsidies				
A. Implementation				
B. Net direct impact on the budget	-97,527,000	291,300,000	26,300,000	37,400,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	97,527,000	-291,300,000	-26,300,000	-37,400,000
Modernisation and restructuring of the Croatian Railways				
A. Implementation				
B. Net direct impact on the budget	-20,961,119	-644,305,388	-276,043,115	28,688,529
B1. Direct impact on revenues				
B2. Direct impact on expenditures	20,961,119	644,305,388	276,043,115	-28,688,529
2. Restructuring of shipbuilding industry (subsidiaries)				
A. Implementation				
B. Net direct impact on the budget	44,173,170	-64,621,093	-23,955,590	27,468,884
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-44,173,170	64,621,093	23,955,590	-27,468,884
3. Small and medium size enterprises				
Total				
A. Implementation				
B. Net direct impact on the budget		-111,849,828	-150,994,110	
B1. Direct impact on revenues		24,499,195	20,734,977	
B2. Direct impact on expenditures		136,349,023	171,729,087	
Entrepreneurial education				
A. Implementation			x	
B. Net direct impact on the budget		-19,782,250	-24,816,065	
B1. Direct impact on revenues				
B2. Direct impact on expenditures		19,782,250	24,816,065	
Competitiveness				
A. Implementation			x	
B. Net direct impact on the budget		-35,803,773	-48,691,857	
B1. Direct impact on revenues		9,856,000	15,579,570	
B2. Direct impact on expenditures		45,659,773	64,271,427	
Entrepreneurship financing				
A. Implementation				
B. Net direct impact on the budget		-62,420,000	-68,427,350	
B1. Direct impact on revenues				
B2. Direct impact on expenditures		62,420,000	68,427,350	
Entrepreneurial infrastructure				
A. Implementation				
B. Net direct impact on the budget		6,156,195	-9,058,838	
B1. Direct impact on revenues		14,643,195	5,155,407	
B2. Direct impact on expenditures		8,487,000	14,214,245	
II. LABOUR MARKET				
Total (1+2+3+4+5)				
A. Implementation				
B. Net direct impact on the budget	-255,312,500	-1,197,052,713	-319,303,162	-261,878,562
B1. Direct impact on revenues	1,687,500	0	0	0
B2. Direct impact on expenditures	257,000,000	1,197,052,713	319,303,162	261,878,562
1. Annual plan for stimulating employment				
A. Implementation	x			
B. Net direct impact on the budget	-128,312,500	-50,000,000	-50,000,000	-50,000,000
B1. Direct impact on revenues*	1,687,500			
B2. Direct impact on expenditures	130,000,000	50,000,000	50,000,000	50,000,000

* Approved PHARE project 2005

Note: Since 2006, new measures have encompassed all available funds of all policy implementing entities which were in previous years registered and monitored as individual budgetary items, in a decentralised manner.

2. Implementation of new social welfare regulations					
A. Implementation		x			
B. Net direct impact on the budget			-141,961,394	-88,937,683	-33,491,155
B1. Direct impact on revenues					
B2. Direct impact on expenditures			141,961,394	88,937,683	33,491,155
3. Employment as part of implementation of new social welfare regulations					
A. Implementation		x			
B. Net direct impact on the budget			-6,091,319	-365,479	-387,407
B1. Direct impact on revenues					
B2. Direct impact on expenditures			6,091,319	365,479	387,407
4. Entitlement to maternity benefit at the level of full salary in the first six months of maternity leave					
A. Implementation		x			
B. Net direct impact on the budget			-110,000,000		
B1. Direct impact on revenues					
B2. Direct impact on expenditures			110,000,000		
5. Equalisation of pension levels of "new" and "old" pensioners (application of law)					
A. Implementation		x			
B. Net direct impact on the budget		-127,000,000	-889,000,000	-180,000,000	-178,000,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures		127,000,000	889,000,000	180,000,000	178,000,000
III. AGRICULTURAL SECTOR					
Total (1+2+3+4)					
A. Implementation					
B. Net direct impact on the budget		-465,628,654	-300,792,332	-84,442,475	-40,508,911
B1. Direct impact on revenues		69,503,636	16,672,050	-7,530,263	-11,210,978
B2. Direct impact on expenditures		535,132,289	317,464,382	76,912,213	29,297,933
1. State aid in agriculture					
A. Implementation					
B. Net direct impact on the budget		-394,700,549	-230,611,232	-100,000,000	-100,000,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures		394,700,549	230,611,232	100,000,000	100,000,000
2. SAPARD implementation					
A. Implementation			x		
B. Net direct impact on the budget		-17,400,000			
B1. Direct impact on revenues		65,000,000			
B2. Direct impact on expenditures		82,400,000			
3. Implementation of the World Bank project for the adjustment of agricultural legislation with acquis communautaire					
A. Implementation					
B. Net direct impact on the budget		-30,428,105	-43,481,100	11,557,525	41,991,089
B1. Direct impact on revenues		4,503,636	16,672,050	-7,530,263	-11,210,978
B2. Direct impact on expenditures		34,931,740	60,153,150	-19,087,788	-53,202,067
4. Research, development and modernisation of technology in the wood processing industry					
A. Implementation					
B. Net direct impact on the budget		-23,100,000	-26,700,000	4,000,000	17,500,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures		23,100,000	26,700,000	-4,000,000	-17,500,000
IV. ADMINISTRATIVE REFORM					
Total (1+2+3+4)					
A. Implementation					
B. Net direct impact on the budget		-2,236,343	-3,263,627	-1,650,000	-2,850,000
B1. Direct impact on revenues		17,659,119	2,502,441		
B2. Direct impact on expenditures		19,895,462	5,766,068	1,650,000	2,850,000
Carrying out functional analysis in state administration bodies (including adoption of the rationalisation programme in the state administration bodies). Grant of Swedish International Development Agency, SIDA					
A. Implementation			x		
B. Net direct impact on the budget		0	0		
B1. Direct impact on revenues		6,774,413	954,457		
B2. Direct impact on expenditures		6,774,413	954,457		
2. Strengthening employee capacities at the Centre for Education and Training of Civil Servants and carrying out analysis of training requirements in civil service. Danish pre-accession aid.					
A. Implementation					
B. Net direct impact on the budget		0	0		
B1. Direct impact on revenues		5,698,269	175,000		
B2. Direct impact on expenditures		5,698,269	175,000		
3. CARDS 2003 - Support to the Decentralisation of Croatia's State Administration					
A. Implementation			x		
B. Net direct impact on the budget		0	0		
B1. Direct impact on revenues		5,186,437	1,372,984		
B2. Direct impact on expenditures		5,186,437	1,372,984		
4. Development and implementation of general training programmes for civil servants					
A. Implementation		x			
B. Net direct impact on the budget		-2,236,343	-3,263,627	-1,650,000	-2,850,000
B1. Direct impact on revenues					
B2. Direct impact on expenditures		2,236,343	3,263,627	1,650,000	2,850,000

V. KNOWLEDGE-BASED SOCIETY				
Total (1+2+3+4+5+6+7+8+9+10+11+12+13+14)				
A. Implementation				
B. Net direct impact on the budget	-19,177,080	-989,569,901	93,875,089	-17,171,954
B1. Direct impact on revenues	14,485,916	64,835,884	24,323,800	15,240,700
B2. Direct impact on expenditures	33,662,996	1,054,405,785	-69,551,289	32,412,654
1. Development of pre-school education				
A. Implementation				
B. Net direct impact on the budget	-3,400,000	-9,360,000	5,520,000	-400,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	3,400,000	9,360,000	-5,520,000	400,000
Note: Partial funding has been secured from the World Bank loan (50%), and the remaining amount will be covered by the state budget.				
2. Curricular changes				
A. Implementation	x			
B. Net direct impact on the budget	-1,500,000	-1,500,000	1,000,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	1,500,000	1,500,000	-1,000,000	
3. Self-evaluation of primary schools				
A. Implementation		x		
B. Net direct impact on the budget		-200,000	-400,000	-400,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		200,000	400,000	400,000
4. National exams for 4th and 8th grade pupils of primary schools				
A. Implementation		x		
B. Net direct impact on the budget		-23,000,000	-2,000,000	-3,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		23,000,000	2,000,000	3,000,000
5. Implementation of pedagogical standard - primary schools				
A. Implementation		x		
B. Net direct impact on the budget	-800,000	-604,200,000	58,000,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	800,000	604,200,000	-58,000,000	
Note: Partial funding has been secured from the World Bank loan (50%), and the remaining amount will be covered by the state budget.				
6. Continued redefinition of vocational areas and occupations, and development of the Croatian qualification framework				
A. Implementation				
B. Net direct impact on the budget	-2,000,000	-4,992,000	-89,920	-290,622
B1. Direct impact on revenues				
B2. Direct impact on expenditures	2,000,000	4,992,000	89,920	290,622
7. Implementation of pedagogical standard - secondary schools				
A. Implementation		x		
B. Net direct impact on the budget		-294,400,940	46,374,000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures		294,400,940	-46,374,000	
Note: Partial funding has been secured from the World Bank loan (50%), and the remaining amount will be covered by the state budget.				
8. Curricular changes in secondary schools				
A. Implementation		x		
B. Net direct impact on the budget	-648,437	-978,154	-113,861	-121,832
B1. Direct impact on revenues				
B2. Direct impact on expenditures	648,437	978,154	113,861	121,832
9. State secondary school-leaving exam and self-evaluation of secondary schools				
A. Implementation		x		
B. Net direct impact on the budget		-30,350,000	-3,050,000	-3,100,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		30,350,000	3,050,000	3,100,000
10. Continued implementation of the Bologna process				
A. Implementation				
B. Net direct impact on the budget	-6,000,000	-168,000	-61,680	-199,350
B1. Direct impact on revenues				
B2. Direct impact on expenditures	6,000,000	168,000	61,680	199,350
11. Seventh Framework Programme				
A. Implementation	x			
B. Net direct impact on the budget	-4,828,643	-8,530,357	-4,223,000	-5,661,000
B1. Direct impact on revenues	14,485,916	-1,126,916	4,223,000	5,661,000
B2. Direct impact on expenditures	19,314,559	7,403,441	8,446,000	11,322,000
Note: In 2007, a total of 75% of the funding is secured from the PHARE programme; it is estimated that 50% of funding for the period 2008-2010 will come from the IPA programme.				
12. Fund for investment in science and innovations				
A. Implementation			x	
B. Net direct impact on the budget			-2,036,700	-1,708,200
B1. Direct impact on revenues			6,168,500	5,146,500
B2. Direct impact on expenditures			8,205,200	6,854,700
Note: It is planned that approx. 75% of the funding will be obtained from the IPA programme.				
13. Incubation Centre for Biosciences				
A. Implementation			x	
B. Net direct impact on the budget			-3,131,700	-8,497,200
B1. Direct impact on revenues			9,395,100	25,433,200
B2. Direct impact on expenditures			12,526,800	33,930,400
Note: It is planned that approx. 75% of the funding will be obtained from the IPA programme.				
14. Technological development project				
A. Implementation		x		
B. Net direct impact on the budget		-11,890,450	-1,912,050	6,206,250
B1. Direct impact on revenues		65,962,800	4,537,200	-21,000,000
B2. Direct impact on expenditures		77,853,250	6,449,250	-27,206,250
Note: It is planned that approx. 85% of the funding will be obtained from the IPA programme.				

VI. HEALTH CARE REFORM				
Total (1+2+3+4)				
A. Implementation				
B. Net direct impact on the budget	143,480,620	-6,808,413	-589,978	-91,470
B1. Direct impact on revenues	150,000,000			
B2. Direct impact on expenditures	6,519,380	6,808,413	589,978	91,470
1. Expanding the telemedicine system to primary health care and introducing telemedicine standards				
A. Implementation	x			
B. Net direct impact on the budget	-3,259,380	-5,170,652	-582,112	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	3,259,380	5,170,652	582,112	1,674,806
2. Establishing community health centres on islands and in areas of special state concern				
A. Implementation	x			
B. Net direct impact on the budget	-3,260,000			
B1. Direct impact on revenues				
B2. Direct impact on expenditures	3,260,000			
3. Establishing the Croatian Mental Health Institute				
A. Implementation	x			
B. Net direct impact on the budget		-1,637,761	-7,866	-91,470
B1. Direct impact on revenues				
B2. Direct impact on expenditures	260,000	1,637,761	7,866	91,470
4. Rationalising medicine consumption through basic and supplementary medicine lists				
A. Implementation	x			
B. Net direct impact on the budget	150,000,000			
B1. Direct impact on revenues	150,000,000			
B2. Direct impact on expenditures				
VII. JUDICIAL REFORM				
Total (1+2+3+4+5+6+7)				
A. Implementation				
B. Net direct impact on the budget	-10,317,124	-1,462,040	-106,448	0
B1. Direct impact on revenues	-12,969,940	5,025,119	21,858,882	0
B2. Direct impact on expenditures	-2,652,816	6,487,159	21,965,330	0
1. Implementation of land registry reform (2004-2008)				
A. Implementation				
B. Net direct impact on the budget	-5,352,000	1,000,000	445,480	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	5,352,000	-1,000,000	-445,480	
Note: The funds shown under B2 have been secured from the World Bank loan and partially from the State Budget. The Ministry of Justice anticipates that the Land Registry Reform will be continued in the course of 2009 and 2010 with a support of a new World Bank loan, as well as the State Budget funds.				
2. Implementation of land registry reform (2004-2008)				
A. Implementation				
B. Net direct impact on the budget	0	0	0	
B1. Direct impact on revenues	-430,000	1,430,000	60,800	
B2. Direct impact on expenditures	-430,000	1,430,000	60,800	
Note: The funds shown under B2 relate to the EU CARDS 2003 and 2004 Donation.				
3. Implementing alignment of Croatian legislation with EU legislation				
A. Implementation				
B. Net direct impact on the budget	0	0	0	
B1. Direct impact on revenues	-11,082,660	3,858,111	14,850,415	
B2. Direct impact on expenditures	-11,082,660	3,858,111	14,850,415	
Note: The funds shown in respect of implementation of the process of alignment of Croatian legislation with EU legislation have been provided by the CARDS 2003 programme "Support to the Reform of the Croatian Court System"; CARDS 2004 "Support to More Efficient, Effective and Modern Operation and Functioning of the Administrative Court of the Republic of Croatia" and CARDS 2004 "Improving Court and Case Management at the High Misdemeanour Court and Selected Misdemeanour Courts"				
4. Alternative resolution of court disputes - "In-Court Conciliation" project				
A. Implementation				
B. Net direct impact on the budget	11,176	93,760	0	
B1. Direct impact on revenues	-1,457,280	-262,992	6,947,667	
B2. Direct impact on expenditures	-1,468,456	-356,752	6,947,667	
Note: The funds shown under B1 relate to the aid under the PHARE 2005 project.				
5. Alternative resolution of court disputes "In-Court Conciliation" project				
A. Implementation				
B. Net direct impact on the budget	-150,000	375,000	0	0
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	150,000	-375,000	0	0
6. Implementing the penal legislation reform				
A. Implementation				
B. Net direct impact on the budget	-30,000	0	0	0
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	30,000	0	0	0
7. Implementing anti-corruption and organised crime prevention process				
A. Implementation				
B. Net direct impact on the budget	-4,796,300	-2,930,800	-551,928	0
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	4,796,300	2,930,800	551,928	0
Note: The funds for 2008 include budgetary funds allocated to the Office for Fighting Corruption and Organised Crime and the Ministry of Justice's Department for Strategic Development.				

VIII. ENVIRONMENTAL PROTECTION				
TOTAL (1+2+3+4+5+6+7+8)				
A. Implementation				
B. Net direct impact on the budget	-107,422,108	-214,481,945	33,117,593	-168,433,856
B1. Direct impact on revenues	15,271,700	28,830,299	-20,870,785	-3,330,000
B2. Direct impact on expenditures	122,693,808	243,312,244	-53,988,378	165,103,856
1. Integrating environment protection goals in planning and implementation of other sector policies aiming at promoting sustainable development (Ministry of Environmental Protection, Physical Planning and Construction, Croatian Environment Agency)				
A. Implementation				
B. Net direct impact on the budget	-2,705,000	-1,955,000	-366,600	-411,900
B1. Direct impact on revenues	895,355	-795,455		
B2. Direct impact on expenditures	3,600,355	1,159,545	366,600	411,900
Note: Within the framework of this measure, setting-up of the information system EPIS is partly financed by the following donations: CARDS 2004: "Support for the Further Approximation of Croatian Legislation with the Environmental Acquis"; the project within the framework of the LIFE programme: "Development of the Croatian Soil Monitoring Programme with a Pilot Project" and by the Flemish Government aid project: "CROW - Preparation of Reporting Water-Related Tables and Their Correlation as a Basis for Implementation into EPIS".				
2. Improving integrated air quality management network and creating conditions for systematic handling of problems related to climatic changes				
A. Implementation				
B. Net direct impact on the budget	-2,665,000	-5,290,000	4,330,000	4,410,000
B1. Direct impact on revenues	6,648,750	1,600,000	-830,000	0
B2. Direct impact on expenditures	9,313,750	6,890,000	-5,160,000	-4,410,000
Note: Within the framework of this measure, establishment of the national air quality monitoring network is partly financed by the EU Pre-Accession Aid: Phare 2006 "Establishment of Air Quality Monitoring Network", which is disclosed in the state budget under the years 2007, 2008 and 2009. As EU Aid funds are not sufficient to cover increased expenditure, the remaining amount will be financed by the state budget funds. Also, capacity building for implementation of Kyoto Protocol will be partly financed by the EU programme LIFE III -Third countries, the project: "Capacity building for implementation of Kyoto Protocol". Support to the activities concerning development of the system of trading in greenhouse gas emissions, including the Greenhouse Gas Register, will be provided by one of the components of the CARDS 2004 project "Support for the Further Approximation of Croatian Legislation with the Environmental Acquis", which is disclosed in the state budget for the period 2007 through 2010.				
3. Establishing integrated waste management system (MEPPPC)				
A. Implementation				
B. Net direct impact on the budget	-1,873,000	-2,555,796	1,379,634	-150,000
B1. Direct impact on revenues	-1,072,405	16,131,878	-8,900,993	-3,330,000
B2. Direct impact on expenditures	800,595	18,687,674	-10,280,627	-3,180,000
Note: Some of the activities for remediation of "hot spots" will be co-financed by the IPA component III on the basis of the Operational Environment Protection Programme. Development of the hazardous waste management system is partly co-financed by the EU pre-accession aid Phare 2006 "Development of hazardous waste management system, including the identification and management of "hot spots" in Croatia". Development of the Waste Management Plan was partly financed (until the end of 2007) by the EU programme LIFE III -Third countries. As from 2008, the support to the implementation of the Plan will be partly financed by the EU pre-accession aid. In 2008, preparation of the project for setting-up of waste management centres (based on the Plan) will be co-financed by the EU pre-accession aid through ISPA measure "Preparation of a list of projects for IPA in the environment protection sector". As from 2008, preparation of the projects for setting-up of the centres will be co-financed by the EU pre-accession aid within the framework of IPA component III on the basis of the Operational Environment Protection Programme.				
4. Water management (Ministry of Agriculture, Forestry and Water Management)				
A. Implementation				
B. Net direct impact on the budget	-69,137,590	-167,729,500	200,000	-193,850,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	69,137,590	167,729,500	-200,000	193,850,000
5. Sea and marine environment protection (MEPPPC)				
A. Implementation				
B. Net direct impact on the budget	-11,190,000	-13,445,000	23,825,000	6,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	11,190,000	13,445,000	-23,825,000	-6,000,000
Note: 50% of the funds shown under B2 have been secured from the IBRD loan, and the remaining portion will be covered by the State Budget.				
6. Nature protection (Ministry of Culture)				
A. Implementation				
B. Net direct impact on the budget	2,710,665	-7,302,065	-3,672,800	14,250,212
B1. Direct impact on revenues	6,262,500	11,893,876	-11,139,792	
B2. Direct impact on expenditures	3,551,835	19,195,941	-7,466,992	-14,250,212
Note: Disclosed funds include donations under the EU project Phare 2005 "Establishment of NATURA 20000" and the donation project of the World Bank "Karst Ecosystem Conservation (KEC)"				
7. Establishing industrial pollution control system (MEPPPC)				
A. Implementation				
B. Net direct impact on the budget	-600,000	-180,000	-20,000	100,000
B1. Direct impact on revenues	1,837,500	0	0	0
B2. Direct impact on expenditures	2,437,500	180,000	20,000	-100,000
Note: Within the framework of this measure and in relation to training of government bodies and economic operators for application of IPPC directive, support will be provided under one of the components of the project CARDS 2004 "Support for the Further Approximation of Croatian Legislation with the Environmental Acquis", which is disclosed in the state budget for the period 2007 through 2010.				
8. Forestry (Ministry of Agriculture, Forestry and Water Management)				
A. Implementation				
B. Net direct impact on the budget	-21,962,183	-16,024,584	7,442,359	1,217,832
B1. Direct impact on revenues	700,000			
B2. Direct impact on expenditures	22,662,183	16,024,584	-7,442,359	-1,217,832

Annex II Statistical appendix

Table 1a: Macroeconomic prospects

	ESA Code	2006	2006	2007p	2008p	2009p	2010p
		Level ^[1]	Rate of change				
1. Real GDP at market prices	B1*g		4.8	6.0	6.1	6.5	7.0
2. GDP at market prices	B1*g	34,220	8.3	9.2	10.2	10.0	10.4
		Components of real GDP, real growth					
3. Private consumption expenditure	P3	19,154	3.5	6.0	5.4	5.1	5.1
4. Government consumption expenditure	P3	6,888	2.2	4.2	1.8	1.4	1.6
5. Gross fixed capital formation	P51	10,214	10.9	7.5	7.2	7.2	7.2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	1,005	2.9	2.8	2.7	2.6	2.5
7. Exports of goods and services	P6	16,383	6.9	8.0	9.3	10.0	10.5
8. Imports of goods and services	P7	-19,423	7.3	7.5	7.1	6.8	6.6
		Contribution to real GDP growth					
9. Final domestic demand		36,256	5.7	6.7	5.8	5.6	5.5
10. Change in inventories and net acquisition of valuables	P52+P53	1,005	0.2	0.0	0.1	0.1	0.0
11. External balance of goods / services	B11	-3,040	-1.1	-0.8	0.2	0.9	1.4

Source: CBS, MFIN

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

[1] Levels represent current prices categories in EUR million

Table 1b: Price developments

<i>Percentage annual changes</i>	ESA Code	2006	2007p	2008p	2009p	2010p
1. GDP deflator		3.4	3.1	3.9	3.3	3.2
2. Private consumption deflator		2.9	2.5	3.1	2.6	2.5
3. HICP		-	-	-	-	-
4. National CPI change		3.2	2.5	3.1	2.6	2.5
5. Public consumption deflator		4.3	5.6	4.5	5.2	5.1
6. Investment deflator		3.8	2.5	2.7	2.3	2.3
7. Export price deflator (goods & services)		2.9	2.5	3.1	2.6	2.5
8. Import price deflator (goods & services)		3.2	2.5	2.2	2.1	2.1

Source: CBS, MFIN

Note: 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	2006	2006	2007p	2008p	2009p	2010p
		Level	Rate of change				
1. Employment, persons ^[1]		1,586,000	0.8	1.1	1.1	1.2	1.3
2. Employment, hours worked		-	-	-	-	-	-
3. Unemployment rate, level ^[2]		11.1	11.1	10.2	9.2	8.1	6.9
4. Labour productivity, persons ^[3]		-	3.9	4.9	4.9	5.3	5.7
5. Labour productivity, hours worked		-	-	-	-	-	-
6. Compensation of employees, real ^[4]	D1	-	2.9	3.9	4.1	4.5	5.1

Source: CBS, MFIN

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

[1] Labour Force Survey Data

[2] Labour Force Survey Data

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

[4] Real growth of average gross wage

Table 1d: Sectoral balances

<i>Percentages of GDP</i>	ESA code	2006	2007p	2008p	2009p	2010p
1. Net lending/borrowing vis-à-vis the rest of the world ^[1]	B.9	11.2	10.6	10.0	9.4	8.8
of which:						
- Balance of goods and services		-7.7	-7.7	-6.0	-4.2	-2.0
- Balance of primary incomes and transfers		0.0	-0.5	-1.5	-2.8	-4.6
- Capital account		-0.4	0.2	0.2	0.2	0.2
2. Net lending/borrowing of the private sector ^[2]	B.9/ EDP B.9	16.7	12.7	12.8	13.4	13.5
3. Net lending/borrowing of general government		-1.4	0.0	-0.6	-1.2	-0.8
4. Statistical discrepancy ^[3]		-3.1	-	-	-	-

Source: CNB, MFIN

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

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

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

[3] Net errors and omissions from balance of payments

Table 2: General government budgetary prospects

	ESA code	2006	2006	2007p	2008p	2009p	2010p
		mill. HRK	% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	-5,630.2	-2.2	-1.6	-1.5	-0.6	0.2
2. Central government	S1311	-5,630.2	-2.2	-1.5	-1.4	-0.5	0.2
3. State government	S1312						
4. Local government	S1313	-72.3	0.0	-0.1	-0.1	-0.1	0.0
5. Social security funds	S1314	72.3	0.0				
General government (S13)							
6. Total revenue	TR	112,237.3	44.8	46.2	43.7	42.8	41.8
7. Total expenditure	TE	117,867.5	47.0	47.8	45.2	43.4	41.6
8. Net borrowing/lending	EDP.B9	-5,630.2	-2.2	-1.6	-1.5	-0.6	0.2
9. Interest expenditure	EDP.D41	5,495.5	2.2	2.0	2.0	1.9	1.8
p.m. 9a. FISIM							
10. Primary balance		-134.7	-0.1	0.4	0.5	1.3	2.0
Components of revenues							
11. Total taxes (11 = 11a+11b+11c)		66,413.8	26.5	26.6	26.0	25.4	24.8
11a. Taxes on production and imports	D2	49,733.5	19.8	19.7	19.1	18.6	18.1
11b. Current taxes on income and wealth	D5	16,678.3	6.7	7.0	6.9	6.8	6.7
11c. Capital taxes	D91	2.0	0.0	0.0	0.0	0.0	0.0
12. Social contributions	D61	34,406.1	13.7	13.6	13.3	13.1	12.9
13. Property income	D4	1,320.6	0.5	0.7	0.3	0.3	0.3
14. Other (14 = 15-(11+12+13))		10,096.8	4.0	5.3	4.2	4.1	3.9
15 = 6. Total revenue	TR	112,237.3	44.8	46.2	43.7	42.8	41.8
p.m.: Tax burden (D2+D5+D61+D91-D995)		100,819.9	40.2	40.2	39.3	38.5	37.6
Selected components of expenditures							
16. Collective consumption	P32						
17. Total social transfers	D62 + D63	45,413.9	18.1	17.7	17.4	16.6	15.9
17a. Social transfers in kind	P31 = D63	8,186.5	3.3	2.8	3.0	2.8	3.1
17b. Social transfers other than in kind	D62	37,227.4	14.9	14.9	14.4	13.8	12.9
18 = 9. Interest expenditure	EDP.D41	5,495.5	2.2	2.0	2.0	1.9	1.8
19. Subsidies	D3	6,562.0	2.6	2.5	2.2	2.1	2.0
20. Gross fixed capital formation	P51	8,709.0	3.5	4.4	3.3	3.0	2.8
21. Other (21 = 22-(16+17+18+19+20))		51,687.1	20.6	21.1	20.3	19.8	19.2
22. Total expenditures	TE	117,867.5	47.0	47.8	45.2	43.4	41.6
p.m. compensation of employees	D1	28,253.2	11.3	11.4	10.9	10.7	10.4

Source: MFIN

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

Table 3: General government expenditure by function

Percentage of GDP	COFOG Code	2005	2010
1. General public services	1	5.2	
2. Defence	2	1.6	
3. Public order and safety	3	2.7	
4. Economic affairs	4	4.5	
5. Environmental protection	5	0.3	
6. Housing and community amenities	6	2.3	
7. Health	7	5.8	
8. Recreation, culture and religion	8	1.3	
9. Education	9	4.4	
10. Social protection	10	16.3	
11. Total expenditure (item 7 = 26 in Table 2)	TE	44.3	

Source: MFIN

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

Table 4: General government debt developments

% of GDP	ESA code	2006	2007p	2008p	2009p	2010p
1. Gross debt		40.8	39.3	37.3	34.8	31.8
2. Change in gross debt ratio		-3.0	-1.5	-2.0	-2.4	-3.0
Contributions to change in gross debt						
3. Change in nominal GDP		-3.4	-3.5	-3.6	-3.4	-3.3
4. Primary balance		0.1	-0.4	-0.5	-1.3	-2.0
5. Interest expenditure		2.2	2.0	2.0	1.9	1.8
6. Stock-flow adjustment		-1.9	0.3	0.1	0.3	0.5
of which:						
- Differences between cash and accruals		-0.2	0.3			
- Net accumulation of financial assets		-1.0	0.1	0.1	0.3	0.5
of which:						
- Privatisation proceeds		-1.1	-0.7	-0.5	-0.2	0.0
- Valuation effects and other		-0.6				
p.m. implicit interest rate on debt		5.4	5.2	5.3	5.4	5.6
Other relevant variables						
7. Liquid financial assets						
8. Net financial debt (8 = 1 - 7)						

Source: MFIN

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

Table 5: Cyclical developments

Percentages of GDP	ESA Code	2006	2007p	2008p	2009p	2010p
1. Real GDP growth (%)	B1g	4.8	6.0	6.1	6.5	7.0
2. Net lending of general government	EDP.B.9	-2.9	-2.6	-2.3	-1.4	-0.5
3. Interest expenditure (incl. FISIM recorded as consumption)	EDP.D.41 + FISIM	-0.8	-0.5	-0.3	0.6	1.3
4. Potential GDP growth (%) [1]		5.2	5.7	6.0	6.0	5.5
Contributions:						
- labour						
- capital						
- total factor productivity						
5. Output gap		-0.5	-0.2	-0.2	-0.2	1.0
6. Cyclical budgetary component		-0.2	-0.1	0.0	0.0	0.3
7. Cyclically-adjusted balance (2-6)		-0.3	-0.1	-0.1	-0.2	0.7
8. Cyclically-adjusted primary balance (7-3)		-0.6	-0.5	-0.2	0.6	1.0

Source: MFIN

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

Table 6: Divergence from previous programme

	2006	2007p	2008p	2009p	2010p
1. GDP growth (% points)					
Previous programme	4.6	4.6	4.8	5.0	-
Latest programme	4.8	6.0	6.1	6.5	7.0
Difference	0.2	1.4	1.3	1.5	-
2. General government net lending (% of GDP)					
Previous programme	-2.2	-1.8	-1.7	-1.5	-
Latest programme	-2.2	-1.6	-1.5	-0.6	0.2
Difference	0.0	0.2	0.2	0.9	-
3. General government gross debt (% of GDP)					
Previous programme	47.7	46.1	44.8	43.4	-
Latest programme	46.4	44.9	42.7	40.1	37.0
Difference	-1.3	-1.2	-2.1	-3.3	-

Source: MFIN

Note: 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

% of GDP	2000	2005	2010p	2020p	2030p	2040p	2050p
Total expenditure ^[1]	-	48.4	41.6	40.6	40.7	41.3	43.5
of which:							
- Age-related expenditures ^[2]	-	16.2	14.3	13.6	14.4	15.4	17.2
- Pension expenditure ^[3]	-	9.9	8.9	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	-	6.2	5.4	6.4	7.8	8.9	10.2
- Long-term care (this was earlier included in the health care)	-	-	-	-	-	-	-
Education expenditure	-	-	-	-	-	-	-
Other age-related expenditures	-	-	-	-	-	-	-
Interest expenditure	-	2.2	1.8	0.8	0.0	-0.3	0.1
Total revenues	-	44.5	41.8	41.7	41.7	41.7	41.7
of which: property income	-	-	-	-	-	-	-
of which: from pensions contributions (or social contributions, if appropriate)	-	6.9	6.0	5.9	5.9	5.9	5.9
Pension reserve fund assets	-	-	-	-	-	-	-
of which: consolidated public pension fund assets (assets other than government liabilities)	-	-	-	-	-	-	-
Assumptions							
Labour productivity growth	-1.2	3.6	5.7	4.3	2.4	1.2	1.1
Real GDP growth	2.9	4.3	7.0	3.5	1.4	0.4	0.2
Participation rate males (aged 20-64) ^[4]	67.8	69.6	71.8	71.1	70.7	69.7	69.7
Participation rates females (aged 20-64) ^[4]	55.5	56.8	58.2	58.2	57.8	56.6	56.8
Total participation rates (20-64) ^[4]	61.5	63.1	65.0	64.6	64.3	63.2	63.3
Unemployment rate, %	16.1	12.7	6.9	7.0	7.0	7.0	7.0
Population aged 65+ over total population, %	-	16.6	17.0	19.6	22.6	24.7	27.3

Source: CBS, MFIN

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

[1] Total expenditures plus net acquisition of non financial assets according to GFS 2001

[2] Pension plus health care expenditures

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

[4] Aged (15 - 64)

Table 8: Basic assumptions on the external economic environment underlying the 2007 PEP framework

Variable <i>(annual growth rates in %, if not otherwise stated)</i>	Assumptions for									
	2006		2007p		2008p		2009p		2010p	
	change ^[1]		change ^[1]		change ^[1]		change ^[1]			
Interest rates (in % p.a., annual averages)										
- Short-term interest rate (annual average, Euro area)	2.2	-0.7	2.9	-0.5	3.4	-0.4	3.4	-0.5	3.4	
- Long-term interest rate (annual average, Euro area)	3.3	-0.6	3.9	-0.4	4.3	-0.3	4.3	-0.3	4.3	
Exchange rates (annual average "-": appreciation)										
Exchange rate vis-à-vis €	7.32	-0.02	7.34	-0.01	7.35	0.00	7.35	0.00	7.35	
USD / €	1.24	-0.02	1.35	0.05	1.36	0.06	1.36	0.06	1.37	
Nominal effective exchange rate, %	-1.3	-	-1.7	-	-0.2	-	0.0	-	-0.2	
Real effective exchange rate, % ^[2]		-	-2.2	-	-1.3	-	-0.5	-	-0.6	
GDP (in real terms)										
- World, excluding EU	5.4	0.3	5.2	0.3	4.9	0.1	4.9	0.1	4.9	
- EU 27 ^[3]	1.6	-	2.3	-	2.2	-	2.2	-	2.2	
World trade (in real terms)										
Country export markets	-	-	-	-	-	-	-	-	-	
World imports	8.1	-1.0	9.6	1.8	8.2	1.2	8.2	1.4	8.2	
International prices										
World import prices, (goods, in €)	6.0	3.6	4.1	2.2	2.0	1.5	2.0	1.5	2.0	
Oil Prices (Brent – USD per barrel)	64.3	-4.9	68.5	-7.0	75.0	0.7	75.0	2.7	75.0	

Source: EC, IMF, MFIN

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

[1] Change vis-à-vis assumptions made for last PEP.

[2] Nominal effective exchange rate calculated as a weighted geometric mean of bilateral exchange rates of HRK against: EUR (weight 72.2%), USD (27.8%). For derivation of the real effective exchange rate the CPI is used as deflator

Changes vis-à-vis last PEP are not shown because in the last PEP base indices were used.

[3] Changes vis-à-vis last PEP are not shown because in the last PEP this line concerned Eurozone

Annex III Structural reforms agenda and achievements

Structural reforms agenda and achievements show realisation of the measures that were to be implemented in 2007 in accordance with the previous year's PEP.

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
ENTERPRISE SECTOR			
Privatisation			
Adopting the Act on Privatisation of Consolidated State Portfolio	No	cancelled	In addition to introduction of the arrangements which should accelerate privatisation of the remaining portfolio of companies managed by the Croatian Privatisation Fund, the concerned Act (or amendments to the Privatisation Act) should provide a legal framework for the ESOP programme. As the social partners have not reached consensus, it has been decided that the issue of legal framework for the ESOP programme be resolved by adoption of a special law.
Adopting the National Steel Industry Restructuring Plan, publication of the invitation to tender and privatisation of Valjaonica cijevi Sisak, d.o.o., Željezara Split d.d. and TLM d.d. Šibenik.	Yes	July/August 2007	In July/August, contracts concerning sale of shares of Valjaonica cijevi Sisak and Željezara Split were signed, whereas in respect of TLM, the Government of the Republic of Croatia adopted in April the decision on acceptance of the strategic partner and at present the contract concerning the sale of shares to the chosen consortium is being finalised.
Adopting the National Shipbuilding Industry Restructuring Programme	No	in progress	
Intensive preparations and publication of invitations to tender along with opening of bankruptcy and winding-up proceedings over the companies which have met the requirements for that.	Yes	September 2006 - September 2007	In the given period, 44 invitations to tender for the sale of companies in majority ownership were published. Of a total of 20 privatised companies, 4 companies were privatised through a public tender procedure, whereas 16 companies were privatised in the bankruptcy- or winding-up process.
Sale of minority packages at the Zagreb Stock Exchange and Varaždin Stock Exchange along with the planned schedule of publication of invitations to tender for approx. 40 companies a month	Yes	September 2006 - September 2007	A total of 171 companies in minority ownership were privatised (132 companies through sale on the stock exchange market and 39 companies through bankruptcy- and winding-up proceedings).
Conclusion of a contract between the Croatian railways and the Croatian Privatisation Fund aimed at making preparations for privatisation of subsidiaries, and preparation of subsidiaries through increase in the share capital of subsidiaries or new capital contribution to subsidiaries along with publication of invitation to tender for the sale of such companies.	Yes	September 2006 - September 2007	The process of privatisation of the national railway company (HŽ), which commenced by publication of invitation to tender for 3 subsidiaries (end-March 2007) has been continued, so additional 4 public tender procedure were announced in July (for 2 companies which were not sold in the first round, the public tender procedures were repeated, whereas for 2 subsidiaries, invitations to tender were published for the first time).
In accordance with the obligations assumed under PAL and with the adopted Strategic Development Framework 2006-2013 and future National Shipbuilding Industry Restructuring Programme, privatise one shipyard (Uljanik) and prepare another one for privatisation	No	in progress	For the shipyard Uljanik, determination of the share capital level, as a precondition for commencement of the privatisation process, is in progress.
Preparing the study for management of remaining state-owned property, including definition of a new organisational structure	No	in progress	Because of complexity of the issues that should be resolved before a new organisational structure for management of the state-owned property is established, possible models are still under consideration.
Competition policy and state aid			
Harmonisation of the Croatian legislation with the EU acquis in the field of competition	Yes	from 2007 onwards	The measure is implemented on a continuous basis. The alignment is focused on adoption of a draft new Act on the Protection of Competition Protection (see the next measure).
Preparing a draft proposal for amendments to the Act on the Protection of Competition or for a new Act on the Protection of Competition and other regulations required to empower the Croatian Competition Agency to enact penalties and change subject-matter jurisdiction of the court deciding on the legality of the Agency's decisions	Yes	from 2007 onwards	Preparatory activities have been under way since the beginning of 2007, and German experts for the PHARE project have also been involved since April. The first draft new Act is expected in the first quarter of 2008.
Increasing the number of expert staff of the Agency and training them to ensure an efficient implementation of competition regulations	Yes	from 2007 onwards	In the course of 2007, three new lawyers were recruited, and two graduate economists are to be recruited by the end of 2007 (selection of candidates is being brought to a close).

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Implementation of the PHARE project in the field of state aid	Yes	2007-2008	Implementation of the twinning project with the FR Germany commenced in April 2007.
Continuing professional training of employees in state administration bodies and local and regional self-government units related to state aid operations	Yes	from 2007 onwards	Within the framework of the CARDS project, in the first half of the year, and the PHARE project from April onwards, a number of seminars were held for representatives of the state administration bodies and initial seminars were also held for employees of local and regional self-government bodies.
Railway restructuring			
Railway Transport Safety Act	Yes	April 2007	The Act was adopted in April 2007
Setting up a regulatory body	No	September 2007	The Act was adopted in July 2007; setting-up of the Regulatory authority in progress.
Allocation of infrastructural lines to operators	No	2009	Allocation will be possible in 2009, given the time limits as from adoption of the Report on the network.
Strengthening of the administrative capacities	No	2008	Adoption of a new Regulation
Meeting the requirements for PAL2 loan	in progress	September 2007	Privatisation in progress; repetition of public tender procedure
Adopting the National Programme	Yes	September 2007	Adoption procedure in progress - September 2007.
Restructuring of shipbuilding industry			
Finalize preparation of individual shipyard restructuring programmes and their adoption by the Government of the Republic of Croatia	No	February 2008	It has been planned that individual shipyard restructuring programmes be completed by the end of 2007, when these should be approved by the Croatian Competition Agency, following which they will be submitted to the Government of the Republic of Croatia for verification.
Finalize preparation of the National Shipbuilding Industry Restructuring Programme and its adoption by the Government of the Republic of Croatia	No	June 2008	A draft of the National Shipbuilding Industry Restructuring Programme was finalized end of September 2006. In the meantime, preparation of individual restructuring programmes commenced upon recommendation of EC, and such programmes should serve as a basis for preparation or finalization of the National Shipbuilding Industry Restructuring Programme.
Implementing the restructuring process at shipyards in accordance with individual restructuring programmes	No	from February 2008 onwards	In the course of 2007, shipyards started to implement measures outlined in the proposed individual restructuring programmes. Full implementation of the restructuring process is subject to approval of the Croatian Competition Agency and verification by the Government of the Republic of Croatia.

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Implementing the privatisation process or the process of winding-up of individual shipyards	No	during 2008 onwards	Privatisation of shipyards is planned in accordance with the obligations assumed under PAL and the adopted strategic framework for further development of Croatia's shipbuilding industry. It has been planned to privatise one shipyard and to prepare another one for privatisation. However, the Government of the Republic of Croatia has received enquiries from certain investors who are interested in participation in the privatisation, so early privatisation will be possible if the requirements are satisfied. Early winding-up of shipyards is also possible if a long-term viability of the shipyards cannot be demonstrated by the restructuring programmes.
Restructuring of metallurgy sector and aluminium industry			
Enactment and adoption of the National Steel Industry Restructuring Programme in the Republic of Croatia and the restructuring of steel companies through privatisation	Yes	1 March 2007	
Privatisation of Željezara Split by which a restructuring will be implemented	Yes	end 2007	Privatisation of the steel companies has been completed. The most advantageous buyers have been selected. The period for fulfilment of the obligations assumed by the buyers in the public tender procedure has not expired yet.
Privatisation of Valjaonica cijevi Sisak by which a restructuring will be implemented	Yes	end 2007	Privatisation of the steel companies has been completed. The most advantageous buyers have been selected. The period for fulfilment of the obligations assumed by the buyers in the public tender procedure has not expired yet.
Privatisation of TLM d.d. Šibenik and related restructuring	Yes	end 2007	Privatisation of TLM has been completed. The most advantageous buyer has been selected and the period for fulfilment of the assumed obligations has not expired yet.
Small and Medium Size Enterprises			
Lifelong training of entrepreneurs	Yes	2006/2007	The measure has been implemented continuously since 2004, on the basis of the Programme of Incentives to Small and Medium Size Enterprises by the Government of the Republic of Croatia, through the Annual Operative Plan compliant with the annual budget and the State Aid Act (OG140/05).
Promoting competitiveness of SMEs	Yes	2006/2007	The measure has been implemented continuously since 2004, on the basis of the Programme of Incentives to Small and Medium Size Enterprises by the Government of the Republic of Croatia, through the Annual Operative Plan compliant with the annual budget and the State Aid Act (OG140/05).
Improvement of financing of SMEs	Yes	2006/2007	The measure has been implemented continuously since 2004, on the basis of the Programme of Incentives to Small and Medium Size Enterprises by the Government of the Republic of Croatia, through the Annual Operative Plan compliant with the annual budget and the State Aid Act (OG140/05).
Promoting quality and development of business and entrepreneurial infrastructure	Yes	2006/2007	The measure has been implemented continuously since 2004, on the basis of the Programme of Incentives to Small and Medium Size Enterprises by the Government of the Republic of Croatia, through the Annual Operative Plan compliant with the annual budget and the State Aid Act (OG140/05).
Public-private partnership			
Implementation of the PPP Legislation Alignment Programme	No	2007-2008	Adoption of the Public Procurement Act is expected in the course of September 2007, whereas adoption of other regulations which constitute the legislative framework of public-private partnership is expected in the course of 2008.
Implementation of pilot projects according to the public-private partnership model	Yes	continuously	
Selection of adequate PPP projects, through domestic and international integration and implementation of EU Directives	Yes	continuously	
Offering PPP projects based on concession and PFI model	Yes	continuously	
Implementation of the PPP Projects Programme by sector, control of the total life costs of public structures etc.	Yes	continuously	
Integrating the project phase, the construction phase, maintenance and use of PPP projects of utility infrastructure and public structures	Yes	continuously	
FINANCIAL SECTOR			
Banking sector			
Adoption of the Financial Collateral Act	Yes	July 2007	The adoption was foreseen by the Negotiating position of the Republic of Croatia for Chapter 9, Financial services.

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Subordinate legislation related to operations of credit unions on the basis of the Credit Unions Act (OG 141/06)	Yes	July 2007	
Foreign exchange system regulation			
Amendments to the Foreign Exchange Act require repealing of all provisions of the Act that restrict free movement of capital	Yes	14 December 2006	
Non-banking sector supervision			
Adoption of the Financial Collateral Act	Yes	July 2007	
Adoption of the Act on the Takeover of Joint-Stock Companies	Yes	2007	
Adoption of the Accounting Act	Yes	2007	
Adoption of the Financial Conglomerate Act	No	2008	According to the Negotiating position for Chapter 9 - Financial services, it has been decided that the Financial Conglomerates Act be adopted in 3rd quarter of 2008.
LABOUR MARKET			
Stimulating employment			
Analysis and evaluation of measures under annual employment incentive plans	Yes	March 2007	The Annual employment incentive plan for 2007 was adopted in March 2007.
Social security system			
Social benefits reform			
Consolidation of social benefits to reduce their total number Introduction of income and means test - improved targeting	Yes	July 2007	Implemented by adoption of a new regulation within the competence of the Ministry of Health and Social Welfare.
Faster and improved access to social benefits by introducing a single register of social benefits and a single register of beneficiaries	No		Single registers have not been established.
Simplifying administration	Yes	July 2007	A new regulation in the area of social welfare has simplified administration procedure.
Equalisation of social benefits - index the social welfare entitlement base to the cost of living	No		The measure has not been implemented because of the macroeconomic policy guidelines.
Decentralisation Introduction of "one-stop-shop office" Deinstitutionalisation - reducing the scope of institutional care (a 10% reduction in new institutionalisation in the areas covered by pilot projects and engaging 15% of beneficiaries in institutionalisation prevention programmes)	in progress	2009	The measure has been implemented continuously as part of the Social Welfare System Development Project.
Development of the information and management systems (downsizing administrative functions)	in progress	2009	Upon completion of a public tender procedure, the contract was awarded to the supplier and contractor, so in 2008 IT equipment will be installed in social welfare institutions in the area of three pilot counties, and by the end of 2009 also in other social welfare institutions on the territory of the Republic of Croatia.
Implementation of the obligations set out in the National Strategy for the Protection against Family Violence and in the family Violence Protocol	Yes	2009 continuously	The measure has been implemented continuously.
National minorities			
The Roma Support Project	Yes	in the course of 2007 and 2008	The project will be materialised by means of the EC funds allocated under PHARE 2005 and 2006 programmes and by participation of the Republic of Croatia with 30% of the state budget funds.
Preparation of a publication on national minority rights that have been exercised	Yes	in the course of 2007	The publication will be printed at the end of 2007.
Election for the councils	Yes	2007	On 9 May 2007, the Government of the Republic of Croatia issued the Decision to call elections for members of councils and representatives of national minorities at local and regional self-government units. The elections were held on 17 June 2007.

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
AGRICULTURAL REFORM			
Preparation of the Land Study	No		Cancelled
Initiating activities aimed at amending the Inheritance Act	No	2008-2009	It has been planned to enact a special regulation which will regulate enlargement of agricultural land.
Implementation of tender procedure for privatisation of VUPIK - 2nd stage	No	2008	The tender procedure has been completed, but there was no acceptable tender.
Creation of a study and pilot project for the establishment of the FADN	No	2008-2009	Cancelled because of long duration of the service procurement procedure under the World Bank project.
ADMINISTRATIVE REFORM			
Adopt a strategy for public administration reform and operative plans for its implementation (measure from 2004 PEP)	in progress	2007	The draft strategy has been prepared and submitted to the Government of the Republic of Croatia.
Adopt amendments to the Act on the State Administration System (measure from 2005 PEP)	Yes	30 July 2007	Official Gazette 79 of 30 July 2007
Adopt amendments to the Act on the Rights and Obligations of State Officials (measure from 2005 PEP)	Yes	27 December 2006	Official Gazette 141 of 27 December 2006
Adopt amendments to the Transfer of Power Act (measure from 2005 PEP)	Yes	12 February 2007	Official Gazette 17 of 12 February 2007
Adopt the Act on the Financing of Political parties (measure from 2005 PEP)	Yes	2 January 2007	Correct title of the Act is: Act on the Financing of Political parties, Independent Lists and Candidates, Official Gazette 1 of 2 January 2007
Adopt amendments to the Act on the Prevention of Conflicts of Interest in the Exercise of Public Office (measure from 2005 PEP)	Yes	27 December 2006	Official Gazette 141 of 27 December 2006
Setting up organisational units for human resources management and development in all state administration bodies with staff of over 50 (measure from 2005 PEP)	Yes	2006/2007	
Adopt subordinate regulations on job system and classification and other implementing regulations for the Civil Service Act (measure from 2005 PEP)	Yes	2006/2007	1. Regulation on announcing and implementing a public competition and internal notice in the civil service (OG 8/2006 and 8/2007). 2. Regulation on the organisation and method of work of the Civil Service Committee (OG 8/2006). 3. Regulation on the possibility for civil servants to work at a separate location and to work part-time (OG 33/2006). 4. Regulation on posting civil servants outside the civil service (OG 33/2006). 5. Code of Ethics for Civil Servants (OG 49/2006). 6. Regulation on the procedure for sitting and the curriculum of the State Civil Service Examination (OG 61/2006). 7. Ordinance on the content of special reports evaluating the work and efficiency of civil servants (OG 78/2006.). 8. Regulation on the content and manner of keeping personal files and the Central Register of civil servants and civil service employees (OG 113/2006). 9. Regulation on the forms and manner of and conditions for the training of civil servants (OG 10/2007). 10. Regulation on job classification in the civil service (OG 77/2007).
			11. Regulation on the manner of and conditions for the promotion of civil servants (OG 77/2007). 12. Ordinance on unified standards and criteria for defining job titles and descriptions in the civil service (OG 116/2007). 13. It has been planned that Regulation on job classification and salaries of civil service employees be adopted together with the Act on the Salaries of Civil Servants in a package.

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Adopt the Act on the Salaries of Civil Servants (measure from 2005 PEP)	in progress	2008	The proposed Act has been submitted to the Government of the Republic of Croatia for adoption procedure, but adoption of the Act has been postponed to 2008 as it is necessary to make a detailed evaluation of its effects on the budget and calculate fiscal effect, and because of early dissolution of Croatian Parliament as well.
Carrying out functional analysis in state administration bodies (including adoption of the rationalisation programme in state administration bodies where a functional analysis has been carried out)	in progress	2007/2008	The project is being implemented with the support of the Swedish Government on the basis of the contract concluded between the Republic of Croatia and the International Bank for Reconstruction and Development concerning the grant of the Swedish International Development Agency (SIDA), intended for support to the public administration reform. The consultancy firm has been chosen for project conduction while the agreement is submitted to the World Bank for approval prior to signing the agreement.
Adopt and implement amendments to the General Administrative Procedure Act	in progress	2008	By revision to the National Programme for the Integration of the Republic of Croatia into the European Union, implementation of this measure has been postponed to 2008. In accordance with the time limit envisaged by the Proposal for the State Administration Reform Strategy, which is assessed as being a realistic time limit for adoption, a working group for preparation of the Act has been formed; the Government of the Republic of Croatia adopted in January 2007 the Guidelines for preparation of the new Act - preparation of the Act is in progress.
Strengthening employee capacity at the Centre for Professional Improvement and Training of Civil Servants	Yes	2006 - I quarter 2007	In the course of 2006 and by the end of 1st quarter of 2007, the staffing process at the Centre for Professional Improvement and Training of Civil Servants was completed (a total of 13 officers were recruited, as foreseen by the Regulation), and during the 1st quarter of 2007, training of employees was conducted at the Centre for preparation and implementation of general education programmes.
Development and implementation of general education programmes for civil service employees	Yes	15 February 2007	On 15 February 2007, the Government of the Republic of Croatia adopted the Plan for the Implementation of General Education Programmes, and the education has been provided continuously according to the Education Programme.
Carrying out an analysis of civil service training needs	Yes	May - August 2007	
Adopting a new regulation on office operations (aligned with electronic functioning of administration)	No	2008	By revision to the National Programme for the Integration of the Republic of Croatia into the European Union, implementation of this measure has been postponed to 2008 in accordance with the time limit envisaged by the Proposal for the State Administration Reform Strategy, which is assessed as being a realistic time limit for adoption.
Informatisation of state administration offices in the counties	Yes	2007	Informatisation has been completed in accordance with the plan for 2007.
Establishing an IT-supported register of civil servants	in progress	2007/2008	Establishment of an IT-supported register of civil servants forms part of the central payroll and human resource management system according to the Decision of the Government adopted in August 2006, the implementation of which is in progress (the project is coordinated by the Ministry of Finance).
Professional improvement of local and regional government employees through the Academy of Local Democracy	Yes	I - IV quarter 2007	Implemented according to the plan for 2007.
Establishing the Operational Plan for the Implementation of the e-Croatia 2007 Programme for 2007	Yes	8 May 2007	
Conducting the seminar "Meeting EU Requirements through Open-Source Solutions" which will include presentation of the state administrations of Slovenia, Germany and Hungary in the process of EU accession, with a view to training civil servants for the application of open-source software	No	first half of 2008	Due to technical problems, organisation of the seminar "Meeting EU Requirements through Open-Source Solutions" has been postponed to 2008. Within the framework of the Contract concerning provision of the service of setting-up, use, maintenance and development of new functionalities and adaptation to EU requirements of common IT resources of state administration bodies and local self-government bodies between the Central Government Office for e-Croatia and APIS IT, it has been envisaged that APIS IT will provide training of IT specialists within the state administration and public sector in application of open-source specification technologies, and the concerned seminar should be organised and held within the state administration and public sector.
Training of IT experts in state administration bodies to ensure high-quality IT education in an increasingly sophisticated IT environment	Yes	continuously	

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Developing of an IT System Interoperability Programme for state administration bodies, in order to ensure a free flow of information	Yes	continuously	A comparative analysis of positive solutions in the area of interoperability of state administration systems in EU Member States has been carried out and particular consideration has been given to the EIF system (European Interoperability Framework) as a basis for development of the national interoperability system in the Republic of Croatia. Individual coordinative adjustments with IDABC working groups have been made towards receiving guidelines on the basis of which a new edition (version 2) of EIF system will be developed and designed - the newlydesigned system represents an acceptable basis for construction of a system of interoperability of state administration bodies in the Republic of Croatia, so in the second half of 2007, a model of recommendations and documentation for implementation of interoperability of state administration bodies by individual public authority service will be developed.
The Study on Accessibility of Public Services on the Internet developed in 2006 by following the methodology used in the EU for monitoring the implementation of the eEurope 2005 Programme	Yes	December 2007 in progress on time	
ADDITIONAL REFORM AREAS			
Knowledge-based society			
Encouraging social and private initiatives (founders) for the opening of a large number of kindergartens with a variety of pre-school education programmes, implementing new programmes at at least 20 new locations (municipalities) where programmes for pre-school children have not been implemented yet, for 2007 onwards, and drawing up the Pedagogical Standard and National Curriculum for pre-school education	Yes	1 September 2007	In 2007, a total of 29 municipalities from six counties opened kindergartens and/or implemented pre-school education programmes. In addition, 35 new kindergartens (of which 28 private) were opened by 1 September 2007 and 298 programmes were implemented. The Pedagogical Standard has been drawn up and is under public discussion. Preparation of the National Curriculum is in progress.
Carrying out systematic professional training of pre-school teachers, associate staff, pre-school principals and representatives of municipalities and towns in the development of varied pre-school education programmes - new programmes for pre-school children to be introduced every year in five counties at four locations (municipalities)	Yes	2006/2007	The implementation was organised by the Education Agency. Until 1 September 2007, there were 53 meetings with 3,700 participants.
Encouraging co-operation between government bodies and local communities to enable quality of access to pre-school education, especially concerning national minority children (devoting special effort to implementing programmes for Roma minority children - three to four new programmes every year)	Yes	2006/2007	Seminars were held in five counties. Total number of participants: 895 The programmes were implemented at the kindergarten Radost in Darda, at the Pre-School Education Centre in Nova Gradiška and at Bubamara in Čakovec with around 100 Roma children.
In the school year 2006/2007, introduce the new National Educational Plan and Programme based on the Croatian National Education Standard (CNES), into all primary schools, monitor and evaluate its implementation, paying special attention to the promotion of creative learning and teaching methods, enhance pupils' capability to learn how to learn, as a precondition for lifelong learning	Yes	1 September 2006	The new Educational Plan and Programme for primary school (based on CNES) has been introduced into all schools. CNES support (of the Ministry of Science, Education and Sports) has visited all counties. The implementation of CNES and the new EPP has been monitored by surveys and direct insight into the work. Monitoring, evaluation and promotion of creative ways of teaching are continuous processes.
Enhancing information and communication skills, foreign language learning, mathematical and scientific literacy, promote technical culture, entrepreneurship and social skills	Yes	school year 2006/2007	The measure has been implemented continuously according to the plan.
Establish a system of evaluation of education programmes and pupils' achievements, introduce national exams for eight grade pupils in the school year 2006/2007 and develop clear criteria for the monitoring, evaluation and self-evaluation of all the participants in the education process	Yes	2 February 2007	National exams for eight grade pupils conducted (sample: 10,690 pupils).
Prepare the Pedagogical Standard	Yes	July 2007	The Proposal for the Draft Pedagogical Standard for primary school was finalized in July 2007 and forwarded to public discussion. Adoption of the Pedagogical Standard is expected by the end of 2007.
Prepare the National Curriculum	No		The Strategy for preparation of the National Curriculum for pre-school-, general compulsory- and secondary education has been finalized in May 2007.
Create legislative, organisational and material conditions for the introduction of compulsory secondary education	Yes	3 September 2007	The National Programme of Measures for the Introduction of Compulsory Secondary Education was adopted in June 2007. Free textbooks, free intercity transportation and accommodation in pupils' hostels were provided to all first grade pupils of secondary schools.

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Conduct annual national exams according to the plan of the National Centre for External Evaluation of Education	Yes	school year 2006/2007	National exams conducted in the first grades of gymnasiums: 98,51% of the registered pupils took the exam. National exams conducted in the second grades of gymnasiums: a total of 12,661 pupils (96,80% of those registered) took the exam. National exams conducted for eight grade pupils of primary schools: a total of 10,502 pupils (98,25% of those registered) took the exam. National exams conducted for the first grade pupils of vocational schools: 98.11% of the registered pupils took the exam. Exam catalogues for the state secondary school-leaving exam are being finalized (will be published in October 2007).
Develop and implement the secondary school self-evaluation project	Yes	school year 2006/2007	An experimental project has been implemented. A total of 21 secondary schools participated in the project.
Create conditions to carry out the second PISA test in 2009 godini	Yes	school year 2006/2007	The National Centre for External Evaluation of Education and the Project Manager for PISA did everything in accordance with the plan.
Prepare a proposal for the pedagogical and psychological education of teachers in line with the Bologna process	Yes	school year 2006/2007	Within the framework of the component I of the CARDS 2003 project, a draft paper has been prepared and will be adopted by the end of 2007 as a basis for preparation of the programme for education and improvement of teachers in vocational schools.
Develop a system for the self-evaluation of all the participants in the education process	No		Through the MATRA project for strengthening of capacities of the National Centre for External Evaluation of Education, as part of the support to the system of self-evaluation of all participants in the process, continued development of the system will be enabled through a pilot project implemented in 21 secondary schools.
Redefine vocational programmes and specialisations, develop the National Qualification Framework, determine pupils' exit competences, prepare new programmes and curricula	Yes	school year 2006/2007	Through implementation of CARDS 2002 and 2003, strategic steps have been taken in development of vocational education - work areas have been redefined
Establish a programme network	No		The programme network will ensue as a result of the project implementation.
Make systematic efforts to equip secondary schools, especially vocational schools	Yes	school year 2006/2007	A grant under CARDS 2003 was used to equip 29 secondary schools - around EUR 2 million (out of EUR 2.7 million). Pooled funds of the Ministry of Science, Education and Sports and the World Bank were used to equip 45 gymnasiums (natural-science laboratories), 12 musical schools (instruments), three schools of art (ceramic ovens), four vocational electrical-engineering schools, five construction- and two catering schools.
Develop adult education	Yes	2007	The Adult Education Act was adopted in February 2007. The Adult Education Strategy was published. The Agency for Adult Education was established by virtue of a Regulation. The CARDS 2004 activities continued.
Increase the number of scholarships and incentives provided to national minority members, adults and unemployed persons	Yes	school year 2006/2007	In 2007, a total of 278 adults were included in the literacy project. A total of 99 secondary school scholarships were granted to Roma minority pupils, and in addition, 10 higher-education scholarships and 20 tuition fees were granted.
Create the prerequisites for a faster inclusion of foreign nationals into the education system	Yes	2006/2007	The obligations under the Asylum Act have been assumed; the Decision on enrolment in the first grade of secondary school has been modified.
Strengthen relations with economic and social partners	Yes	2006/2007	All appointed commissions and working groups involved in development of the vocational education system include representatives of social partners, various institutions and decision-making levels.
Carry out an evaluation of post-graduate studies (doctoral and specialist)	Yes	in the course of 2007	On the basis of the opinion of the National Higher Education Council, permits for carrying out post-graduate studies have been issued to institutions of higher education.
Preparing a comprehensive action plan for the establishment of the National Qualification Framework	No		Appointment of the Commission for preparation of the Croatian Qualification Framework is in progress and should be finalized by the end of 2007.
Implement the dual (binar) system by 2010-2011. Introduce the Diploma Supplement and Certificate Supplement. Draft the Students Rights Act. Carry out external evaluation of higher education programmes and institutions simultaneously with the development of quality assurance units at institutions of higher education, with comparative development of quality assurance units at institutions of higher education, and in connection with the mobility of professors and students	Yes	in the course of 2007	Universities are autonomous in deciding on their organisation and activity, and universities and their institutions of higher education may organise, carry out or implement specialist studies after 2010/2011. The Act on Student Assembly and Other Student Organisations has been adopted, as well as the Ordinance on amendments to the Ordinance on the content of diplomas and additional study-related documents.
Adjusting the mechanisms of investment and control over spending of budgetary funds and encouraging private initiatives	Yes	continuously	Continued implementation of LUMP SUM (integrated university financing model).

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Train staff for the permanent monitoring and evaluation of scientific and higher education work in accordance with world standards	Yes	continuously	In 2007, a total of 400 development positions were approved.
Stimulate co-operation with foreign faculties and universities, openness and international integration	Yes	continuously	Co-operation activities are carried out systematically.
Systematically increase inflow of information on labour market needs into the higher education system and strengthen the co-operation between the higher education system and the private sector	Yes	continuously	The labour market needs are constantly monitored and adjusted with the enrolment quotas for institutions of higher education. A network of private institutions of higher education is also promoted and developed (three private high schools were founded).
Strengthen the capacities of the Agency for Science and Higher Education and the National ENIC/NARIC Office, as a centre for promoting openness of the higher education system	Yes	continuously	Evaluation of higher education programmes and recognition of foreign higher education qualifications is carried out systematically.
Develop professional higher education programmes in small urban communities	Yes	continuously	The project "Development of professional higher education programmes with a view to stimulating employment in small urban communities" is implemented in co-operation with the Development and Employment Fund.
Evaluate economic needs to stimulate development and young people's employment in small urban communities	Yes	continuously	Implementation of the project "Development of professional higher education programmes with a view to stimulating employment in small urban communities".
Evaluate needs in the segment of managerial and organisational skills	Yes	continuously	The needs evaluation project is in progress, except in the segment of economic and trade programmes.
Continue with the reorganisation of the system of science and strengthen the co-operation between the system of science, the Government of the Republic of Croatia and the economy	Yes	continuously	Action Plan to stimulate investment in the science and research is in acceptance procedure.
Evaluate and reorganise scientific organisations	Yes	continuously	In September 2007, the National Council for Science and the Agency for Science and Higher Education started evaluating 10 scientific organisations.
Access the Seventh Framework Programme and enhance the participation of Croatian scientists and other entities in EU framework programmes	Yes	1 January 2007	Seventh Framework Programme has been fully operational since 1 January 2007.
Foster employment of young scientists and provide support to investments in the scientific infrastructure	Yes	continuously	New positions for junior researchers and returned emigrants (Croatian scientists returning from foreign countries) approved.
Allocate financial aid earmarked for scientific programmes and projects to priority programmes and projects (environment, health, energy, materials)	Yes	continuously	Evaluation of scientific projects and programmes completed. In the third cycle of registration of scientific projects and programmes, particular attention will be paid to priorities at the time of approval of the projects and programmes.
Increase funding for basic research, environment protection research, research on economic development of the karst areas, the Adriatic Coast, sea and islands, agriculture, biotechnology, food, health, information and communication technologies, nanoscience, new materials, construction and new production processes, energy and sources of alternative renewable energy, transport and safety, social and humanistic sciences, Croatian identity, social integration, education and learning, as well as lifelong learning	Yes	continuously	Evaluation of scientific projects and programmes completed. In the third cycle of registration of scientific projects and programmes, particular attention will be paid to priorities at the time of approval of the projects and programmes.
Provide quality technological infrastructure through specialised or general entrepreneurial incubators enabling newly established companies to start operation	Yes	continuously	Implemented by the Croatian Business and Innovation Centre (BICRO).
Initiate new projects to promote the co-operation between the academic community and the economy	Yes	continuously	Implemented by the Technological Council, Croatian Technology Institute (HIT) and BICRO.
Improve the funding procedure for technological project monitoring	Yes	continuously	Technological Council, HIT.
Draw up guidelines to stimulate the innovation and technology system	Yes	continuously	The guidelines are in acceptance procedure.
Entrust HIT d.o.o. with operations related to these activities	Yes	continuously	Since end of 2006 these activities have been within the competence of HIT d.o.o.
Health care reform			
Health care system reform			
Ensuring joint assistance provision by the health care system, social welfare system and civil society system to the most vulnerable population groups	Yes	June - September 2007	Public tender procedures for financing of projects and programmes of associations in the area of health care and social welfare completed.
Establishing community health centres on islands and in areas of special state concern	No		Establishment of community health centres on islands pursuant to the Act on Amendments to the Health Care Act (Official Gazette 85/06) is in progress, and it is planned that community health centres be established in 2008 on the following islands: Brač, Cres, Hvar, Korčula, Krk, Lošinj, Pag, Rab and Vis.
Establishing the Croatian Mental Health Institute	Yes	December 2007	
Improvement of quality and accreditation of health care institutions according to their activities	Yes	3 October 2007	Health Care Quality Act was adopted.

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Reform of health care system financing			
Introducing hospital payments through the DRG system	Yes	June 2007	The pilot project of application of payment by diagnosis related groups (DRG) is under way; since 15 June 2007, selected hospitals have been issuing invoices through the DRG system as well.
Public health system reform			
Harmonisation of relevant legislation and secondary legislation with the regulations and practices of the EU	Yes	18 June 2007	The Ordinance on the system of traceability of blood products and monitoring of serious adverse events and reactions was adopted.
	Yes	18 June 2007	The Ordinance on the conditions with regard to premises, expert staff and medicinal and technical equipment for removal and storage of blood-forming stem cells from umbilical cord was adopted.
	Yes	30 April 2007	The Ordinance on the conditions with regard to premises, expert staff and medicinal and technical equipment for removal, storage and transplation of ocular tissue transplants was adopted.
	Yes	30 July 2007	The Act on the Protection of the Population against Contagious Diseases was adopted.
Health care prevention (promotional activities aimed at preventive health protection comprised within the so-called "lifestyle category" (e.g. prevention of addiction to alcohol, nicotine, narcotics, fight against obesity)	Yes	September - October 2007	The National Programme for Early Diagnosis of Colon Cancer was adopted.
	Yes	October - December 2007	The National Action Plan for the Prevention of and Reduction in Overweight for 2007-2011 drafted, adoption by the Government of the Republic of Croatia is expected.
Judicial reform			
Modernisation and increase in efficiency of Croatian courts			
Redistribution of cases, from overburdened to less burdened courts	Yes	2007	Continuously
Implementation of the project of monitoring the resolution of "old" and unsolved cases (both civil and criminal)	Yes	2007	Continuously
Preparation of Framework measurements relating to work performance of judges	Yes	applied since 1 July 2007	
Supervision over the work of judiciary network (by Judiciary Inspectorate of the Ministry of Justice)	Yes	2007	Continuously
Transfer of execution cases to public notaries on the basis of certified documents	Yes	2007	Continuously
Pilot project "In-Court Conciliation" between parties in the civil procedure	Yes	2007	
Pilot project of the merger of 8 minor offence courts and municipal courts	Yes	2006	The results of the pilot projects were not satisfactory, and after having analysed the implemented pilot project, the working group for rationalisation of the court network proposed to give up rationalisation of the court network in such manner as to merge municipal courts and minor offence courts and carry out rationalisation by merging courts of the same type. The Government of the Republic of Croatia adopted on 9 March 2007 the Conclusion on commencement of the court network rationalisation process in the Republic of Croatia by merging courts of the same type.
The analysis of the adequacy of the current court network	Yes	2007	The results of the pilot projects were not satisfactory, and after having analysed the implemented pilot project, the working group for rationalisation of the court network proposed to give up rationalisation of the court network in such manner as to merge municipal courts and minor offence courts and carry out rationalisation by merging courts of the same type. The Government of the Republic of Croatia adopted on 9 March 2007 the Conclusion on commencement of the court network rationalisation process in the Republic of Croatia by merging courts of the same type.
Land registry reform			
Strengthening of activities in clearing land registry backlog	Yes	2007	

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Systematic supervision over implementation of measures and land registry operations	Yes	2007	
Training of land registry officers	Yes	2007	
Establishment of digital land registry database at all land registries	Yes	2007	
Implementation of measures for creation of the joint Database containing land registry and cadastre data	Yes	2007	Continuously
Closing of manually operated land registries	Yes	2007	
Establishment of new land registries	Yes	2007	Continuously
Increasing the efficiency of creditor protection and claim collection			
Implementation of the Action plan for reducing the number of enforcement cases at courts	Yes	2007	
Education of bankruptcy judges in connection with novels to the Bankruptcy Act	Yes	2007	
Programme of expert examination for bankruptcy trustees	Yes	2007	
Establishment of criteria for appointment of bankruptcy trustees	Yes	2007	
Penal legislation reform			
Implementation of the novelled Penal Procedure Act and education of judges and state attorneys	No		In the session held on 9 March 2007, the Government of the Republic of Croatia adopted the platform for adoption of the new Penal Procedure Act, which contains strategic guidelines for a radical modification of the Penal Procedure Act. A working group responsible for its preparation was formed and charged with the task of forwarding, by 30 September 2008, a draft proposal for the Penal Procedure Act to the Government procedure.
Implementation of the National Programme for Prevention of Corruption 2006-2008	Yes	2007	Continuously
Environmental protection			
Enactment and start of implementation of subordinate legislation pursuant to the Environment Protection Act relating to the assessment of the impact on the environment and strategic assessment of the impact on the environment	No	2008	The new Environment Protection Act was adopted by Croatian Parliament in October 2007. The implementing regulations have not been enacted yet, their preparation is under way and will be adopted in the course of 2008.
Development of the Air Quality Protection and Improvement Plan	Yes	November 2007	The Plan has been prepared and its adoption by the Government of the Republic of Croatia is scheduled for the first quarter of 2008.
Air quality assessment at state level and division into zones and areas	Yes	May 2007	Preliminary assessment of air quality on the territory of the Republic of Croatia was prepared in May 2007.
Creation of the national strategy for the implementation of the Framework Convention of the UN on climate change (UNFCCC) and the Kyoto protocol with an action plan	Yes	May 2007	The National strategy was prepared in May 2007.
Creation of the greenhouse emissions allocation plan	No	III quarter 2008	The Plan will be created within the framework of implementation of CARDS 2004 project, which started in September 2007.
Preparation of strategic documents and projects for IPA financing	Yes	20 September 2007	The Government of the Republic of Croatia accepted the IPA Operating programme for environmental protection. Preparation of the projects by beneficiaries of IPA financing is under way.
Strengthening of water management planning and adoption of the Water Management Strategy and continuation of work on the second phase of water management plans in certain areas	Yes (related to adoption of the Water Management Strategy)	31 December 2007	As regards the Water Management Strategy, its adoption is in statutory procedure and a continuous implementation pursuant to 2006 PEP will follow.

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Creation of the annual National Adriatic Sea Monitoring Report	No	II quarter 2007	The report for 2005 was drawn up and submitted to MED-POL in October 2006. The reports for 2006 and 2007 will be drawn up during the first half of 2008.
Creation of an annual report, leaflet and map of sea water quality on beaches	under way	31 December 2007	Creation of an annual report, leaflet and map of sea water quality on beaches will follow upon completion of 2007 swimming season.
Revision of the National Strategy for the Protection of Biological and Landscape Diversity	No	II quarter 2008	The priorities and action plans within the National Strategy and Action Plan for Biological and Landscape Diversity are related to the establishment of eco-network of the Republic of Croatia. Cancellation of promulgation of the eco-network slowed down the revision of the strategy, completion of which is expected in the 2nd quarter of 2008.
Development and implementation of implementing regulations based on the Nature Protection Act (and the Act on GMOs)	Yes/in progress	2007	OG 05/07, OG 11/07, OG 89/07
Establishment of the National Eco-Network	in progress	2007	The Regulation on the establishment of the eco-network of the Republic of Croatia with a system of ecologically important areas and eco-corridors with the aim of preservation of and guidelines for protection measures intended for maintenance or establishment of favourable conditions for endangered species and rare habitat types and/or wild taxa (in adoption procedure)
Protection of new areas (Nature Park Neretva)	No	<i>see comments</i>	Expert bases for promulgation of the Neretva valley as a nature park have been prepared (budgetary funds for 2007 secured), but owing to disagreement among the representatives of the local community, the procedure for promulgation of the protected area has not continued and the public institution Neretva Nature Park has not been established.
Implementation of wolf and lynx management plans (revision after 2007)	Yes	December 2007	Revision of action plans within the framework of protected species management plans (for wolf and lynx). Revised plans will be adopted before the end of 2007.
International co-operation in the area of nature protection (implementation of the projects): KEC-World Bank	Yes	2007	
NATURA 2000 - PHARE	No	2009	Implementation of the PHARE project "Establishment of NATURA 2000 Network" has started, whereas the completion of the project has been extended until the end of 2009.
Further development of the register of dangerous and risky industrial facilities	Yes	2007	The Register was upgraded in 2007 and, pursuant to the requirements of Seveso II Directive, it will be developed into the Register of dangerous industrial facilities by 2009.
Public procurement			
Creation and entry into procedure of the Government of the Republic of Croatia of the Proposal of the new Public Procurement Act	Yes	13 April 2007	
Adoption of the Public Procurement Act	Yes	3 October 2007	The Act on Public Procurement has been adopted on Croatian parliament session on October 3rd 2007. It is announced in OG 110/2007 from October 25th 2007 and will become effective as of January 1st 2008.
Creation, adoption and entry into force of the Regulation on announcements and records of public procurements	No	2008	The measure will be implemented in accordance with the provisions of the new Public Procurement Act (OG 110/2007).

MAIN MEASURES UNDER THE 2006 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Regulation of procedure for public procurement of goods, works and services of small value, as well as regulation of the application of CPV/CPC will be made in accordance with the new Public Procurement Act	No	2008	The measure will be implemented in accordance with the provisions of the new Public Procurement Act (OG 110/2007).
Creation of a public procurement manual (creation of a manual for bidders)	Yes	February 2007	
Creation of the public procurement dictionary	No	December 2008	It has been planned that the public procurement dictionary/glossary be created within the framework of the project proposal.
Restructuring the Public Procurement Office as an expert service of the Government of the Republic of Croatia into the Central Government Office for Public Procurement	No		It has not been foreseen that this measure be implemented by the end of 2007.
Proposal of the implementation and application of IT system to serve the purposes of the Central Government Office for Public Procurement, statistics system and analysis of data related to public procurement	No		It has not been foreseen that the Public Procurement Office as an expert service of the Government of the Republic of Croatia be restructured into the Central Government Office for Public Procurement by the end of 2007.
Development of an IT system for the purposes of the Central Government Office for Public Procurement (statistica and data analysis, internal and external communication) and for the purposes of the public procurement system	No		It has not been foreseen that the Public Procurement Office as an expert service of the Government of the Republic of Croatia be restructured into the Central Government Office for Public Procurement by the end of 2007.
Introduction of an Internet site of the Official journal of public procurements in the Republic of Croatia	No	2008	The measure will be implemented in accordance with the provisions of the new Public Procurement Act (OG 110/2007).
Development of the system of electronic procurement and centralization of public procurement depending on its advisability	No	2008-2010	The measure will be implemented in accordance with the provisions of the new Public Procurement Act (OG 110/2007).
Development of the methodology for creating procurement plans (contracting)	No		Not provided by the provisions of the new Public Procurement Act, (OG 110/2007).
Strengthening of administrative capacity of the Central Government Office for Public Procurement	No/Yes		It has not been foreseen that the Public Procurement Office as an expert service of the Government of the Republic of Croatia be restructured into the Central Government Office for Public Procurement by the end of 2007. However, within the framework of strengthening of capacities of the existing Public Procurement Office for 2007, the Annual education of the Office staff plan has been made. Office staff have attended the Module "training the trainer" organized in cooperation with the Center for public servants education of the Central State Administrative Office for Public Administration so that the Office has 18 trainers trained to conduct modules on public procurement. Also, Office staff have participated in number of domestic and international seminars and workshops regarding the public procurement and have attended TAIEX study visit.
Strengthening of the administrative capacity among those obligated to apply the Public Procurement Act: education of trainers for public procurement, training of employees for procurement and supervision and their continuous education	Yes	continuously 2007 - 2009	The Draft was prepared in February 2007 and the final Education programme for those obligated to apply the Public Procurement Act for the period 2007-2009 was made in May 2007. In May, June and September of 2007 number of moduls regarding the public procurement had been held aimed at education of the public officials and public servants. During November and December 2007, the module "Public procurement" is being conducted regarding the provisions of the new Act on Public procurement (OG 110/2007).
Strengthening the perception of the public procurement system by issuing bulletins and publications, maintaining a web site, holding seminars and workshops, contacting the media etc.	Yes	continuously 2007 - 2009	Three e-bulletins on public procurement were issued in the course of 2007 (February, May and September). The new Office's web site "Public Procurement Web Portal" was created. In the second quarter of 2007, the application for submission of annual reports was upgraded in such manner that a clearly visible banner was added to the Internet site of the Office on the home site which directs the visitors to submit or search for annual reports. This has enabled non-registered visitors of the web site to search annual reports, as well as review them. Within the framework of a number of seminars related to the public procurement system in the Republic of Croatia, some seminars were held in co-operation with TAIEX and some were organised by USAID.