



REPUBLIC OF CROATIA



2012 PRE-ACCESSION ECONOMIC PROGRAMME

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1 OVERALL ECONOMIC POLICY FRAMEWORK AND OBJECTIVES

According to the Programme of the Government of the Republic of Croatia the main objective of the economic policy is to establish competitive economy that is knowledge-based and export-oriented, which ensures a rise in value added and employment, observing the principle of social cohesion. In the context of growing uncertainty and risks, in both global and local terms, the key challenge is to create the conditions for economic recovery and growth and to maintain macroeconomic stability. This will primarily be achieved by stimulating investment activity, implementing fiscal consolidation and accelerating and intensifying structural reforms.

As regards economic activity, it is crucial to start the investment cycle. The government will provide the incentive by starting its own investment cycle and by supporting private investments through reduced illiquidity, tax and non-tax levies for entrepreneurs and investors and by ensuring financial stability.

Fiscal consolidation will result in a reduction in consolidated general government deficit, a fall in the share of budget expenditures in GDP and in a suspension of growth and reversal of trends of public debt share in GDP. Along with the planned savings on the expenditure side of the budget, the structure of public consumption will also change in favour of more productive investments. Changes on the revenue side of the budget are directed at reducing the tax burden of labour and at creating the conditions for strengthening tax burden of capital which will reinforce fairness of the tax system.

Structural reforms are planned in a great number of areas. Active measures will be implemented for promoting new employment, as well as industrial policy horizontal measures, on the basis of the defined guidelines for developing both modern and traditional industries. Business environment will be strengthened through the development of the judicial system and institutions supporting entrepreneurship. Financing of propulsive sectors will primarily be ensured by private investors, EU funds, international financial institutions and public-private partnership. The use of land, agricultural and food processing potentials will be reinforced. Education and life-long learning will be promoted, as well as research and development and a relationship between research and entrepreneurial sector. Reorganisation and rationalisation of public administration will be implemented for the purpose of improving its quality, efficiency and availability. The reforms are also planned for better-targeting of social benefits, stabilising the pension system and expanding availability of health care services, as well as a simultaneous strengthening of sustainability of all of the above mentioned areas. Functional and fiscal decentralisation will also be addressed and differences in regional development will tend to be diminished.

Economic activity developments in the Republic of Croatia will be determined in the forthcoming period by strength and speed of implementing structural reforms, as well as by the global and, in particular, European economic environment. In that regard, the still present high uncertainty in the environment should be pointed out. However, it should also be noted that in the second half of 2011, the Republic of Croatia successfully concluded the accession negotiations with the EU and signed the Accession Treaty, that it has continuously been harmonising with the EU standards and that it will become the full EU Member State on 1 July 2013, which provides additional positive implications and an impetus for the overall economic policy and the Croatian economy which, in synergy with a mobilisation of domestic potentials, creates a framework for economic recovery and growth.

2 MACROECONOMIC DEVELOPMENTS

2.1 CURRENT MACROECONOMIC DEVELOPMENTS

The effects of the global financial and economic crisis on the Croatian economy were most pronounced in 2009. In 2010, the adverse movements were mitigated, so that a real fall in gross domestic product (GDP) slowed down to 1.2% following a 6.0% decrease in 2009¹. Apart from exports of goods and services, which rose by 6.0%, all the components on the expenditure side of GDP recorded a real decrease on a year-on-year basis in 2010. The largest real year-on-year decrease of 11.3% was recorded by gross fixed capital formation, followed by imports of goods and services (-1.3%), household consumption (-0.9%) and government consumption (-0.8%). As regards the contributions to the year-on-year GDP change, a trend from the previous year continued into 2010, i.e. a negative contribution to a change in GDP came from domestic demand, while a positive contribution came from net foreign demand. Accordingly, gross fixed capital formation contributed to a change in GDP with -2.8 percentage points, household consumption with -0.5 percentage points, changes in inventories² with -0.4 percentage points and government consumption with -0.2 percentage points. A contribution of net exports to a change in GDP in 2010 amounted to 2.6 percentage points, as a result of a positive contribution of exports of goods and services of 2.1 percentage points and imports of goods and services of 0.5 percentage points.

The comparison between the realised GDP and that projected for 2010 under the previous year's PEP shows that the realised real GDP fall was 0.4 percentage points weaker than projected. The real fall in household consumption was 1.1 percentage points weaker, in government consumption 0.2 percentage points and the real fall in gross fixed capital formation was 0.4 percentage points weaker than the projected fall. The real growth in exports of goods and services was 1.9 percentage points stronger than that projected, while the real decrease in imports of goods and services was 0.6 percentage points weaker.

Movements in the first three quarters of 2011 point to a further recovery of economic activity. More specifically, GDP recorded a real year-on-year growth of 0.3%, which is a result of a year-on-year decrease of 0.8% in the first and an increase of 0.8% and 0.7% in the second and third quarters of 2011, respectively. Real GDP growth in the first three quarters of 2011 was a consequence of a positive contribution of net foreign demand, while domestic demand continued to make a negative contribution to a GDP change. Consequently, household consumption contributed to a GDP change with 0.1 percentage points, the contribution of government consumption was neutral, while gross fixed capital formation and changes in inventories had a negative contribution to a GDP change, with -1.6 percentage points and -0.2 percentage points, respectively. Household consumption and government consumption were the only categories on the expenditure side that recorded a year-on-year growth in the first three quarters of 2011. Household consumption thus increased by 0.2% in real terms in the first three quarters, as a consequence of its 0.1% fall in the first quarter and 0.6% and 0.1% rise in the second and third quarter, respectively. Government consumption recorded a real year-on-year growth of 0.1% in the first three quarters of 2011, as a result of its decline of 0.9% in the first quarter, growth of 1.7% in the second quarter and a fall of 0.4% in the third quarter. In 2011, gross fixed capital formation remained the component which recorded the greatest real fall. In the first three quarters of 2011, it was reduced by 7.5% compared

¹ At the end of 2010, a minor methodological revision of the annual GDP calculation from 1995 to 2007 was carried out, according to new and improved sources of data and calculation methods, which resulted in an increase in the nominal GDP level of 0.4%, on average, in the 1995-2007 period. According to the annual revised calculation, in 2011, a quarterly GDP series for a period from the first quarter 2000 to the fourth quarter 2010 was also revised, together with the preliminary GDP calculation for 2008, 2009 and 2010, obtained as a sum of quarterly data.

² The category of changes in inventories includes statistical discrepancy.

to the same period of 2010, owing to a decline in all three quarters, of 6.7%, 7.3% and 8.4%, respectively. Net exports contributed positively to a change in GDP with 2.0 percentage points in the first three quarters of 2011, as result of a negative contribution of exports of goods and services of -0.6 percentage points and a positive contribution of imports of goods and services of 2.5 percentage points. Such an outturn can be accounted for by a real year-on-year reduction in exports of goods and services of 1.4% in the first three quarters of 2011, which is a result of an 11.1% fall in the first quarter and a 1.1% and 2.0% rise in the second and third quarter, respectively. Imports of goods and services were on a decline in all three quarters on a year-on-year basis (of 5.3%, 6.0% and 8.3%, respectively), so that their real year-on-year decrease amounted to 6.6% in the first three quarters of 2011.

The high-frequency indicators of economic activity that have been published so far point to a continued mild recovery of economic activity in the last quarter of 2011. More specifically, in October and November 2011, industrial production rose by 0.9% on a year-on-year basis, retail trade real turnover rose by 1.4% and number of tourist nights by 11.2%. However, indicators of foreign trade in goods point to a stronger year-on-year decrease in goods exports (16.7%) than imports (4.2%) in October and November, while the index of construction works fell by 7.4% in October.

Unfavourable developments on the labour market continued in 2011. The average registered unemployment increased by 2,908 or 1.0% in 2011 relative to 2010. The average employment was reduced by 36,889 or 2.6% in the first eleven months of 2011 on a year-on-year basis³. Administrative unemployment rate stood on 17.9%, on average, in the first eleven months of 2011, which is a 0.6 percentage point increase compared to the same period of 2010. The latest Labour Force Survey data available show that the average Labour Force Survey unemployment rate was 13.3% in the first three quarters of 2011, which is a year-on-year growth of 1.6 percentage points. The acceleration of a year-on-year growth in nominal wages in 2011 relative to 2010 was not sufficient to curb the trend of a year-on-year wage reduction in real terms. Accordingly, the average gross wage recorded a nominal year-on-year growth of 1.4% and a real decrease of 0.8% in the first ten months of 2011, and the average net wage increased by 1.9% in nominal terms, while it decreased by 0.3% in real terms in the same period⁴. Stronger nominal growth of net against gross wages was also affected by changes in income tax in July 2010.

The average inflation measured by the consumer price index stood at 2.3% in 2011, accelerating by 1.2 percentage points relative to 2010. The largest contribution to this acceleration of inflation in 2011 was made by the prices of food, which rose by 3.6% compared to 2010, most notably of bread and cereals (5.4%), milk, cheese and eggs (4.8%) and of oils and fats (16.1%). In addition, a significant contribution to inflation acceleration in 2011 also came from the prices of fuels and lubricants for personal transport equipment, which increased by 13.3% on a year-on-year basis, prices of tobacco (8.7% growth), prices of liquid fuels (22.3%) and prices of water supply (4.2%). This increase in consumer prices is primarily a consequence of a spillover of increase in prices of raw materials on the world market, especially of crude oil and food raw materials, present from mid-2010, reaching its peak in April 2011, and partly, of the effect of a rise in excise duties on tobacco products in October 2010. The biggest influence on mitigation of the year-on-year growth in prices in 2011 had clothing and footwear prices, which decreased by 3.3%, and telephone and telefax equipment and services prices (a decrease of 4.2%). Inflation remained relatively low in 2011, which can mostly be accounted for by domestic factors, such as poor domestic demand and

³ For the purpose of comparison, the average registered unemployment increased by 14.9% in 2010, while the average employment went down by 4.5% in the first eleven months of 2010, against the same period of 2009.

⁴ Data on net wages are not corrected for the special tax on salaries, pensions and other receipts.

reduced unit labour costs at the annual level, which was a consequence of the labour market adjustments. End-year inflation was somewhat lower than the average inflation in 2011. Particularly, consumer price inflation increased moderately from 1.8% recorded in December 2010 to 2.1% in December 2011. Core inflation recorded a year-on-year growth of 1.7% in the first eleven months of 2011. Industrial producer price index (on domestic market) recorded a year-on-year increase of 6.4% in 2011.

The average nominal exchange rate of the kuna against the euro stood at 7.29 HRK/EUR in 2010, appreciating by 0.7% compared to 2009. The main characteristic of the monetary environment in the first half of 2011 was extremely favourable kuna liquidity, supported by the central bank as of the end of 2009, with an aim of spilling over a surplus of banks' free reserves, to the largest extent possible, into revival of credit activity of banks. The CNB is ready to support such a policy as long as the exchange rate of the domestic currency remains stable. In order to improve foreign exchange liquidity of the system, in March 2011, the central bank reduced the rate of minimum required foreign currency claims from 20% to 17%, as a result of which approximately EUR 850 million (almost 2% of GDP) was released at the system level. Supporting the liquidity of the banking system by the CNB was possible in the first half of 2011, since the exchange rate of the kuna against the euro was stable, at the average level of 7.39 HRK/EUR. However, in the third quarter of 2011, depreciation pressures on the domestic currency appeared, with the average exchange rate increasing to 7.45 HRK/EUR, which prompted the CNB to intervene twice (in July and in September) on the foreign exchange market, selling approximately EUR 0.4 billion. Additionally, in September, the central bank raised the rate of reserve requirement from 13% to 14%, which, together with the previously mentioned foreign exchange transactions, had a negative impact on kuna liquidity of the banking system, thus stabilising the exchange rate of the domestic currency. Nevertheless, kuna liquidity remained abundant. In the last quarter of 2011 the exchange rate moved, without large variations, at the average level of 7.49 HRK/EUR. In 2011, the average nominal exchange rate of the kuna against the euro amounted to 7.43 HRK/EUR, which is a year-on-year depreciation of 2.0%.

Movements of real exchange rates suggest improvement of price competitiveness of the domestic economy. More specifically, the real effective exchange rate of the kuna depreciated by 2.6%, deflated by consumer prices, or by 1.8% deflated by producer prices on a year-on-year basis in the first ten months of 2011. The nominal effective exchange rate of the kuna recorded a depreciation of 2.3% in the first ten months of 2011 relative to the same period of 2010.

The CNB's international reserves increased in the first eleven months of 2011 by 7.1%, reaching EUR 11.4 billion at end-November, their increase being primarily a consequence of foreign exchange transactions with the central government. More specifically, the government issued a bond abroad at the beginning of the year and the CNB purchased from the central government the largest portion of the funds received on that basis (EUR 0.9 billion). Accordingly, selling foreign exchange to banks in the third quarter mitigated only partly the expected annual growth in international reserves.

A year-on-year growth in bank loans amounted to 6.3% at the end of November 2011. The credit growth in 2011 was based on lending to corporate and central government sectors, whereas household loans, which have the largest share in bank loans, recorded a poor growth. Accordingly, central government loans recorded a year-on-year growth of 18.8% in November 2011, corporate loans rose by 8.6% and household loans by 1.6%. The year-on-year growth of housing loans, accounting for 46.1% of total household loans, stood at 4.4% in November 2011, while other household loans (excluding housing loans) dropped by 0.7%. The year-on-year growth in money (M1) amounted to 5.4% at end-November 2011, while the broadest monetary aggregate, total liquid

assets (M4), increased by 4.0% relative to the same month of 2010. The largest contribution to the year-on-year growth in total liquid assets in November 2011 came from kuna time and savings deposits, which increased by 18.2%, while foreign currency deposits, the biggest category of monetary aggregate M4, decreased by 0.4%, year-on-year.

Unfavourable macroeconomic developments contributed to a continued deterioration of the banks' credit portfolio quality. The share of partly or fully irrecoverable placements in total placements went up to 12.2% in mid-2011. Despite that, banking system stability in Croatia was not undermined and the average capital adequacy ratio stood at 18.9% at end-September 2011 at the system level.

At end-November 2011, the CNB revoked the authorisation from one smaller bank. The reason for withdrawing the authorisation and initiating the compulsory winding-up procedure is an insufficient level of capital. Although that bank did not borrow to a large extent on the domestic banking market, in view of possible difficulties in financing of other small banks, at the end of November, the CNB allowed for a possibility for other banks to use, under special conditions, in addition to Lombard loans and liquidity loans, the allocated or maintained reserve requirement.

Reduced domestic demand contributed to a strong contraction of balance of payments deficit. Current account deficit was reduced from 5.2% of GDP in 2009 to its record low of 1.2% of GDP in 2010. This can be accounted for by a year-on-year decline in goods account deficit of 19.4% and a reduction in the negative balance in the income account of 13.4%. The services account, which contributed most to a mitigation of the current account deficit, recorded a moderate year-on-year growth in the positive balance of 2.0%, despite a 2.3% reduction in its most significant component, tourism revenues. Surplus in the current transfers account rose by 5.0% in 2010. The coverage of imports of goods and services by exports of goods and services amounted to 99.5% in 2010, which is an increase of 8.7 percentage points compared to 2009. Current account deficit in 2010 was mainly financed by other investment, which recorded a net inflow of EUR 776 million, which is 67.3% less than in 2009. The account of portfolio investment witnessed a net inflow of EUR 397 million in 2010, whereas net direct investment stood at EUR 393 million, or 73.6% less than in 2009. Net errors and omissions amounted to EUR -729 million in 2010, while international reserves rose by EUR 84 million.

The year 2010 saw a stronger fall in balance of payments current account deficit than it was projected under the previous year's PEP. Particularly, the projected level was -2.8% of GDP, which is a 1.6 percentage points difference from the realised -1.2% of GDP. More pronounced growth in exports of goods than that expected and the absence of growth in goods imports contributed most to a stronger contraction of current account deficit.

Surplus of EUR 1.2 billion in the balance of payments current account was recorded in the first three quarters of 2011, which is EUR 668 million, or 136.5%, more than in the same period of 2010. Such movements result from a year-on-year reduction in the goods account deficit of EUR 377 million, increase in the services account surplus of EUR 471 million, increase in the income account deficit of EUR 149 million and a decrease in the current transfers account surplus of EUR 32 million. The coverage of imports of goods and services by exports of goods and services stood at 114.0% in the first three quarters of 2011, which is a 6.7 percentage point rise compared to the same period of 2010. Movements in the financial account were marked by a net inflow from direct investment of EUR 1.0 billion in the first three quarters of 2011, an increase of 46.4% relative to the same period of 2010. The portfolio investment account recorded a net inflow of EUR 308 million in the first three quarters, while net inflow in the other investment account amounted to

EUR 189 million. Net errors and omissions were EUR -1.9 billion and international reserves rose by EUR 666 million in the first three quarters of 2011.

2.2 MID-TERM MACROECONOMIC PROGRAMME

In 2011, its second half in particular, unfavourable macroeconomic developments in international environment intensified and economic growth slowed down both in developed and developing economies. In addition, strengthening of adverse risks and uncertainty regarding the forthcoming period were also present. The latest macroeconomic projections of the relevant international institutions thus point to a decelerated growth of the global economy in 2012 and 2013 relative to the previous projections. Unfavourable economic developments are again expected in the EU in 2012, as a result of the public debt crisis and its repercussion to financial and real flows, restricted loan supply due to problems in the banking sector, further need for fiscal consolidation in view of fiscal deficit and public debt problems of individual Member States, deceleration of global demand and strengthening of general uncertainty regarding economic and socio-political developments. Significance of the described movements in international environment for domestic economy can be accounted for by a high degree of Croatia's trade and financial relationships with the countries in the environment and especially with individual EU economies, which are, at present, characterised by pronounced adverse economic developments and a relatively gloomy mid-term perspective.

Taking into account the cyclical position, structural characteristics and financing needs of the domestic economy, the described unfavourable conditions in the environment require preservation of macroeconomic stability to be the primary objective of the economic policy, ensuring, at the same time, the conditions for the strongest possible economic recovery, in the given circumstances. As regards fiscal policy, this implies a need for stronger consolidation and returning public finances to a sustainable footing in the short run, together with accelerated implementation of structural reforms aimed at correcting imbalances and enhancing the economic potentials, taking also into account social aspects of fiscal policy measures. On the other hand, monetary policy will remain focused in the forthcoming period on supporting financial system liquidity to the extent possible, in view of stability of the kuna exchange rate against the euro.

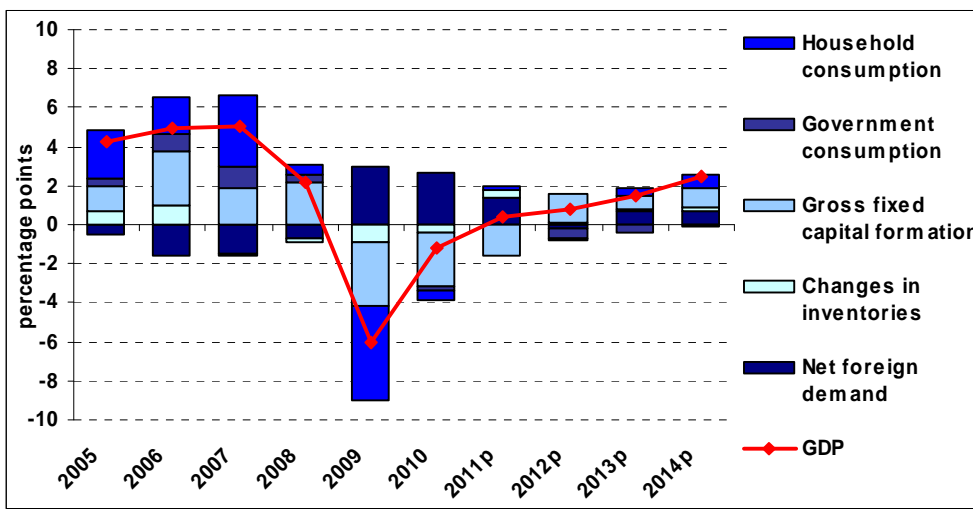
The macroeconomic projections are based on the published GDP and the balance of payments estimates for the first three quarters of 2011, as well as high-frequency indicators of economic activity published by mid-January 2012.

2.2.1 Real Sector

In Croatia, the effects of the global economic crisis were most pronounced in 2009, whereas the effects of the crisis weakened in 2010. A fall in foreign demand for domestic exports, a decline in availability of foreign capital and an increase in its price, as a result of a changed risk perception of investors, and spreading of pessimistic economic expectations to the domestic market were the main transmission channels of the negative effects of the crisis to the domestic economy. Adverse effects of external factors on the developments in the country were additionally strengthened by structural limitations of the domestic economy. Financial and economic crisis thus pointed to unsustainability of the pre-crisis pattern of the Croatian economic growth, based on a growth in domestic demand and financed, to a large extent, by an inflow of foreign capital, which led to accumulation of the structural problems in the real sector of the economy. Although the rates of fall in economic activity in Croatia at the beginning of the crisis did not depart significantly from those in the comparable foreign economies, unfavourable structural characteristics of the economy, as a result of which a rise in foreign demand could not compensate sufficiently for the absence of growth in domestic demand, are largely responsible for a slower recovery relative to the

comparable countries later on. More specifically, relatively high level of domestic prices and costs of living, to a large extent present as a result of a lack of competitiveness in many segments of the internal market, along with a rigid labour market, co-exists with high costs of labour, financing and operation of companies in general, thus weakening competitiveness of the domestic economy. At the same time, a high level of relative external indebtedness, 'euroisation' of the economy and import dependence prevent the weakening of the nominal exchange rate for the purpose of mitigating the problem of overvalued domestic currency in real terms. Apart from the already mentioned poor competitiveness of the domestic economy, narrow base and unfavourable structural characteristics of goods exports, in terms of a large share of products of a lower level of processing and value added and a relatively slower growth in major export markets, prevented a growth in foreign demand to become a generator of a stronger recovery in the short run. In addition, due to external and internal imbalances, Croatia was not in a position to pursue anti-cyclical economic policy, which further limited economic recovery.

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



Source: CBS, MF

Following two recession years, a real growth in GDP of 0.4% is expected in 2011. In short, a negative influence of a further correction in domestic demand on GDP growth will be offset by a positive influence of net exports and changes in inventories. Such a projection for 2011 implies a continuation of a mild GDP growth in the fourth quarter of 2011, which is also mostly supported by the available high-frequency indicators for the last quarter of 2011. However, looking at all the published high-frequency indicators so far for 2011, it is evident that the beginning of GDP recovery is accompanied by the still present, rather unfavourable economic developments, primarily as regards the indicators of the labour market, industrial production and construction.

Looking at the GDP components on the expenditure side at the entire 2011 level, a real growth in personal consumption of 0.3% is expected, as well as its insignificant contribution to the increase in economic activity. However, it should be noted here, that a real decline in household disposable income is estimated in 2011, as a result of a stronger reduction in employment than a real growth in net wages, as well as a real fall in government transfers to households and net other income. In addition, further real reduction in granted consumer loans indicates a continuation of the process of household sector deleveraging, implying that the estimated growth in personal consumption in 2011 is probably accompanied by a real reduction in accumulated household assets. Insignificant decline in government consumption of -0.1% and its neutral contribution to economic growth are estimated in 2011.

Investment consumption, which represented an important generator of economic growth in the pre-crisis period, has recorded extremely negative movements since the beginning of the crisis, which continued into 2011, so that a year-on-year drop in gross fixed capital formation is estimated at -7.3%. This can be accounted for by an extensive correction in domestic consumption over the past few years, as well as a reduced foreign demand, pessimism regarding the future movements in demand, liquidity-related problems in the economy, diminished availability of financing and deteriorated financing conditions. Although banks' interest rates on corporate loans were reduced relative to 2009, in the present macroeconomic conditions they turned out to be still too high for many companies to undertake new investment activities. Furthermore, it should be noted that in 2011 a significant year-on-year growth in corporate loans was recorded, the purpose of which was, nevertheless, predominately non-productive, and this growth did not reflect significantly in investment consumption. Apart from the indicated difficulties concerning the movements in demand, financial framework and business sector expectations, the negative movements in investments could also be accounted for by their structure, since in the pre-crisis period, they were, to a large extent, directed at non-tradable sector, which was strongly affected by a correction in domestic demand due to the economic crisis. Infrastructure projects and construction activity in general should be noted in particular. The pre-crisis volume of the latter proved to be unsustainable during the economic crisis, which is evident from the movements in construction indicators and the number of the real estate properties that have not been sold until today. After three years of adverse movements, a considerable positive contribution to economic growth of 0.4 percentage points is estimated to come from changes in inventories.

As regards net exports, in 2011, its positive contribution to economic growth, but somewhat smaller than in the previous two years, is estimated for the third consecutive year. More specifically, as a consequence of a reduction in demand, a real fall in imports of goods and services of -5.4% is estimated, accompanied by a further decline in the share of imports in final demand. A decrease in exports of goods and services is estimated at -1.7% in 2011. Such movements primarily reflect the indicated deficiencies of goods exports and accumulated problems in the economy, and, in view of the movements in foreign demand for domestic products, also imply further reduction in domestic market share in the Croatian export markets. In addition, exports are also negatively affected by the base effect, primarily since ship exports, as the most important category of Croatian goods exports, recorded record high amounts in 2010 and by the weakening of foreign demand towards the end of the year. On the other hand, according to the data available, exports of services again recorded favourable results, a contribution to which was also made by the poorer results of individual competitive destinations, due to geopolitical tensions. The majority of contribution to a growth in tourist services relates to record high volume indicators in tourism, whereas the movements in average tourist consumption will record only slightly more favourable movements relative to 2010.

In 2012, a real GDP growth of 0.8% is projected, generated by a strong real growth in gross fixed capital formation of 7.4%. However, general government investments will record a real decrease in 2012 and, at the same time, no significant private sector investments are likely due to a poor demand, diminished availability of capital and deteriorated financing conditions, as well as illiquidity problems in the economy and pessimistic expectations. The aforementioned growth in total gross fixed capital formation will thus largely arise from investments of public enterprises. As regards personal consumption, its mild real fall of -0.3% is expected, as a result of a real reduction in the household disposable income on account of a further fall in aggregate employment, real reduction in net wages and fiscal consolidation measures, which, among other things, include reduced compensation of employees and government transfers to households. However, it should be noted here that the projected fall in personal consumption will be smaller than the projected reduction in household disposable income, which, taking into account the existing level of

household sector indebtedness, its pessimistic expectations concerning the future dynamics of income and uncertainty regarding the interest rate and kuna nominal exchange rate movements, also implies a further real fall in accumulated household assets, since it is not likely that marginal propensity to consume will significantly rise. The projected real decrease in government consumption of -2.4% in 2012 is in line with the implementation of fiscal consolidation and it primarily relates to a reduction in compensation of employees and intermediate consumption of general government. A mild positive contribution to economic growth of 0.1 percentage point in 2012 will come from changes in inventories. In 2012, a mild real growth in exports of goods and services of 1.1% is expected. An increase in goods exports will be restricted by, in addition to the previously mentioned fundamental problems, a poor foreign demand, without expecting a significant outturn of exports of services, due to the unfavourable base effect and a poor dynamics of disposable income in major outbound markets. However, cost and price competitiveness of the Croatian exports, which, as a reflection of structural deficits and imbalances in the domestic economy in the previous period, also prevented a more dynamic export growth, should record a certain improvement, among other things, on account of a reduced rate of contribution for compulsory health insurance in 2012. An increase in imports of goods and services of 1.5% in 2012, mainly relates to imports generated by the previously mentioned launching of the public investment cycle. Consequently, a slight negative contribution of net exports to the economic growth is expected in 2012.

As regards the remaining part of the projection period, acceleration of economic activity growth to 1.5% is expected in 2013 and to 2.5% in 2014. This growth should reflect, to a large extent, a contribution of exports of goods and services, whereas in 2014, a more significant contribution of domestic demand to economic growth is expected as well. However, it should be noted that a portion of a fall in economic activity in the previous period also reflects a reduced level of potential output due to a loss of a part of production capacities and decreased capitalisation of the economy, together with a diminished availability of foreign capital. Accordingly, taking into account the current cyclical position of Croatia and of the relevant foreign economies, as well as all the previously mentioned structural disturbances of the domestic economy, together with the level of underutilisation of the existing economic capacity, the indicated projections imply an imminent stabilisation of international macroeconomic conditions, quick implementation and effects of the planned structural reforms and favourable movements in the sphere of economic expectations.

As regards the labour market in 2011, a fall in Labour Force Survey employment of 3.1% and a rise in the Labour Force Survey unemployment rate to 13.3% are estimated. As a result of the described movements and a real GDP growth, a rise in the average labour productivity will accelerate to 3.6%. As a result of a faster growth in labour productivity than the increase in nominal gross wages, a reduction in the unit labour cost is expected in 2011, which would, nevertheless, be somewhat slower than in the previous year. Since recovery of employment will lag behind the recovery of economic activity, 2012 is expected to see a continuation of unfavourable developments, though at a rate slower than in the previous years, and a gradual improvement in labour market indicators by the end of the year. Accordingly, a reduction in Labour Force Survey employment of 1.3% is expected in 2012, as well as a growth in the Labour Force Survey unemployment rate to 14.0%. The projected stagnation in nominal gross wages and the growth in average labour productivity will result in further reduction in the unit labour cost. Net wages will record a moderate real decrease, which will, nevertheless, be somewhat smaller compared to gross wages as a result of the legislative changes in the system of income taxation. As of 2013, negative developments on the labour market are expected to end. More specifically, an increase in Labour Force Survey employment of 0.1% is projected for 2012, and its acceleration to 0.8% for 2014 with the Labour Force Survey unemployment rate remaining at the previous year's level in 2013 and decreasing to 13.4% in 2014.

The described projections are exposed to certain internal and external adverse risks. First, the projected economic growth in 2012 rests on the assumption that a strong real growth of gross fixed capital formation of public enterprises will be achieved, and a failure to realise that assumption, whether due to financing difficulties, or due to changes in the time frame, could threaten the projected economic activity growth. In addition, uncertainty concerning the banks' propensity to grant loans to domestic sectors, and the conditions of financing and refinancing of economic sectors in general, is still present, which is to a large extent related to development of the situation on foreign financial markets and internal factors as well. Furthermore, more adverse labour market movements than those projected would have an implication on personal consumption dynamics, fiscal consolidation process and quality of assets of the domestic financial system, and as a consequence, on the overall economic activity. Construction activity, and thereby investment activity and the financial sector as well, will be affected by further developments on the real estate market, concerning the demand dynamics and movements of the equilibrium price. More unfavourable movements in the international environment compared to the expected ones, and primarily more pronounced recessionary movements in the EU Member States, represent an external risk, which would affect Croatia mainly through decreased availability of foreign capital and weakening of foreign demand for domestic goods and services.

2.2.2 Inflation

The average growth of consumer price index of 2.4% is expected in 2012. Inflation movements will be determined by subsiding imported inflationary pressures, weak personal consumption, further weakening of domestic cost-driven pressures on prices and by the envisaged economic policy measures. More specifically, it is expected that the net effect of the increase in VAT rate from 23% to 25% in March 2012 and the decrease in VAT rate on certain products from 23% to 10% in the same month will be, at the yearly level, partly cancelled by the decrease in the rate of contribution for compulsory health insurance from May 2012. A stable rate of inflation at the level of 2.5% in 2013 and 2.4% in 2014 is expected in the forthcoming period.

Table 1: Consumer Price Index (average year-on-year rates of change, in %)

	2010	2011p	2012p	2013p	2014p
CPI, PEP 2011 - 2013	1.1	2.2	2.5	2.5	-
CPI, PEP 2012 - 2014	1.1	2.3	2.4	2.5	2.4

Source: CBS, MF

As regards risks for the inflation projection, a larger reduction in personal consumption than that expected, for instance, due to more serious disturbances on the labour market or more pronounced pessimistic expectations of households, would increase deflationary pressures from the demand side, which would make the growth in consumer prices lower than it was projected. On the other hand, stronger transmission of the previous increase in the price of raw materials on the world market on domestic prices, new price shocks on the global markets of primary raw materials, mainly oil, greater increases in administrative prices or stronger depreciation of the domestic currency than that assumed, could lead to a higher consumer price inflation relative to the projections.

2.2.3 Monetary and Exchange Rate Policies

Monetary policy pursued by the Croatian National Bank is based on maintaining stability of the exchange rate of the kuna against the euro as the main nominal anchor for achieving its primary objective – maintenance of price stability. The choice of such a monetary policy reflects the main characteristics of the Croatian economy. More specifically, Croatia is a small and open, highly

euroised economy, with a high level of external debt, where the stable exchange rate of the domestic currency is the assumption of the overall macroeconomic stability.

The period following the outbreak of the global financial crisis was marked by increasingly poorer inflow of capital from abroad. In view of the developments on the world financial market, it is realistic to expect that inflow of capital from abroad will remain limited. In such conditions, maintenance of the exchange rate stability becomes more and more demanding, with fiscal consolidation and implementation of structural reforms in the real sector becoming the assumptions for achieving growth in the Croatian economy.

Therefore, it is expected that the exchange rate of the kuna against the euro remains stable until the end of the projection period. More specifically, the average exchange rate is projected at the level of 7.47 HRK/EUR in 2012 and 7.48 HRK/EUR in the next two years.

2.2.4 External Sector and its Medium-term Sustainability

The recent outturns in October and November 2011 point to unfavourable developments in trade in goods in the last quarter. More specifically, exports recorded a year-on-year decrease which was substantially stronger than the fall in imports. Therefore, a stagnation of exports and a decrease in imports of goods is expected in 2011, which should influence on further reduction of the negative balance on the goods account.

Although exports of goods will rise gradually until the end of the projection period, it is unlikely to reach the pre-crisis growth rates. Implementation of structural reforms, together with strengthening of cost and price competitiveness, would be a prerequisite for its more significant growth. Otherwise, the market share of Croatian exports in the world market, which has been stagnating for the entire decade, is unlikely to increase. As regards competitiveness of the domestic exports, movements in the real effective exchange rates of the kuna⁵ over 2010 and 2011 pointed to an improvement of its position in the foreign market, but it did not have a particular effect on exports results. In 2012, continued depreciation of the real effective kuna exchange rate is also expected, as a result of a mild nominal effective depreciation and a slower growth in domestic consumer prices relative to those in the principal trading partners⁶. However, as early as in the coming years, an increase in domestic prices could be somewhat more pronounced, threatening thus price competitiveness of domestic exporters.

In addition to trade in goods, trade in services is evidently likely to contribute to the improvement of the current account balance in 2011, primarily on account of tourism revenues which, according to the available data for the high tourist season, rose considerably relative to the same period of the previous year. In that regard, the number of arrivals increased and the average consumption of foreign tourists recovered to a certain extent. However, such a revenue growth dynamics is not

⁵ Real effective exchange rate of the kuna is a weighted geometric average of bilateral nominal exchange rates of the kuna against the selected currencies of the main trading partners, adjusted for the appropriate relative price or cost indices (i.e. the ratio of the price or cost index in the trading partners to domestic prices). The currencies of the principal trading partners and their weights are determined on the basis of the structure of imports and exports of manufactured goods, the weights reflecting direct import competition, direct export competition and export competition in third markets (for details see Box 2 of the CNB's Bulletin No. 165). The group of countries for forming the real effective exchange rate of the kuna comprises 16 trading partners (Austria, Belgium, France, Germany, Italy, the Netherlands, Slovenia, Spain, Czech Republic, Hungary, Poland, Sweden, Great Britain, the USA, Japan and Switzerland). The real effective kuna exchange rate series are based on fixed weights as they are simple and practical to use in calculations.

⁶ Projections of exchange rates and consumer prices, in the principal trading partners are taken over from the publications Consensus Forecasts and EU Commission Forecast.

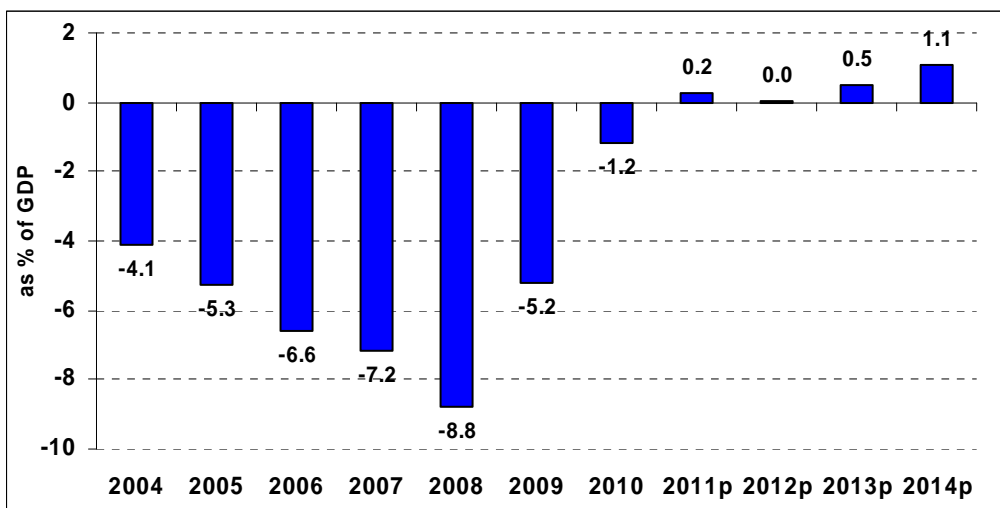
sustainable in the mid-term, especially if political instabilities in the competitive destinations of southern Mediterranean are resolved and the real economic growth in the main outbound markets decelerates. It cannot be expected that volume indicators in tourism will grow at a quick pace within the present tourism capacity and without making major investments.

In 2011, income account deficit will probably exceed the last year's outturn, primarily due to a rise in interest expenditures. Expenditures arising from foreign direct investments (dividends paid out and retained earnings) are also likely to grow. In the forthcoming period, similar trends are expected and the increase in interest expenditures could even become sharper, provided that uncertainty concerning the resolution of the debt crisis in the eurozone continues or provided that the Croatian credit rating deteriorates.

It is estimated that the surplus in the current transfers account in 2011 could be below that in the previous year, due to reduced central government revenues. Private sector revenues show stagnation, reflecting uncertainty in the EU economies from where most of the current transfers to households originate. By the end of the projection period, recovery of revenues is envisaged owing to the accession to the EU and the associated transfers to domestic sectors. Nevertheless, after joining the EU, increased expenditures should be expected due to the contributions to be paid to the joint EU budget.

In general, the current account of the balance of payments could improve additionally by the end of 2011, so the surplus of approximately 0.2% of the projected GDP is expected for 2011. Under the 2011 PEP, a considerably less favourable balance (-3.8% of GDP) was projected, which was in line with the expectations at that time of a significantly faster economic recovery and strengthening of the import demand. Except from a mild decrease in surplus in 2012, a gradual increase in positive balance on the current account to the level of 1.1% of the projected GDP is expected towards the end of the projection period.

Figure 2: Current Account of the Balance of Payments



Source: CNB, CBS, MF

Mid-term and long-term sustainability of the current account balance is largely determined by the implementation of structural reforms and a gradual strengthening of competitiveness of goods and services exports. A moderate growth in interest expenditures, which could, in case of significant deterioration in external financing conditions, exert a strong pressure upon the new growth in deficit, is also a prerequisite for a sustainable balance of payments position. In that context,

sustainable fiscal position has an important role, affecting both the possibility of accession and the financing conditions on the international capital market.

As of the onset of economic crisis, a strong contraction in current account deficit has been accompanied by a sharp contraction in capital inflows, both equity and debt.

By the end of the 2011, foreign direct investment should reach a maximum of EUR 0.9 billion, mainly owing to retained earnings. That amount outstrips by one third the outturn in 2010 (excluding the effect of round tripping⁷), exclusively due to a somewhat smaller deleveraging with respect to affiliated companies. Although the expected direct equity investments at the entire 2011 level are at the previous year's level, it should be noted that, according to data for 2011 available up to this time, only a smaller portion of the received funds was invested in new production capacities, while the greatest portion was used for repaying external debt or the owners converted debt receivables into capital, which also increased the stock of direct investments. If such transactions are excluded, 2012 should bring positive moves, although a more intense growth in investments will be conditional on the elimination of a range of obstacles that are currently present on the domestic market. A certain incentive for investors, such as a completion of negotiations with the EU, could raise direct investments to approximately 3% of GDP in the mid-term.

As regards external borrowing by the end of 2011, the central government, following the bond issue in July, should not generate any further debt growth and the same holds true for corporates, whereas banks are expected to increase slightly their foreign liabilities. The debt stock in relation to affiliated companies should be reduced, after converting a part of debt receivables into equity capital. Total external debt of the Republic of Croatia would thus amount to EUR 45.8 billion at the end of 2011, with relative indicators standing at around 99% of GDP, or 256% of exports of goods and services. Primarily related to the general government sector and public enterprises, an increase in external debt and a rise in the relative indicator of external indebtedness to approximately 100% of GDP are expected in 2012. The relative indicators of gross external debt could gradually improve towards the end of the projection period to the level of around 95% of GDP, or 236% of exports of goods and services.

A strong borrowing of the public and private sector, accompanied by an inflow of direct investment and an increase in the value of companies in foreign ownership in the years before the economic crisis, resulted in a considerable deterioration of the Republic of Croatia's international investment position. Nevertheless, in the period of crisis, the value adjustment of the companies in foreign ownership took place and the trend of heavy borrowing by domestic sectors was mitigated, so that the international investment position indicator held steady at the level of approximately -92% of GDP. In the mid-term period, a further stagnation or only a mild deterioration of the Republic of Croatia's investment position is expected, which will primarily depend on the position of the public sector. The investment position of the private sector is unlikely to change substantially, since the market value of direct investments will recover very slowly from the crisis adjustment, whereas external debt is likely to stagnate or even decline mildly. Despite stabilisation, the present level of net foreign liabilities, where debt liabilities are prevailing, exposes the country to high risks, especially in the context of poor economic growth and non-competitive exports, as well as a possible worsening of the financing conditions in the forthcoming period.

In the previous period, negative international investment position of the domestic sectors has been mitigated, to a large extent, by international reserves, which can be assessed, according to the

⁷ Transactions related to direct round-tripping (winding up of companies within the related group) reduced the total stock of direct investments in Croatia in 2010 by EUR 0.4 billion. Winding up of these companies resulted in the equal reduction in Croatian direct investments abroad, so that the overall effect on the financial account was neutral.

relative indicators, as being adequate. Provided that the preconditions for a return to positive economic growth rates are ensured and the access to the international capital market retained, the relative indicators of international reserves adequacy should gradually improve in the mid run.

3 PUBLIC FINANCES

3.1 GENERAL GOVERNMENT BALANCE AND DEBT

3.1.1 Fiscal Policy and Medium-Term Objectives

In the context of greater uncertainty and risk at the global and domestic level, in the forthcoming mid-term period, the key challenge of the economic policy is preservation of macroeconomic stability and creation of conditions for recovery and stable economic growth. Fiscal policy in the forthcoming mid-term period will be based on three principles: 1) creation of preconditions for reviving the economy, primarily through the investment cycle and the improvement of business conditions, 2) sustainability of public finances in accordance with the Fiscal Responsibility Act, 3) focusing on the protection of socially most vulnerable groups of society.

The aforementioned three principles of fiscal policy will be implemented on both revenue and expenditure side of the budget. Accordingly, several measures are being prepared at the revenue side. For the purpose of a further strengthening of fairness in taxation of income from labour, the level of basic personal allowance will be raised, tax brackets will be changed, whereas the tax rates themselves will remain the same. The contribution rate for compulsory health insurance, paid by employers on gross salary of their employees will be reduced by two percentage points, which will improve cost competitiveness of the economy and stimulate employment. The new general value-added tax rate of 25% will be introduced and a lower rate will also apply to certain groups of goods and services that represent a heavier burden, in relative terms, for citizens with lower income. In order to make the value-added tax system more rational and transparent, the abolishing of input VAT in receipts for representation expenditure and expenditure related to cars, airplanes, vessels, etc. usage is proposed. In the forthcoming period, the revenue side of the budget will be marked by further rationalisation of non-tax levies burdening entrepreneurs and revenues that are under the influence of further harmonisation of the Republic of Croatia with the European Union.

The measures on the expenditure side of the budget will primarily be directed at improving fiscal imbalances and ensuring a sustainable level of financing in presently still unfavourable financial and economic conditions. In adjusting expenditures to the realistic framework, apart from savings, additional space should be provided for certain categories of expenditure in the forthcoming years. This primarily relates to interest expenditure, expenditure arising from pensions and contributions that the Republic of Croatia will have to make to the EU budget. Accordingly, observing the provisions of the Fiscal Responsibility Act, as well as the need for closing the fiscal gaps, savings must be made in other groups of expenditure, where it is crucial to implement structural measures and reforms.

Consequently, an accelerated closing is expected of the fiscal gaps that have been present in the past several years as a direct consequence of adverse economic developments. Apart from deficit reduction, one of the most important objectives is to halt the growth and then reverse the trend of the public debt share in the gross domestic product value. For the described fiscal policy orientation to be successful, it is extremely important to implement the Fiscal Responsibility Act in practice.

3.1.2 Actual Balances and Medium-Term Perspectives

Recent Movements in the Consolidated General Government Budget

Fiscal developments in the previous period were primarily determined by the adverse economic developments which were felt especially on the revenue side of the budget, as a result of which the share of consolidated general government in GDP was reduced from 39.1% to 37% in the 2008-2010 period. At the same time, the expenditure side of consolidated general government increased

from 40.4% of GDP in 2008 to 41.9% of GDP in 2010. The aforementioned impact of the crisis deepened fiscal imbalances, so that consolidated general government budget deficit, in accordance with ESA 95 methodology, rose from 1.4% of GDP in 2008 to 4.1% of GDP in 2009 and 4.9% of GDP in 2010. In 2011, further increase in general government deficit was planned, which was primarily a result of changes on the revenue side of the budget, demonstrating their full effect in 2011. More specifically, during 2010, the state budget recorded on the revenue side a considerable amount of receipts based on tax debt from the previous period and the revenue side of the budget also contained in that year a special tax on salaries, pensions and other receivables, which was no longer in force in 2011. In addition, in 2011, the whole-year effect of changes in the income tax system from mid-2010 was present, which also resulted in a lower level of income on that basis compared to 2010. Expanding of deficit also contributed to a growth in public debt, reaching from 29.2% of GDP in 2008 the level of 41.3% of GDP in 2010.

In the forthcoming mid-term period, further fiscal consolidation will be the fiscal policy objective, together with a continuation of structural reforms and alignment in the EU accession process.

Medium-Term Fiscal Projections

Consolidated General Government Revenue

The consolidated general government revenue plan for 2012 and projections for the 2013-2014 period are based on macroeconomic assumptions for the aforementioned period, changes in the tax legislation, further harmonisation of Croatian legislation with the EU *acquis communautaire* and a full EU membership of the Republic of Croatia as of 1 July 2013.

As regards the changes in the tax legislation it is important to note the changes in income taxation, value added tax and contributions. By the amendments to the Income Tax Act, which enter into force on 1 March 2012, the level of basic personal allowance is raised from HRK 1,800 to HRK 2,200, the level of personal allowance for pensioners is raised from HRK 3,200 to HRK 3,400, tax brackets are changed, but the rates at which this tax is paid remain unchanged. More specifically, under the new legislative amendments, income tax is levied at a rate of 12% on the amount from the taxable income to the amount of the basic personal allowance, at a rate of 25% on the taxable income difference from the amount of the basic personal allowance to the quadruple basic personal allowance and at a rate of 40% on the taxable income above the quadruple amount of the basic personal allowance. Accordingly, an increase in net wages for lower income groups is provided, and a reduction in net wages for higher income groups, which also contributes to progressiveness of taxation. It is expected that revenues from income tax wouldn't significantly change under the aforementioned legislative changes. Namely, amendments to the Income Tax Act resulting in the increased level of basic personal allowance, the level of personal allowance for pensioners, and tax brackets, will lead to decrease of revenues from income tax, while taxation of dividends, shares in profit, pension supplements and pensions from abroad will lead to increase in this kind of revenues.

The amendments to the Profit Tax Act introduce obligation to pay tax after deduction on dividends and shares in profit. It is estimated that according to this legislative change revenue will increase by approximately 0.06% of GDP on annual basis. Furthermore, amendments refer to decreasing taxable base in proportion to the part of the profit achieved and put into the fixed capital of the company, in accordance with special provisions. Effects from these amendments are estimated to ensure continuity of revenues on this basis.

The amendments to the Act on Contributions will reduce the rate of contribution for compulsory health insurance by two percentage points, i.e. from 15% at present to 13%. This will ensure lifting

of a tax burden off the gross labour cost, which is one of the measures for a more stimulating tax system in terms of the labour cost, and it will also contribute to the competitiveness of the domestic economy. The effect of income reduction on this basis is estimated at around 0.7% of GDP at the annual level. The amendments to the Act on Contributions will be in force from 1 May 2012.

Changes in taxation will also encompass the most significant tax revenue, the value added tax. As of 1 March 2012, the new general value added tax rate of 25% will enter into force, implying the increase of VAT general rate of two percentage points. Given the regressive nature of this tax form, there is intention to make some changes in the tax system in order to ease the effect of the changes for lower-income categories of population. In that respect, instead of the present 23%, the VAT rate of 10% will apply for individual products and services, such as edible oils and fats of vegetable and animal origin, children's food and processed food for children and infants on the basis of cereals, supply of water, except bottled or otherwise packaged drinking water, white sugar from sugar cane and sugar beet. Furthermore, in order to achieve greater rationality of the VAT system, abolishment of input VAT deduction is stipulated for acquisition and renting of vessels for entertainment, airplanes, personal motor cars and other types of personal transport, including acquisition of all goods and services in relation to of the aforementioned goods. Furthermore, complete abolishment of input VAT deduction is stipulated for acquisition of goods and services for the purpose of representation. These provisions would simplify the process of determining the tax obligation, decrease tax evasion and also ensure the inflow of funds in the state budget. Analyses estimate annual effect of all changes in the framework of VAT Law to approximately 0.9% of GDP.

Assistance directly related to the use of the EU pre-accession and accession funds, also represents an important category of revenues, the significance of which is growing towards the end of the medium-term period. It is estimated that these revenues will record a change from approximately 0.5% of GDP in 2012 to 0.8% of GDP in 2014.

Apart from the described changes, certain changes are also planned at the level of 2012 regarding the non-tax levies, in order to improve competitiveness, i.e. lift the tax burden off entrepreneurs and investors. A 50% reduction of water contribution is thus being proposed, which represents a revenue of Hrvatske vode (Croatian water management company), as well as a 50% reduction of a fee for using forest functions of general use, which is a revenue of Hrvatske šume (Croatian forest management company), as well as the abolishment of an indirect part of the monument annuity. The overall estimated annual effect of these non-tax changes is about 0.1% of GDP.

Accordingly, in 2012, total consolidated general government revenues are planned at the level of 35.7% of GDP, they are projected at the level of 35.1% of GDP for 2013 and at the level of 34.6% of GDP for 2014. Revenues from value added tax represent the most important budget revenues, which will average around 11.6% of GDP in the observed medium-term period. Indicated legislative changes also have significant impact on projected movements of the revenues in the mid-term period. The share of income tax revenues in the value of gross domestic product will thus move at the average level of 2.6% until the end of the observed period. Profit tax revenues are projected to average around 2.2% of GDP at the same time. In accordance with the medium-term projections, revenues from special taxes will be on average around 3.2% of GDP. Revenues of customs and customs duties are expected to gradually decrease their share in GDP and projections imply the decrease from 0.5% of GDP in 2012, 0.3% of GDP in 2013 to 0.2% of GDP in 2014.

Revenues from social contributions represent the second most important group in the structure of revenues. The aforementioned legislative changes will give significant contribution to developments in this area. According to the projections, the share of social contributions in the value of gross domestic product will decrease from 10.9% in 2012 to 10.2% in 2014.

As regards other budget revenues, revenues from financial assets has are projected to decline in nominal terms in 2012, primarily on account of the revenues on the basis of the Republic of Croatia' ownership in individual companies. Nominal decrease of these revenues in 2012 is linked to the effect of 2011 base period, during which significant revenues were realised. Intention is to encourage investment in these companies and thus not to absorb this kind of revenues into the state budget.

Consolidated General Government Expenditure

In the following three-year period, consolidated general government expenditures will continuously decrease their share in GDP, thus contributing to a long-term sustainability of public finances. Rationalisation of the expenditure side of the budget represents the key prerequisite in terms of achievement of fiscal sustainability in the unfavourable economic conditions. Accordingly, taking into account widening of fiscal imbalances in the past several years, a need for complying with the Fiscal Responsibility Act and returning of public finances to a sustainable footing, it was important to identify significant savings that could be made on the expenditure side of the budget. For 2012, a reduction in general government budget expenditures of 0.9 percentage points of GDP is thus projected, i.e. from the planned level of 41.4% in 2011 to 39.5% in 2012. The most important part of the general government budget, i.e. the state budget, records a nominal decrease in expenditures in almost all categories, whereas expenditures arising from interests and pensions are the most significant expenditures which record a year-on-year growth. The projections for 2013 and 2014 show a further reduction in general government budget expenditures, of 1.2 percentage points of GDP annually, or from 38.4% in 2013 to 37.2% in 2014, which is also in compliance with the provisions of the fiscal rule set out in the Fiscal Responsibility Act.

The most significant group of general government budget expenditures are social benefits which will see a steady decline in their share in GDP over the next three-year period, from 13.1% in 2012 to 12.1% in 2014. The developments in these expenditures are largely determined by developments in the major categories of social benefits, most notably expenditures for pensions and health care. In 2012, the adjustment of pensions to the consumer price index and gross salaries, which was absent in the past two years, will be carried out, as provided for by the law. An additional expenditure of about 0.1% of GDP is envisaged for that purpose. On the other hand, outlays in the health care sector will continue to be influenced by further implementation of the health care reform, particularly in primary and secondary health care, which is aimed at sustainability of the health care system financial stability. This category of expenditures also encompasses other types of social benefits, such as child allowance, maternity allowance, active employment policy, etc.

Compensation of employees in public and state administration, in terms of its share in total expenditures, makes up the second largest expenditure item of the general government budget. The amount of these expenditures will largely be determined by developments in the number of civil and public servants. It should be noted that measures are being taken to carry out rationalisation of these expenditures, relating to special supplements to salaries, part time work, overtime work and special working conditions, by means of which savings of about 0.6% of GDP could be made at the annual level. The share of compensation of employees in GDP is projected to move from 9.7% of GDP in 2012 and to 9.0% of GDP in 2014.

Expenditures for intermediary consumption which relate mostly to expenditures for goods and services earmarked for compensation of employees, material, energy and services are expected to average 4.3% of GDP over the mid-term period. Their dynamics will largely be determined by activities and projects financed under EU pre-accession and accession assistance programmes, since the majority of the EU related projects and activities are reflected through this group of expenditures.

The share of expenditures for subsidies in the value of GDP will decrease from 1.9% of GDP in 2012 to 1.8% of GDP in 2014. The greatest savings will be made in subsidies to agriculture and Hrvatske željeznice (Croatian railways), the annual impact of which is, in general, estimated at around 0.3% of GDP. By the time of the EU accession, the entire system of subsidies in agriculture will have to be reviewed, which will make the agricultural sector more ready and competitive in view of the EU membership. As regards the subsidies to Hrvatske željeznice, accelerated implementation of structural reforms is required, in order to achieve increasingly small reliance of railways on the state budget and contribute to strengthening of their competitiveness.

The expenditures for property income in the forthcoming period will be determined by the developments in interest expenditures. More specifically, under the influence of developments in financial markets and the total needs for budget financing due to a rise in fiscal deficits, in the previous years, interest expenditures recorded steady nominal increases. Their further growth of around 0.1% of GDP is projected for 2012 as well. These expenditures will average 2.0% of GDP over the next three-year period.

Other current transfers, which comprise current grants and current donations, are projected at 1.3% of GDP in 2012, 1.7% of GDP in 2013 and 2.2% of GDP in 2014. This category of expenditures is partly determined by the contribution of the Republic of Croatia to the EU budget, amounting to around 0.4% of GDP in 2013 and 0.9% of GDP in 2014. Capital transfers, which include capital grants and capital donations, are expected to average 1.4% of GDP in the observed medium-term period.

Expenditures for gross fixed capital formation comprise net expenditures for the acquisition of fixed assets, strategic inventories and valuables. These expenditures are planned to range from 1.6% of GDP in 2012 to 1.5% in 2014, and will largely be determined by activities associated with capital investments in health care, social welfare, science, education, judiciary, etc.

Net lending/borrowing

For the purpose of ensuring the basis for a future as fast economic growth as possible, changes in the revenue policy of the budget play an important role, whereas savings on the expenditure side should allow for closing of a part of fiscal imbalances and create a path for sustainable, financially acceptable sources of financing and a possibility of settling financial liabilities.

Accordingly, the planned fiscal consolidation in the forthcoming medium-term period will result in a reduced share of budget expenditures in GDP, reduced consolidated general government deficit and in stabilising and reversing the trend of a continuous increase in the share of public debt in GDP, the beginning of which is expected after 2014. In the mid-term period, a decrease in net lending/borrowing of general government is expected from 3.8% of GDP in 2012 to 3.3% in 2013 and 2.6% of GDP in 2014. The largest contribution to this will be made by the budgetary central government, which will in 2012 record a deficit of 3.3% of GDP, compared to 2.8% of GDP in 2013. Towards the end of 2014, budgetary central government deficit is planned to be additionally reduced to 2.2% of GDP. As regards movements in net lending/borrowing of other levels of the general government budget, extrabudgetary users and the units of local and regional self-government will retain the same level of deficit over the entire medium-term period, averaging 0.2% of GDP.

Table 2: Revenue, expenditure and net lending/borrowing of the General Government 2010-2014 according to government level

ESA 95	% of GDP	2010.	2011.p	2012.p	2013.p	2014.p
Budgetary central government - unconsolidated						
TR	Total revenue	32.1	31.2	31.0	30.5	30.1
TE	Total expenditure	36.9	36.0	34.3	33.3	32.4
B.9	Net lending/net borrowing	-4.8	-4.9	-3.3	-2.8	-2.2
Extrabudgetary users - unconsolidated						
TR	Total revenue	1.5	1.5	1.5	1.4	1.4
TE	Total expenditure	1.6	1.9	1.7	1.6	1.5
B.9	Net lending/net borrowing	-0.1	-0.4	-0.2	-0.2	-0.1
Local government - unconsolidated						
TR	Total revenue	4.5	4.2	4.2	4.1	4.0
TE	Total expenditure	4.5	4.5	4.4	4.3	4.2
B.9	Net lending/net borrowing	0.0	-0.3	-0.2	-0.2	-0.2
Consolidated general government						
TR	Total revenue	37.0	35.8	35.7	35.1	34.6
TE	Total expenditure	41.9	41.4	39.5	38.4	37.2
B.9	Net lending/net borrowing	-4.9	-5.5	-3.8	-3.3	-2.6

Source: MF

Financing of the general government budget

As regards budget financing, it should be noted that widening of fiscal imbalances over the past few years, together with the needs for repayment of old debts, called for large financing needs, which was reflected in the price, maturity and availability of sources of financing on the domestic financial market. On the other hand, considerable needs for financing on the foreign financial markets had an impact on strengthening of external vulnerability of the country. Increased needs for financing in the previous periods were also reflected in a significant rise in interest expenditures and public debt. Accordingly, fast closing of fiscal imbalances represents a priority in terms of sustainability of public finances, whereas stimulation of economic growth is an absolute priority in mitigating the effects of the previous unfavourable economic developments.

Developments in total needs for financing over a medium-term will be determined by developments in the fiscal balance, expected developments in financial assets and liabilities maturing during that period. The financing policy in the forthcoming period will be characterised by reduced needs for financing, primarily as a result of a decrease in fiscal deficit, while financing itself will be distributed into domestic and foreign sources of financing, in the ratios that will produce most favourable economic effects both in terms of the general situation and conditions on the domestic financial market and in terms of external exposure. As regards positive implications on financing and dynamics of public debt, special emphasis should be made on the significance and need for privatisation receipts in the forthcoming period, where around 0.6% of GDP from privatisation is expected at the level of budgetary central government in 2012, and around 0.2% of GDP on average in the following two years.

The bulk of the required general government budget financing in the forthcoming period is at the level of budgetary central government and it should be stressed that the level of financing covers net lending/borrowing and repayments of public debt and net changes in financial assets. It should be noted that most of the maturities of the liabilities in the 2012-2014 period relates to four bond maturities, three domestic and one foreign. Two of the domestic bonds are denominated in euro, the first in the amount of EUR 500 million and the second in the amount of EUR 650 million, whereas the third bond is denominated in kuna, in the amount of 4.0 billion. The foreign maturity relates to an eurobond worth EUR 500 million, maturing in 2013. As regards loans, the biggest maturities during the observed period relate to maturing syndicated loans issued on the domestic financial market.

Table 3: Overview of bond maturities of the Republic of Croatia in the 2012-2014 period

Bond	Date of issue	Amount (in million)	Interest rate	Date of maturity
DOMESTIC BONDS				
Series 03 D-12	23.5.2002	500 EUR	6,88%	23.5.2012
Series 11 D-13	11.7.2006	4.000 HRK	4,50%	11.7.2013
Seriya 05 D-14	10.2.2004	650 EUR	5,50%	10.2.2014
FOREIGN BONDS				
Euro - EUR VI 2014	15.4.2004	500 EUR	5,00%	15.4.2014

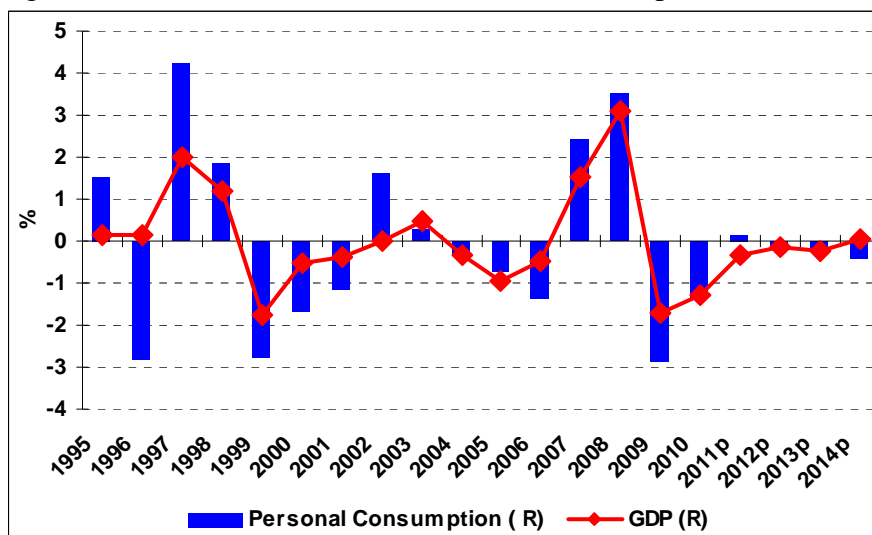
Source: MF

3.1.3 Estimate of the Cyclically Adjusted Primary Deficit

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

The calculation of the cyclically adjusted deficit was based on the method of the European Central Bank⁸. Personal income tax, profit tax, value added tax, excise duties and social contributions were observed as cyclically sensitive components on the revenue side, whereas, on the expenditure side, unemployment benefits were observed. The wage bill, gross operating surplus, personal consumption and the number of unemployed persons were used as macroeconomic bases for individual cyclical components. Long-term trend values of individual macroeconomic bases were determined by applying the Hodrick-Prescott filter on their quarterly seasonally adjusted values with the chosen smoothing parameter $\lambda=300$.

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



Source: MF

⁸ Bouthevillain et al., (2001), „Cyclically Adjusted Budget Balances: An Alternative Approach“, European Central Bank Working Paper Series, No. 77.

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

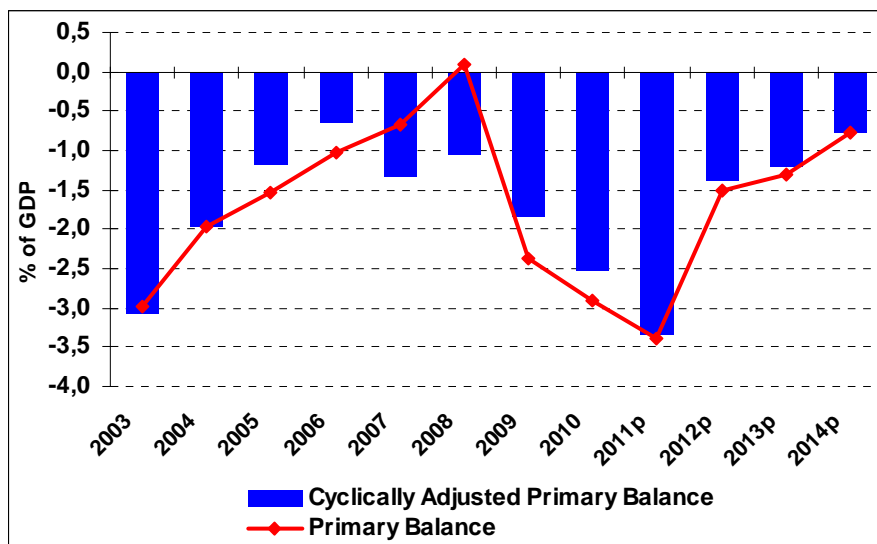
$$\Delta \ln X_t^i = \alpha + \beta(\ln X_{t-1}^i - \gamma \ln V_{t-1}^i + \phi + \delta + \dots) + \delta_1 \Delta \ln V_t^i + \delta_2 \Delta \ln V_{t-1}^i + A + \zeta,$$

where X^i represents the observed cyclical component and V^i the respective macroeconomic basis, while δ_1 and δ_2 are the short-term elasticity of cyclical components relative to the relevant macroeconomic base in the same and the preceding period.

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

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

Figure 4: Primary Balance and Cyclically Adjusted Primary Balance



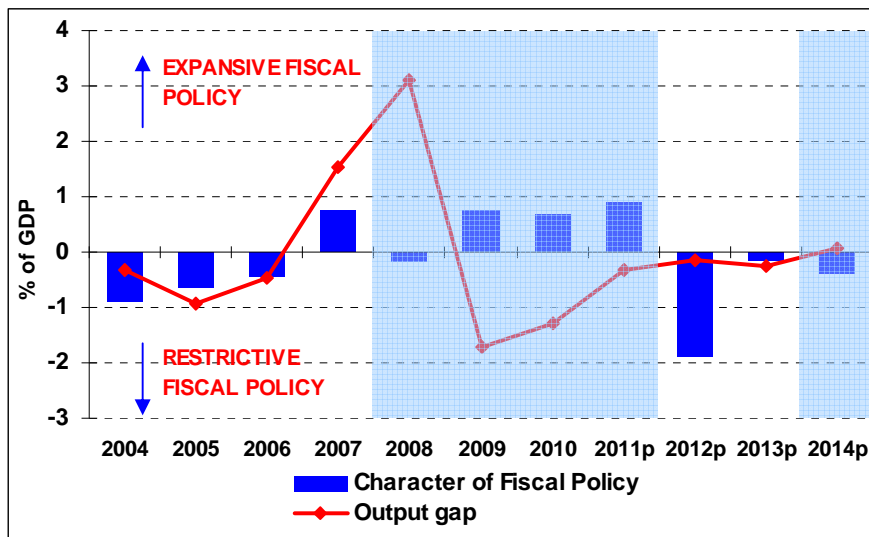
Source: MF

The evaluation of the fiscal policy character, taking into account the imperfections of the Hodrick-Prescott filter, indicates that fiscal policy has changed its cyclical characteristics many times in the analysed period. Pro-cyclical fiscal policy is characterised by expansive fiscal policy in the period of overheating of the economy, and restrictive fiscal policy in the period of underemployment. Anti-cyclical fiscal policy is characterised by expansive fiscal policy in the period of underemployment and restrictive fiscal policy in the period of overheating of the economy.

Restrictive fiscal policy in a year is defined as a reduction and expansive fiscal policy as an increase of the cyclically adjusted primary fiscal deficit relative to the previous year.

The ratio between expansivity or restrictivity of fiscal policy and the output gap in the 2004 to 2011 period indicates pro-cyclical character of the fiscal policy in the period 2004-2007 and anti-cyclical character of the fiscal policy in 2008-2011. Based on projections for 2012-2014, the output gap is expected to be slightly negative with pro-cyclical character of the fiscal policy in the years 2012 and 2013, and slightly positive with anti-cyclical character of the fiscal policy in 2014.

Figure 5: Character of Fiscal Policy



Source: MF

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

3.1.4 Debt Levels and Developments

As described previously, further domestic and global unfavourable economic developments in 2010 reflected on fiscal developments, leading as a result to further worsening of fiscal imbalances and an increase in the nominal amount of public debt, as well as its share in GDP. At the end of 2010, the total public debt reached HRK 138 billion, accounting for 41.3% of GDP. The foreign debt component accounted for 35.3% and the domestic debt component accounted for 64.7% of the total public debt.

The largest share of public debt was created by borrowing on the basis of long-term securities, and then by borrowings through loans and T-bills.

As per government level, at the end of 2010, the bulk of public debt refers to the Central Government (93.8%), while Extrabudgetary Users and Local Government units accounted for 4.8% and 1.5%, respectively, of the total public debt. The Central Government borrowed mostly on the domestic market, as a result of which the domestic component of its debt accounted for 64.1% of the total Central Government debt. The Local Government also borrowed mainly domestically, with the domestic component of the total Local Government debt standing at 83.9%. As regards Extrabudgetary Users, the domestic component of the debt also prevailed, accounting for 69.8% of the total debt of Extrabudgetary Users.

As regards debt currency structure, it should be noted that a significant part of the debt is denominated in foreign currency, with the largest share of this amount being denominated in the euro.

In 2011, the Republic of Croatia met its financing needs on the foreign and domestic markets. In March 2011, a ten-year bond was issued on the American market, amounting to USD 1.5 billion, at a coupon interest rate of 6.375%. At the same time while this bond transaction was being negotiated, a currency risk hedging transaction was conducted and the dollar debt converted into the euro. Helped by economic recovery, stable credit rating and completion of EU accession negotiations, a EUR 750 million government eurobonds were issued in June 2011, at an annual coupon of 5.875%, and maturing in 2018. In July 2011, a five-year bond of HRK 1.5 billion at an annual coupon of 5.75% was issued on the domestic market, maturing in 2016 and a EUR 600 million bond with a currency clause, at an annual coupon of 6.50%, maturing in July 2022. In September 2011, a five-year EUR 260 million loan was taken at a fixed interest rate of 5.5% to refinance a part of the 1991 bonds for economic restructuring. This helped eliminate unfavourable borrowing instruments, such as 1991 bonds, from government debt portfolio, in accordance with the Public debt management strategy 2011-2013. Part of the total financing needs in 2011 was also met by means of short-term instruments, in particular syndicated loans of domestic banks and T-bills.

As a result, at the end of October 2011, general government debt stood at HRK 153.7 billion or 44.8% GDP, with the share of the domestic debt component accounting for 66.4% and the share of the foreign debt component accounting for 33.6%.

Financing policy in the forthcoming period will be characterised by reduced financing needs, primarily as a result of a reduction in the fiscal deficit, and will involve both domestic and foreign sources of financing.

The described fiscal developments will also affect public debt dynamics, with the key task being to halt the growth of its share in GDP and bringing about a reversal in its continuous growth trend. As regards positive implications on public debt financing and dynamics, note should be taken of the significance of privatisation receipts and the need for these receipts in the forthcoming period.

The projections of public debt developments indicate that, due to a continuous reduction in the budgetary central government deficit and the general government budget deficit over the entire mid-term period, the trend of public debt growth is expected to stabilise in 2014 and to be followed by a fall in its share in GDP. Faster adjustment, i.e. a reversal in the trend of public debt to GDP ratio can also be expected, in the case that higher than planned non-debt financing income materialises.

Table 4: Public debt development projection

<i>% of GDP</i>	2010	2011*	2012*	2013*	2014*
Public debt	41.3	44.9	47.2	48.9	49.4
Foreign	14.6	16.9	19.5	22.0	23.0
Domestic	26.7	28.0	27.8	26.9	26.4

*projection

Source: MF

3.1.5 Budgetary Implications of Major Structural Reforms

The Pre-Accession Economic Programme for the next three-year period was drafted at a specific moment if we take into account the political election cycle in the Republic of Croatia and the ensuing changes in the priorities regarding key economic policies. The particularity of the moment arises also from the fact that the Pre-Accession Economic Programme was being drafted in parallel with the preparation of the 2012 draft budget that is targeted towards improving the previously described conditions of public finances and the need for a turn in focus of fiscal and economic policies.

This was recognised in the Programme of the Government of the Republic of Croatia which determines the establishment of an export-oriented competitive economy based on knowledge that can ensure growth in value added and employment, while observing the principles of social cohesion, as the key economic policy objective. As a result, the fiscal policy for 2012 and projections for 2013 and 2014 are based on three main principles:

- the creation of preconditions for kick-starting the economy, primarily through investment cycles and improved business conditions;
- public finances sustainability in accordance with the Fiscal Responsibility Act;
- the protection of socially most vulnerable groups of society.

In accordance with fiscal policy orientation, changes will be made in budget revenue and expenditure policy in the forthcoming period, with the aim of achieving positive effects in several important areas, the fiscal impacts of which are described in the preceding chapters.

On the revenue side, the policies will be targeted towards achieving competitiveness of the domestic economy through lower labour costs for the entrepreneurs as the key players of future economic growth. To this end, changes were made to the system of contributions on salaries and reductions in the non-tax burden for the entrepreneurs. Furthermore, tax policy changes ensure a righteous taxation system that will enable a redistribution of tax burden among Croatian citizens primarily through income tax changes and a reduction in value added tax for certain groups of goods and services which represent a relatively heavier tax burden for individuals with poorer taxable capacity. The planned significant taxation of property, the conditions for which have to be created, will contribute to a righteous system of taxation that will target more heavily those strata of the society that has bigger taxable capacity.

The measures on the expenditure side reflect the need for a faster closure of fiscal imbalances and for ensuring a sustainable level of financing in what are currently still unfavourable financial and economic conditions. This primarily implies the need for generating large savings through expenditures rationalisation but at the same time it will also provide room for covering increases in individual expenditure categories.

Table 5: Estimated annual effects of the most important budget changes

% of GDP	annual effect
REVENUES	0.2
Income Tax	-0.01
Profit Tax	0.1
Contributions	-0.7
Value Added Tax	0.9
Water contribution	-0.04
EXPENDITURE	-1.2
Compensation of employees	-0.6
of which:	
<i>special supplements to salaries</i>	-0.3
<i>part time work</i>	-0.1
<i>overtime work</i>	-0.1
<i>special working conditions</i>	-0.03
Subsidies	-0.3
of which:	
<i>Croatian railways</i>	-0.1
<i>agriculture</i>	-0.2
Grants	-0.1
Social benefits (health care)	-0.1
Intermediary consumption	-0.1
NET EFFECT ON DEFICIT	-1.3

Source: MF

3.2 SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS PROGRAMME

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

Fiscal Risks

Revenue and expenditure projections for the next three-year period were made on the basis of conservative macroeconomic projections, changes in individual budget policies and in the context of EU accession and full membership of the Republic of Croatia in the EU. As regards the risks associated with these projections, the greatest risk is that which arises from lower than projected outturn of real GDP growth due to internal and external factors outlined in subchapter 2.2 Mid-term macroeconomic programme.

A lower level of economic activity than that planned would have a direct impact on the revenue side of the budget and in such a case would represent a risk of possibly wider budget deficit than that originally planned. The plan of consolidated general government revenues for 2012 and the projections for the 2013-2014 period are also based on legislative changes in the system of taxation. Therefore, there is also the risk that the envisaged positive effects of legislative changes fail to materialise which may thus lead to a lower level of revenues than that planned. More unfavourable developments in the labour market than those envisaged would also pose an additional risk.

Looking at the expenditure side of the budget, in the next three-year period we expect to see a continual reduction in the share of general budget expenditures in GDP. It should be noted that contribution to this objective will also come from compliance with the fiscal rules of the Fiscal Responsibility Act, which provides for an annual reduction in the general government deficit of at least 1 percentage point of GDP. Significant savings on the expenditure side that are associated with structural reforms have also been envisaged for the next three-year period. There is a risk,

therefore, that key structural reforms fail to materialise in accordance with the planned dynamics and a risk of failure to comply with the provisions of the Fiscal Responsibility Act.

Should the risk of a higher budget deficit than that originally planned materialise, this would lead to negative effects in public debt developments that would, due to higher financing needs, grow above the level planned under the central projection. Looking at the possible negative implications on public debt developments over the next three-year period, special account should be taken of the risk posed by a significant change in the exchange rate of the domestic currency, given that a considerable share of the total public debt is denominated in foreign currency. Activation of contingent liabilities, or guarantees, would also lead to a growth in public debt level over a medium term. Significant fiscal risks, in the case of further worsening in the conditions on the financial markets and smaller capital availability, could also lie in increased debt repayment burden and interest accruing, that would put greater pressure on current business transactions of the government.

Net Lending/Borrowing Sensitivity Analysis

The analysis of fiscal balance developments is based on the presumed central macroeconomic projection and fiscal projections for the medium term. By changing the individual assumed determinants the result, i.e. the net lending / borrowing is also changed. The results of the analyses carried out, i.e. the impacts of changed assumptions relative to the baseline projection are then compared to the baseline scenario.

As described in previous chapters, the basic scenario of fiscal projections is based on the draft budget for 2012, which is aimed at consolidating public finances and the need for a turn in focus of fiscal and economic policies.

It should be noted that these tests are conducted on the basis of arbitrary assumptions or projections made on the assumptions of unchangeable fiscal policy, but they still give a clear indication of what effects on the net lending / borrowing can be expected in the medium term, should it come to adverse events related to the basic determinants.

A brief overview is given below of the net lending / borrowing sensitivity analyses that were carried out which include the test of no fiscal policy change in the mid-term and the test of lower growth level of real GDP in 2012.

The test of unchangeable fiscal policy over the medium term implies the assumption that the fiscal policy would maintain the approximate direction of the revenue and expenditure side of the budget as in previous years, i.e. that the revenues would be determined by the existing structure and legal framework of the tax system taking into account the effects of accession and full membership in the EU, while the movements in the expenditure side components would face the dynamics that has been recorded in previous years, and consequently, among others, interest expenditure as a result of higher deficits, would also recorded growth. The results of sensitivity test indicate that in such developments this would have significant impact on larger fiscal deficits in relation to the baseline projection, with the net lending / borrowing being higher in 2012 by 2.0 percentage points, in 2013 it would be higher by 2.3 percentage points and in 2014 by 2.7 percentage points.

The test of lower level of real GDP growth is carried out with the assumption of the shock of lower real GDP growth in 2012 by 1 percentage point compared to the baseline projection. The tests show a reaction of revenue side of the budget, especially tax revenues related to personal consumption and those closely related to developments in the labour market indicators which would record a weaker outturn than projected in the baseline scenario. This test assumes unchanged levels of

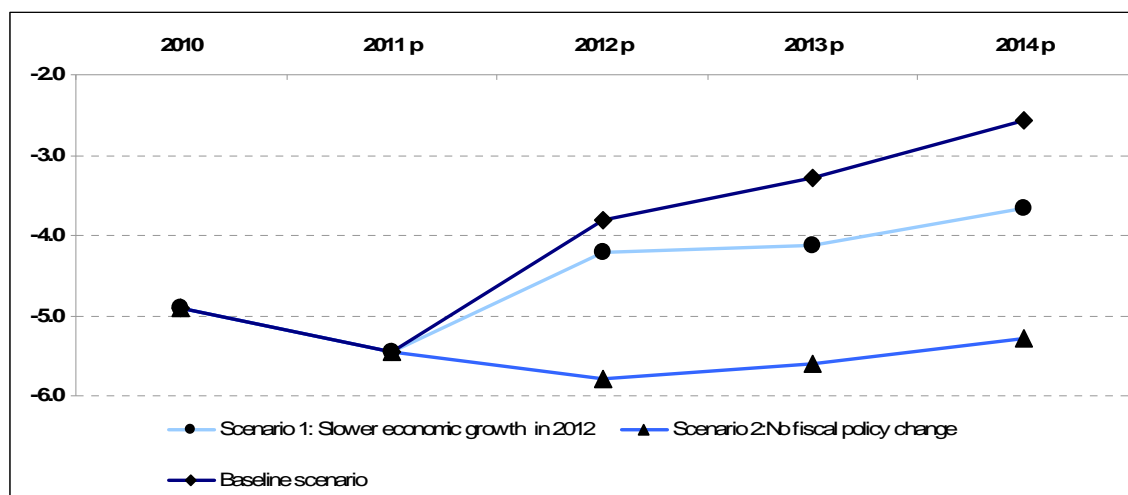
expenditure, except interest expenditures, compared to the baseline projection. The results of the sensitivity test in this course of events show the worsening in net lending / borrowing in relation to the baseline medium-term projection whereby the net lending / borrowing in 2012 would be higher by 0.4 percentage points, in 2013 it would be higher by 0.8 percentage points, while in 2014 net lending / borrowing would be higher by 1.1 percentage points. Furthermore, as another drawback of lower revenue growth it should be pointed out that after a period of shock, the recovery is relatively slow.

Table 6: Assumptions of the Baseline Scenario and Results of the Sensitivity Analysis

	2010	2011 p	2012 p	2013 p	2014 p
Assumptions (baseline scenario)					
Real GDP, growth rate	-1.2	0.4	0.8	1.5	2.5
Inflation (GDP deflator)	1.0	2.3	1.3	2.2	2.4
Net lending (+) / borrowing (-)					
Baseline scenario	-4.9	-5.5	-3.8	-3.3	-2.6
Scenario 1: Slower economic growth in 2012	-4.9	-5.5	-4.2	-4.1	-3.7
Scenario 2: No fiscal policy change	-4.9	-5.5	-5.8	-5.6	-5.3

Source: MF

Figure 6: Results of Sensitivity Analysis



Source: MF

Public Debt Sensitivity Analysis

Developments in public debt levels are very closely related to macroeconomic assumptions and assumptions and results of fiscal policy implementation. Therefore analyses of public debt sensitivity to various factors are being continuously conducted so as to be able to examine realistically the various implications associated with possible changes in the assumptions that determine public debt projections over the medium-term and thus pose the greatest risk and to ensure that such a risk is avoided or its effects mitigated. The public debt sensitivity analyses are based on the baseline scenario, which rests on medium-term macroeconomic and fiscal projections. A series of alternative scenarios are then made whereby the assumed values are subjected to various shocks. The shocks may be connected to historical values of the values under review and their variability, but can also be arbitrary. For the purpose of this analysis, three alternative scenarios were made which examined public debt sensitivity over a medium-term.

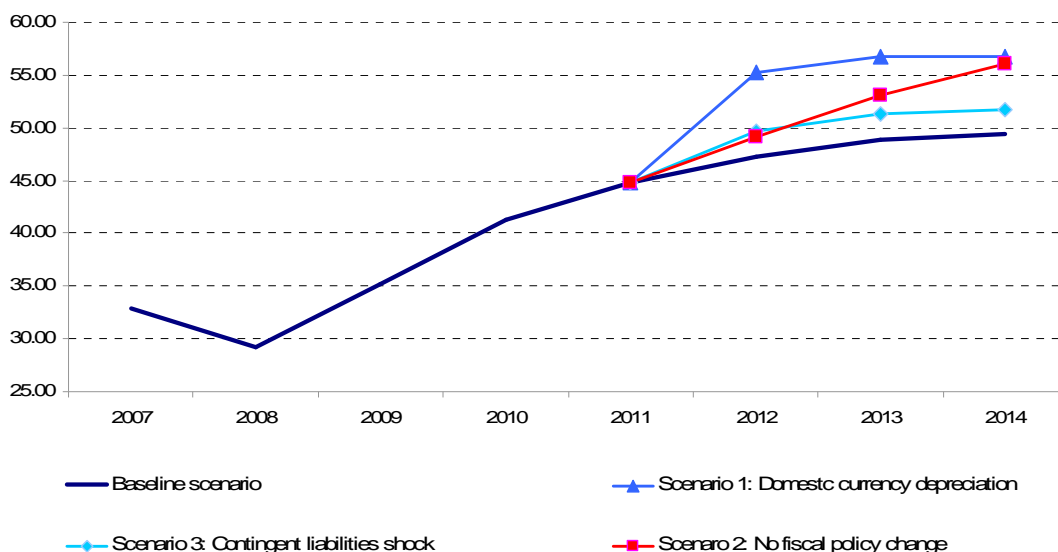
The conducted public debt sensitivity analysis showed that depreciation of the domestic currency, especially against the euro, would have the strongest impact on its movement. The reason for this lies in the fact that a sizable share of the debt is denominated in foreign currency. The conducted sensitivity analysis reflects that the arbitrary shock of the kuna depreciating by 25% has a negative impact on the public debt level, i.e. public debt grows on the level above 56% of GDP in the 2013-2014 period.

Public debt also shows unfavourable medium-term developments when subjected to the assumption of unchangeable fiscal policy in the medium term. Such a scenario would lead to substantially higher fiscal deficits in the medium term than those planned in the baseline scenario, which would be reflected in higher financing needs than planned and negative effects in terms of developments of public debt, that would achieve significant growth over the presumed one according to the central projection and at the end of medium term would reach a level of 56% of GDP.

Significant impact on public debt developments, i.e. its growth, comes from the changes in contingent liabilities (guarantees). For the purposes of this analysis, a one off increase in public debt during 2012 was assumed pursuant to takeover of contingent liabilities under the restructuring program of the shipbuilding industry, according to which public debt reaches the level above 51% of GDP in 2013.

Therefore, it is important to highlight once again the necessity of conducting further fiscal consolidation over the medium term, so that in case of materialisation of potential risks additional space would be ensured for fiscal policy response and mitigation of possible shocks.

Figure 7: Public debt as a share in GDP under certain scenarios (in %)



Source: MF

3.2.2 Comparison with Previous Programme

Comparison of the total amount of revenues, expenditures and net lending/borrowing of the consolidated general government in the previous year's and this year's PEP shows differences arising from different levels of nominal GDP which are result of changed mid-term macroeconomic assumptions and their effects on budgetary revenues and expenditures. Namely, last year's programme rested on the assumption of real GDP growth of 1.5% in 2011 to 2.5% in 2013. In this

year's PEP expectations of economic growth have been downsized and projected growth rates are 0.8% in 2012, 1.5% in 2013 and 2.5% in 2014.

Discrepancies in some fiscal variables in these two programmes emerge also from other reasons specific for revenues and expenditures. Continuation of unfavourable economic developments during 2010 and legislative changes on revenue side of the budget impacted on their lower level in relation to the plan. Corrections on the expenditure execution side more than compensated for the aforementioned effects on revenue side, which finally resulted in lower net lending/borrowing amounting 0.3 percentage points in relation to the plan. In 2011 differences of planned revenues and expenditures arise from changed level of nominal GDP. In years ahead different projections of revenues are consequence of certain changes in tax system which will be in force from 2012, and which will have impact on decreasing of the total amount of budget revenues. On the other hand, expenditure side of the budget reflects significant savings which will be implemented in the coming period through further rationalisation of costs and implementation of basic structural measures and reforms in order to contribute to decreasing fiscal imbalances and ensuring sustainable level of budget financing.

Table 7: Comparison of Revenue, Expenditure and Net Lending/Borrowing of the General Government according to previous year's and this year's PEP

	2010	2011 p	2012 p	2013 p	2014 p
PEP 2012-2014 (% of GDP)					
Total revenue	37.0	35.8	35.7	35.1	34.6
Total expenditure	41.9	41.4	39.5	38.4	37.2
Net lending/borrowing	-4.9	-5.5	-3.8	-3.3	-2.6
PEP 2011-2013 (% of GDP)					
Total revenue	37.8	36.3	36.8	36.6	
Total expenditure	43.0	41.9	40.7	39.0	
Net lending/borrowing	-5.2	-5.6	-3.9	-2.4	
Difference					
Total revenue	-0.8	-0.5	-1.1	-1.5	
Total expenditure	-1.1	-0.5	-1.2	-0.6	
Net lending/borrowing	0.3	0.0	0.1	-0.9	

Source: MF

3.3 QUALITY OF PUBLIC FINANCES

In 2011, implementation of reforms and other activities aimed at strengthening the quality of public finances continued. Further unfavourable economic developments over the year had an impact on revenues and expenditures trends, but to a somewhat smaller extent than in 2010, so that there was no need during the year for the adoption of the amendments to the budget.

The financing models from 2010, which were used to boost credit activity in the country, were upgraded in 2011, i.e. certain determinants of the model were redefined with an aim to provide assistance to entrepreneurs in overcoming the times of crisis and also to promote investment projects. The supplemented model "A", i.e. the model "A+" has introduced novelties, such as more lenient criteria for entrepreneurs, a possibility of using the loan for both financing of working capital and settling the liabilities to suppliers, financial institutions, to the state and other creditors. In addition, the share of a loan that can be used for refinancing of the existing liabilities in banks has been raised from 20% to 40%, which allows entrepreneurs to substitute the old, more expensive sources of financing with the cheaper ones. Other new options include a one-off repayment of a

half of the amount of loan, as well as bridge loans, allowing granting of the loan to the entrepreneur immediately after the allocation of the quota at the auction, instead of waiting for a completion of the procedure between the CBRD and the bank. In addition, the model "A+" offers lower interest rates on CBRD's funds. In 2011, 5 auctions were held under this model. Furthermore, with an aim of providing the entrepreneurs with high-quality financing for their high-quality new or already launched investment projects, the Act on the Guarantee Fund for Promoting Economic Development (OG 34/11), as a supplement to model "B". That Act has removed, to a large extent, the obstacles to the launching of the projects that could not be previously realised on account of the problems with instruments of collateral or entrepreneur's own participation in the project

In the past two years, public enterprises carried out rationalisation of their operation through various measures and improved efficiency of their business processes. For the purpose of strengthening financial discipline, certain measures were implemented, relating to an on-going liquidity monitoring and maintenance of 60-day payment periods, as well as the introduction of the payment period of 45 days as of 1 January 2011. In October 2011, the Act on Deadlines for Settling Monetary Obligations was adopted, restricting the time limits for settling monetary obligations in contracts between entrepreneurs up to 60 days in general. As an exception, payment periods longer than 60 days may be contracted, provided that such an extension of the time limit is not null and void. Furthermore, the Act which has introduced a new special measure for collection of the tax debt caused by the economic crisis was adopted, as one of the measures aimed at preventing generation of illiquidity and preserving financial stability of the payers who settle their obligations in a timely manner. The Act has created the assumptions which allow taxpayers to restructure their tax debt incurred before 31 December 2010, for a period of 30 months, at the interest rate of 8.25%, provided that they have settled their tax liabilities for 2011. In addition, in order to prevent an increase in illiquidity and to eliminate the participation in legal transactions of the entities that have been blocked for a long time and who do not settle their liabilities, both regular and shortened bankruptcy proceedings have been initiated to remove the failing business entities from the business sphere. Furthermore, liquidity has been continuously monitored and payments of the companies in majority ownership of the Republic of Croatia have been supervised, which resolved the problem of non-payments by public enterprises.

In addition, acting with an aim of facilitating the operating conditions and affecting the illiquidity problem, non-tax levies were reduced, lifting the tax burden off the economy by 25% on average. In the forthcoming medium-term period, the tax policy of the Government of the Republic of Croatia will be directed at reducing the share of the overall tax burden in GDP and at adjustments that will ensure greater fairness in taxation. By lifting tax burden off the economy, by tax reliefs and direct incentives, a potential for new investments will increase. Among other things, new investments in tourism, energy products, infrastructure and irrigation and environment will be stimulated in particular.

In 2011, the system of the full application of the personal identification number (OIB) was further developed. For taxpayers and for beneficiaries of the state aid system, such a system will simplify administration, allow for efficient mechanisms for a review of the exercised rights, improve services for taxpayers and citizens and enhance confidence in the tax and legal system of the Republic of Croatia.

Despite high volatility and challenges on the financial markets, the Republic of Croatia meets all its financial liabilities towards foreign and domestic creditors in a timely manner. In 2011, Croatia continued to have a free access to international financial markets on which it managed to issue bonds under relatively favourable conditions over the past two years. In February 2011, the Ministry of Finance prepared a document the Public Debt Management Strategy for the 2011 -

2013 period. That document provides an overview of the balance and projected movements of public debt, as well as currency, interest rate and maturity structure of public debt, and a structure by the instrument type. Furthermore, the document also contains guidelines for public debt management in the said medium-term period. In accordance with the Strategy determinants, costs associated with new borrowings were reduced and yields on bonds issued in 2011 also decreased compared to the previous issues. In addition, currency risk hedges were applied, for a US dollar bond from 2011 at the time of its issue, i.e. for the US dollar bond from 2010 in July 2011.

In the forthcoming medium-term period, further efforts will be made to consolidate public finances and to additionally increase fiscal responsibility and transparency of spending the public money. Among other things, in order to achieve the optimum dimensioning of public spending and fiscal stabilisation in the long run, a comprehensive reform of public administration and structural reforms will be implemented in the social, pension and health care sector. Future structural reforms will also be supported by an efficient use of the EU funds.

A total of EUR 297.2 million were allocated to the Republic of Croatia through pre-accession assistance programmes CARDS, PHARE, ISPA and SAPARD of which EUR 264.3 million or 88.90% were contracted. The contracting terms for projects under CARDS programme expired in 2006 and 2007, for projects under PHARE programme in 2007 and 2008, for projects under SAPARD programme in 2009 and for projects under ISPA programme in 2010 and 2011. Payments under the above indicated programmes are also completed; until 31 December 2011, EUR 240.8 million were paid.

Under the new pre-accession IPA programme, a total of EUR 749.8 million were allocated to the Republic of Croatia. Contracting is completed for the funds allocated under IPA component I in 2007, while contracting for other components is underway. Amendments are currently being made to operating programmes and financial agreements which will encompass the funds allocated for 2012 and for the first half of 2013. Until 31 December 2011, EUR 250 million or 39.39% of the allocations for the 2007-2011 period were contracted. Payments are also underway; until 31 December 2011 EUR 127 million was paid. It should be noted that the dynamics of contracting is satisfactory and that the contracting and implementation terms determined by IPA regulations are respected.

As regards the functioning of the AFCOS system for the protection of the financial interests of the EU, in the period from October 2010 to June 2011, the Independent Department for Combating Irregularities and Fraud (IDCIF) implemented the IPA TWL project entitled "Strengthening Croatian AFCOS system with the aim of protection of EU financial interests". As a result of the project, the new improved procedures were adopted for irregularities management for the bodies involved with the Irregularity Reporting System. In addition, trainings and seminars were held for the representatives of the bodies in the AFCOS system, in which more than 300 of employees participated. In order to enhance the public awareness about a need for fighting irregularities and fraud, various activities were organised (e.g. promotional materials and brochures were prepared, IDCIF representatives participated in promotional campaigns and a conference was held on 27 May 2011 entitled "Achievements and challenges in the protection of EU financial interests in the Republic of Croatia").

In 2012, further strengthening of administrative capacities is planned through an on-going organisation of trainings concerning irregularities and fraud under the FMC module 11 "Irregularities and fraud", carried out by the IDCIF employees and through participation in other FMC modules by IDCIF employees.

Furthermore, in 2011, IDCIF prepared a proposal of the new TWL project „Enhancing the functioning of Croatian AFCOS system with the aim of efficient protection of the EU financial interests“. The project was approved by the European Commission in November 2011 and its

implementation is planned for 2012. The purpose of the project is to prepare the AFCOS system for functioning in the environment of structural and cohesion funds and organising of training for the bodies in the AFCOS system, as well as improvement of cooperation between IDCIF and bodies within the AFCOS network.

3.4 SUSTAINABILITY OF PUBLIC FINANCES

An estimate of long-term sustainability of public finances is based on long-term population projections for Croatia in the 2005 - 2050 period of the Croatian Bureau of Statistics, using variance of mid fertility with migration and basic macroeconomic assumptions of future developments. Compared to the previous year's PEP, lower real GDP growth rates are expected in the initial period as well as higher unemployment rates and new fiscal projections for the period until 2014.

The projections were made under the assumption that during the forecast period there will be no significant changes in the application of currently applicable legislative solutions regulating public expenditures for pensions and health care and that there will be no changes in the calculation and collection of contributions for pension insurance during that period. Under Amendments to the Contributions Act, the rate of contributions for compulsory health insurance paid by employers on the basis of gross salary of their employees has been cut by two percentage points, i.e. from the present 15% to 13%. In estimating pension expenditures, we took into account the expected developments in the number of pensioners, the expected effects of adjustments between the so called old and new pensioners, the expected effects of the latest amendments to the Pension Insurance Act and further pension indexation in accordance with the consumer price index and gross salaries that had been left out in 2010 and 2011.

Expenditure projections in the field of health insurance envisage an implementation of a health reform, particularly in primary health care, hospital system and specialist outpatient health service. All other income, except contributions, will keep the same share in GDP, as will all other expenditures, except expenditures for pensions, health care and interest, throughout the entire observed period.

Participation rates by characteristic age groups (15-24, 25-49, and 50-64) and sex will remain unchanged. Under such an assumption, the total participation rates will vary slightly after 2010, mainly as a result of fluctuation of population in these age groups.

The unemployment rate has been projected as falling, and it is expected to fall to the structural unemployment rate of 7% until the year 2020 and hold steady at that level until 2050. The growth in labour productivity per employee is based on the assumptions of real GDP growth and developments in the number of employees, determined on the basis of long-term demographic projections and assumed participation rates.

In line with the given assumptions, it is expected that revenues from contributions for pension insurance will fall from 5.7% of GDP in 2010 to approximately 5.2% of GDP in 2015 and that they will stabilise in the period after that. Such expectations are based on the gradual increase in the share of employed persons with pension insurance in both mandatory pension funds, i.e. those employees that pay 15% of their gross salary into the first pension system pillar and 5% of their gross salary into the second pension system pillar. Overall, older employees tend to be insured only through the first pension system pillar, with 20% of their contributions being paid into the first pillar. With gradual retirement of this group, there will be an increase in the number of pensioners

that pay 15% of contributions in the first pillar. The stabilisation in the share of contributions from pensions at 5.2% of GDP after 2015 is built upon an assumption under which the growth in the real wage per employee equals growth in labour productivity, and the rate of contributions is defined as a constant share of wage, with contributions for pension insurance being calculated based on higher rates of contributions into the first pillar in the case of older pensioners.

The projections point to a decline in expenditures for pensions from 8.9% of GDP in 2010 to 8.7% of GDP in 2050, with pensions of war veterans being excluded from this analysis. Despite an increase in the number of older persons, the pension system reform and a relative reduction in pensions paid from the first pillar, long-term estimates point to a fall in the share of public pension expenditures in GDP, provided the currently applicable formula of pension indexation is adhered to. There are also estimates that point to a reduction in the share of pensioners whose pensions are fully paid from the first pillar, and an increase in the share of those pensioners whose basic pensions are paid from the first pillar and the remaining part from the second pillar that will be financed from individual capitalised pension plan savings.

Health care expenditures are projected to increase from 6.4% of GDP in 2010 to 9.2% of GDP in 2050. The projection is based on the estimate of the pure ageing effect of the population and takes into account changes characterised by an ever increasing share of older age groups, which are also the largest users of health care services. The projection was built upon an assumption of growing expenditures in line with labour productivity growth, and the expected effects of implementation of the health reform and ever increasing costs associated with the health sector development, particularly in the area of outlays for medications and new technologies. It is also assumed that health care expenditures for each age group and sex will grow in line with GDP growth per employee, which means that they will follow developments in the economy and society as a whole. In addition to affecting the growth in outlays, in the next 50 years demographic changes will also affect the distribution of these costs by age groups and lead ultimately to an increase in the share of total outlays for persons over 65 years of age.

Interest expenditure will increase its share in GDP from 2.0% in 2010 to 3.4% in 2050. In accordance with the projected developments in the mentioned revenue and expenditure categories, total revenues will stand on average at the level of approximately 35.6% of GDP and total expenditures will stand at a level of approximately 40.7% of GDP throughout the entire observed period.

3.5 INSTITUTIONAL FEATURES OF PUBLIC FINANCES

The Budget Act, which entered into force on 1 January 2009, introduced the obligation of preparing strategic plans for the ministries and other government bodies at the first level of organisational classification (hereinafter: relevant government entities) and the obligation to develop the Strategy of Government Programmes for a three-year period.

In the two cycles of strategic planning so far, relevant government entities defined in their strategic plans, among other things, objectives and methods for achieving these objectives. By the implementation of the methods of achieving the set objectives, risks have been identified which may affect their achievement. As a result, it was extremely important for the risk management process to become a constituent part of the process of strategic planning. More specifically, the purpose of risk management is to reduce the extent of uncertainty that could threaten business performance of the government entities, anticipate the changed circumstances and respond to them in a timely manner. Due to complexity of the risk management process in the cycle of strategic

plans preparation for the 2012-2014 period, the relevant government entities were focused exclusively on risk identification and assessment.

Although relevant government entities developed strategic plans, the cycle of strategic planning has not been completed. More specifically, since the Croatian Parliament did not adopt the state budget and the projections for the 2012 - 2014 period in 2011, due to the parliamentary elections, the Government of the Republic of Croatia also did not adopt the new Strategy of Government Programmes for the same period.

The implementation of the strategic plan should be systematically and regularly monitored and measured. Well-defined indicators of results and effects represented a basis for introducing the monitoring system. It is possible to monitor the performance in achieving the set objective through the well-defined performance indicators. The entities subject to the application of the act have, in accordance with their special characteristics, established an internal monitoring system, thus providing information about the achievement of the set objectives. On the basis of the data collected through the internal monitoring system, the Ministry of Finance was for the first time notified of the implementation of the method for the achievement of the strategic plan for the 2011 - 2013 period, i.e. for the first six months of 2011.

Pursuant to the Fiscal Responsibility Act⁹, in June 2011, the Government of the Republic of Croatia adopted the Regulation on Preparing and Submitting the Fiscal Responsibility Statement and the Report on the Application of Fiscal Rules¹⁰, which prescribes the form and content, as well as the procedure and time limits for preparing and submitting the Statement. In accordance with that Regulation, the head of a body does not only make the Statement, but also, among other things, encloses it with the filled in Questionnaire on Fiscal Responsibility.

The Fiscal Responsibility Statement is an annual statement by means of which the head of the budget and extrabudgetary users of the state budget or the budget of the local and regional self-government units and the head of the local and regional self-government unit confirms that he/she has ensured in his/her work legal, discretionary and dedicated use of the funds, as well as efficient and effective functioning of the financial management and control system within the framework of the funds determined by the budget or financial plan. By means of this Statement, the head's concern is being shifted from the planning process to execution, with an aim of achieving the optimum results, in view of the funds limited by the budget.

On the basis of the questions contained in the Questionnaire, self-assessment is being carried out of the processes, procedures and controls by the budget areas (budget/financial plan planning, execution, public procurement, accounting and reporting), which is aimed at confirming a legal, discretionary and dedicated use of the budget funds, and efficient and effective functioning of the system of financial management and control.

As regards the implementation of the Fiscal Responsibility Act, the establishment of the Fiscal Policy Committee represents another successful measure aimed at efficient management of public finances and improvement in the implementation of fiscal policy. It was established pursuant to the Decision of the Government of the Republic of Croatia on the establishment of the Fiscal Policy Committee of 25 March 2011, whereas the members of the Fiscal Policy Committee were appointed by the decision of the Government of the Republic of Croatia upon the proposal by the institutions with which they are associated (Institute of Economics, Zagreb, Institute of Public Finance, Croatian National Bank, State Audit Office, faculties of economics and business and

⁹ Official Gazette, number 139/10

¹⁰ Official Gazette, number 78/11

Faculty of Law, Zagreb University). The Fiscal Policy Committee, as a professional and independent body, will contribute to the enhancement of the system of public finances and to the monitoring of application of fiscal rules determined by the Fiscal Responsibility Act. Complying with the principle of transparency, which is extremely important in view of the insight of the public and all the parties interested in the work of the Committee, the Committee is obliged to inform the public about its positions, by publishing them on the Ministry of Finance website.

Furthermore, pursuant to the Budget Act, the Ordinance on the Method of State Budget Execution and Effecting Repayments to the State Budget and Keeping Records on the Repayments¹¹, was adopted, which defined the principal procedures of executing the state budget. The process of budget execution has changed significantly as of the beginning of 2011. The principal procedures of executing the state budget prescribed by the Ordinance include: entry of monthly financial plans, commitment of funds, recording liabilities in the general ledger of the state budget and making payments based on payment applications.

The monthly financial plan is a presentation of expenses and expenditures by months within a single budgetary year, according to budget classifications, with respect to the expected maturity of liabilities. All the state budget beneficiaries are obliged to prepare the financial plan by months, for the entire year in accordance with the planned maturity of liabilities, by 15 January of the current year, on the basis of the amounts planned by the state budget.

All the state budget beneficiaries are obliged to record the invoices in their business books, after compulsory accounting controls have been carried out. Until the beginning of 2011, the state budget used to be executed in a manner that all the state budget beneficiaries entered their payment applications based on invoices into the state treasury system, which they have already entered into their information system. At present, this is done by the beneficiaries whose information systems for managing finances have not yet been integrated with the information system of the state treasury.

By introducing this new method and conditions for executing the budget from the state budget account, as of 2011, conducting of payment transactions without submitting the payment applications in paper form to the Ministry of Finance has been allowed.

In early 2011, three pilot ministries were integrated (the Ministry of the Sea, Transport and Infrastructure, Ministry of Defence and Ministry of Finance). Furthermore, activities have continued aimed at creating the preconditions for the integration of the Ministry of the Interior, Ministry of Regional Development, Forestry and Water Management, Ministry of Agriculture, Fisheries and Rural Development and Ministry of the Economy, Labour and Entrepreneurship which will be integrated at the beginning of 2012.

In the 2009 - 2011 period, technical and operational assumptions were created for the construction of a single foreign exchange account in the Croatian National Bank. This implies expanding the scope of the existing foreign exchange account opened in 2002, i.e. centralisation of foreign exchange payment transactions in one place. The objective is to connect the state treasury information system with the application for conducting foreign exchange payment transactions of the Croatian National Bank. This will ensure payment automation and recording of the executed liabilities at the time of making the payment. In early 2011, the first testings were performed of the exchange of documents, defined for the purpose of conducting international payment transactions, between the information systems of these two institutions.

¹¹ Official Gazette, number 48/11

4 STRUCTURAL REFORMS

4.1 OBSTACLES TO GROWTH AND THE STRUCTURAL REFORM AGENDA

The period of the global economic crisis was, not surprisingly, full of challenges. From its very beginning, it had a negative impact on the Croatian economy, thus pinpointing additionally to structural obstacles to economic growth. The Government of the Republic of Croatia will over a medium-term work on alleviating or eliminating such obstacles. In this context, special emphasis is being placed on the following areas: fiscal consolidation, the labour market, business environment and competitiveness and public administration reform.

In the area of public finances, further measures will be taken over a medium term towards consolidation, further enhancement of fiscal responsibility and public spending transparency. To achieve optimum dimensioning of public spending and fiscal stabilisation over a long term, a thorough public administration reform as well as other structural reforms will be made. Fiscal consolidation will result in a reduction in the consolidated general government deficit, a reduction in the share of budget expenditures in GDP and in halting and reversing the trends of public debt share in GDP. In addition to savings planned on the expenditure side of the budget, the structure of public spending will also change by targeting more productive investments. These savings, as well as the change in the structure of public spending will create room in the budget for the drafting of measures and financing of proactive economic policy measure packages that will ensure faster economic recovery, growth and new employment.

As regards the labour market, one of the key priorities of the Government over a medium and long term is to create the conditions for new job creation and new employment. As regards structural reforms that would address the existing obstacles in the field of labour market, particularly important are those measures that will aim at achieving higher labour market flexibility and connecting labour market needs with the educational system. The speed of adjustment between labour market needs and relevant workforce competencies should be enhanced and so should the general level of skills needed for higher value added jobs.

One of the priorities of the Government of the Republic of Croatia will also include radical moves towards eliminating barriers for new investments. The Government plans to improve the environment for entrepreneurship development through improved efficacy of the state administration, in particular the judiciary, the development of institutions for the promotion and support to entrepreneurial development and the use of institutions of learning and scientific and research institutions in strengthening the competitiveness of the Croatian economy. Over a short term, the economic policy will be targeted towards creating more favourable conditions for investment growth and increased competitiveness of the Croatian economy.

Furthermore, improved rule of law, protection of creditors, contract compliance and public administration reform will also contribute towards the achievement of positive investment climate and hence to the improved competitiveness of the Croatian economy for foreign investments. With a view to achieving greater efficacy and providing better quality public administration services, efforts have been initiated towards reorganisation and rationalisation of the system in place and improvement of quality and efficiency levels.

Education and science, as one of the key preconditions for economic development also rank high on the list of priorities of the Government of the Republic of Croatia. In this context, further efforts will be made towards stimulating investment in research and development and new technologies.

4.2 KEY AREAS OF STRUCTURAL REFORM

4.2.1 ENTERPRISE SECTOR

4.2.1.1 Competition Policy and State Aid

Competition Policy

The new legal framework in the area of antitrust legislation, fully aligned with the *acquis*, began to be implemented in the Republic of Croatia in 2011. The purpose of the reform of the existing system was to create legislative and institutional conditions for more efficient fight against the behaviour of those entrepreneurs that prevent the development of efficient competition in the Croatian Market. An important step in this reform lay in the delegation of greater authority to the Croatian Competition Agency (hereinafter: the Agency), particularly as regards the authority of the Agency to impose fines aimed at strengthening prevention and deterrence of violations of regulations and to seize the illegally obtained proceeds. This called for an increase in the administrative capacities and internal reorganisation of the Agency. The medium management level of the Agency was abolished with the aim of strengthening employee responsibility and an anti-cartel unit and a chief economist office were set up in line with the Agency's key activities which include the prevention of agreements on prices and market or client distribution between the competing firms.

With a view to achieving further strengthening of the competition policy in the Republic of Croatia, the Agency is working on a proposal that the preparation and adoption of each new piece of legislation or regulation be subject to a competition assessment; i.e. the assessment of the effect that any such piece of legislation or regulation would have on competition. The objective behind this proposal and the introduction of such a regulatory impact assessment is to prevent or minimise the distortion of competition which might result from legislation that is in contravention with the competition rules, reduce the need for ex-post intervention and reduce the number of entities negatively affected by the distortion of competition. This proposal of the Agency is in line with OECD recommendations.

State Aid

As envisaged under 2011-2013 PEP, the Agency has finalised the procedures for the evaluation of the plans for the restructuring of Croatian shipyards in difficulties and approved aid for their restructuring. The costs of restructuring of four Croatian shipyards (3. Maj Rijeka, Brodogradilište Kraljevica, Brodograđevna industrija Split, together with Brodosplit, special objects shipyard d.o.o.) stand at HRK 27.6 billion. The key condition that these shipyards have to meet in order to obtain this aid is their market profitability without state aid following a five-year restructuring period. In the forthcoming period until EU membership, the Agency will, in addition to the activities involving the monitoring of state aid, focus its activities more on greater cooperation between aid providers and aid beneficiaries in the preparation of programmes and projects using EU structural funds, to achieve maximum alignment between these programmes and projects' proposals and regulations governing state aid.

Developments in the Area of State Aid

The amount of state aid granted in Croatia in 2010 increased by 8% compared to 2009. The share of state aid in GDP also increased. The total state aid granted in 2010 stood at HRK 9.4 billion, accounting for 2.8% of GDP. State aid granted to agriculture and fisheries stood at HRK 4 billion (42.7%) and those to industry and the services sector stood at HRK 5.4 billion (57.3%). State aid to

agriculture, fisheries and railway transport excluded, the total of HRK 4.5 billion in state aid was granted, which accounted for 1.35% of Croatia's GDP in 2010 (this indicator is used in comparisons with the EU). According to Agency estimates, similar developments marked the area of state aid in 2011.

The structure of state aid again shows a significant participation of sectoral state aid in the total state aid granted (agriculture and fisheries excluded), with sectors such as transport, shipbuilding, and public television accounting for the largest share of state aid, while the share of horizontal aid (research and development, innovation, environmental protection, small and medium-size companies, regional development, etc) is much smaller and accounts for approximately 23% of the total state aid granted to industry and the services sector.

The Agency's estimates indicate that the situation in the area of state aid will not change considerably neither in terms of a reduction in the absolute amount of aid, i.e. its share in GDP, or improvement in the structure of state aid, until structural reforms in the area of industry (shipbuilding) and transport (railways) are completed and until agriculture and fisheries are channelled more towards the use of aid from European funds. Only then can we expect to see room for improvement in terms of more intensive use of horizontal objectives, including those relating to regional development. Working in synergy with structural EU funds, this will enable changes in the approach to state aid policy and changes in this policy that will result in smaller but more efficient aid.

4.2.1.2 Privatisation

In accordance with the defined objectives and the measures providing for the consolidation of state property and more efficient management of this property, the Government Asset Management Agency (hereinafter: GAMA) was established. Created on the basis of a merger between the Croatian Privatisation Fund and the Central State Administrative Office for State Property Management, GAMA became operative on 1 April 2011. The institutional and legislative framework governing state property management is regulated by the Act on Managing the State Property¹⁰ (hereinafter: the Act), and relevant subordinate legislation¹¹.

Over a long term, state property management as determined by law is based on a Strategy adopted by the Parliament covering a four year period and a Management Plan adopted by the Government covering a one year period. The draft proposal of a Strategy whose adoption is planned for 2012 focuses in particular on mobilising state property and its use as a tool for economic growth and stimulation of investment, protection of Croatia's national interests, maximum rationalisation of the use of state property and creation of a sustainable state property management system over a long term in accordance with the law and the applicable legislation of the EU.

To achieve the stated strategic objectives, the Act provides for and operationalises a wider range of the ways of management of state property in the form of shares, holdings, and real estate property.

¹⁰ Official Gazette 145/2010

¹¹ Regulation on the disposition of real estate property owned by the Republic of Croatia (OG 55/2011), Regulation on the Register of state owned assets (OG 55/2011), Regulation on the sale of shares and business interests in companies owned by the Republic of Croatia, institutes and other legal persons founded by the Republic of Croatia (OG 64/2011), Regulation on founding building rights and easement rights for real estate property owned by the Republic of Croatia (OG 78/2011), Regulation on the disposition of real estate property given for use to state administrative bodies or other bodies beneficiaries of the state budget, and other persons (OG 80/2011), Regulation on the method of disposition in the case of exchange, donation and establishing of lien rights on shares and business interests in companies owned by the Republic of Croatia (OG 109/2011), Regulation on the donation of real estate property owned by the Republic of Croatia (OG 123/2011).

In contrast with the Privatisation Act which provided for only two ways of sale of shares and holdings, this Act provides for seven ways of sale of shares and holdings as a way of management of state property in the form of shares and holdings which are much more dynamic and better suited to modern capital market and economic developments.

The sale of shares and holdings will be carried out by means of public offer (initial public offering), public bidding (public auction), public tenders, sale on a regulated capital market, sale through the acceptance of a takeover bid and sale through the acceptance of minority holders squeeze-out bids and capital injection. The Act makes it possible to combine these ways of sale to achieve the method which is optimal for a particular company. This will surely have a positive effect on the sale of companies with inherited difficulties that dominate the state portfolio. It should be noted that the transfer of shares and holdings to GAMA is still underway and that the completion of this process is expected in 2012.

As at 15 January 2012, the portfolio of GAMA comprised 682 companies with the total nominal initial capital value of HRK 91.2 billion, while the total nominal value of the state portfolio stood at HRK 40.5 billion. The bulk of the portfolio comprises companies in difficulties which as such are not interesting to potential investors and require comprehensive restructuring and consolidation prior to their sale or in the course of their sale.

Table 8: State assets in the form of shares and holdings as at 15 January 2012

Description	Number of companies as at 15 January 2012	Total nominal value of initial capital (in HRK)	Total nominal value of the state portfolio (in HRK)
Portfolio up to 49.99% of the initial capital	441	40,948,679,786	5,768,134,809
Portfolio over 50% of the initial capital	64	37,781,574,948	34,245,029,058
Unavailable portfolio – ownership up to 50% (reserved shares)	175	12,457,503,539	497,205,497
Unavailable portfolio – ownership over 50% (reserved shares)	2	15,454,500	14,983,200
TOTAL	682	91,203,212,773	40,525,352,564
Companies not performing an economic activity	48		

Source: GAMA

As evident from the structure of shares in the initial capital of these companies, it can be concluded that in order to resolve the issue of the remaining portfolio, a highly differentiated approach will need to be taken that will use the most appropriate combination for the sale of shares and holdings.

Using the seven legally prescribed ways of sale, since its establishment and until 15 January 2012, GAMA announced/accepted the sale of holdings in 59 companies, 10 of which were successfully completed, generating some HRK 68.9 million in income. Underway as at 15 January 2012 was the sale of shares/holdings of 19 companies (9 of which were companies in the minority ownership that were being sold through the model of public auction, 4 of which were companies in the majority ownership that were being sold through the model of public tenders while 6 companies were being

sold through the model of sale on a regulated market). In 2011, bankruptcy or liquidation proceedings were initiated in 25 companies.

In the context of state property management, with the establishment of GAMA, a significant emphasis is placed on the management of real estate property in state ownership. In this context, GAMA performs a number of activities as determined by law and in accordance with the Strategy and the Management Plan. In addition to its regular tasks relating to, for instance, current and investment maintenance, preparation of proposals for spatial development solutions and ensuring that the real estate property meets all the requirements as regards the documentation required by law, in the management of state property in the form of real estate property, GAMA lays emphasis on the mobilisation of real estate property for the purpose of stimulating economic activity, attracting new investment and in general, spurring economic growth and development.

Under the Act, GAMA is responsible for the implementation of activities associated with the disposal of real estate property including its sale, leasing or renting, company recapitalisation by entering real estate property in the initial capital of companies, real estate property donations and exchange, establishment of a lien on real estate property, the founding of easement rights on real estate property, dissolution of a co-ownership community of the real estate property, joint construction or construction financing of real estate property, and other forms of disposal. As at 15 January 2012, the state assets in the form of real estate property managed by GAMA comprised building land, business premises, state-owned flats, residential units and diplomatic and consular representative offices. Between 1 April 2011 and 15 January 2012, GAMA sold a total of 29 real estate properties, generating approximately HRK 20.3 million in income from this activity.

One of the key preconditions for efficient implementation of the Act and the strategic objectives in the area of real estate property management lies in the establishment of a comprehensive Register of real estate property in the ownership of the Republic of Croatia that is planned to be completed during 2012. Thus income from the sale and from the disposal of real estate property in general is planned to intensify in the forthcoming years, particularly following the setting up of the said Register.

4.2.1.3 Railway Restructuring

The activities of institutional and administrative alignment in the railway sector with the requirements of the *acquis* continued in the previous period. Four new ordinances in the area of railway traffic safety were adopted and issued in 2010 and three in the first half of 2011. The Croatian Railway Safety Agency started operating in the first half of 2011 and until now, several decisions have been issued which regulate the conditions of own account transport. Adoption of a new act is being planned that would regulate the area of traffic accident investigation and there are plans to set up an independent body for traffic accident investigation.

Unfavourable trends in transportation effects continued into 2011, with the January to December 2011 period recording a further fall in the number of passengers carried (29%) and the quantity of goods carried (4%), compared to the same period previous year. At the same time, the level of own market income held steady at approximately the same level, with passenger traffic recording a small fall in income of 4% while goods transport reported an increase in income of 1%. The estimated consolidated financial result of railway companies in the HŽ Group in 2011 was a loss of HRK 72.5 million.

The railway infrastructure projects are characterised by the use of pre-accession IPA and ISPA funds. ISPA funds have been used for the project of rehabilitation of the railway line section Vinkovci-Tovarnik and for two projects for the preparation of studies relating to the modernization

and renovation of railway tracks on corridor X. The project of rehabilitation of the railway line section Vinkovci-Tovarnik was formally completed and it is the first large EU pre-accession funds funded project in the transport sector that had been completed. The funds of IPA IIIa 2007 are used to finance the projects of rehabilitation of the Okučani-Novska section, where the beginning of works are expected to take place soon, Novska-Dugo Selo section and the project of the Zagreb Main Station signalling and interlocking system. A part of funding provided under IPA IIIa 2007 is planned to be used for the financing and preparation of project documentation for railway line reconstruction project on the Hrvatski Leskovac-Karlovac and Goljak-Skradnik sections.

In the area of responsibility of the company HŽ Holding, a tender procedure for the supply of services regarding the drafting of the Plan of restructuring of HŽ Holding companies by groups was carried out. Final evaluations of the bids received are currently being made. In HŽ Group companies, new ordinances on company organisation have been issued and new collective agreements made in line with the Labour Act, which maintain and increase to an extent employee rights. At the same time the collective agreements envisage cuts in the material rights of employees such as Christmas bonuses, holiday allowances, etc. The restructuring plans adopted for three subsidiaries (Proizvodnja-regeneracija d.o.o., Remont i održavanje pruga d.o.o. and OV-održavanje vagona d.o.o.) are being implemented. The primary purpose of the existing operational restructuring plans is to halt the trend of growth in operating losses of individual subsidiaries. The business activities and implementing measures in force are aimed at business rationalisation with an emphasis on the settlement of obligations towards suppliers, the resolution of the issue of redundancies, recapitalisation by the parent and the resolution of the status of real estate property.

4.2.1.4 Shipyard Restructuring

Further negative developments on the global shipbuilding market led to further negative trends in the business operations of Croatian shipyards in 2011. In the absence of new contracts, Croatian shipyards failed to achieve productivity levels seen in the previous periods and increased their operating losses in 2011.

Shipyard Uljanik d.d., which unlike other shipyards in majority state ownership, does not have such large financial expenditures, created the preconditions for further positive business performance in 2011. Despite restructuring measures taken, all other shipyards continued to report negative business trends, which had a negative effect on the completion of the process of privatisation. Further efforts were thus made in 2011 towards the finalisation of the process of restructuring and privatisation.

The programme of restructuring of Brodograđevna industrija Split d.d., endorsed by the European Commission in February 2011, was approved by the Croatian Competition Agency (AZTN) in July 2011. AZTN approval paved the way for the final phase of the privatisation process, in terms of final negotiations of the terms of agreement between the contractual parties. In line with the obligations assumed under the negotiating Chapter 8 (Competition policy), Croatia submitted a proposal of the privatisation agreement to the European Commission in September 2011. After having taken into account the comments to the privatisation agreement provided by the European Commission, the agreement was submitted to the potential investor in October 2011.

AZTN formally approved the programmes of restructuring of the shipyard Brodotrogir in September 2011 and of shipyards 3. Maj d.o.o Rijeka and Kraljevica d.d., Kraljevica in October 2011. These shipyards' restructuring programmes had already been endorsed by the European Commission and AZTN in June 2011. The proposals of the privatisation agreements for these shipyards had been submitted to potential investors who submitted their counterproposals which are now being examined. After the terms of the proposals of these agreements are finally negotiated,

the proposals of the privatisation agreements will be submitted to the European Commission for endorsement.

4.2.1.5 Energy

The activities relating to the new legislative framework continued into 2011. The most important activity in 2011 involved the preparation of draft legislative framework for the implementation of the third package of the EU energy legislation. In this context, it is necessary to adopt a new Energy Act and align the Act on the Regulation of Energy Activities, the Electricity Market Act and the Gas Market Act. The adoption of these acts by the Government and the Parliament is expected to take place in 2012.

Amendments to the Oil and Petroleum Products Market Act were adopted in 2011. They have ensured legislative alignment of this Act with the latest EU Directive 119/09 and Croatia's full alignment with the EU legislation in this segment.

In the area of natural gas, the regulations adopted in the previous year are in the process of implementation. Despite the fact that the gas market is an open market and a new supply line through Hungary has been put into operation, which has ensured free transport capacity, no new suppliers have appeared on the market apart from Prirodni plin d.o.o., a part of INA d.d. company.

In the field of electricity, further efforts were made towards further development and market relations liberalisation based on the model of bilateral agreements. Unlike the gas market, new suppliers have appeared on the electricity market with the result that one market segment, most notably city lighting, has been won by new operators for the supply of electricity.

In order to ensure market-based operations, further efforts are being made towards the activities aimed at strengthening the administrative and technical capacities of the Croatian Energy Regulatory Agency and of the Croatian Energy Market Operator. The field of responsibility of the Croatian Energy Market Operator was expanded in 2011 to include not only the electricity market, but also the natural gas and biofuels markets. There is also the need for administrative capacity strengthening of the Energy Department of the Ministry of the Economy vis-à-vis the implementation of EU-funded projects.

In the transport sector, based on the Act on Biofuels for Transport¹²³ the National Action Plan for the promotion of production and use of biofuels in transport for 2011-2020, which contains national objective on introduction of biofuels on the market for the 2011-2020 period (that is in line with Croatia's defined strategic objective that envisages a 10% share of renewable sources of energy in the transport sector until 2020, in line with Directive 2009/28/EC) is prepared. The adoption of subordinate legislation based on the Act on Biofuels for Transport created in 2011 a complete new legislative and institutional framework for the promotion of production and use of biofuels in transport as a support to a systematic development of the Croatian biofuel market.

For the purpose of implementation of relevant EU energy regulations in the area of renewable sources of energy and energy efficiency, it is necessary to initiate the drafting of the relevant legislative framework.¹³ It is also necessary to provide a system that would be conducive to the use of energy services (in accordance with ESCO model projects), particularly in the public sector and to draw up a programme for the reconstruction of the existing buildings.

¹² Official Gazette 65/2009, 145/2010, 26/2011.

¹³ The Act on Renewable Energy Sources and relevant implementing regulations and action plan and the Act on Amendments to the Act on Efficient End-Use of Energy.

Amendments to the Oil and Petroleum Products Market Act were adopted in 2011. This Act provided for alignment of a part of the legislation with the latest EU Directive 119/09, which legislation is now in this segment fully aligned with the EU legislation. In the context of accession negotiations regarding the question of security of oil and petroleum products supply in Croatia, Croatia has been granted a transition period until 31 July 2012 for the creation of obligatory oil and petroleum products reserves in the quantity that is equal to the volume of a 90-day average consumption in the previous calendar year. In February 2011, the Act on Amendments to the Oil and Petroleum Products Market Act was adopted. This Act has created the preconditions for full alignment of Croatia's legislative framework with the *acquis* in the area of security of supply, i.e. the creation and storage of obligatory reserves of oil and petroleum products, that will continue to apply after 31 December 2012.

Additional storage capacity of approximately 800,000 m³ is planned to be constructed in Croatia to meet the needs for the storage of obligatory reserves. The planned capacities may ultimately also have a regional significance. It is estimated that the construction of storage capacities alone will require an investment of EUR 130 million. The project concerning the creation of obligatory reserves will also be used for the development of storage installations for commercial storage with a view to reducing the cost of creation and renewal of obligatory reserves but also with a view to further market opening and promoting competitiveness.

In accordance with the Energy Strategy of the Republic of Croatia, further efforts have been made towards continued development of energy supply security, energy system competitiveness and sustainability of development in the energy sector. A Programme for the implementation of the Energy Strategy of the Republic of Croatia has been drafted that will be adopted following the adoption of the third package energy legislation. Priority investment projects in the energy sector have been determined and significant private investments in the energy sector are expected. Taking into account the EU energy strategy until 2020 and the February 2011 conclusions of the European Council regarding energy, an initiative has also been launched regarding the development of a North-South energy corridor in South-eastern Europe in the area of electricity, gas and oil, with a view to strengthening regional connectivity and increasing the security of energy supply and diversifying the supply lines.

Infrastructural projects and activities in the Republic of Croatia envisaged by the Action plan for infrastructural construction on the North-South corridor include:

In the area of electricity:

1. A 400kV power-transmission line TE Plomin – Melina of 400 kV, a new double-circuit OHL line connecting the new 400 kV switchyard and the existing 400/220/110 kV substation. This facilitates integration of conventional production and enhances supply security. The deadline for project completion is 2015/2016.

In the area of natural gas:

1. The first phase envisages floating terminal installation for liquefied natural gas (RV terminal) and its connection to the mainland, and with the growing demand, a stationary LNG terminal installation. The deadline for the completion of the first phase of the project is 2014.
2. Slobodnica – Jadranski LNG, a 326 km long transmission gas pipeline, to connect the Adriatic LNG terminal/RV terminal to the gas interconnector between Hungary and Croatia, and enable the transport of gas to Slovenia. The deadline for the completion of the project is 2020.
3. Reversible gas pipeline from Croatia to Hungary. The deadline for project completion is 2020.
4. Interconnector between Croatia and Slovenia, the M8 Kalce – Jelšane/Lisac gas pipeline, a 51 km long transport gas pipeline connecting the Adriatic LNG terminal to the interconnector between Hungary and Croatia. This would enable the transport of gas to Slovenia by way of the

existing Slovenian systems of transmission and the transport of gas from the LNG terminal to Austria, Italy, and secure an alternative route to Hungary. The deadline for the realisation of the project is 2017.

In the area of oil:

1. Reconstruction and increasing the capacity of the existing JANAF and Adriatic pipelines (Sahy-Százhalmobatta section included) connecting the Croatian port of Omišalj to the south route of the Družba oil pipeline. This project ensures a full security route to Slovakia, Hungary and Croatia in the South-North direction and to Croatia in the North-South direction. This project, together with JANAF storage capacities, is a part of the Danube Strategy.

Continued efforts are also being made as regards the activities related to energy planning, supply security and energy market improvements in the energy sector. The Instrument for Pre-Accession Assistance (IPA) is used for these activities. Infrastructural projects related to energy supply security in Croatia will be financed by the Western Balkan Investment Fund (WBIF). The energy sector is also preparing for the use of structural funds that will become available after the accession of the Republic of Croatia to the EU, i.e. in the next financial perspective, covering the 2014-2020 period.

4.2.1.6 Small and Medium-size Enterprises

According to the financial reports for the January-September 2011 period, the small economy consists of 70,157 micro companies (76.58%), 11,684 small companies (12.75%), 1,274 medium-size companies (1.27%), 1,119 co-operatives (1.22%), 4,271 crafts and trades operating as individual traders (4.66%), or a total of 88,505 economic entities that employ 575,563 persons and account for 64.69% of the total economy which numbers 91,607 entities. In September 2011, the number of registered crafts and trades stood at 89,130, employing 120,678 persons. The small economy increased its export income (the January to September 2011 to the January to September 2010 index stood at 119.24, with the share in total exports standing at 40.67%), while its share in GDP, depending on the analysis period, ranged between 42% and 48%.

The hitro.hr service, which was devised as a one-stop-shop, and the e-tvrtka service made it possible to conduct all the activities necessary for company establishment in one place, in a single day. These services are available in all counties. An electronic service for crafts and trades registration was also developed (e-crafts and trades)¹⁴. Since its establishment in 2005 until 31 January 2012, 47,540 companies and 5,647 crafts and trades, of which 3,597 were foreign-owned companies, were registered through the HITRO.hr service. As at 31 January 2012 the total number of registered e-companies stood at 7,183.

With the entry into force of the Act on Organisation and Scope of Ministries and other Central Authorities of State Administration¹⁵, the Ministry of the Economy, Labour and Entrepreneurship has been dissolved and replaced by the new Ministry of the Economy, the Ministry of Entrepreneurship and Crafts and the Ministry of Labour and Pension System. The Ministry of Entrepreneurship and Crafts acts as an umbrella institution for small and medium-size companies. Based on the Programme of incentives to small and medium-size enterprises 2008–2012, so far four Operational plans were conducted with incentive programmes aimed at strengthening

¹⁴ The small economy has already a large number of e-services at its disposal. Many of these services are public e-services provided to citizens free of charge (HITRO.hr, e-health care, e-invoice, e-pensions, e-islands, e-cadastre, e-REGOS, e-tax, e-administration, e-indicators, e-help line, e-crafts and trades, e-firm, e-inclusion, e-office, e-business, e-education, e-judiciary, e-customs, e-culture, MojaUprava.hr (MyAdministration), etc.).

¹⁵ Official Gazette 150/2011

competitiveness, innovation and the use of new technologies, fast-growing activities, clusters, women entrepreneurship and beginner and disabled persons entrepreneurship, cooperative entrepreneurship, crafts development, education in entrepreneurship and vocational training, in accordance with the needs of the economy. The measures for regional development promotion also include, in addition to the stated measures, a system of entrepreneurial support institutions¹⁶ which has been improved in terms of standardisation of the quality of expert and consultative assistance provided to entrepreneurs.

The work of the Croatian Agency for SME has been improved through operational tasks involving the implementation of incentives to the small economy. The funding ensured under the operational plans helped co-finance the feasibility study, the establishment and the work of the Regional centre for entrepreneurial competencies (SEECCEL)¹⁷. Women entrepreneurship development strategy 2010-2013, Entrepreneurial learning strategy 2010-2014 and Cluster development strategy 2011-2020 are being implemented. The Ministry of Entrepreneurship and Crafts is preparing a plan to encourage entrepreneurship and crafts for 2012 with 6 program areas including: competitive entrepreneurship, favorable financing and guarantees, education for entrepreneurship and crafts, improving the entrepreneurial environment, the EU programs and projects and the improvement and development of institutional support for entrepreneurship and crafts.

The economic estimate of the regulatory impact, as a measure of entrepreneurial environment enhancement, is made in accordance with the European regulations and good practice, with an emphasis on the principles applicable to small and medium size enterprises, through EU IPA funded projects¹⁸. Six projects and one grant scheme worth in total EUR 15.9 million are currently being implemented. Four new projects and one grant scheme totalling EUR 10.9 million are to be implemented until 2013/2014. This makes a total of 10 projects and 2 grant schemes funded from the EU IPA IIIc component for regional competitiveness totaling EUR 26.8 million¹⁹.

Additional support to small economy development should come from the newly-established funds for economic cooperation. These are open end venture capital investment funds with a private

¹⁶ Under the Programme of incentives to small and medium-size enterprises 2008-2012, co-financing support was provided annually to an average of 50 entrepreneurship centres, 21 regional development agencies, 32 entrepreneurial incubators and 6 technological parks.

¹⁷ SEECCEL was established as an independent institution in 2009, based on an agreement concluded between Croatia and the Croatian Chamber of Economy. This model of partnership between the Government and an umbrella business association was commended by the European Commission as the most advanced form of cooperation which is in line with all the recommendations related to entrepreneurship and entrepreneurial learning. SEECCEL is devised as a reference centre for entrepreneurial learning with participating countries including Albania, Bosnia and Herzegovina, Montenegro, Croatia, Kosovo, Macedonia, Serbia and Turkey and Moldavia as an observing country.

¹⁸ Under the project of the Ministry of Entrepreneurship and Crafts entitled „*Improving information to the Croatian business community*“ (BIZIMPACT II), the beginning of which is scheduled for August 2012, a methodology for an economic estimate of the regulatory impact will be made, the principles of the Small Business Act, in particular the “Think small first” will be applied as well as a SME test as a mandatory measure of the estimate of the regulatory impact; the project of the establishment of the Regulatory Impact Assessment – RIA system „*Development of regulatory impact assessment system*“ is carried out by the Legislation Office.

¹⁹ In accordance with the Operational Programme for Regional Competitiveness, IPA IIIc, following projects are currently implemented: (1) Improvement of administrative efficiency on the national level, (2) Improvement of business competitiveness through e-business, (3) Capacity building for the performance of business services and institutions responsible for providing business support - CABBS, (4) Promoting and providing advisory services to small and medium enterprises - SMEPASS, (5) The development of investment environment, (6) Support to the development of clusters, and (7) grant scheme "Support to strengthen the competitiveness of small and medium businesses." Projects whose implementation is planned for 2013/2014 are: (1) Improving business competitiveness through electronic business (e-Business II), (2) promotion and provision of advisory services to small and medium enterprises - SMEPASS II, (3) Improving access to information for the Croatian business community – BIZIMPACT II, (4) Strengthening competitiveness of Croatian tradesmen using information-communication technologies, and (5) grant scheme "Support to strengthen the competitiveness of small and medium businesses - the second call."

offering managed by management companies for open end venture capital investment funds with a private offering. These funds may invest exclusively in companies registered in Croatia that conduct the bulk of their operations in Croatia. Investments are made only in shares and holdings in companies, with the maximum amount of investment in an individual company standing at 33% and in the sector at 40%. Investment in stock-exchange listed securities for the purpose of short-term trading is not allowed. There are five funds for economic cooperation operating in Croatia.

In addition to creating positive investment climate, the funds for economic cooperation as a model ensure the sharing of risks with the “private” sector that has proven successful in creating new value, promote the development of venture capital funds industry as the promoter of new industries (the Internet, web, media, renewable sources of energy, etc.), promote entrepreneurship, corporate leadership and supervision.

In view of the achievements made, further systematic support to the small economy is planned by way of the following measures: (1) Improved financing of small and medium-size enterprises and crafts, (2) Market position and competitiveness strengthening, (3) Growth and development acceleration, (4) Education and employment, (5) Entrepreneurial culture and (6) Strategy implementation.

Small and Medium-size Enterprises in Tourism

The work on the drafting of Croatia’s tourism strategy commenced in 2011 and is expected to be finalised towards the end of 2012. This document will, among other things, provide answers to some key questions, most notably regarding the course of tourism development, efficient management of tourism destination region, and tourist season extension.

Subsidies to small family enterprises in tourism will continue to be paid in the 2012-2014 period. In the framework of the programme of the Government entitled “Incentive for Success”, these types of enterprises can be granted loans at a subsidised interest rate. Small family hotels, as the main target group of this programme, currently account for 31% of the total number of Croatian hotels and for 5.4% of the total number of permanent beds in the Croatian hotels. The development of small family hotels to an extent implies hotel supply restructuring efforts in Croatia, given that prior to the year 2000 the tourist market was dominated exclusively by large hotels with 50 or more accommodation units that operated within large tourist companies.

In 2011, in the context of hotel and restaurant industry co-financing, 27 projects of 12 companies and 4 crafts in restaurant business received support with a view to ensuring continuous improvement in business quality and the provision of services through the introduction of innovation and new technology and through competitive advantage building. With the programme entitled “Heritage in tourism”, the Government provided support in 2011 to 8 crafts and 15 companies for projects regarding renovation, valorisation, and revitalisation of cultural, traditional and natural heritage. The expected improvement in the tourist offer through the introduction of objects of cultural and natural heritage is expected to result in turn in increased tourist turnover in touristically less developed regions and more uniform regional development. The effects of all the stated programmes will contribute to increased competitiveness, offer diversification, tourist season extension, increased revenue, and better positioning on the tourist market.

4.2.1.7 Public Private Partnership

For the purposes of alignment of individual procedural provisions of the Act on Public Private Partnership with the General Administrative Procedure Act, the Act on Amendments to the Act on Public Private Partnership was adopted in May 2011.²⁰

The Register of public private partnership agreements that was set up in the first quarter of 2011 provides a formal and legal basis for the official submission of data to the Agency for Public Private Partnership (hereinafter “the Agency”). Until the end of the second quarter of 2011, public bodies that are the subject of entry in the Register, submitted most of the required documentation relating to projects in the field of public private partnership whose implementation is underway. Since December 2011, public data in the Register have been made available to the public at large on the Agency’s web page.

The Register provides a comprehensive database with information on the concluded public private partnership agreements. The opening of the Register to outside users added to the transparency and provided a model of communication with the citizens, the private and the public sectors by offering them an insight into individual projects of public private partnership. The Register provides to the Agency and the Ministry of Finance an additional platform for the supervision of the implementation of public private partnership projects which is expected to contribute to the promotion of the efficacy of the system of public private ownership in the Republic of Croatia and to attract investment under the model of public private partnership.

In 2011, a complete system of training on public private partnership projects preparation and implementation was provided for all public bodies authorised to propose and implement public private partnership projects. In the context of the twinning light project²¹, a Fiscal impact and risk assessment guideline was prepared and the implementation of the seminar on public private partnership cycle commenced. Pursuant to the Act on Public Private Partnership²², four private public partnership project proposals were approved in 2011, with bidding documentation being approved for two of these projects. At least the same number of projects is expected to be approved in 2012.

The Agency will, as a national body responsible, together with the Ministry of the Economy, for public private partnerships, through its activities in the area of training and support in the project preparation processes, in cooperation with the Ministry of Finance and leading international centres of knowledge, continue to work towards developing continuous processes of preparing and proposing of fiscally feasible public private partnership projects that are sustainable over a long-term and that provide the best possible value for money and final service quality.

Such an approach will enable the realisation of advantages associated with the model of public needs financing through public private partnership, most notably those associated with faster and better infrastructural development, more efficient management of infrastructure, better and cheaper public services, fiscal unburdening and generation of new investment and economic growth through considerable multiplier effects.

²⁰ Official Gazette 55/2011

²¹ IPA 2007 (HR/2007/IB/FI/06-TL) twinning light project “Strengthening the administrative capacity of the Ministry of Finance of the Republic of Croatia in relation to the implementation of the new concession and public-private partnership legislation”.

²² Official Gazette 128/2008

Bearing in mind the fact that under the Act the Ministry of Finance is determined as the body that participates in the evaluation and approval of public private partnership projects in all key phases, and taking into account the international practice and developments that emphasise the crucial importance of comprehensive examination and supervision of the fiscal impacts and risks associated with public private partnership projects, a twinning light project was conducted in 2011²³. Some of the project components dealt exclusively with the establishment of an integral model for public private partnership projects analysis and evaluation from the fiscal and financial standpoints and the creation of administrative preconditions for its implementation. The new Fiscal impact and risk assessment guideline for PPP projects, prepared in the context of this project, thus offers a qualitative addition to the scope of activities of the Ministry of Finance, complementing the Ministry's current practice-based methodology and mechanisms developed through a similar project²⁴ carried out in 2009 which was financed by the World Bank.

In addition to creating a stimulating environment and developing processes essential for the further development of public private partnerships on the national, regional and local levels, the Agency, as the central body of the SEE PPP Network, developed in the framework of the Regional Cooperation Council of the countries of the South-East European Economic Cooperation Process²⁵, actively promotes the development of legislative and institutional frameworks in line with the *acquis* and the strengthening of the administrative capacities of the competent authorities in the Network member countries. These activities are aimed at creating the necessary preconditions for proper preparation and implementation of cross border PPP projects and at promoting regional cooperation with the aim of attracting direct investment.

In this context, the Network's Internet subpage was created on the Agency's Internet page in 2011, a two-day international conference entitled "Capacity building on public private partnership in South East Europe" was held in 2011 and towards the end of November 2011, a three-day seminar on PPP was held for the Network members in the framework of the Regional School of Public Administration of Montenegro. A South-East Europe PPP Network Internet forum is planned to be launched and an annual conference held in 2012.

In addition to the Agency that is responsible for the operational tasks of the implementation of the measures determined under this programme, in accordance with the applicable legislation regulating the area of public private partnership, the Ministry of the Economy, as the central state administrative body responsible for public procurement pursuant to the Public Procurement Act²⁶ participates in the carrying out of administrative and other tasks relating to the development and enhancement of the system of public private partnership.

²³ IPA 2007 (HR/2007/IB/FI/06-TL) twinning light project "Strengthening the administrative capacity of the Ministry of Finance of the Republic of Croatia in relation to the implementation of the new concession and public-private partnership legislation".

²⁴ RebelGroup Advisory, the Institute of Economics, Zagreb: "Review of Institutional Framework and Development of Fiscal Risk Assessment Model for the Public Private Partnerships (PPP) in Croatia", a project financed by the World Bank.

²⁵ Countries participating in the South-East European Economic Cooperation Process include Albania, Bosnia and Herzegovina, Montenegro, Bulgaria, Greece, Croatia, Macedonia, Moldavia, Romania, Serbia, Turkey and UNMIK/Kosovo.

²⁶ Official Gazette 90/2011

4.2.2 FINANCIAL SECTOR

Towards the end of September 2011, the total assets of banks accounted for 75.6% of the total assets of all financial intermediaries. Such a high share of the total assets of banks indicates the dominant position of banks in the financial system of the Republic of Croatia. The share of mandatory and voluntary pension funds and insurance companies in the total assets of all financial intermediaries has been rising since the end of 2007, while the share of open-end and closed-end investment funds has been falling during the same period as a result of smaller investor preference for this type of investments.

Table 9: Financial Sector Structure (% of total assets, end of period)

Financial intermediaries	2007	2008	2009	2010	September 2011
Banks	73.5	76.7	75.5	75.3	75.6
Open-end investment funds, net assets	6.4	2.0	2.4	2.6	2.5
Croatian veterans fund	n.a.	0.5	0.4	0.4	0.3
Closed-end investment funds, net assets	1.7	0.4	0.4	0.4	0.3
Insurance companies	5.0	5.3	5.6	5.8	5.9
Factoring companies	0.9	1.3	1.4	1.2	1.1
Housing savings banks	1.4	1.4	1.3	1.3	1.4
Mandatory pension funds, net assets	4.5	4.7	5.8	7.0	7.4
Voluntary pension funds, net assets	0.2	0.2	0.3	0.3	0.4
Leasing companies	6.5	7.3	6.7	5.6	5.0
Credit unions	0.1	0.1	0.1	0.1	0.1
Total	100.0	100.0	100.0	100.0	100.0

Source: CNB, MF, CFSSA

In the process of accession to the EU, the Republic of Croatia has recognised the policy of consumer protection in the financial sector as one of the priority areas for the adoption of measures for the protection of consumer interests. With a view to enhancing the level of consumer protection in the financial sector, the Government, acting on a proposal by the Ministry of Finance, issued a Conclusion in October 2011, obligating the Ministry of Finance to prepare, in cooperation with the competent ministries and relevant representatives of scientific institutions and institutions of learning, supervisory bodies, consumers and the financial industry, within a year, a proposal for the national strategic financial literacy framework. During 2011, CNB intensified its activities in the field of consumer protection policy. In the organizational context, CNB set up a special organizational unit which deals with consumer protection in the banking sector.

4.2.2.1 Banking Sector

Operation

At the end of 2011, there were 32 banks and 5 housing savings banks operating in the Republic of Croatia. They accounted for 77% of the total assets of all financial intermediaries. The banking system was a highly concentrated system, with the two largest banks accounting for approximately 42% and the ten largest banks for approximately 92% of total banking system assets. In terms of ownership, banks in majority foreign ownership were the dominant category, accounting for 90.7% of the total assets of all banks, while domestic state ownership accounted for 4.5% of the total assets of all banks and those in domestic private ownership for 4.8% of the total banking system assets.

The total banks assets at the end of 2011 stood at HRK 407.4 billion, increasing by 4.2% from the end of 2010. The share of deposits held steady compared to the previous three years, and at the end of 2011 it accounted for 69% of the total liabilities of banks that relates mostly to the household sector, while the share of capital stood at 13.8%. At the same time household deposits accounted for 57% of total banks' deposits, while the funds from majority owners accounted for 15% of received deposits and 51% of received loans. HRK 438.2 billion in placements and off-balance sheet liabilities were exposed to credit risk, of which 9.0% were distributed into B and C risk categories which represent non-performing placements. The total amount of provisions for placements and off-balance sheet liabilities accounted for 5% of total placements and liabilities, with this indicator continuing its increase since 2009 and reaching its highest value since 2004. Banks' profit before tax recorded in 2011 stood at HRK 4.7 billion, with 8 smaller banks recorded losses. At the end of 2011, the capital adequacy ratio of banks stood at 19.15%, ROAE at 7.1% and ROAA at 1.18%.

Legislative Framework

The Credit Institutions Act²⁷ (hereinafter: "the Act"), implementing the provisions of the Capital Requirements Directive (CRD²⁸) relating to credit institutions, was adopted in September 2008. In January 2009, the Croatian National Bank adopted subordinate legislation regulating in detail the calculation of credit institutions' capital adequacy, as well as a number of other subordinate legislation based on the new Credit Institutions Act²⁹. The Act prescribes that credit institutions must have a minimum capital adequacy of 12 percent. The new capital adequacy calculation applied as of 31 March 2010, since the CNB had transposed the amendments to the CRD, adopted in 2009 at the EU level, into the relevant subordinate legislation at the beginning of 2010.³⁰ In the course of 2011, CNB amended certain bylaws and thus implemented CRD III provisions into the domestic legislation referring to the credit institutions³¹, except in the part regarding remuneration policy receipts which will be addressed through CRD IV. During 2011, CNB commenced studying draft CRD IV and drafted indicative implementation plan. Under the assumption that CRD IV will be adopted by October 2012, by the end of 2012 draft Act on Credit Institutions will be sent to the Government procedure. After the Accession Treaty of the Republic of Croatia to the EU was signed, CNB Supervision staff have joined the work of the European Banking Authority – EBA as observers.

Agreements

For the purpose of strengthening cooperation between supervisory institutions, a Memorandum of understanding for financial crisis management was signed by the CNB, the Croatian Financial Services Supervisory Agency and the Ministry of Finance. The basis for cooperation with the supervisors of banks in majority foreign ownership are the memoranda of understanding concluded with the representatives of Austria, France, Italy, Hungary, Germany and San Mario, whereas the agreements with the supervisory bodies from Bosnia and Herzegovina and Montenegro relate to the supervision of subsidiary banks in these countries. Following the entry of Turkish shareholders in

²⁷ Official Gazette 117/2008

²⁸ The Capital Requirements Directive encompasses Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions.

²⁹ Official Gazette 117/2008, 74/2009, 153/2009; in addition to the CRD it also includes the transposed provisions of Directive 2001/24/EC on the reorganisation and winding up of credit institutions, Directive 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and Council Directive 89/117/EEC on the obligations of branches established in a Member State of credit institutions and financial institutions having their head offices outside that Member State regarding the publication of annual accounting documents.

³⁰ The amended decisions were published in the Official Gazette 2/2010.

³¹ Official Gazette 118/2011

the ownership structure of the Croatian banks, a memorandum of understanding was concluded with the Turkish supervisory authority in September 2011.

Payment System

The Payment System Act entered into force in 2011³², transposing Directive 2007/64/EC on payment services in the internal market³³, while the Electronic Money Act³⁴ transposed the provisions of Directive 2009/110/EC³⁵ in the Croatian legislation. The draft Act on Settlement Finality in Payment Systems and Financial Instruments Settlement Systems and the draft Financial Collateral Act were prepared in 2011, whereby transposition of Directive 2009/44/EC³⁶ will be finalised in 2012.

Administrative Capacities

In view of the new regulations concerning payment system and electronic money, the CNB's supervision power was extended and new employees were recruited for the supervision of payment system and electronic money institutions. A considerable number of the CNB employees are involved in the training project organised by the ECB for the countries in the region.

4.2.2.2 Non-banking Sector

On 31 December 2011, 26 insurance companies and 1 reinsurance company were authorised to conduct insurance business in Croatia. In February 2012, there were 31 insurance intermediation companies operating in the country and 272 intermediaries-natural persons conducting the insurance intermediation business. There were also 157 crafts authorised for insurance representation and 205 insurance representation companies and 10,913 insurance agents (natural persons) authorised for conducting the insurance representation business (including insurance agents in the bank channel).

One can take a compulsory insurance policy for the motor vehicle owner or user, from liability for damage to third parties as well as additional motor vehicle accident insurance at the 37 vehicles technical inspection stations. All the legal and natural persons listed above operate on the basis of a decision issued by the Croatian Financial Services Supervisory Agency (CFSSA), while the 25 banks obtained an authorisation for performing the tasks of representation in insurance from the Croatian National Bank, upon a prior approval by CFSSA.

On 31 December 2011, the total assets of insurance companies stood at HRK 31.9 billion while the assets of reinsurance companies totalled HRK 0.9 billion. Gross written premium for non-life insurance amounted to HRK 6.7 billion at the end of the last quarter of 2011 while that for life insurance amounted to HRK 2.4 billion.

In February 2012, there were 39 investment companies and credit institutions authorised to provide investment services, 29 investment fund management companies, with 125 open-end investment funds and 7 closed-end investment funds. There were also 4 compulsory pension funds, 6 open-end voluntary pension and 15 closed-end voluntary pension funds, as well as two funds established

³² Official Gazette 133/2009

³³ Directive 2007/64/EC on payment services in the internal market

³⁴ Official Gazette 139/2010

³⁵ Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions

³⁶ Directive 2009/44/EC on settlement finality in payment and securities settlement systems

pursuant to a special law (the Fund of Croatian Homeland War veterans and members of their families and the Pensioners' Fund).

On 31 December 2011, the total assets of investment companies stood at HRK 0.5 billion, and of investment fund management companies at HRK 0.4 billion. Net assets managed by pension companies amounted to HRK 43.0 billion. On 30 September 2011, the assets of the funds established pursuant to a special law amounted to HRK 2.4 billion.

At present there are 25 leasing companies and 17 factoring companies operating in Croatia. The assets of leasing companies as at 31 December 2011 stood at HRK 25.9 billion while those of factoring companies stood at HRK 5.8 billion (on 30 September 2011).

As a supervisory authority responsible for entities providing non-banking financial services, CFSSA revises and improves its approach to supervision to enhance the supervision of legislative compliance of the entities within its competence and ensure better assessment of their business risks.

CFSSA is a signatory to the Multilateral Memorandum of Understanding with the members of the International Organisation of Securities Commissions (IOSCO). It has also entered into a number of bilateral cooperation agreements with the non-banking financial market regulators. To achieve better financial market supervision CFSSA plans to cooperate, on a continuous basis, with all regulatory bodies with which it has signed agreements.

Also, to ensure better provision of information to the professional as well as the general public, and to educate the users of financial services, CFSSA regularly publishes informational, publicational and educational content on its web page RIPE-www.ripe.hanfa.hr, a service which provides descriptions of individual financial services, serves as a contact FAQ point for financial services users and information on developments in regulatory practice abroad and future legislative changes, draft legislation and implementing measures of the EU.

As regards legislation in the area of accounting, in an effort to reduce costs for the state budget, an Ordinance on the types and the amount of charges paid to the Financial Agency for the publication of annual financial reports and issuance of documentation from the Register of annual financial reports was adopted in 2011. Also, harmonization with amendments to the International financial reporting standards continues.

In the area of audit, further activities are being implemented as regards oversight and quality assurance of audit firms, independent and certified auditors. The Croatian Audit Chamber reports to the Audit Public Oversight Committee about the results of these activities.

International cooperation was established in 2010 with the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) of the United Nations Conference on Trade and Development (UNCTAD) which continued into 2011. In December 2010, Croatia was also voted an ISAR member by acclamation for the 2010-2012.

4.2.3 LABOUR MARKET

Developments in the labour market reflect economic conditions, and are as a rule in a certain time-based relationship with them. Unfavourable economic conditions in the recent past led to negative trends on the labour market, both in terms of a fall in employment and rising unemployment.

Negative developments in the Croatian labour market eased off in the last few months of 2011. This was seen in a deceleration of a fall in registered employment. Registered employment in November 2011 stood at 1,381,847, a decline of 1% from the same month previous year. Registered unemployment did not rise, but fell slightly. At the end of December 2011, registered unemployment was down 1.4% from the end of the same month previous year. The fall in registered unemployment was largely due to active employment policy measures. As regards the indicators obtained on the basis of the labour force survey, the unemployment rate rose from 11.5% in the third quarter of 2010 to 12.2% in the same quarter of 2011.

4.2.3.1 Stimulating Employment

The measures for promoting employment are envisaged by the National Employment Promotion Plan 2011–2012, which is based on the Joint Assessment of Employment Policy Priorities (JAP). The National plan consists of 31 implementing measures and 175 implementing activities falling within the competence of 31 institutions. They include renovation of residential units demolished during the war (The Ministry of Regional Development and EU Funds), financing of entrepreneurship in tourism and island development support (The Ministry of Tourism), incentives to small and medium-size enterprises, cooperatives and crafts (The Ministry of Entrepreneurship and Crafts), the activation of war veterans and the disabled on the labour market (The Ministry of War Veterans and the Fund for Professional Rehabilitation and Employment of People with Disabilities). These measures and activities are funded, among others, by pre-accession EU funds and Croatia submits to the European Commission a detailed annual report on the results of the implementation of this plan.

In 2011, the Croatian Employment Service spent HRK 281 million kuna for the implementation of active employment policy measures within its competence, an increase of 55.3% compared to the previous year. The number of persons participating in these active measures also increased, from 13,088 in 2010 to 33,972 in 2011, which is an increase of 160%. There were 13,788 persons participating in training for the unemployed, an increase of 202% from the previous year and 10,780 persons participated in public works, an increase of 114% from the previous year. Training and public works were the measures intended primarily for persons unemployed for an extended period of time with a very difficult access to the labour market.

It should also be noted that the number of persons included in workplace training without concluding employment contract, intended for young persons with no previous work experience, rose from only 448 in 2010 to 4,760 in 2011. Such a sharp increase was due to the fact that lack of experience was identified as one of the main obstacles to young persons' employment. An external evaluation of active employment policy measures taken by the Croatian Employment Service in 2009 and 2010 was performed towards the end of 2011. It revealed considerable differences between the participants in the measures and their control groups. However, these differences can to a large extent be attributed to the effect of the participants' selection which had not been fully eliminated by the quasi-experimental method used.

Despite a sharp increase in expenditures for active employment policy measures in 2011, compared to the previous year, they still remained relatively low compared to the expenditures for passive

measures. Active measures to unemployment compensation expenditures ratio stood at 20% in 2011.

4.2.3.2 Social Security System

Legal Protection of Unemployed Persons

The primary form of social protection during unemployment is payment of financial compensation for unemployment. The number of financial compensation beneficiaries in 2011 stood at 74,501, a decrease of 5% from the previous year. Expenditures for financial compensation in 2011 totalled HRK 1.39 billion, a decrease of 6.3% from the previous year. Despite a small increase in the unemployment rate in 2011, compared to 2010, the number of unemployed persons entitled to financial compensation declined. As a result, the total amount of financial compensation in 2011 fell by HRK 170 million. This is very much due to a slowdown in the rate of employment fall, a considerably smaller inflow of unemployed persons from employment, that are entitled to this compensation, and an increased inflow of persons from regular education and from inactivity, that are not entitled to this compensation.

Pension Insurance

With a view to further implementation of the pension system reform and improvement which aims at ensuring its fiscal and social sustainability in unfavourable demographic and economic conditions, the Croatian pension system underwent several changes last year.

According to data provided by the Croatian Pension Insurance Institute, the insured person to beneficiary ratio under the generation solidarity scheme was again very unfavourable. The number of insured persons in December 2011 was 1,468,133 and the number of pension beneficiaries was 1,213,121 (1.21 to 1). The share of pension expenditure in GDP in 2010 reached 10.60%. This was due to the increase in the number of retired persons, payments of pension supplements for pensions earned from 1 January 1999 under the Act on Amendments to the Pension Insurance Act³⁷, the implementation of the Amendments to the Pension Insurance Act³⁸ which provide for an increase in early old-age retirement pensions, the lowest pensions and disability pensions due to professional incapacity for work of employed users, from 1 January 2008. A contribution to the growth in pension expenditure in GDP came from a fall in the nominal amount of GDP in 2010. In August 2011, the replacement rate³⁹ for an average pension earned under the Pension Insurance Act stood at 39.03%, the replacement rate for an average old-age pension earned under the Pension Insurance Act stood at 42.87% and the replacement rate for an average old-age pension for a completed qualifying period of 40 years or more stood at 58.29%.⁴⁰

In view of ensuring long-term sustainability of the generation solidarity pension system, an Act on Amendments to the Pension Insurance Act⁴¹ was adopted that entered into force on 1 November 2010. This Act envisages, starting from 1 January 2011, a gradual increase in the age limit for entitlement to old-age and early retirement pension for women of 3 months per year, during a 20-year transitional period. This will ensure equal conditions for acquiring rights to pension for both men and women from the year 2030. The same Act envisages tighter conditions for the calculation of early retirement pensions, that are more appropriate to the costs associated with earlier retirement and increased pensions for persons that wish to continue working after having met the

³⁷ Official Gazette 79/2007

³⁸ Official Gazette 79/2007

³⁹ The replacement rate is the share of average pension in average net wage.

⁴⁰ Official Gazette 102/1998, 127/2000, 59/2001, 109/2001, 147/2002, 117/2003, 30/2004, 177/2004, 92/2005, 43/2007, 79/2007, 35/2008, 40/2010, 121/2010, 130/2010 – as amended, 61/2011 and 114/2011

⁴¹ Official Gazette 121/2010

conditions for old-age pension. Over a medium and long-term, these measures are expected to result in a slowdown in the inflow of new pension beneficiaries and a slowdown in the growth in pension and pension-related expenditures. After the expected initial negative fiscal impacts of the implementation of the said Act, from 2013 onwards, the authorities expect to generate savings in pension and pension-related expenditures. It is estimated that expenditures will decline by approximately HRK 50 million in 2013, by approximately HRK 140 million in 2014 and by approximately HRK 240 million in 2015. In addition, over a long-term these measures will have a favourable effect on revenue from pension insurance contributions, given that insured persons will remain longer in the labour market and will exercise their entitlement to pension at a later stage in life.

The decision on the suspension of pension adjustment in 2010, pursuant to the Act on Special Tax on Salaries, Pensions and other Receivables,⁴² remained in force throughout 2011 in line with the Act on Postponing Pension Adjustment in the period from 1 January to 31 December 2011.⁴³ In the two year period these measures reduced the state budget expenditures by a total of HRK 260 million. As of 1 January 2012, pension adjustment will be reinstated through the application of the so-called Swiss formula for pension indexation, i.e. adjustment in accordance with an index resulting from a 50% increase in gross salaries and 50% consumer price increase.

The monitoring of the implementation of the Act on the Supplement to a Pension Earned under the Pension Insurance Act⁴⁴ led to the realisation that the pension supplement⁴⁵ should be integrated into the amount of the pension. The pension supplement was part of a different taxation regime, providing the beneficiaries of the supplement with a more favourable position compared with other pensioners. Pursuant to the Act on Adjustments to the Act on the Supplement to a Pension Earned under the Pension Insurance Act,⁴⁶ as of 1 January 2012 for some 300,000 beneficiaries of the pension supplement, in the average amount of HRK 351, the pension supplement was integrated in the overall amount of their pensions. It is estimated that as a result of the inclusion of the amount of the supplement in the total amount of the pension as of 1 January 2012 (the pension in February) some 70,000 beneficiaries of the pension supplement will be obligated to pay higher health care contributions, at the rate of 3%, due for pensions above the net wage in the Republic of Croatia, as well as tax and surtax arising from the supplement in the average amount of HRK 51, making the taxation regime equitable for all pensioners.

The adoption of the Act on Reduction of Pensions Determined i.e., Realised under the Special Pension Insurance Regulations⁴⁷, (which as of 1 July 2010 reduced pensions of certain special categories of pensioners by 10%), was followed by the adoption of the Act on Amendments to the Act on Diminishing Pensions Determined i.e., Realised under the Special Pension Insurance Regulations⁴⁸, which exempted from the aforementioned reduction the survivor's pensions paid out to family members of the killed Croatian Homeland War defenders, children who lost both parents, that are realised under the Act on the Rights of Croatian Homeland War Defenders and Members of their Families⁴⁹. The adoption of the said Act is estimated to have saved HRK 250

⁴² Official Gazette 94/2009 and 56/2010

⁴³ Official Gazette 139/2010

⁴⁴ Official Gazette 79/2007

⁴⁵ The pension supplement has been calculated and paid out as of 1 October 2007, as a separate receipt in addition to the pension received, totalling from 4% to 27%, depending on the calendar year in which the beneficiary realised his/her right to pension, aiming to measure the differences among pensions realised under old pension insurance regulations and the ones realised under the current Pension Insurance Act.

⁴⁶ Official Gazette 114/2011

⁴⁷ Official Gazette 71/2010

⁴⁸ Official Gazette 130/2011

⁴⁹ Official Gazette 147/2004, 92/2005, 107/2007, 56/2009, 137/2009 and 55/2011

million in 2010, HRK 610 million in 2011 and will save HRK 620 million in 2012, and the corresponding amounts over the coming years. In addition, on 25 January 2012 Parliament adopted the Act on Amendments to the Act on the Rights and Obligations of Representatives in the Croatian Parliament, under which, MPs, Constitutional Court Judges and the Auditor General will, in the future, earn their pensions pursuant to the Pension Insurance Act.

As for the system of generation solidarity, the system of the minimum pension is to be revised, in particular the system of financing the minimum pension, re-examining the possibilities of being granted minimum pension pursuant to the income or property qualifications, as well as re-examining the possibility of widening the scope of pension beneficiaries allowed to work under contracts of employment in addition to receiving their pension⁵⁰.

Amendments to the Compulsory and Voluntary Pension Funds Act⁵¹ provided the insured persons who voluntarily joined the 2nd pillar of the pension insurance scheme (insured persons who on 1 January 2002 were aged 40 or more, but below the age of 50, and who by their own choice joined the so-called 2nd pillar – some 95,000) with the possibility of opting out from the scheme when they acquire the right to old-age or early-retirement pension under the Pension Insurance Act⁵². Aiming for a comprehensive solution of the issue regarding individuals who voluntarily joined the 2nd pillar, it was necessary to press ahead with amendments to the Act on Amendments to the Act on Pension Insurance Companies and Payment of Pensions Based on Individual Capitalised Savings⁵³ in order to solve the status of former members of the mandatory pension funds and current beneficiaries of pensions from the 2nd pillar who by their own choice joined the 2nd pillar. It is estimated that it will prove more favourable for a significant number of insured persons who might decide to retire in the following years to return to the 1st pillar and that the transfer of assets from their personal accounts to mandatory pension funds, despite incurring expected higher costs arising from the payment of their pension from the 1st pillar, will benefit the state budget through increased income. The estimate for the exit from the 2nd pillar involving 95,000 of insured persons, the so-called volunteers, i.e. the future pension beneficiaries has been calculated gradually for the period from October 2011 to 2040. Accordingly, it is estimated that in 2011 some 46 of the so-called volunteers will opt for a pension realised only under the 1st pillar, with the net effect for the state budget of some HRK 3 million, in 2012 their number is estimated at 643 insured persons, with the net effect of some HRK 22 million.

Aiming to cut administrative costs regarding the 2nd pillar of pension insurance, the Act on Amendments to the Act on Collecting Insured Persons' Data on Mandatory Pension Contributions⁵⁴ was adopted, which regulates the new way of financing of the Central Registry of Insured Persons by transferring a share of costs incurred by the uniform accounting-keeping of personal accounts of mandatory pension fund members from the state budget to mandatory pension companies. In addition, pursuant to the Decision of the Croatian Financial Services Supervisory Agency on the highest percentage of the fee for the management of the mandatory pension company in 2012⁵⁵, the fee for the costs of mandatory pension companies was cut so a mandatory pension company now

⁵⁰ The above-mentioned has been envisaged by the following documents: *Joint Memorandum on Social Inclusion of the Republic of Croatia* (JIM) and the *Joint Assessment of Employment Policy Priorities* - JAP.

⁵¹ Official Gazette 114/2011

⁵² It should be stressed that this Act provides for the possibility of opting out for contributors to the 2nd pillar and members of the mandatory pension funds who are beneficiaries of new pensions and who on the date of the entry into force of this Act have not entered into a pension agreement with a respective pension insurance company, as well as to beneficiaries of survivor's pensions realised after the death of an insured persons, member of a respective fund, if the assets arising from capitalised contributions on the personal account of the deceased have not been inherited.

⁵³ Official Gazette 114/2011

⁵⁴ Official Gazette 90/2011

⁵⁵ Official Gazette 154/2011

has the right to a management fee by deducting 0.45% per year from the total assets of a given pension fund (0.65% in 2011).

Further, it is necessary to examine the possibility of raising contributions to the 2nd pillar of the pension insurance and reducing fees for its management. The proposed increase in the contribution rate will depend upon the results of the required analyses aimed at ensuring adequate pensions for future beneficiaries. In addition, the formula for calculating the basic pension will be re-examined, as well as the investment policies of pension funds in terms of investment differentiation with respect to age cohorts.

Social Welfare

The Social Welfare Development Strategy in the Republic of Croatia 2011–2016 was adopted in an effort to optimise social welfare measures, laying special emphasis on EU guidelines in the area of social inclusion. In addition, the Plan of Deinstitutionalisation and Transformation of Social Welfare Institutions and Other Legal Entities Providing Social Welfare Services in Croatia 2011–2016 (2018) was adopted, as a basis for the planned network of homes and social welfare activities.

As part of the measures under the Economic Recovery Programme an analysis of social transfers was completed and a definition of the uniform concept of family (household) proposed. To be more precise, a uniform methodology was determined for setting up a proprietary census, as well as the census amount for the entitlement to social benefits; proposals were submitted for amendments to individual pieces of legislation. The eligibility for social benefits is determined based on the income and receipts of the applicant and family members living in the same household, and on the basis of the property owned by the applicant and family members living in the same household.

In line with the proposed measures, the Social Welfare Act,⁵⁶ adopted in May 2011, introduced a uniform definition of households and a clearer income and property census as regards the eligibility for social assistance, benefits, support and services. Under the previous Social Welfare Act the basis for entitlement to social welfare was set exclusively by the Government and was not adjusted to costs. The new Act introduced a basis that is linked to the relative poverty threshold, published yearly by the Croatian Bureau of Statistics. The basis is 22.5% of the monthly amount of the relative at-risk-of-poverty threshold for single-person households. This way, assistance is linked to changes in average income. The introduction of this basis does not presuppose an increase in the so-called permanent support, except for categories of beneficiaries at risk of poverty and social exclusion. The new Act introduces an equivalent scheme, which provides more equitable assistance to single persons, especially those suffering general disability to work, and single parent households.

In an effort to enable further deinstitutionalisation and expansion of the service network, the new Foster Care Act⁵⁷ was adopted in July 2011. It regulates new forms of foster care (kinship foster care, non-kinship foster care and professional foster care, as a completely new type of foster care), laying emphasis on training and education of foster care providers, as a contribution to the deinstitutionalisation of the social welfare system. In order to harmonise the Foster Care Act with the provisions of the new Social Welfare Act some amendments are underway.

The planned introduction of special “benefits for the elderly” without pension and in the social welfare system (the introduction of the so-called social pension) did not see the light of day for several reasons. In addition to economic reasons, the problem lies in the small difference between

⁵⁶ Official Gazette 57/2011

⁵⁷ Official Gazette 90/2011

the social welfare benefits for elderly persons and the lowest pension for the minimum length of service of 15 years. Nevertheless, the new Social Welfare Act provides for some improvements in the material status of households of elderly single person⁵⁸ without pension since the adopted temporary solution provides for a 20% increase in social assistance to single persons unable to work (HRK 100), while the introduction of the special assistance to the elderly will be postponed until the economic conditions will have enabled the required expenditure estimated at HRK 59.6 million.

In line with the above-mentioned Strategy further strategic measures and activities for the period 2012–2014 in the area of social welfare are related to: 1) the improvement of the quality of work of expert workers through the implementation of relevant legislation that regulates the activity of professional associations of persons employed in the field of social welfare and other systems such as health care, judiciary, economy and the civil sector; 2) the improvement of the position of the socially vulnerable groups through introduction of monetary assistance aimed at elderly persons without pensions or monetary assistance aimed at disabled persons (inclusive supplement) and the introduction of uniform criteria for determining disability and functional incapacity, as well as the establishment of a common assessment body; 3) the new organisation of social welfare centres under the model of “one-stop-shops” and the implementation of the social welfare IT system; 4) the expansion of the social welfare service network and further deinstitutionalisation of the social welfare system, as well as preparation and implementation of pre-accession activities in the area of social inclusion.

Protection of Motherhood and Family Allowance

Within the implementation of the 2006 National Population Policy⁵⁹, the application of the Act on Maternity and Parental Benefits⁶⁰ and Child Support Act⁶¹ continued, while the Act on Amendments to the Act on Maternity and Parental Benefits⁶² and the Act on Amendments to the Act on Child Support Act⁶³ were adopted for the purpose of legislative alignment with the EU *acquis*.

For the purpose of exercising the rights prescribed by the Act on Maternity and Parental Benefits and the Child Support Act, a decrease in investment of funds of HRK 37.8 million was recorded in 2011 relative to 2010 through the Ministry of Family Affairs, War Veterans and Intergenerational Solidarity.⁶⁴ In the period 2012–2014, a total of HRK 8.8 billion is planned to be allocated. In

⁵⁸ An elderly single person household includes persons above the age of 65 living alone, a group at the highest risk of poverty (some 27%).

⁵⁹ Official Gazette 132/2006

⁶⁰ Official Gazette 85/2008 and 110/2008-Corrigendum

⁶¹ Official Gazette 94/2001, 138/2006, 107/2007, 37/2008-Constitutional Court Decision

⁶² Official Gazette 34/2011

⁶³ Official Gazette 61/2011

⁶⁴ The decrease in total expenditures arising from the rights under the Act on Maternity and Parental Benefits is connected directly to the fall in the number of newborn children during 2011. In the period January to September 2011 relative to the same period the previous year, 4.19% less children were born (30,834:32,181), while in the work-related status structure of beneficiaries the most prominent drop was observed in the group of employed and self-employed mothers/parents. It has been scientifically proven that the fertility rate is directly linked to the employment rate of women, i.e. the higher the employment rate the higher the fertility rate. A strong correlation between the marital status and the number of newborn children is a specific feature of Croatia. According to CBS statistical data, the number of marriages entered into in the Republic of Croatia has been stagnating (in the last 27 years the number of marriages declined by 29.64%). Concurrently, but at a steeper rate, the rate of newborn children per marriage declined and was not compensated by the number of children born out of wedlock as in some EU Member States. Since the system of family allowances is aimed at supporting the birth rate, maintaining social security and quality family life, its goal is fulfilled only under the precondition that other population/family policy factors are attainable or stable. In circumstances of increased exposure to the risk of social poverty by entire families as a consequence of loss of work,

addition, the work of 17 county family centres continued and two new centres were established in 2011.

Improvement of student standards

Aiming to increase the number of highly educated persons in Croatia, it is necessary to provide adequate financial support for students. This is to be ensured via an efficient and equitable model of student standard, which will enable all students to rely on a different set of financial support during their studies at universities and higher education colleges in Croatia. The model is based on the development of an equitable model of awarding scholarships to students, on subsidised accommodation at student dormitories, pupils' dormitories, private accommodation and other alternative accommodation and the construction of new student accommodation. The Ministry of Science, Education and Sports (MSES) has made continuous efforts towards the improvement of the model of subsidised transportation for full-time and handicapped students and has been working on the improvement of the quality of subsidised meals for students, as well as on harmonising the quality and the level of service in all establishments that prepare meals for students in Croatia.

In 2011, all measures planned by the MSES in an effort to improve student standard were successfully implemented. The realisation of implementing measures will continue in 2012, including the planned new 2,200 state scholarships for several categories of full-time students at universities, higher education colleges and for post-graduate students. In addition, co-financing of transportation for full-time students will continue in Osijek, Split and Rijeka, as well as for handicapped students. In 2012, the MSES will co-finance meals for some 115,000 full-time students, accommodation in student and pupil dormitories for some 12,000 full-time students and subsidise private accommodation for some 6,000 students.

4.2.4 AGRICULTURAL SECTOR

Agricultural Land

The aim of agricultural land policy is the increase in the size of agricultural land used by farmers for agricultural production. The increase in the size of agricultural land in Croatia has been carried out mainly through purchase or lease of the agricultural land in private or public ownership.

Agricultural Land Act, in a form of a special law together with subordinate regulations on real estate, stipulates the use of agricultural land through sales, lease and long-term lease in 2 phases:

1. Local self-government units (SGUs) draft and adopt respective Programmes for state-owned agricultural land management (hereinafter: the Programme), conditional on the approval of the Ministry of Agriculture. The Programmes define planned use of state-owned agricultural land regarding sale, lease, long-term lease, restitution and other scopes.
2. In accordance with their Programmes, SGUs carry out tenders for sale and lease of agricultural land owned by the state with the approval of the Ministry of Agriculture. The Committee for the Long-Term Lease of the State-Owned Land and Ponds, on the other hand, carries out tenders for long-term lease of state-owned land and ponds.

long-term unemployment, loss of dwelling, decline in or absence of other income, etc., in other words, long term insecurity, parent/family structures react in the above-described manner – the decline in the number of newborn children, which is a demographic characteristic of Mediterranean countries (with the exception of France) and post-socialist transition countries.

Out of 547 SGUs, 472 have at their disposal agricultural land which is owned by the state. 383 SGUs adopted their Programmes with the approval of the Ministry of Agriculture, covering 546,541 ha of agricultural land owned by the state. The Programmes were not adopted mainly by the SGUs which have small-size, far-away pieces of state-owned agricultural land, and characterised by open legal ownership issues or by the SGUs where areas of state-owned agricultural land are covered by forestry issues.

According to the Programmes, 263,532 ha of agricultural land were managed in this way, which is 48% of state-owned agricultural land, defined by the Programmes. Due to complex and open legal ownership issues, areas of land planned for sales or restitution were leased until their respective legal ownership issues were resolved.

Management of agricultural land in private ownership is stipulated by the general regulations on real estate and is characterised by the interplay of free market forces. The realisation of legal transactions regarding privately owned agricultural land (such as purchase or lease agreements) are solely dependant on the terms stipulated by the owner, and on their acceptance on the part of the buyer or potential lease-holder. The increase in the size of the farms through the use of the agricultural land owned by private persons is practically negligible; resulting from the fact that privately owned land is also stricken with the problem of unresolved legal ownership issues.

Agency for Agricultural Land is currently being set up, and it will take over the tasks of managing agricultural land owned by the state. The Agency will speed up and make more efficient the management of state-owned agricultural land, which should contribute to the increase in the size of the farm land used for agricultural production. Furthermore, the Agency has the possibility to buy the agricultural land on market terms, or the disposal of the agricultural land through sale, lease or exchange with farmers with the aim of the increase of the agricultural land.

Regulation of the Agricultural and Food Products Market and Establishment of the Market Price Information System for the Market in Agricultural Products

Regulation of the agricultural and food products market and the harmonisation with EU standards has been carried out since 2009 and the adoption of the Act on the Regulation of the Agricultural and Food Products Market⁶⁵. In the meantime required bylaws have been drafted regarding production limits (sugar, milk) and trade mechanisms. There are also measures in force regarding specific sectors such as: beef, milk, pork, cereals, fruit and vegetables, sugar, wine, olives and olive oil. The adoption and implementation of these regulatory acts have transposed EU standards respectively into the Croatian legislation and Croatian agricultural and food products market.

In accordance with the EU legislation, the Member States are obliged to establish the market price information systems. In 2011, the Department for Market Information System in Agriculture (MISA) of the Ministry of Agriculture organised the monitoring of prices and quantities of certain agricultural products⁶⁶ on the domestic representative markets, in accordance with EU regulations and had the system of price reporting audited, obtaining a positive audit report.

State Aid in Agriculture

The bulk of the state aid to agriculture is administered in accordance with the Act on State Support for Agriculture and Rural Development⁶⁷, which was amended⁶⁸ in November 2011 to take into

⁶⁵ Official Gazette 149/2009,22/2011

⁶⁶ Beef carcass, fresh raw milk and dairy products, cereals and oil crops, sugar and agricultural input (fodder).

⁶⁷ Official Gazette 92/2010, 127/2010, 124/2011

account the results of negotiations in the field of agriculture and rural development. The most important results of the negotiations have to do with the financial support package for agriculture and rural development which will be made available to Croatia following its EU accession.

The Ordinance on the manner of registering and reporting on state subsidies in agriculture and rural development was adopted in mid-2011⁶⁹. The strengthening of administrative capacity of the Paying Agency for Agriculture, Fisheries and Rural Development and the agricultural inspection service was intensified parallel with the legislative alignment with the EU *acquis*.

The Excise Duties Act,⁷⁰ in force since the beginning of 2010, regulates the utilisation of gas oils for use in agriculture and fisheries under privileged tax conditions, without payment of excise duty. The Act on Agriculture⁷¹ lays down the framework for rights to use gas oils under privileged conditions, while the Ordinance on implementation of the excise duties act concerning blue-dyed gas oil for uses in agriculture, fishing and aquaculture⁷² lays down detailed conditions for exercise of that right. According to data on the used quantities of gas oil coloured blue for use in agriculture, fisheries and aquaculture tax exemption as a form of direct subsidy to beneficiaries in agriculture and fisheries totalled some HRK 382 million in 2010 and almost HRK 405.5 million in 2011. Since this measure is also intended to be applied after Croatia's accession to the EU it is necessary to establish a system that will comply with the provisions of EU regulations.

Farm Accountancy Data Network

The establishment of the Farm Accountancy Data Network (FADN)⁷³ is provided for under the Act on Agriculture⁷⁴. The new Ordinance on the farm accountancy data network⁷⁵ was adopted in July 2011, laying down in more detail the manner of and the conditions for the establishment of the FADN in Croatia. The farm accountancy data are collected by the Croatian Agricultural Extension Service with the Croatian Chamber of Agriculture through the annual FADN survey. In 2011, the FADN pilot survey for the accounting year 2010 was carried out in 21 counties on a sample of 510 farms. The planned number of farms for the 2012 survey is 777, while the final objective in 2013 is to reach a representative sample of some 1,250 farms.

Rural Development

Due to the short period available for application following Croatia's accession to the EU (second half of 2013) and as a result of accession negotiations on Chapter 11: Agriculture and Rural Development, Croatia will start implementing the EAFRD as of the beginning of the next programme and financial period 2014–2020. Of the rural development measures, until the end of the current EU programme period (2007–2013) measures under the IPARD programme will be implemented, support for insurance against possible damages to agricultural production, support to the conservation of native and protected breeds of domestic animals, support to the income of agricultural farms (only in 2012), support to organic and integrated agricultural production and

⁶⁸ Official Gazette 124/2011

⁶⁹ Official Gazette 76/2011

⁷⁰ Official Gazette 83/2009

⁷¹ Official Gazette 52/2009

⁷² Official Gazette 1/2010, 44/2010, 65/2010, 78/2010, 131/2010, 144/2010, 4/2011 and 44/2011

⁷³ *Farm Accountancy Data Network* – FADN is a system established for the purpose of collecting accountancy data (production, economic and financial) on a sample of agricultural farms in order to establish the level of income and analyse the operation of agricultural farms in the EU Member States.

⁷⁴ Official Gazette 149/2009

⁷⁵ Official Gazette 89/2011

support to areas of difficult farming conditions. In the period 2007–2013 assets set aside under the IPARD programme totalled EUR 184.4 million (HRK 1.3 billion) (75% EU: 25% HR).

Phytosanitary Area

The process of establishing of the Phytosanitary Register and the system of plant passports was completed. In 2011, work continued on the improvement and acceleration of the process of registration and re-registration of plant protection products in accordance with uniform EU principles. The Phytosanitary Information System will continue to be upgraded in 2012, and its integration with the Register of agricultural farms, the Customs IT system and the IT system of the Institute for Plant Protection will go on, as well as the linking of the codebook of subjects with the central registry in the Tax Administration. The existing Phytosanitary strategy will be revised in 2012 due to the entry into force of new EU regulations in the phytosanitary area. A long-term national action plan for the reduction of risks of pesticides and influence on human and animal health, and the environment will be created by the end of 2012 and laid before the Government to be adopted.

In 2011, the phytosanitary inspection continued with continued phytosanitary supervision of plant owners registered in the phytosanitary register, who have obtained authorisation for issuing plant passports, and commenced with phytosanitary supervision of the domestic and imported seed and propagation material. The construction of premises to house the phytosanitary, veterinary and sanitary inspection was started at the border-crossing Zračna Luka Zagreb, as well as the construction of premises for the phytosanitary and veterinary inspection at the border-crossing Stara Gradiška.

Food Quality and Safety

The implementation of food and feed safety controls is co-ordinated by the Ministry of Agriculture. In this segment, a long-term National plan of official controls by the Republic of Croatia 2011–2015 was created in 2011, as well as the Plan of required official controls on imports of food of non-animal origin as regards the presence of micotoxines 2011–2013. A plan of official controls regarding sample taking related to microbiological criteria for food is to be created in 2012. Three audits were carried out by the Food and Veterinary Office of the European Commission. In an effort to establish a system of authorised official and reference laboratories for food and feed, 15 official and 3 reference laboratories were authorised. The Ministry of Agriculture also serves as a national contact point, co-ordinating the national Rapid Alert System for Food and Feed. In the segment of food labelling and quality, harmonisation with the relevant EU regulations continued in 2011. The 7th issue of the Guide on labelling, advertising and presentation of foodstuffs was published in August 2011, including Appendix 7 on the labelling of beef.

With respect to quality policy, alignment with the relevant EU regulations also continued in 2011, with the new Act on the designation of origin, protected geographical indication and traditional specialty guaranteed labels for agricultural products and foodstuffs being prepared, to be followed by implementing regulations. The creation of a Guide on the registration of designations of origin and geographical indications of agricultural products and foodstuffs is also underway.

With a view to Croatia's imminent accession to the EU, the process of establishing the HR RASFF has been continued in the aspect of completion and planned maintenance of the HR RASFF ICT web-application, maintenance of the information and communication equipment and training of employees participating in the work of the HR RASFF, including persons who carry out official controls. It is also planned to improve the functioning of the HR RASFF ICT pertaining to the collection of data on specimen collected as part of official controls and their unification into final

reports to serve as a basis for the assessment of risks in the territory of the RC. The ultimate goal of the improvement in the functioning of HR RASFF is the ability for timely reaction in terms of undertaken activities and measures and an increase in the efficiency of organised official controls and the overall food and feed safety system, which will ultimately lead to better protection of human health through prevention of disease and spreading of disease stemming from food or feed.

Veterinary Area

Veterinary checks of farms continued throughout 2011, aiming at informing and training animal owners as regards the requirements of veterinary regulations the adherence to which is a precondition for the entitlement to agricultural subsidies. The practice of concluding contracts on delegating official controls to accredited veterinary organisations continued. The Ministry of Agriculture has been implementing programmes of early detection, prevention and eradication of disease and confirmation of officially disease-free status for the purpose of certifying animal health status for the internal EU market and third countries, thus strengthening the competitiveness of stock-breeding in the RC. In 2011, the Ministry started work as regards undertaken commitments of enabling the entry to the market of EU centrally authorised veterinary medicinal products. In addition, work was intensified on the establishment of the Central Veterinary Information System (CVIS) defined under the Veterinary Act⁷⁶ as the unified system of registries and computer programmes with the purpose of providing efficient access to information and support to timely decision-making and effective management of all segments of the veterinary service. The CVIS is expected to become fully operational in 2012.

Fisheries

As regards the last year's PEP, in the segment relating to fisheries, all measures and objectives planned were fulfilled in 2011, apart from equipping 15–18 meter vessels with the vessel monitoring system⁷⁷ and the creation of the Operational Programme for Implementing Structural Measures in Fisheries. The National programme of Data Collection in the Area of Sustainable Management of Marine Bio-resources was drawn up in 2011.

In order to establish a system of structural measures in fisheries in 2012, it is planned to complete the preparation of the National Strategic Plan and the Operational Programme aimed at identifying measures to be financed in the fisheries sector. As for the strengthening of surveillance and control at sea, the plan for the period 2012–2014 is to strengthen inspection capacities and connect different authorities carrying out marine control pursuant to the Marine Fisheries Act⁷⁸. In view of the obligations arising from EU membership, in the coming three-year period, significant resources are planned to be allocated to the issue of aligning the fisheries effort with the available resources and the establishing of the automated identification system (AIS) of all fishing vessels in excess of 15 meters.

⁷⁶ Official Gazette 41/2007, 55/2011

⁷⁷ The vessels were not equipped with the vessel monitoring equipment because complaints were received as regards the implementation of the public tendering procedure so the issue is to be decided by the State Commission for Public Procurement. Depending on the decision the activities necessary for the implementation of this measure will be undertaken.

⁷⁸ Official Gazette 56/2010 and 55/2011

4.2.5 PUBLIC ADMINISTRATION REFORM

In 2011, the implementation of the State Administration Reform Strategy 2008–2011 (as the framework for the modernisation and rationalisation of state administration) continued and preparations were started for the drawing up of a new strategic document. The implementation of the decentralisation process laid down in the Guidelines and Principles for the Functional and Fiscal Decentralisation and Territorial Reorganisation continued through collecting and updating of data and carrying out of preliminary analyses as the basis for a new model of territorial organisation and functional and fiscal decentralisation.

Out of 62 special acts to be aligned with the General Administrative Procedure Act⁷⁹, 53 were aligned in 2011, with the adjustment of remaining 9 acts being underway, so the project entered its final phase.

The rationalisation process of state administration was continued with the adoption of the Regulation on the Principles for the Internal Organisation of State Administration⁸⁰ and the Act on the Structure and Scope of Ministries and Other Central State Administration Bodies⁸¹. The Act on Amendments to the Civil Service Act⁸², which entered into force in May 2011, and implementing regulations adopted pursuant to this Act, improved the evaluation system, increased the mobility of civil servants, strengthened their responsibility and introduced the possibility of expert training with state authorities without permanent employment. The State School for Public Administration commenced its activities in 2011.

The new Political Activity and Electoral Campaign Financing Act⁸³ was adopted in 2011. It envisages a cut in the funds set aside by the state budget for regular annual financing of political parties from the current 0.056% of current budget expenditures to the 0.05% of the realised operating expenditures of the previously published report on budget execution, which represents a decrease or cut of some 10% relative to the funds available thus far. The Act also reduced the maximum amount of donations that natural and legal persons may make to political parties annually and laid down maximum cost limits for election campaigns.

The Act on Amendments to the Freedom of Information Act⁸⁴ was adopted, broadening the circle of public authorities and introducing public interest and proportionality test in case of withheld information.

The Act on the Register of Public Sector Employees⁸⁵ was adopted with a view to establishing a quality and efficient system of centralised wage calculation and human resources management. Consequently, the Register was established and until 30 December 2011 it included 227,127 employees of the altogether 230,000 employees in 2,227 institutions.

Within the framework of electronic administration development, activities envisaged by the e-Administration Development Strategy 2009–2012 were continued in 2011, the establishment of the Croatian interoperability framework being one of the main goals.

⁷⁹ Official Gazette 47/2009

⁸⁰ Official Gazette 154/2011

⁸¹ Official Gazette 150/2011

⁸² Official Gazette 49/2011

⁸³ Official Gazette 24/2011 and 61/2011

⁸⁴ Official Gazette 144/2010 and 77/2011

⁸⁵ Official Gazette 34/2011

Preparations were made for the drafting of the new State Administration Reform Strategy, whose completion is planned in the third quarter of 2012. Aiming at alignment with the provisions of the Act on Amendments to the Civil Servants Act⁸⁶, draft amendments to the Regulation on the forms, modalities and conditions for education and training of civil servants, the Regulation on the structure and operation of the State Administration Committee and the Regulation on the procedure, manner of sitting for and Programme of the state civil service exam, are underway. The Act on Salaries in the Public Sector will regulate salaries and other material rights of all persons employed in the public sector, the system of monitoring salaries, the basis of the classification system, evaluation system, promotion system and other issues important for the system of remuneration in the public sector. The draft of the Act is planned to be presented to the Government in the third quarter of 2012 and drafts of implementing regulations, accompanying the Act, in the fourth quarter of 2012. The Register of Public Sector Employees is planned to be completed with new data and updated in 2012 and activities are to be continued relating to the upgrade of the Register application.

In the coming period, the implementation of activities for the preparation of the reform of local and regional self-government will continue, aiming to ensure the optimum organisation and models of financing of activities in the public domain.

In the period 2012–2014, in the field of electronic administration, the stress will be placed on the implementation of the goals from the document *e-Government Action Plan 2011–2015* of the European Commission. By participating in the Digital Agenda for Europe Croatia undertook to enable the integration of its public administration into the common European administrative area by 2020.

Since the implementation of the Operational Programme: *Administrative Capacity Development 2012–2013* for the six-month period of Croatia's EU membership was given up, in 2012 preparations will commence for the creation of the Operational Programme: *Administrative Capacity Development 2014–2020*. The Ministry of Public Administration will continue within the scope of IPA, Component I, Transition Facility, developing projects in line with the guidelines of the Public Administration Reform Strategy.

4.2.6 OTHER REFORMS

4.2.6.1 Development of a Knowledge-based Society

Measures aimed at promoting knowledge and excellence have been systematically and actively implemented and work continued on sustainable quality of the system of education and science and research in order to meet the requirements of the labour market, economic development and society as a whole. Consequently, all levels of education have been monitored, evaluated and self-evaluated, improving quality and paying special attention to the adjustment of vocational training to the needs of the economy and the labour market, to ensuring the quality of higher education and developing and strengthening of the adult education system by widening the number of programmes and the institutions offering them.

The development of the primary school-leaving exams (2011–2015) continued. The state secondary school-leaving exams are implemented and there is a noticeable improvement in the graduation rate by both college and university students. With a view to continue ensuring quality and comparability at the European level PIRLS and TIMSS examinations have been administered, as well as

⁸⁶ Official Gazette 49/2011

preliminary student tests relating to ESLC examinations. The participation in the TALIS programme continued and Croatia is to participate in the PISA examination of student knowledge and skills in 2012 as well. Special attention is paid to the improvement of professional knowledge and skills of teachers of mathematics, natural and technical sciences.

Taking into account rationalisation, demographic projections and regional needs, two documents were drawn up – *Primary and Secondary School, Student Homes and Educational Programmes Network* and *Higher Education Institutions and Study Programmes Network*. The first document defines the existing schools and identifies the areas in which new schools can be established or new educational programmes introduced. The document is about the rationalisation of schools and programmes, taking into account the entitlement to equal access for all citizens in accordance with the developmental needs of the society. The stress is laid on strengthening quality and standardising the achievements of students belonging to different social groups and receiving their education in different regions, as well as on the rational establishment of quotas for individual sectors in relation to the existing economic capacities and economic development plans for certain regions. *Higher Education Institutions and Study Programmes Network* is a strategic document adopted in October 2011, defining statistic and other indicators as the basis for planning the development of higher education institutions and study programmes. The document's added value lies in a series of qualitative criteria that should serve as a basis for decision on establishing new higher education institutions and study programmes.

Work on the *Croatian Qualification Framework* is expected to be concluded in the coming period, contributing to the arrangement of the system of lifelong learning. The completion of new curricula will enable better competence mobility within the country and cross-border area because education and study programmes will be harmonised with the criteria and employability indicators for different professions. In 2001, Croatia became a full member of the EU Lifelong Learning Programme and the *Eurydice Network*.

In October 2011, the Agency for Science and Higher Education, as the first in the region, became a full member of the European Association for Quality Assurance in Higher Education (ENQA). Initiating a discussion on the integration of the university, external evaluation of higher education institutions and study programmes⁸⁷, the strengthening of the mobility of students, teachers and researchers, as well as the draft reform of the higher education financing system are only some of important activities in the national higher education that are continually carried out and harmonised with positive European trends.

In the past period, the Business Innovation Centre of Croatia (RC – BICRO) and the Croatian Institute of Technology (HIT) carried out a series of initial activities relating to the creation of better conditions for development in the area of science, research and technology, especially as regards the linking of the business, public and private sectors with the science and research sector for the purpose of commercialisation of research results (UKF, TEST, RAZUM, TEHCRO, POC, IRCRO and EUREKA programmes). The reorganisation of the BICRO into a public institution competent for the entire sector of public programmes for stimulating innovation and technology sector is currently underway. The project of construction and launching of the Biosciences Technology Commercialisation and Incubation Centre (BICRO BIOCENTAR) was approved in

⁸⁷ Pursuant to the Act on Quality Assurance in Science and Higher Education, the initial accreditation of study programmes includes the procedure of external evaluation of new study programmes aimed at establishing whether they comply with the necessary requirements and standards of the procedure for issuing a recommendation for accreditation by the Agency for Science and Higher Education for the purpose of obtaining approval for the implementation of study programmes. The application is submitted to the Ministry one year before the start of the academic year in which the implementation of the study programme is to be started.

2011, in the co-operation of the BICRO, University of Zagreb and the City of Zagreb. Projects under the framework of the Science and Innovation Investment Fund continued, as well as the co-operation at the level of institutes and university centres for technology transfer.

In the forthcoming period, scientific excellence and networking of existing scientific capacities will continue to be stimulated and technology infrastructure will continue to be strengthened, while the co-ordination and consolidation of the measures and instruments of the innovation system, supported intensively by other state administrating authorities, will raise the contribution of the science and research system to the economic competitiveness of the RC. The procedure of valuation and re-accreditation of scientific organisations will be continued for the purpose of establishing the preconditions for the implementation of new ways of science financing, aiming at strengthening the overall quality in the segment of science.

4.2.6.2 Health Care Reform

The downward trend in health care costs continued. Within the scope of two redistributions of state budget funds, the planned expenditures of the Croatian Health Insurance Institute (CHII) were cut by HRK 128 million. The manner in which these funds were reduced is presented in the table below.

Table 10: Health Care Cost Reduction

Indicators	I - IX 2010	I - IX. 2011	Difference
Prescription medication	2.376.347.041	2.262.300.646	-114.046.395
Sick leave benefits	821.984.467	771.555.760	-50.428.707
CHII operating costs	302.073.536	258.833.632	-43.239.904

Source: Croatian Health Care Insurance Institute (CHII)

In the past period, accumulated debt was eliminated and costs were placed under control, the high rate of sick leave was reduced and so were the long waiting lists. The process of renewing old medical equipment and the construction of new and completion of started health care facilities was started.

Thus far, open tendering procedures were initiated and contracts awarded for the procurement of medical equipment worth HRK 426 million. The project aimed at the creation of the master plan of health care institutions and human resources strategy in the health sector was launched, containing a plan for investment into human resources in the health care segment. Special attention will be given to the capacity strengthening in the segment of one-day treatments and day hospitals, reducing health care costs and increasing the satisfaction of patients with the health care system.

Through the introduction of the payment model for health care services regarding acute hospital treatments, according to diagnostic therapeutic groups (DTS), the average number of hospital stays was reduced and the quality of treatment improved. The system of payment collection for treatment of traffic accident casualties, which generated large losses in the past, was revised. There is a new model of financing activities of general/family medicine, medical care of pre-school children, medical care of women and dental medical care, which implies mixed paying model for medical care, and which includes amounts based on the number of insured persons, payment of executed diagnostic therapeutic treatments and amounts for the participation in the work of general/dental health care centres and execution of the preventive programme.

As of 24 January 2011, all primary health care doctors, pharmacies and laboratories started operating without paper prescriptions and referral slips for biochemical laboratories (e-

prescriptions, e-referral slips). The project covers altogether 6,004 health care units in the territory of the RC.

The process of primary health care system decentralisation was carried out and a system of concessions was introduced. The Amendments to the Health Care Act in 2011 provided the basis for the creation of the palliative care system. Its capacity was defined by the Public health care network, currently standing at 121 hospital beds, which is 0.54% of the overall number of hospital beds or 1.9% of hospital beds earmarked for chronic diseases.

There are new ordinances regulating the market of medical aids (the Ordinance on the measures for determining the prices of orthopaedic and other aids and the Ordinance on the measures for inclusion of orthopaedic and other aids on the CHII medical aids list). The new Ordinance on the orthopaedic and other aids with the new list of orthopaedic and other aids was adopted defining the conditions and the manner of realising the right to orthopaedic and other aids and introducing the ISO 9999 standard. The prices of most orthopaedic aids were reduced by 5%.

Despite the increased number of innovative medicines on the CHII medication list, thanks to the reduction in the price of medicines the total cost of prescription medicines significantly decreased. The deadline for payment was shortened by 140 days and the debt for prescription medicines is eliminated. It is noteworthy that in Croatia the annual increase in the use of medicines is 8%-10%, same as in EU countries.

The improvement in the control of expenditures was also achieved through better control of granted sick leaves. An *ex-ante* control of expenditures in primary health care was introduced in addition to the existing *ex-post* control. Thanks to the above measures sick leave expenditures were substantially reduced, lowering the daily average of workers absent from work from 61,322 (2007) to 46,615 (2011).

Investments into construction of clinical hospital centres and general hospitals will continue in 2012, as well as the process of renewing of medical equipment in hospitals. The system of e-appointments and e-medical records will become operational by mid-2012. The completion of the informatization process of the health care system by hospitals informatization and by linking all hospitals and primary health care offices into a unified health care information system and the widening of telemedical services to other areas, especially to the segment of emergency medical assistance is planned by late 2013.

Emergency medicine institutes will be established in all counties by mid-2012. Parallel with the establishment of county emergency medicine institutes all community medical centres will introduce family medicine centres, improving access to health care at primary level, making house calls equally available to all patients.

In 2012, the system of palliative care will be established at all health care levels. Special training will be provided for the treatment of terminal patients. Efforts will be continued at perfecting the criteria for the inclusion of medicines in the basic medicine reimbursement list thus enabling for it to be supplemented.

4.2.6.3 Judicial Reform

In line with the Economic Recovery Programme of the Government of RC, the improvement of the rule of law, protection of creditors and adherence to concluded contracts are some of the measures to be implemented in order to secure a positive investment climate and thus strengthen the competitiveness of the Croatian economy as regards foreign investments. Supporting the judiciary

in the efficient implementation of the execution law, establishing labour courts, reducing the duration of court proceedings, especially in the segment of receivables collection, and motivating parties in commercial disputes to opt for alternative methods of dispute solving will contribute to the achievement of the said goal, together with efficient anti-corruption measures at all levels of the society.

The Judicial System Reform Strategy 2011–2015 reflects medium-term assumptions and guidelines of the judicial system in the RC relative to the above-mentioned and the upcoming full membership in the EU. The implementation of the Strategy is monitored on an ongoing basis through the implementation of measures under the 2011 Action Plan (98% implementation rate). The creation of the 2012 Action Plan started in July 2011.

In 2011, the State School for Judicial Officials, as part of the Judicial Academy, continued providing training to judicial officials and enrolling trainees to be trained for positions of judicial officials. In the period 2012–2013, it is planned to implement projects financed by EU funds, aiming at further professionalisation of the Judicial Academy and consequently the strengthening of judicial system efficiency.

The rationalisation of the network of courts and state attorney's offices⁸⁸ continued both through additional amendments to the legislative framework and the implementation of physical unification of judicial authorities⁸⁹. Aiming at comprehensive court network rationalisation, the Plan of investments in infrastructure 2011–2019 was adopted in February 2011, laying down short-term, medium-term and long-term rationalisation priorities. The implementation of these Acts is financed from the state budget and through other sources of finance.⁹⁰ The planned investments in the buildings of individual judiciary authorities and the relevant time horizon are described in more detail in the Implementing Measures Matrix.

One of the measures to increase the efficiency of the judicial system is the establishment of a unified system of monitoring cases at the courts and in the network of state attorneys. The Court Case Management System (ICMS) was upgraded in 2011. Its introduction at the remaining municipal courts is to be finished by the end of 2013 and its full harmonisation with the provisions of the Criminal Procedure Act (CPA)⁹¹ during 2014. As for the case management system in the network of state attorney's offices, its improvement (in line with CPA provisions and other upgrade plans) began in July 2011, with its introduction in all state attorney's offices in Croatia to be finished by the middle of 2013.

In 2011, preparation of the judiciary system was completed as regards the comprehensive application of the provisions under the Criminal Procedure Act. In addition to ongoing training activities, state attorney's offices were equipped with the necessary equipment. Measures under the Action Plan for the probation system development in the period 2010–2014 continued to be implemented, as well as measures under the Action Plan associated with the Anti-Corruption Strategy and the Action Plan for Prison System Improvement for the period 2011-2014.

⁸⁸ Act on Court Jurisdictions and Seats (Official Gazette 84/2011), Act on Jurisdictions and Seats of State Attorney's Offices (Official Gazette 84/2011)

⁸⁹ In the period thus far rationalisation has been completed at all county state attorney's offices, 15 municipal state attorney's offices, 20 municipal courts and 9 misdemeanour courts.

⁹⁰ Funds from the Instrument for Pre-accession Assistance and funds under an EBRD loan.

⁹¹ Official Gazette 121/2011 – final draft

In the past period, legislative amendments were introduced in the segment of the enforcement procedure that should lead to the successful and efficient enforcement system,⁹² that is, in the segment of administrative disputes,⁹³ to higher degree of legal protection and better protection of the rights of parties in the proceedings. The final implementation of the adopted legislative reforms is expected in the coming period. In this context, the beginning of 2012 is very important as the beginning of entry into force of these new legislative measures.

Continued implementation of all adopted strategies and action plans and monitoring of their implementation is planned for the period 2012–2014. Special stress is laid on the adjustment of the judiciary to the challenges set by full EU membership, primarily on the strengthening of administrative capacity of judiciary officials and civil servants in the system. In this sense, investments in infrastructure development will continue in order for the planned process of rationalisation of the judiciary network to be completed by 2019. One of the planned measures is also the implementation of the European Convention on Human rights and fundamental freedoms in the prison system, to be achieved by strengthening the accommodation capacity⁹⁴ and investments in the training of prison and probation system officers.

4.2.6.4 Environmental Protection

Greenhouse Emissions Trading System

The deadlines and the conditions for the establishment of the institutional framework have been set as regards the implementation of the emissions trading system for installations as of 1 January 2013 and aviation emissions as of 1 January 2014. For the period 2013–2020, a system of limits of greenhouse emissions was adopted for sectors not included in the emissions trading system (agriculture, services, transport, households, small industrial plants, Croatia +11% in 2020 relative to the 2005 level), to be implemented by setting up of annual allocations which are not to be exceeded. As of 1 January 2010, plant operators are obligated to monitor and report on their greenhouse emissions.

The new Air Protection Act⁹⁵ was adopted in October 2011, partly transposing the EU *acquis* relating to substances depleting the ozone layer and fluorinated greenhouse gases into the Croatian legislation. The alignment with the EU *acquis* in the segment of climate protection, adopted after June 2008, will be fully completed upon the adoption of adequate implementing regulations pursuant to the new Air Protection Act. As one of the priorities, it is necessary to establish an institutionalised framework for carrying out auctions within the system of trading in greenhouse emission units.

Air Protection

As regards air quality, in 2012, the implementation of the measures under the Air Quality Protection and Improvement Plan for 2008–2011 will continue to be monitored. In addition, the national network of air quality monitoring will be widened by establishment of an air quality monitoring station in Slavonski Brod for the purpose of monitoring cross-border transfer of air

⁹² The Enforcement Act (Official Gazette 139/2010, 25/2011, 150/2011), Regulation on amendments to the Enforcement Act (Official Gazette 154/2011).

⁹³ The Administrative Disputes Act (Official Gazette 20/2010) entered into force on 1 January 2012. The preconditions for the operation of Administrative Courts in Zagreb, Rijeka, Split and Osijek were met and following a selection process, completed by 31 December 2001, 21 administrative court judges was appointed.

⁹⁴ The funds obtained under the loan by the European Council Development Bank will be used for the upgrade and renewal of Zagreb prison starting in 2012 as well as Šibenik penitentiary and prison starting from 2013.

⁹⁵ Official Gazette 130/2011

pollution, as well as by initiating the monitoring of airborne fine particles in Croatia (PM 2.5) to determine the indicators of average exposure and targeted reduction of exposure. In 2012, a new air quality assessment will be carried out in accordance with the criteria set by the Directive 2008/50/EC along with the revision of division of the Republic of Croatia into zones and agglomerations with respect to the established air quality categories pursuant to the new Air Protection Act.

As part of the project *Support to the preparation of the National action plan for reduction of airborne PM 10 and nitrogen oxides NOx in the Republic of Croatia* framework action plans will be prepared by end-February 2012 for selected populated areas (the towns of Kutina, Sisak and Split) where limit values for PM 10 and NOx are exceeded. The preparation of the National action plan for reduction of PM and NOx concentrations in ambient air is to be started in 2012 pursuant to the above-mentioned plans, as an integral part of the new Plan for air protection, Ozone protection and mitigation of climate changes 2012–2017 in Croatia.

Croatian Environment Agency

In the period 2012–2014 the Croatian Environment Agency (CEA) will continue its activities on the establishment, administration and maintenance of the Croatian Environmental Information System (CEIS) via the inclusion of the existing CEA databases and databases of affiliated agencies into a uniform information system in accordance with the information system standards of the European Environment Agency – *Shared Environmental Information System* (SEIS). Within the framework of CEA activities relating to databases, final preparations are carried out as regards the Greenhouse Gas Emissions Registry (GHG Registry) for the commencement of emissions trading under the EU Emissions Trading Scheme (about to commence in Croatia as of 1 January 2013).

The National List of Indicators (NLI) is expected to be published in the Official Gazette in 2012. The revised NLI contains 245 data tables for the compilation of indicators, aiming at monitoring the state of the environment and preparing national Environment reports. The NLI is also one of the bases for CEIS upgrading.

Waste Management

In the field of waste management, activities were continued on the rehabilitation and closing of the existing waste disposal sites. Out of the total 299 waste disposal sites, 102 are rehabilitated. Construction of the waste management centre (WMC) Bikarac in Šibenik–Knin County is completed. The contract awarded for the supply of equipment to WMC Bikarac will be completed early in 2012, while contracts as regards construction works relating to the rehabilitation of the waste management site Pirovac and the supervision of these works will be completed in June 2012. In 2012, the preparation of project application for EU funds for the second phase of the Bikarac project is planned, drawing on the assistance of the Environmental Protection and Energy Efficiency Fund. Within the framework of the IPA programme, contracts were signed in December 2011 on the construction works for WMC Kaštijun in Istria County and Marišćina in Primorje-Gorski Kotar County, which are to be started in the second half of 2012. Further WMC construction projects are underway, as well as rehabilitation of waste management sites and locations highly polluted by waste which will be co-financed by EU structural instruments. The process of legislative alignment with the new EU *acquis* will continue in 2012.

Water Management and Water and Marine Protection

Activities aimed at improving the integrated water management system continued. On the basis of the Water Act⁹⁶ subordinate legislation will be adopted, laying down service areas and their boundaries, to be used as the basis for the reform of the existing water utilities sector. The adoption of the Decision on determining vulnerable areas, that was planned by the end of November 2011 is expected in 2012 in accordance with the results of the study *Determining nitrate sensitive zones and the economic implications of the Nitrate Directive implementation in the Republic of Croatia*, which will serve as the basis for ultimate determination of vulnerable areas.

The preparation of the Draft Water Management Plan (WMP) will follow the adoption of the Decision on determining vulnerable areas and the implementation of the Strategic evaluation of the WMP impact on the environment. The allocation of funds from the state budget, the assets of Hrvatske vode, legal entity for water management, grants, loans and the EU assistance funds for the period 2012–2014 is envisaged for the following sectors: irrigation and protection from harmful impacts of water, development of public water supply and drainage, and waste water treatment systems.

In the segment of sea and maritime protection, the Programme of monitoring sea bathing water quality was carried out in 2011 and will be continued throughout 2012. The initial evaluation of the state of and pressures on marine environment of the Croatian Adriatic Sea coastline was conducted and by the end of 2012 further strategic documents will be drawn up, establishing the framework for the implementation of the Marine Strategy Framework Directive. 2012 will see the implementation of the 2nd phase of the project with the aim of strengthening the coastal water quality supervision system – which is an integral part of the project against pollution of water in the coastal area (2nd phase of the IBRD loan in implementation since 2010 until 2014). The Government is expected to adopt a decision on the establishment of the Maritime Reference Centre – to support the activities of the Croatian Environment Agency in the segment of collecting and analysing data on environment monitoring, including the indicators from the National list of indicators relating to the sea.

Nature Protection

Among the priorities in the period 2012–2014 are the completion of legislative alignment with the EU *acquis* and the strengthening of administrative capacity. The plan for 2012 is to continue efforts as regards defining the proposal for the EU NATURA 2000 Ecological Network and measures necessary for its protection. In the period 2012–2014, Regulation on ecologically significant areas of the EU NATURA 2000 will be prepared. The new Nature Protection Act will be adopted in 2012. Alignment with the new regulation relating to cross-border transport and trade in protected species (suspension regulation) relating to the ban on the imports of endangered species is planned. Activities will continue in the segment of declaring new protected areas, improving visitors' infrastructure in protected areas and as regards the preparation of remaining plans for national and nature park management.

Industrial Pollution and Risk Management

In the period 2012–2014, activities will continue in the implementation of assessment procedures of integrated environmental protection conditions (IPPC environmental permits) for new and

⁹⁶ Official Gazette 153/2009,130/2011

existing plants. The new Act on Amendments to the Environment Protection Act is to be adopted along with subordinate legislation for the purpose of legislative alignment with the EU *acquis*.

Hazardous Chemicals and Biocides

Aiming at successful implementation of chemical protection measures in the area of hazardous chemical and biocides, projects directed at strengthening the legislative and institutional framework for the protection against hazardous chemicals, strengthening the biocides registering capacity will be continued as well as work on started programmes (IPA 2007 Chemical safety, G2G Matra biocides), and the project of three conventions synergy: the Basel, the Stockholm and the Rotterdam Conventions implemented in co-operation with the Basel Convention Regional Centre in Bratislava. As regards the legislation regulating chemicals, changes to the REACH Regulation (registration, evaluation, authorisation and restriction of chemicals), the CLP Regulation (classification, labelling and packaging) and the import and export of hazardous chemicals are monitored, and legislative alignment with EU legislation is continued accordingly.

In the area of biocidal products, the Ordinance on amendments to the Ordinance on the list of existing active substances not permitted in biocidal products, the Ordinance on the list of existing active substances permitted in biocidal products and the List of biocidal products approved to be marketed in the Republic of Croatia is to be enacted in 2012 and the Regulation on biocides, entering into force in the EU in 2013, is to be transposed.

Genetically Modified Organisms

In 2001, amendments were adopted to the Regulation on the threshold for genetically modified organisms in products below which such products need not be labelled as products containing genetically modified organisms when placed on the market. The laboratory of the Croatian Centre for Agriculture, Food and Rural Affairs became a member of the European network of GMO laboratories. Consequently, the adoption of the Regulation on amendments to the Regulation on the threshold for genetically modified organisms in products below which such products need not be labelled as products containing genetically modified organisms when placed on the market is planned in 2012. The continuation of relevant training activities and the appointment of the national referral laboratory for examination of GMO presence in food, seed and other products are planned in 2012, along with the process of accrediting legal persons for risk assessment as regards the placing of GMOs on the market.

Noise

The procedure of accrediting legal persons for performing the expert tasks of noise protection, carrying out professional examinations in the field of noise protection and preparation of strategic noise maps and action plans was continued in 2011. The project Technical Assistance for the Development of *National Environmental Noise Strategy for the Republic of Croatia* was launched on 10 October 2011.⁹⁷ Aiming at legislative alignment with the EU *acquis*, the preparation of the National Environmental Noise Protection Strategy is planned.

Forestry

In the field of forestry, activities were continued as regards equipping of the laboratory for physical and chemical examinations aimed at performing analysis for the purpose of monitoring the damage

⁹⁷ The main beneficiary of the project is the Ministry of Health, along with its partners the Ministry of Environmental and Nature Protection, the Croatian Environment Agency and the Croatian National Institute of Public Health.

to forest ecosystems. Ongoing supervision of forests will be continued in the period 2012–2014 through the Programme of measures for the collection of data and the setting up of the Registry of forest damage and Registry of forest fires.

5. ECONOMIC POLICY MATRIX

5.1. ENTERPRISE SECTOR AND RESTRUCTURING		
5.1.1. Competition and state aid		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Adjustment of the competition policy to the requirements for membership in the EU	<ul style="list-style-type: none"> Submitting the proposal for introduction of analysis of regulatory impact on competition 	III quarter 2012
Adjustment of the state aid system to the requirements for membership in the EU	<ul style="list-style-type: none"> Establishing the advisory contact point for rules on state aid in the context of structural fund projects 	III quarter 2012
5.1.2. Privatisation		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Establishing a long term sustainable system for state property management in accordance with regulations and the <i>acquis</i>	<ul style="list-style-type: none"> Drafting documents on state property management in accordance with the law (the Strategy and the Management Plan) 	IV quarter 2012
Efficient management of state property	<ul style="list-style-type: none"> Establishing the register of state property (creating the register of real property, and transfer of shares and stakes in accordance with the law) 	IV quarter 2012
Reduction in the number of companies whose shares and stakes are in state ownership	<ul style="list-style-type: none"> Sale of companies in accordance with provisions of the law, the Strategy and the Plan 	Continuously
Efficient management of real property in state ownership to increase the degree of usage, ensure rational use and economic growth, and maximise profit	<ul style="list-style-type: none"> Management of real property in accordance with provisions of the law, the Strategy and the Plan 	Continuously
5.1.3. Railway restructuring		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Alignment of legislation with the <i>acquis</i>	<ul style="list-style-type: none"> Drawing up subordinate legislation Establishing an independent body for traffic accident inquests 	Continuously 2012
Liberalisation of the rail transport market	<ul style="list-style-type: none"> Drawing up a network report Allocation of routes to operators Activities of the Rail Market Regulatory Agency Activities of the Railway Transport Safety Agency 	Continuously
Restructuring and modernisation of railway companies	<ul style="list-style-type: none"> Preparation and definition of restructuring indicators Drawing up the Restructuring Plan for HŽ (Croatian Railways) Group companies 	Continuously 2012
Implementation of the National Programme for Railway Infrastructure	<ul style="list-style-type: none"> Drawing up annual maintenance and modernisation plans 	Continuously
5.1.4. Restructuring of the shipbuilding industry		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Privatisation and restructuring with the aim of ensuring conditions for long-term sustainable operation of shipyards under conditions compatible with EU policy, and rules on state aid in the shipbuilding sector	<ul style="list-style-type: none"> Completion of the privatisation process (depending on the investors' acceptance of the terms and conditions) and conclusion of privatisation contracts Implementation of the restructuring programme (depending on the completion of privatisation, and the approval of final drafts of the privatisation contracts by the Croatian Competition Agency and the European Commission) 	2012 Continuously from the completion of privatisation (5 years) 2012 - 2017
5.1.5. Energy sector		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Establishment of a system aligned with EU practice	<ul style="list-style-type: none"> Alignment with the Third Energy Package Adjustment of the internal market to European conditions Adjustment of the infrastructure to market needs Encouraging investment in the energy sector Refined petroleum products - increasing the level of reserves in oil and refined petroleum products to the 90 days level, and fuel extraction in accordance with EU standards 	2012 2013 - Continuously Continuously 31 July 2012
5.1.6. Small and medium-size enterprises		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Competitiveness and innovation	<ul style="list-style-type: none"> Strengthening competitive ability of small businesses Innovation and new products Stimulating fast-growing small business entities Women entrepreneurs Young, beginner and disabled entrepreneurs Entrepreneurship in culture and culture-related industries Clusters Development of crafts and trades Development of cooperatives Use of new technologies and technological procedures Introduction of EU standards Linking SMEs and R&D Marketing and advertising of small business entities Promotion of entrepreneurship Coordination of activities in the e-Croatia project, e-trade and e-business enhancement, public portals for small businesses 	2012
Improvement of financing	<ul style="list-style-type: none"> Low-cost loans Financial instruments for regional development of entrepreneurship Guarantees Development of the fund industry EU projects and grants for SMEs, use of the Competitiveness and Innovation Framework Programme 	2012

Development of entrepreneurial support structure	<ul style="list-style-type: none"> Stimulating the development of the Croatian Agency for Small Business Stimulating regional development agencies Training and development of a network of consultants Support to the development of regional development agencies, entrepreneurial centres, technological parks and business incubators 	2012
Lifelong education for entrepreneurship	<ul style="list-style-type: none"> Project for the National entrepreneurial learning programme in formal and informal education South East European Centre for Entrepreneurial Learning (SEECEL) Students' entrepreneurial incubators Education for crafts and trades and cooperatives Children's entrepreneurship week Co-financing of universities with specialist entrepreneurial programmes Pupils' cooperatives and pupils' enterprises 	2012
Strengthening expertise and capacity for the EU	<ul style="list-style-type: none"> Implementation of projects financed from EU IPA funds under the Regional Competitiveness Operational Programme, component IIIc 	2012
Small and medium-size enterprises in tourism		
Stimulating the development of tourism	<ul style="list-style-type: none"> Programme of new product development of sustainable tourism Programmes of subsidizing credit programmes in tourism Programme to encourage the development of tourism in the undeveloped tourist areas Programme to improve the offer of the tourist sector 	Continuously
5.1.7. Public-private partnership		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Increasing the quality of public infrastructure and public services	<ul style="list-style-type: none"> Education of participants in the preparation and implementation procedures of public-private partnership projects 	Continuously
Increasing the quality of approved projects realised according to the public-private partnership model	<ul style="list-style-type: none"> Cooperation between the Agency for Public-Private Partnership and the Ministry of Finance in the activities of approval and implementation of public-private partnership projects 	Continuously
Implementation of cross-border projects according to the public-private partnership model	<ul style="list-style-type: none"> Coordination of exchange of knowledge and expertise in the field of public-private partnership in SEECP Member States 	Continuously
Increasing the transparency and efficiency of supervision	<ul style="list-style-type: none"> Implementation of the Regulation on the supervision of implementation of public-private partnership projects Implementation of the Regulation on the criteria for assessing and approving public-private partnership projects 	Continuously Continuously
5.2. FINANCIAL SECTOR		
5.2.1. Banking sector		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further development and improvement of prudential regulations and the banking system	<ul style="list-style-type: none"> EU legislation monitoring 	Continuously
Establishment of the supervisory body, human resources development	<ul style="list-style-type: none"> Presentations to banks, credit unions and savings banks related to new legislation adopted in 2011 and to be implemented from 2012 onwards Education of supervisors in relation to new regulations and banking risks Improving the system of prudential reporting of banks 	Continuously Continuously Continuously
5.2.2. Non-banking sector		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further development and improvement of the non-banking sector	<ul style="list-style-type: none"> EU <i>acquis communautaire</i> monitoring and alignment where necessary Supervision of entities - risk assessment based supervision Education of the public and investors 	Continuously 2012 - 2013 Continuously
5.3. LABOUR MARKET		
5.3.1. Employment stimulation		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Increasing employment and employability through alignment of supply and demand on the labour market	<ul style="list-style-type: none"> Analysis and independent evaluation of annual employment stimulation plans 	Continuously
Focusing the measures of active employment policy on particularly sensitive groups on the labour market (young and long time unemployed persons)	<ul style="list-style-type: none"> Continued implementation of the National Employment Stimulation Plan 2011 - 2012 	2012

5.3.2. Social security system		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improve quality of social welfare services	<ul style="list-style-type: none"> Monitoring and implementation of the new Social Welfare Act Further implementation of the social welfare IT system 	2012 - 2014 2012 - 2014
Deinstitutionalisation of the social security system	<ul style="list-style-type: none"> Implementation of the National Plan for the deinstitutionalisation and transformation of social welfare homes and other legal entities providing social welfare services in the Republic of Croatia 2011 - 2016 (2018) Planning a network of social services at the level of all counties in the Republic of Croatia Development of alternative accommodation capacities, such as foster families, family homes and housing communities for organised supported lodging Transformation of social welfare institutions and development of a network of non-institutional services 	2012 - 2014 2013 2013 2016
Systematic protection of maternity and improvement of family benefits	<ul style="list-style-type: none"> Ensuring the right of the parent or equivalent person who cares for a child to time benefits and financial benefits with the aim of protecting maternity, infant care and upbringing, and the balancing of family and professional life in accordance with the Act on Maternity and Parental Benefits Ensuring the right to child allowance which is disbursed depending on total household income and other conditions regulated under the Act on Child Allowance 	2012 - 2014
Systematic protection of the rights and interests of children and vulnerable groups, and alignment with international standards	<ul style="list-style-type: none"> Drawing up and adoption of the National strategy for the protection of children against abuse and neglect Drawing up and adopting a Protocol on the procedure in case of serious neglect of a parent, adoptive parent, guardian or another person pertaining to the responsibility to provide for or care for a child Drawing up the National plan to prevent sexual exploitation of children Initiating the procedure for signing and ratification of the Convention on the Protection of Children and Cooperation in Respect of Intercountry Adoption (The 1993 Hague Convention) 	2012 2012 2012 2012
Preparation and implementation of pre-accession and accession activities in the field of social inclusion	<ul style="list-style-type: none"> Encouraging providers of social services to increase their usage of pre-accession funds of the EU, and to have a stronger role in future use of structural funds and EU programmes Strengthening capacity of social service providers for the implementation of projects financed from IPA, structural funds, and EU programmes 	2012 - Continuously
Improvement of student standard and availability of higher education to a larger number of students in the Republic of Croatia	<ul style="list-style-type: none"> Providing state scholarships to full-time students enrolled in university, vocational and postgraduate courses Subsidising transportation costs for full-time students and disabled students, subsidising meals and accommodation of students in students' and pupils' halls of residence in the Republic of Croatia 	2012 - Continuously
5.4. AGRICULTURAL SECTOR		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improve competitiveness and adjustment to EU market standards	<ul style="list-style-type: none"> More efficient distribution of total budgetary funds earmarked for aid within the sector between the 1st pillar (market price supports) and the 2nd pillar (rural development) 	Continuously
Introduction of the Central Veterinary Information System	<ul style="list-style-type: none"> Completing the establishment of a full database Fully operational Central Veterinary Information System 	Continuously
Establishment of the Phytosanitary Information System	<ul style="list-style-type: none"> Upgrading modules for integral support to the phytosanitary field 	Continuously until 2015
Prevention and control of infectious animal diseases	<ul style="list-style-type: none"> Continue carrying out veterinary examinations at farms Establishment of crisis response centres and their furnishing Implementation of the Programme for monitoring, control and eradication of serious animal diseases and diseases of interest to the EU, including zoonoses Collection and safe disposal of animal cadavers 	Continuously
Uniform animal marking system	<ul style="list-style-type: none"> Implementation of animal marking Updated maintaining of the Register of domestic animals 	Continuously
Improve competitiveness of agricultural farms, preserve and improve the environment and biological diversity, and improve living conditions in rural areas	<ul style="list-style-type: none"> Drawing up the National Strategic Plan and Programme for Rural Development Implementing rural development measures from the instrument for pre-accession assistance IPA component V of IPARD programme 2010-2013: investment in agricultural farms for the purpose of restructuring and reaching EU standards, investment in processing of and trading in agricultural and fish products for the purpose of restructuring and reaching EU standards, improvement and development of rural infrastructure, diversification and development of rural economic activities, preparation and implementation of local rural development strategies (LEADER), technical assistance Implementing rural development measures financed from the state budget: aid for insurance against potential losses in agricultural production, aid for preservation of authentic and protected breeds of domestic animals, income support for agricultural farms (only in 2012), aid for ecological and integrated agricultural production and aid for the areas where conditions for agricultural husbandry are unfavourable 	2013 31 December 2013 By the end of 2013
Improve situation in the food processing sector in the Republic of Croatia	<ul style="list-style-type: none"> Drawing up the Food Processing Industry Development Strategy Adoption of the National operational programme of subsidies for the food processing sector 	2012 2012 - 2014

Consolidation of the average agricultural farm	<ul style="list-style-type: none"> • Programme for agricultural land consolidation in the Republic of Croatia for the period 2009 - 2021 	Continuously until 2021
Establishment of structural measures in fisheries	<ul style="list-style-type: none"> • Preparation of the final draft of the National Strategic Plan • Preparation of the Operational programme • Implementation of measures in accordance with the European Fisheries Fund 	2012 - 2014
Supervision and control of fishing activities	<ul style="list-style-type: none"> • Establishment of the automatic identification system - installation of devices on fishing vessels 	2012 - 2014
Further strengthening of the fisheries inspection service	<ul style="list-style-type: none"> • Providing equipment for the inspection service 	2012 - 2014
Strengthening of the inspection service	<ul style="list-style-type: none"> • Construction and furnishing of long-term veterinary and phytosanitary border crossings 	2012 - 2013
5.5. PUBLIC ADMINISTRATION REFORM		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improve efficiency and rationalisation, and lower costs of the administrative apparatus	<ul style="list-style-type: none"> • Improvement and implementation of the Public Administration Reform Strategy • Drafting the new Public Administration Reform Strategy • Adjustment of the system of public agencies in accordance with EU standards • Implementation of territorial reorganisation and decentralisation of regional and local self-government units 	2012- 2013 2012 2012 Continuously
Uniform application of the new General Administrative Procedure Act and improved protection of citizens' rights in administrative procedures	<ul style="list-style-type: none"> • Establishing the Reporting methodology for the purposes of monitoring the implementation of the General Administrative Procedure Act, and further strengthening of administrative capacity of the Ministry of Public Administration in relation to the implementation of the General Administrative Procedure Act • Alignment of procedural acts and subordinate regulations with the new General Administrative Procedure Act, and providing training to civil servants for proper application of the General Administrative Procedure Act 	2012 2012 - 2013
Increase motivation of civil servants for quality work and reduced drain of quality personnel from the civil service	<ul style="list-style-type: none"> • Implementation of the Action plan for the implementation of the Development Strategy for Human Resources in Civil Service for the period 2010 - 2013 and preparation of the new Development Strategy for Human Resources in Civil Service and the Action Plan for the period 2014 - 2016 • Regulation of salaries in the public sector through laws and subordinate legislation • Continued education in the Centre for professional education and training of civil servants and the State School for Public Administration 	2012 - 2013 2012 Continuously
Optimal utilisation of resources from EU structural funds	<ul style="list-style-type: none"> • Setting up the management body for the Operational Programme: Building of administrative capacity for use of funding from the EU structural funds 	Continuously
Establishment of an IT-supported central register of civil servants	<ul style="list-style-type: none"> • Unification of data on employees in the public sector (including public administration) in the Register of employees in the public sector 	2012
Improve coordination of public administration bodies in the planning and implementation of informatization	<ul style="list-style-type: none"> • Implementation of the Decision of the Government of the Republic of Croatia on establishing electronic administration development goals for the period 2011 - 2015 	2012 - 2015
5.6. OTHER REFORMS		
5.6.1. Development of a knowledge-based society		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improve quality of primary and secondary education	<ul style="list-style-type: none"> • Increase the number of children and youth in the educational system • Develop and implement subject and inter-subject curricula • Implement the national pedagogic standards in accordance with feasibility coefficients • Developing the Croatian Qualifications Framework • Increase the number of participants in adult education programmes in accordance with the demands of the economy • Developing a quality assurance system 	Continuously 2012 - Continuously Continuously 2012 Continuously Continuously
Continue implementation of the Bologna process	<ul style="list-style-type: none"> • Developing professional and university programmes in line with the demands of the economy and the labour market • Strengthening the cooperation between the higher education system and the private sector • Encouraging and strengthening the integration of universities • Developing a quality assurance system 	Continuously
Strengthening the connection between science and research in the service of economic development	<ul style="list-style-type: none"> • Encourage the development of technological and scientific infrastructure • Encourage the commercial application of research findings, and the transfer of knowledge and technology, to ensure development of the economy • Networking of existing scientific capacities 	Continuously
5.6.2. Health care reform		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further financial stabilisation of the health care system	<ul style="list-style-type: none"> • Drawing up and implementation of the "Master Plan" for health care institutions • Restructuring of the hospital system (outsourcing the activities unrelated to health care) • Drawing up the National programme for the prevention of cardiovascular diseases and diabetes • Supervision of sick leave expenditure 	2012 - 2014 2012 - 2015 2012 Continuously
Improve the control of the health care expenditures system	<ul style="list-style-type: none"> • Informatization of the primary health care system • Continuing the informatization of hospitals 	2012 2012 - 2014
Improve availability of health care	<ul style="list-style-type: none"> • Purchasing medical equipment and furnishing hospital premises • Reorganisation of emergency medical services and construction of unified emergency reception premises 	2012 - 2014 2012 - 2013

5.6.3. Reform of the judiciary			
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD	
Strengthening the independence of the judiciary	<ul style="list-style-type: none"> • Selection and education of candidates at the National school for judicial officials 	Continuously	
Improve efficiency of the judicial system	<ul style="list-style-type: none"> • Carrying out activities for the establishment of two-instance administrative court procedures 	Continuously	
	<ul style="list-style-type: none"> • Implementation of the activities required for the establishment of a more efficient public enforcement system 	2014	
	<ul style="list-style-type: none"> • Implementation of the activities required for full establishment of the probation system 	2014	
	<ul style="list-style-type: none"> • Further rationalisation of municipal and misdemeanour courts and state attorney's offices and rationalisation of the network of county and commercial courts 	Continuously until 2019	
	<ul style="list-style-type: none"> • Introduction of ICMS and CTS in courts and state attorney's offices 	2013	
	<ul style="list-style-type: none"> • Further strengthening of the free legal aid system 	2012	
	<ul style="list-style-type: none"> • Construction of the Justice Square in Zagreb and Split 	Continuously	
	<ul style="list-style-type: none"> • Strengthening administrative and accommodation capacity of the prison system 	Continuously	
	<ul style="list-style-type: none"> • Construction and remodelling works at the Municipal Court in Karlovac 	2014	
	<ul style="list-style-type: none"> • Construction and remodelling works at the premises of the State Attorney's Office/Office for the Suppression of Corruption and Organised Crime (USKOK) in Zagreb 	2013	
Prevention of corruption	<ul style="list-style-type: none"> • Remodelling works at the Municipal State Attorney's Office in Pula 	2013	
	<ul style="list-style-type: none"> • Reconstruction and remodelling works at the Municipal Court in Daruvar 	2014	
	<ul style="list-style-type: none"> • Construction and remodelling works at the Municipal Court in Virovitica 	2014	
	<ul style="list-style-type: none"> • Construction and remodelling works at the Municipal Court in Slatina 	2014	
	<ul style="list-style-type: none"> • Reconstruction and extension works at the County Court in Osijek and Sisak, and the Municipal Courts in Ivanić Grad, Benkovac and Valpovo 	2014	
	<ul style="list-style-type: none"> • Purchasing IT equipment for judicial bodies 	Continuously	
	<ul style="list-style-type: none"> • Implementation of the Action Plan accompanying the Corruption Prevention Strategy 	Continuously	
	5.6.4. Environmental protection		
	POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
	Establishment of a comprehensive waste management system	<ul style="list-style-type: none"> • Further development of the waste management information system 	2012 - 2014, Continuously
<ul style="list-style-type: none"> • Improving waste reporting - the project "Improving waste reporting in Croatia" 		2012	
<ul style="list-style-type: none"> • Improving reporting on biodegradable waste - applied project "Environmentally sustainable and economical sound approach to municipal solid waste disposal practices in SEE countries" 		2012	
<ul style="list-style-type: none"> • Establishment of county/regional waste management centres 		Continuously	
<ul style="list-style-type: none"> • Rehabilitation of municipal landfill sites and "hot spots" through transformation for other use, continued use or shutdown 		Continuously	
Enhancing the integral system for air quality management and ensuring conditions for systematic resolution of problems related to climate change	<ul style="list-style-type: none"> • Improving the system for national and international reporting in the field of waste management 	2012 - 2014, Continuously	
	<ul style="list-style-type: none"> • Development and upgrading of the Air Quality Information System (as part of the Environmental Protection Information system) 	Continuously	
	<ul style="list-style-type: none"> • Maintaining the greenhouse gas emission registry 	Continuously	
	<ul style="list-style-type: none"> • Maintaining the system for EU ETS (registering and opening user accounts, establishing the payment system, preparing instructions, etc) 	2012	
	<ul style="list-style-type: none"> • Involvement in the EU emission trading scheme, and trading in emission units under the EU ETS system upon accession to the EU 	2013	
	<ul style="list-style-type: none"> • Plan for the protection of air, ozone layer and the alleviation of climate changes 2012-2017 in Croatia 	2012	
	<ul style="list-style-type: none"> • Establishment of monitoring of airborne particulate matters PM2.5 with a view to determining average exposure indicator and the national exposure reduction target (preparatory activities in 2012; start of monitoring in 2013) 	2012	
	<ul style="list-style-type: none"> • EU project "Modernisation of air quality monitoring networks at national and local levels" - preparation and implementation of the project through EU structural funds 	2012 - 2013, Continuously	
	<ul style="list-style-type: none"> • Training for reporting under the Directive on ambient air quality as part of the G2G project "Implementation of the CAFE Directive in the Republic of Croatia" 	2012	
	<ul style="list-style-type: none"> • Inclusion of airplane activity in the system of greenhouse gas emission and tonne kilometres reporting system (drawing up the monitoring plan, emission monitoring, drawing up emission reports) 	2012 - 2013	
	<ul style="list-style-type: none"> • Assessment of air quality according to the criteria laid down by the new Directive 2008/50/EC on ambient air quality and cleaner air for Europe, and review of the division of the Croatian territory into designated areas and populated areas according to air quality categories. Determining designated areas and populated areas where PM10 limit values are exceeded due to winter salting. 	2012	
	<ul style="list-style-type: none"> • Extension of the national network for monitoring of air quality - construction of an additional monitoring station in Slavonski Brod 	2012	
	<ul style="list-style-type: none"> • Establishing the institutional framework for auctions in the greenhouse gas emission trading scheme 	2013	
	<ul style="list-style-type: none"> • Full implementation of greenhouse gas emission trading for airplane operators 	2014	
	<ul style="list-style-type: none"> • Annual assessment of air quality in designated zones and agglomerations on the territory of the state 	2012 - Continuously	
	<ul style="list-style-type: none"> • Drawing up the Action Plan for reduction in air pollution by ground-level ozone in zones and agglomerations in the Republic of Croatia where target values are exceeded 	2012	
	<ul style="list-style-type: none"> • Drawing up the National plan for the implementation of the Stockholm Convention on Persistent Organic Pollutants 	2013	
<ul style="list-style-type: none"> • Report on the implementation of the Plan for air quality protection and improvement for the period 2008 - 2011 	2012		
<ul style="list-style-type: none"> • Drawing up the draft Plan for the protection of air and the ozone layer and mitigation of climate change in the Republic of Croatia for the period 2012 - 2017 	2012		
<ul style="list-style-type: none"> • Drawing up the Monitoring programme for the quality of liquid fuel products for the year 2013 	2012		
<ul style="list-style-type: none"> • Establishing the Greenhouse Gas Inventory 	2012 - Continuously		

<p>Integration of environmental protection objectives in planning and implementation of other sectoral policies, with the aim of promoting sustainable growth</p>	<ul style="list-style-type: none"> • International reporting in accordance with the assumed obligations and reporting to the Republic of Croatia in accordance with national legislation and international obligations • Maintaining the Environmental Protection Information System in accordance with the Programme for maintaining the Environmental Protection Information System in the Republic of Croatia for the period 2009 - 2012 • Drawing up the Programme for maintaining the Environmental Protection Information System in the Republic of Croatia for the period 2013 - 2016 • Implementation, control and certification of the information security system in accordance with the ISO 27001 : 2005 standard (the Agency) • Maintaining the database of projects in the field of environmental protection • Establishing the Agency's reference centres for individual theme areas • Review of the national list of indicators and its publication in the Official Gazette after receiving the opinion of the Ministry of Environmental and Nature Protection • Drawing up the Report on the status of the environment in the Republic of Croatia for the period 2009 - 2012 • Drawing up further guidelines for the implementation of EIA and SEA procedures • IPA 2010 - Building capacity for the implementation of strategic environmental assessment at the regional and local level 	<p>Continuously</p> <p>2012 - Continuously</p> <p>2012</p> <p>2012 - 2014, Continuously</p> <p>Continuously</p> <p>Continuously</p> <p>2012</p> <p>2012 - 2014, Continuously</p> <p>Continuously</p> <p>2012 - 2013</p>
<p>Establishment of industrial pollution control system</p>	<ul style="list-style-type: none"> • Further development and upgrading of the Environmental Pollution Register and the Register of installations containing hazardous materials within the Information System of Installations and Emissions as part of the Environmental Protection Information System • Reporting in accordance with data in the Environmental Pollution Register and the Register of installations containing hazardous materials 	<p>2012 - Continuously</p> <p>Continuously</p>
<p>Strengthening regional capacities for the implementation of the IPPC Directive</p>	<ul style="list-style-type: none"> • Setting up regional centres for the implementation of the IPPC Directive 	<p>2012 - 2013</p>
<p>Improvement of the system of integrated water management</p>	<ul style="list-style-type: none"> • Preparation and adoption of the Water Areas Management Plan for the first plan cycle (2012 - 2015) • Monitoring the implementation of the Water Areas Management Plan (2012 - 2015) and preparing the draft Water Areas Management Plan for the second plan cycle (2016 - 2021) • Development and setting up of the Water Information System related to reporting on the quality, quantity and use of waters and waste water in accordance with WISE (Water Information System for Europe) requirements and integration into the Environmental Protection Information System • Training for the establishment of reporting as part of the G2G project "Reporting in accordance with the Framework Directive and the Urban Waste Water Treatment Directive" 	<p>2012</p> <p>2013</p> <p>Continuously</p> <p>2012</p>
<p>Development of the public water supply and drainage system</p>	<ul style="list-style-type: none"> • Restructuring of the water supply sector and building capacity at the national, regional and local levels • Improvement of the water protection system, in particular in relation to the preparation and implementation of infrastructure projects for the drainage and purification of waste waters; investment in the reconstruction of the existing and construction of new public drainage facilities • Reduction in losses in the existing water supply systems and an increase in connections to the public water supply systems (regional water supply systems), through connection of low-volume water supply systems outside the control system to the public water supply system so as to ensure the safety of drinking water; investment in the reconstruction of the existing and construction of new public water supply facilities 	<p>2012</p> <p>Continuously</p> <p>Continuously</p>
<p>Development of the system for the protection against harmful effects of waters and melioration systems</p>	<ul style="list-style-type: none"> • Increasing investment into the construction of water regulation and safety structures and structures for basic melioration drainage • Increasing the volume of agricultural land covered by irrigation systems through rehabilitation and reconstruction of existing, and construction of new irrigation systems 	<p>Continuously</p> <p>Continuously</p>
<p>Sea and marine environment protection</p>	<ul style="list-style-type: none"> • Drawing up the annual National Report on Monitoring of the Adriatic Sea • Drawing up the annual report, brochure and chart on the quality of beach seawater • Establishing and maintaining the national Database for input, processing and valorisation of data on the quality of sea bathing water, reporting and providing information to the public • Drawing up the implementing regulation on the establishment of the framework for action in the Republic of Croatia related to the protection of the marine environment • Drawing up the assessment of environmental status and the pressures on the marine environment • Determining the good environmental status of the marine environment • Establishing the series of environmental targets and associated indicators • Establishment and further development of the Sea Information System; Database and indicators of the environmental status of the marine environment, mariculture and fisheries; reports on the environmental status of the sea; upgrading of IT support for the purposes of implementation of the Marine Strategy Framework Directive, i.e. the national implementing regulation • Adjustment of software support and the modelling and monitoring data from Phase I of the Project for protection against seaside water pollution for use by expert institutions and the interested public • Strengthening the monitoring system for the quality of seaside water (Project for protection against seaside water pollution) 	<p>2012</p> <p>2012</p> <p>2012 - Continuously</p> <p>2012</p> <p>2012</p> <p>2012</p> <p>2012</p> <p>2012 - Continuously</p> <p>2014</p> <p>2012</p>

Improvement of the nature protection system	<ul style="list-style-type: none"> • Alignment with the international reporting system • Preparing for the establishment of reporting in accordance with the HaBiDes system • Further development of the Biodiversity Information System • Preparation activities for monitoring of genetically modified organisms in the Republic of Croatia 	Continuously 2012 Continuously 2012 - Continuously
Protection of natural values	<ul style="list-style-type: none"> • Reporting to the EEA on protected areas (CDDA) 	Continuously
Strengthen management and control system in nature protection	<ul style="list-style-type: none"> • Administrative strengthening of nature protection institutions at the state and regional level, including the inspection service • Preparation and adoption of new implementing regulations and revision of the existing ones based on the Nature Protection Act, with the aim of alignment with the acquis (including the new environmental acquis) • Integration of environmental protection into the strategies, plans and programmes of other sectors 	Continuously
Ensure a favourable state of preservation of species and habitats, and achieve the optimal preservation model for the use of protected areas and N2000 areas	<ul style="list-style-type: none"> • Protection of new areas, revision of the existing areas; development of the system of protected areas, revision and digitalisation of the boundaries of protected areas • Management of areas in the environmental network of the Republic of Croatia, • establishing the European environmental network „NATURA 2000“, drawing up the management framework and setting up monitoring of the status • Implementation of Wolf and Lynx Management Plan • International cooperation in the field of nature protection (implementation of projects): <ul style="list-style-type: none"> • Project for the integration into the EU NATURA 2000 network (World Bank advance) • Establishing the fauna and speleology databases (CRO fauna and CRO speleo) as part of the Environmental Protection Information System (IPA TAF 2007) • Strengthening capacity for preparation of management plans, and strengthening nature protection supervision activities for the proposed NATURA 2000 areas (IPA TAIB 2009) • Establishing the database of habitats (CRO Habitats) as part of the Environmental Protection Information System (IPA Framework Contract Beneficiaries 2009) 	Continuously 2012 - Continuously Continuously 2012 - 2016 2012 2012 - 2013 2012 - 2013
Efficient and harmonised implementation of the national policy in the field of chemical safety	<ul style="list-style-type: none"> • Participation in the project "Chemical Safety – strengthening the legal and institutional framework for the protection against hazardous chemicals" 	2012
Establishment of the legal framework for chemical safety in the Republic of Croatia	<ul style="list-style-type: none"> • Transposition of EU legislation into Croatian legislation • Implementation of the IPA 2007 project "Chemical Safety"; ECHA IPA project; MATRA project • Project entitled "Synergy of the Three Conventions" (Stockholm, Basel and Rotterdam) with the Regional centre for the Basel Convention in Bratislava 	Continuously
Protection of human health and the environment against direct and indirect effects of chemicals	<ul style="list-style-type: none"> • Implementation of the legislative provisions in the field of chemicals and biocides • Inspection control 	Continuously
Establishment of the legal framework in the field of noise protection	<ul style="list-style-type: none"> • Drawing up the National Noise Protection Strategy and the framework for the noise protection programme - the project entitled "Strengthening capacity for the implementation of environmental acquis in the fields of waste management, integrated prevention and control of pollution, and noise protection" - component "Technical assistance for the development of a National Environmental Noise Strategy for the Republic of Croatia" 	2012
Protection of human health and the environment against direct and indirect effects of noise	<ul style="list-style-type: none"> • Implementation of the legislative provisions in the field of noise protection measures • Inspection control 	Continuously
Establishment of the legal framework in the field of GMO	<ul style="list-style-type: none"> • Transposition of EU legislation into Croatian legislation • Appointment of the national reference laboratory for the detection of GMO • Authorisation of legal entities to carry out risk assessments for the purpose of placing on the market GMOs or products containing and/or composed of or derived from GMOs 	I and III quarter 2012 II quarter 2012 I quarter 2012
Protection of human health and the environment against direct and indirect and cumulative effects of GMOs	<ul style="list-style-type: none"> • Implementation of the legislative provisions in the field of GMO • Official control (supervision, monitoring) 	Continuously
Establishment of a system of continuous forest supervision	<ul style="list-style-type: none"> • Programme of measures for data collection and establishment of the registry of forest damage • Establishing and maintaining a unique information system and registry of forest fires 	Continuously

Annex I Matrix of Policy Commitments

	2011	2012	2013	2014
OVERALL ASSESSMENT OF FISCAL IMPACTS OF MAJOR IMPLEMENTING MEASURES				
A. Implementation				
B. Net direct impact on the budget	-1,105,335,875	1,154,776,140	497,651,145	263,307,757
B1. Direct impact on revenues	319,115,855	168,523,413	-122,185,343	128,920,655
B2. Direct impact on expenditures	1,424,451,730	-986,252,727	-619,836,488	-134,387,102

I. ENTERPRISE SECTOR				
Total (1+2+3+4)				
A. Implementation				
B. Net direct impact on the budget	-236,557,918	86,753,280	-596,639	-2,480,269
B1. Direct impact on revenues	11,795,940	20,872,367	-21,905,029	-1,031,479
B2. Direct impact on expenditures	248,353,858	-65,880,913	-21,308,390	1,448,790

1. Competition and State Aid

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

A. Implementation				
B. Net direct impact on the budget	-508,669	-589,872	0	-38,000
B1. Direct impact on revenues	-383,099	3,978,751	-7,523,230	0
B2. Direct impact on expenditures	125,570	4,568,623	-7,523,230	38,000

Note: Activities of the Croatian Competition Agency are partly financed by EU assistance funds, the impact of which is shown in item B1.

2. Railway Restructuring

Total

A. Implementation				
B. Net direct impact on the budget	370,670,519	547,417,239	228,080,710	82,575,861
B1. Direct impact on revenues	88,106,005	9,171,063	231,562,021	91,623,229
B2. Direct impact on expenditures	-282,564,514	-538,246,176	3,481,311	9,047,368

Subsidies

A. Implementation				
B. Net direct impact on the budget	107,429,264	284,700,000	-9,000,000	-3,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-107,429,264	-284,700,000	9,000,000	3,000,000

Investment in Modernisation

A. Implementation				
B. Net direct impact on the budget	267,055,237	268,917,239	231,700,710	85,375,861
B1. Direct impact on revenues	91,479,778	7,471,063	233,262,021	91,623,229
B2. Direct impact on expenditures	-175,575,459	-261,446,176	1,561,311	6,247,368

Note: The measure is partly financed by EU assistance funds.

MMTI, Reforms, Legislation, Studies

A. Implementation				
B. Net direct impact on the budget	-3,813,982	-6,200,000	5,380,000	200,000
B1. Direct impact on revenues	-3,373,773	1,700,000	-1,700,000	0
B2. Direct impact on expenditures	440,209	7,900,000	-7,080,000	-200,000

Note: The measure is partly financed by EU assistance funds.

3. Small and Medium-Size Enterprises

Total

A. Implementation				
B. Net direct impact on the budget	-235,799,249	87,503,152	-436,639	-2,442,269
B1. Direct impact on revenues	12,179,039	16,893,616	-14,381,799	-1,031,479
B2. Direct impact on expenditures	247,978,288	-70,609,536	-13,945,160	1,410,790

Lifelong Entrepreneurial Education

A. Implementation				
B. Net direct impact on the budget	2,088,800	-4,883,000	0	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-2,088,800	4,883,000	0	0

Competitiveness and Innovations				
A. Implementation				
B. Net direct impact on the budget	20,916,377	-33,705,067	-4,092,430	-769,225
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-20,916,377	33,705,067	4,092,430	769,225
Improvement of Financing				
A. Implementation				
B. Net direct impact on the budget	-187,894,483	102,594,483	0	-2,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	187,894,483	-102,594,483	0	2,000,000
Development of Entrepreneurial Support Infrastructure				
A. Implementation				
B. Net direct impact on the budget	9,340,846	20,934,721	-47,611	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-9,340,846	-20,934,721	47,611	0
EU projects for SME and Building Expertise and Capacity for the EU				
A. Implementation				
B. Net direct impact on the budget	-6,704,002	1,160,120	4,140,041	1,743,790
B1. Direct impact on revenues	12,179,039	16,893,616	-14,381,799	-1,031,479
B2. Direct impact on expenditures	18,883,041	15,733,496	-18,521,840	-2,775,269
Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.				
Stimulating the Development of Tourism				
A. Implementation				
B. Net direct impact on the budget	-73,546,787	1,401,895	-436,639	-1,416,834
B1. Direct impact on revenues				
B2. Direct impact on expenditures	73,546,787	-1,401,895	436,639	1,416,834
4. Public-Private Partnership				
Total				
A. Implementation				
B. Net direct impact on the budget	-250,000	-160,000	-160,000	0
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	250,000	160,000	160,000	0
Education of Participants in the Preparation and Implementation Procedures of PPP Projects				
A. Implementation				
B. Net direct impact on the budget	-100,000	-100,000	-100,000	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	100,000	100,000	100,000	0
Coordination of Exchange of Knowledge and Expertise in the Field of PPP in SEEC Member States				
A. Implementation	X			
B. Net direct impact on the budget	-100,000	-10,000	-10,000	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	100,000	10,000	10,000	0
Implementation of the Regulation on the criteria for assessing and approving public-private partnership projects				
A. Implementation				
B. Net direct impact on the budget	-50,000	0	0	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	50,000	0	0	0
Implementation of the Regulation on the supervision of implementation of public-private partnership projects				
A. Implementation				
B. Net direct impact on the budget	0	-50,000	-50,000	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	0	50,000	50,000	0

II. LABOUR MARKET				
Total (1+2+3+4+5+6+7)				
A. Implementation				
B. Net direct impact on the budget	-28,733,548	-56,517,330	163,077,867	129,108,811
B1. Direct impact on revenues	-49,000,000	53,000,000	58,000,000	62,000,000
B2. Direct impact on expenditures	-20,266,452	109,517,330	-105,077,867	-67,108,811
1. Active Employment Policy				
A. Implementation				
B. Net direct impact on the budget	-100,402,900	-77,397,100	-93,603,093	-113,905,627
B1. Direct impact on revenues				
B2. Direct impact on expenditures	100,402,900	77,397,100	93,603,093	113,905,627
2. Rights during the Unemployment Period				
A. Implementation				
B. Net direct impact on the budget	65,445,000	-13,845,000	108,400,000	100,000,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-65,445,000	13,845,000	-108,400,000	-100,000,000
3. Increasing Mandatory Retirement Age and Change of the Method of Determination of Early Retirement Pension				
A. Implementation				
B. Net direct impact on the budget	-59,000,000	58,000,000	143,000,000	142,000,000
B1. Direct impact on revenues	-49,000,000	53,000,000	58,000,000	62,000,000
B2. Direct impact on expenditures	10,000,000	-5,000,000	-85,000,000	-80,000,000
4. Implementation of Regulations Aimed at Protecting Maternity and Family Benefits				
A. Implementation				
B. Net direct impact on the budget	36,718,590	3,725,378	0	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-36,718,590	-3,725,378	0	0
5. Scholarships for Full-time Students				
A. Implementation				
B. Net direct impact on the budget	10,760,000	-19,600,000	68,260	1,391,740
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-10,760,000	19,600,000	-68,260	-1,391,740
6. Subsiding Students' Accommodation and Meals				
A. Implementation				
B. Net direct impact on the budget	18,973,347	-7,952,908	5,212,700	-377,302
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-18,973,347	7,952,908	-5,212,700	377,302
7. Informatization and Maintenance of the Social Welfare System				
A. Implementation				
B. Net direct impact on the budget	-1,227,585	552,300	0	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	1,227,585	-552,300	0	0
III. AGRICULTURE				
Total (1+2+3+4+5+6+7+8)				
A. Implementation				
B. Net direct impact on the budget	4,908,435	720,859,167	-61,504,407	31,006,479
B1. Direct impact on revenues	126,441,076	36,140,315	-109,157,495	540
B2. Direct impact on expenditures	121,532,641	-684,718,853	-47,653,088	-31,005,939
1. State Aid in Agriculture and Rural Development				
A. Implementation				
B. Net direct impact on the budget	109,154,329	693,125,912	-37,857,011	31,006,479
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-109,154,329	-693,125,912	37,857,011	-31,006,479

2. Establishment of the Market Price Information System for the Agricultural Products Market					
A. Implementation					
B. Net direct impact on the budget	-13,717	55,500	-117,200	0	
B1. Direct impact on revenues					
B2. Direct impact on expenditures	13,717	-55,500	117,200	0	
3. Establishment of the Farm Accountancy Data Network (FADN)					
A. Implementation					
B. Net direct impact on the budget	-42,809	-24,584	-1,344,500	0	
B1. Direct impact on revenues					
B2. Direct impact on expenditures	42,809	24,584	1,344,500	0	
4. Construction and Furnishing of Long-Term Phytosanitary and Veterinary Border Crossings					
A. Implementation					
B. Net direct impact on the budget	-15,120,602	7,555,672	7,685,111	0	
B1. Direct impact on revenues	45,361,808	-19,299,113	-32,113,866	540	
B2. Direct impact on expenditures	60,482,410	-26,854,785	-39,798,977	540	
Note: Construction and furnishing of permanent phytosanitary and veterinary border crossings is partly financed by EU assistance funds, the impact of which is shown in item B1.					
5. IPARD Implementation					
A. Implementation					X
B. Net direct impact on the budget	-65,500,215	-18,635,307	24,441,667	0	
B1. Direct impact on revenues	75,000,000	56,250,000	-65,146,725	0	
B2. Direct impact on expenditures	140,500,215	74,885,307	-89,588,392	0	
Note: IPARD is partly financed by EU assistance funds, the impact of which is shown in item B1.					
6. Implementation of the World Bank Project of Alignment of Agricultural Legislation with the Acquis Communautaire					
A. Implementation		X			
B. Net direct impact on the budget	-45,131,332	47,125,500			
B1. Direct impact on revenues					
B2. Direct impact on expenditures	45,131,332	-47,125,500			
7. Veterinary Practice					
A. Implementation					
B. Net direct impact on the budget	18,838,149	-5,530,916	-57,255,113	0	
B1. Direct impact on revenues					
B2. Direct impact on expenditures	-18,838,149	5,530,916	57,255,113	0	
8. Structural Measures in the Fisheries					
A. Implementation					
B. Net direct impact on the budget	2,724,633	-2,812,610	2,942,639	0	
B1. Direct impact on revenues	6,079,268	-810,573	-11,896,904	0	
B2. Direct impact on expenditures	3,354,635	2,002,038	-14,839,543	0	
Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.					

IV. PUBLIC ADMINISTRATION REFORM

Total (1+2+3)

A. Implementation					
B. Net direct impact on the budget	-764,500	-848,325	610,475	440,275	
B1. Direct impact on revenues	0	10,382,925	-352,275	-3,962,475	
B2. Direct impact on expenditures	764,500	11,231,250	-962,750	-4,402,750	

1. Implementation of Activities Relating to E-administration

A. Implementation					
B. Net direct impact on the budget	-764,500	-28,000	613,000		
B1. Direct impact on revenues					
B2. Direct impact on expenditures	764,500	28,000	-613,000		

2. Preparation of the Management Body for the Operational Programme: Building of Administrative Capacity for Use of Funding from the EU Structural Funds

A. Implementation		X	X		
B. Net direct impact on the budget		-300,000	37,500		
B1. Direct impact on revenues		5,700,000	-712,500		
B2. Direct impact on expenditures		6,000,000	-750,000		

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

3. Alignment of Procedural Laws and Subordinate Legislation with the General Administrative Procedure Act and Education of Civil Servants for the Implementation of the GAPA

A. Implementation		X		
B. Net direct impact on the budget		-520,325	-40,025	440,275
B1. Direct impact on revenues		4,682,925	360,225	-3,962,475
B2. Direct impact on expenditures		5,203,250	400,250	-4,402,750

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

V. DEVELOPMENT OF A KNOWLEDGE-BASED SOCIETY

Total (1+2+3+4+5+6+7+8+9+10+11)

A. Implementation				
B. Net direct impact on the budget	91,076,267	-6,843,253	86,828	-13,562,221
B1. Direct impact on revenues	80,769,680	21,290,052	-70,029,912	7,752,934
B2. Direct impact on expenditures	-10,306,587	28,133,305	-70,116,740	21,315,155

1. Education Development

A. Implementation				
B. Net direct impact on the budget	-8,074,014	-915,986	-1,178,000	-1,270,000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	8,074,014	915,986	1,178,000	1,270,000

2. Development of the National Curriculum for Pre-School, Primary and Secondary Education

A. Implementation				
B. Net direct impact on the budget	-677,944	521,021	0	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	677,944	-521,021	0	0

3. National Exams and State Graduation Exam

A. Implementation				
B. Net direct impact on the budget	14,294,965	557,519	36,766	0
B1. Direct impact on revenues	12,857,604	3,000,000	5,858,889	3,000,000
B2. Direct impact on expenditures	-1,437,361	2,442,481	5,822,123	3,000,000

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

4. Application of National Pedagogical Standards in Accordance with the Feasibility Coefficient

A. Implementation				
B. Net direct impact on the budget	7,180,788	40,725	0	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-7,180,788	-40,725	0	0

5. Development of the Croatian Qualifications Framework

A. Implementation				
B. Net direct impact on the budget	-263,852	20,837	0	0
B1. Direct impact on revenues	15,552,896	30,401,077	-54,163,777	6,935,719
B2. Direct impact on expenditures	15,816,748	30,380,240	-54,163,777	6,935,719

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

6. Strengthening the Quality of Adult Education

A. Implementation				
B. Net direct impact on the budget	800,082	14,073	10,781	-478,492
B1. Direct impact on revenues	22,014,150	-15,449,133	-9,618,693	971,473
B2. Direct impact on expenditures	21,214,068	-15,463,206	-9,629,474	1,449,965

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

7. Development of the Quality Assurance System

A. Implementation				
B. Net direct impact on the budget	203,479	223,508	0	0
B1. Direct impact on revenues	12,699,714	-9,860,938	577,969	-6,254,258
B2. Direct impact on expenditures	12,496,235	-10,084,446	577,969	-6,254,258

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

8. Continued Implementation of the Bologna Process

A. Implementation				
B. Net direct impact on the budget	50,964	-1,040,069	0	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-50,964	1,040,069	0	0

9. Strengthening Potential in Science and Technologies

A. Implementation				
B. Net direct impact on the budget	19,689,518	-3,833,934	450,000	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-19,689,518	3,833,934	-450,000	0

10. Development of Scientific and Technological Infrastructure

A. Implementation				
B. Net direct impact on the budget	-1,198,689	4,661,685	-1,223,427	-3,766,764
B1. Direct impact on revenues	17,645,316	13,199,046	-12,684,300	3,100,000
B2. Direct impact on expenditures	18,844,005	8,537,361	-11,460,873	6,866,764

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

11. Commercial Application of Research Findings

A. Implementation				
B. Net direct impact on the budget	59,070,970	-7,092,632	1,990,708	-8,046,965
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-59,070,970	7,092,632	-1,990,708	8,046,965

Note: The measure is partly financed by IBRD funds.

VI. HEALTH CARE REFORM**Total (1+2+3+4+5)**

A. Implementation				
B. Net direct impact on the budget	-93,703,263	27,036,458	-44,705,091	31,456,972
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	93,703,263	-27,036,458	44,705,091	-31,456,972

1. Reduction in Sick Leave Expenditure

A. Implementation				
B. Net direct impact on the budget	-8,074,171	141,574,171	0	0
B1. Direct impact on revenues				
B2. Direct impact on expenditures	8,074,171	-141,574,171	0	0

2. Informatization of Primary Health Care

A. Implementation		X		
B. Net direct impact on the budget	406,721	-51,355,333		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-406,721	51,355,333		

3. Purchasing Medical Equipment and Furnishing Hospital Premises

A. Implementation				
B. Net direct impact on the budget	-51,613,466	-14,273,223	2,426,459	-40,444,557
B1. Direct impact on revenues				
B2. Direct impact on expenditures	51,613,466	14,273,223	-2,426,459	40,444,557

Note: Funds for the purchase of medical equipment provided by the MH.

4. Reorganisation of Emergency Medical Service

A. Implementation				
B. Net direct impact on the budget	-33,119,432	-48,323,575	-45,993,407	72,448,749
B1. Direct impact on revenues				
B2. Direct impact on expenditures	33,119,432	48,323,575	45,993,407	-72,448,749

5. Accreditation of Hospitals

A. Implementation				
B. Net direct impact on the budget	-1,302,915	-585,582	-1,138,143	-547,220
B1. Direct impact on revenues				
B2. Direct impact on expenditures	1,302,915	585,582	1,138,143	547,220

VII. REFORM OF THE JUDICIARY				
Total (1+2)				
A. Implementation				
B. Net direct impact on the budget	-40,157,454	45,270,739	-20,322,273	-34,159,866
B1. Direct impact on revenues	14,783,531	4,647,273	11,036,500	-11,657,000
B2. Direct impact on expenditures	54,940,985	-40,623,466	31,358,773	22,502,866

1. Reform of the Judiciary

A. Implementation				
B. Net direct impact on the budget	-33,789,763	41,582,946	-23,287,273	-33,830,366
B1. Direct impact on revenues	14,708,548	7,831,616	20,190,000	-11,657,000
B2. Direct impact on expenditures	48,498,311	-33,751,330	43,477,273	22,173,366

Note: The reform of the judiciary is partly financed by EU assistance funds and donations made by international organisations, the impact of which is shown in item B1. A portion of the planned funds shown in item B2 has been secured from the World Bank loan for the financing of the Judiciary Development Support Project. Deviation from the estimated funds for 2014 in relation to 2013 refers to the planned EBRD loan for the construction of the prison in Šibenik and the renovation of the Zagreb prison. The loan agreement procedure between the EBRD and the Republic of Croatia is under way.

2. Prevention of Corruption

A. Implementation				
B. Net direct impact on the budget	-6,367,691	3,687,793	2,965,000	-329,500
B1. Direct impact on revenues	74,983	-3,184,343	-9,153,500	0
B2. Direct impact on expenditures	6,442,674	-6,872,136	-12,118,500	329,500

Note: The reform of the judiciary in the part relating to prevention of corruption is partly financed by EU assistance funds and donations made by international organisations, the impact of which is shown in item B1, and a World Bank loan.

VIII. ENVIRONMENTAL PROTECTION

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

A. Implementation				
B. Net direct impact on the budget	-801,403,894	339,065,404	461,004,385	121,497,576
B1. Direct impact on revenues	134,325,629	22,190,481	10,222,868	75,818,135
B2. Direct impact on expenditures	935,729,523	-316,874,923	-450,781,517	-45,679,441

1. Integrating Environmental Protection Goals in the Planning and Implementation of Other Sector Policies for the Purpose of Promoting Sustainable Development

A. Implementation				
B. Net direct impact on the budget	1,548,300	-3,775,008	-73,292	298,000
B1. Direct impact on revenues	0	3,663,000	0	0
B2. Direct impact on expenditures	-1,548,300	7,438,008	73,292	-298,000

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

2. Air Quality and Climate Protection

A. Implementation				
B. Net direct impact on the budget	941,686	-1,530,000	-300,000	0
B1. Direct impact on revenues	-1,681,071	0	0	0
B2. Direct impact on expenditures	-2,622,757	1,530,000	300,000	0

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

3. Waste Management

A. Implementation				
B. Net direct impact on the budget	0	0	0	0
B1. Direct impact on revenues	31,590,965	37,785,876	42,699,970	77,947,045
B2. Direct impact on expenditures	31,590,965	37,785,876	42,699,970	77,947,045

Note: The measure is partly financed by EU assistance funds.

4. Water Management

A. Implementation				
B. Net direct impact on the budget	-794,624,580	363,642,970	466,078,086	122,071,190
B1. Direct impact on revenues	98,897,131	-27,163,606	-30,248,109	-2,128,910
B2. Direct impact on expenditures	893,521,711	-390,806,576	-496,326,195	-124,200,100

Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.

5. Protection of the Sea and Marine Environment					
A. Implementation					
B. Net direct impact on the budget	-17,713	-4,550,000	-8,330,000	3,250,000	
B1. Direct impact on revenues					
B2. Direct impact on expenditures	17,713	4,550,000	8,330,000	-3,250,000	
6. Nature Protection					
A. Implementation					
B. Net direct impact on the budget	-9,469,704	-13,403,238	3,684,361	-4,121,614	
B1. Direct impact on revenues	5,284,796	1,772,217	696,337	0	
B2. Direct impact on expenditures	14,754,500	15,175,455	-2,988,024	4,121,614	
Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.					
7. Establishing the Industrial Pollution Control System					
A. Implementation					
B. Net direct impact on the budget	-32,000	-448,000	-30,000	0	
B1. Direct impact on revenues	0	3,580,200	0	0	
B2. Direct impact on expenditures	32,000	4,028,200	30,000	0	
Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.					
8. Chemicals and GMOs					
A. Implementation					
B. Net direct impact on the budget	385,117	-1,096,320	475,280	0	
B1. Direct impact on revenues	233,808	2,552,794	-2,925,330	0	
B2. Direct impact on expenditures	-151,309	3,649,114	-3,400,610	0	
Note: The measure is partly financed by EU assistance funds, the impact of which is shown in item B1.					
9. Forestry					
A. Implementation					
B. Net direct impact on the budget	-135,000	225,000	-500,050	0	
B1. Direct impact on revenues					
B2. Direct impact on expenditures	135,000	-225,000	500,050	0	

Annex II Statistical Appendix

Table 1a: Macroeconomic Prospects

Croatia

Percentages unless otherwise indicated	ESA Code	Year 2010	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
		Level (bn EUR)	Rate of change				
1. Real GDP at market prices	B1*g	45.455	-1.2	0.4	0.8	1.5	2.5
2. Current GDP at market prices	B1*g	45.917	-0.2	2.7	2.0	3.7	4.9
Components of real GDP							
3. Private consumption expenditure	P3	25.262	-0.9	0.3	-0.3	0.7	1.3
4. Government consumption expenditure	P3	9.808	-0.8	-0.1	-2.4	-2.0	-0.8
5. Gross fixed capital formation	P51	10.156	-11.3	-7.3	7.4	3.2	4.6
6. Changes in inventories and net acquisition of valuables	P52+P53	0.821	-18.1	21.0	4.7	2.3	5.8
7. Exports of goods and services	P6	17.276	6.0	-1.7	1.1	3.8	4.8
8. Imports of goods and services	P7	17.868	-1.3	-5.4	1.5	2.1	3.2
Contribution to real GDP growth							
9. Final domestic demand		45.2	-3.4	-1.4	0.8	0.7	1.6
10. Change in inventories and net acquisition of valuables	P52+P53	0.8	-0.4	0.4	0.1	0.0	0.1
11. External balance of goods/services	B11	-0.6	2.6	1.4	-0.1	0.7	0.7

Source: CBS, MF

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

Table 1b: Price Developments**Croatia**

Percentage changes, annual averages	ESA Code	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
1. GDP deflator		1.0	2.3	1.3	2.2	2.4
2. Private consumption deflator		1.1	2.4	2.4	2.5	2.4
3. HICP		-	-	-	-	-
4. National CPI change		1.1	2.3	2.4	2.5	2.4
5. Public consumption deflator		0.7	1.7	-2.4	1.4	1.9
6. Investment deflator		-2.2	0.8	1.9	2.1	2.3
7. Export price deflator (goods & services)		1.9	5.8	1.3	1.7	2.1
8. Import price deflator (goods & services)		-0.2	4.8	1.1	1.6	1.9

Source: CBS, MF

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

Table 1c: Labour Markets Developments**Croatia**

	ESA Code	Year 2010	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
		Level	Level/Rate of change				
1. Population (thousands)			4,417.8	4,417.8	4,417.8	4,417.8	4,417.8
2. Population (growth rate in %)			-0.26	0.00	0.00	0.00	0.00
3. Working-age population (persons)[1]			2,758.0	2,751.1	2,744.8	2,739.3	2,733.8
4. Participation rate			63.4	62.6	62.4	62.6	62.8
5. Employment, persons [2]			1,541.3	1,492.8	1,473.0	1,474.5	1,486.3
6. Employment, hours worked[3]			n.a.	n.a.	n.a.	n.a.	n.a.
7. Employment (growth rate in %)			-4.0	-3.1	-1.3	0.1	0.8
8. Public sector employment (persons)			n.a.	n.a.	n.a.	n.a.	n.a.
9. Public sector employment (growth in %)			-	-	-	-	-
10. Unemployment rate [4]			11.8	13.3	14.0	14.0	13.4
11. Labour productivity, persons[5]		214,888	2.9	3.6	2.1	1.4	1.6
12. Labour productivity, hours worked[6]			n.a.	n.a.	n.a.	n.a.	n.a.
13. Compensation of employees	D1	156,935,768,618	-4.1	-0.1	-1.7	1.5	3.9

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

[1] Age group of 15-64 years

[2] Occupied population, domestic concept national accounts definition

[3] National accounts definition

[4] Harmonised definition, Eurostat; levels

[5] Real GDP per person employed

[6] Real GDP per hour worked

Table 1d: Sectoral Balances

Croatia

Percentages of GDP	ESA code	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-1.1	0.3	0.1	0.8	1.6
<i>of which:</i>						
- Balance of goods and services		-0.2	1.7	1.6	2.3	3.0
- Balance of primary incomes and transfers		-1.0	-1.5	-1.6	-1.8	-1.9
- Capital account		0.1	0.0	0.1	0.3	0.5
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	3.8	5.8	3.9	4.1	4.2
3. Net lending/borrowing of general government		-4.9	-5.5	-3.8	-3.3	-2.6
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

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

Table 1e: GDP, Investment and Gross Value Added**Croatia**

	ESA Code	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
GDP and investment						
GDP level at current market prices (in domestic currency)	B1g	334.6	343.4	350.5	363.4	381.0
Investment ratio (% of GDP)		21.6	19.7	21.1	21.5	21.9
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		-0.2	1.5	1.3	1.9	2.0
2. Industry (excluding construction)		-1.6	-0.6	2.9	2.5	3.3
3. Construction		-16.4	-9.4	1.6	2.1	2.2
4. Services		-0.4	1.3	-0.4	0.9	2.1

Source: CBS, MF

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

Table 1f: External Sector Developments

Croatia

Billion Euro unless otherwise indicated		Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
1. Current account balance (% of GDP)	% of GDP	-1.2	0.2	0.0	0.5	1.1
2. Export of goods	NCU or EUR	9,102	9,090	9,286	9,986	10,885
3. Import of goods	NCU or EUR	15,054	14,640	14,941	15,472	16,274
4. Trade balance	NCU or EUR	-5,952	-5,550	-5,655	-5,485	-5,388
5. Export of services	NCU or EUR	8,490	8,840	8,977	9,268	9,736
6. Import of services	NCU or EUR	2,603	2,485	2,565	2,672	2,813
7. Service balance	NCU or EUR	5,886	6,355	6,411	6,596	6,923
8. Net interest payments from abroad	NCU or EUR	-1,327	-1,440	-1,497	-1,557	-1,608
9. Other net factor income from abroad	NCU or EUR	-230	-290	-336	-418	-505
10. Current transfers	NCU or EUR	1,088	1,037	1,089	1,096	1,123
11. <i>Of which</i> from EU	NCU or EUR	n.a.	n.a.	n.a.	n.a.	n.a.
12. Current account balance	NCU or EUR	-535	113	13	232	544
13. Capital and financial account	NCU or EUR	1,264	n.a.	n.a.	n.a.	n.a.
14. Foreign direct investment	NCU or EUR	341	969	588	706	773
15. Foreign reserves	NCU or EUR	10,660	n.a.	n.a.	n.a.	n.a.
16. Foreign debt	NCU or EUR	46,496	45,827	47,032	47,730	48,645
17. <i>Of which</i> : public	NCU or EUR	13,998	n.a.	n.a.	n.a.	n.a.
18. <i>O/w</i> : foreign currency denominated	NCU or EUR	n.a.	n.a.	n.a.	n.a.	n.a.
19. <i>O/w</i> : repayments due	NCU or EUR	n.a.	n.a.	n.a.	n.a.	n.a.
20. Exchange rate vis-à-vis EUR (end-year)	NCU/EUR	7.39	7.53	7.50	7.51	7.51
21. Exchange rate vis-à-vis EUR (annual average)	NCU/EUR	7.29	7.43	7.47	7.48	7.48
22. Net foreign saving	% of GDP	-	-	-	-	-
23. Domestic private saving	% of GDP	-	-	-	-	-
24. Domestic private investment	% of GDP	-	-	-	-	-
25. Domestic public saving	% of GDP	-	-	-	-	-
26. Domestic public investment	% of GDP	-	-	-	-	-

Source: CNB, MF

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

Table 1g: Sustainability indicators**Croatia**

	Dimension	Year	Year	Year	Year	Year
		2007	2008	2009	2010	2011
1. Current Account Balance	% of GDP	-7.2	-8.8	-5.2	-1.2	0.2
2. Net International Investment Position	% of GDP	-92.6	-73.2	-85.4	-92.4	-88.7
3. Export market shares	%, yoy	-5.1	-7.5	2.6	15.0	-8.6
4. Real Effective Exchange Rate [1]	%, yoy	-1.2	-4.3	-0.7	1.6	2.5
5. Nominal Unit Labour Costs	%, yoy	4.4	7.4	4.8	-3.6	-0.3
6. Private sector credit flow	% of GDP	-	-	-	-	-
7. Private sector debt	% of GDP	1.9	3.7	1.8	-0.1	-0.4
8. General Government Debt	% of GDP	32.9	29.2	35.1	41.3	44.9

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

Table 2: General Government Budgetary Prospects

Croatia

	ESA code	Year	Year	Year	Year	Year	Year
		2010	2010	2011	2012	2013	2014
		Level (bn NCU)	% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	-16.402	-4.9	-5.5	-3.8	-3.3	-2.6
2. Central government	S1311	-16.370	-4.9	-5.3	-3.6	-3.0	-2.4
3. State government	S1312	0.000	0.0	0.0	0.0	0.0	0.0
4. Local government	S1313	-0.032	0.0	-0.3	-0.2	-0.2	-0.2
5. Social security funds	S1314	0.000	0.0	0.0	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	123.715	37.0	35.8	35.7	35.1	34.6
7. Total expenditure [1]	TE	140.118	41.9	41.4	39.5	38.4	37.2
8. Net borrowing/lending	EDP.B9	-16.402	-4.9	-5.5	-3.8	-3.3	-2.6
9. Interest expenditure	EDP.D41 incl. FISIM	6.659	2.0	2.2	2.3	2.0	1.8
10. Primary balance [2]		-9.743	-2.9	-3.4	-1.5	-1.3	-0.8
11. One-off and other temporary measures [3]		0.000	0.0	0.0	0.0	0.0	0.0
Components of revenues							
12. Total taxes (12 = 12a+12b+12c)		71.399	21.3	20.2	20.9	20.7	20.3
12a. Taxes on production and imports	D2	53.087	15.9	15.8	15.8	15.8	15.4
12b. Current taxes on income and wealth	D5	18.309	5.5	4.5	5.1	5.0	4.9
12c. Capital taxes	D91	0.003	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D61	39.330	11.8	11.6	10.9	10.3	10.2
14. Property income	D4	1.415	0.4	0.4	0.3	0.3	0.3
15. Other (15 = 16-(12+13+14)) [4]		11.571	3.5	3.6	3.6	3.7	3.8
16 = 6. Total revenue	TR	123.715	37.0	35.8	35.7	35.1	34.6
p.m.: Tax burden (D2+D5+D61+D91-D995) [5]		110.729	33.1	31.9	31.8	31.1	30.5
Selected components of expenditures							
16. Collective consumption	P32	0.000	0.0	0.0	0.0	0.0	0.0
17. Total social transfers	D62 + D63	69.630	20.8	19.9	19.1	18.5	17.8
17a. Social transfers in kind	P31 = D63	11.971	3.6	3.3	3.0	2.9	2.9
17b. Social transfers other than in kind	D62	57.659	17.2	16.6	16.1	15.6	15.0
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	6.659	2.0	2.2	2.3	2.0	1.8
19. Subsidies	D3	7.881	2.4	2.1	1.9	1.9	1.8
20. Gross fixed capital formation	P51	4.425	1.3	1.9	1.6	1.6	1.5

21. Other (21 = 22- (16+17+18+19+20) [6]		51.523	15.4	15.3	14.6	14.3	14.2
22. Total expenditures	TE [1]	140.118	41.9	41.4	39.5	38.4	37.2
p.m. compensation of employees	D1	34.98683	10.5	10.4	9.7	9.5	9.0

Source: MF

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

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

[2] The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3] A plus sign means deficit-reducing one-off measures

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

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

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3: General Government Expenditure by Function**Croatia**

% of GDP	COFOG Code	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
1. General public services	1	4.8	-	-	-	-
2. Defence	2	1.4	-	-	-	-
3. Public order and safety	3	2.4	-	-	-	-
4. Economic affairs	4	4.8	-	-	-	-
5. Environmental protection	5	0.3	-	-	-	-
6. Housing and community amenities	6	1.2	-	-	-	-
7. Health	7	6.2	-	-	-	-
8. Recreation, culture and religion	8	1.2	-	-	-	-
9. Education	9	4.2	-	-	-	-
10. Social protection	10	14.6	-	-	-	-
11. Total expenditure (item 7 = 23 in Table 2)	TE	41.9	41.4	39.5	38.4	37.2

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

Table 4: General Government Debt Developments

Croatia

% of GDP	ESA code	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
1. Gross debt [1]		41.3	44.9	47.2	48.9	49.4
2. Change in gross debt ratio		6.1	3.6	2.4	1.7	0.5
Contributions to change in gross debt						
3. Primary balance [2]		2.9	3.4	1.5	1.3	0.8
4. Interest expenditure [3]	EDP D.41	2.0	2.2	2.3	2.0	1.8
5. Stock-flow adjustment		1.2	-1.9	-1.5	-1.6	-2.1
<i>of which:</i>						
- Differences between cash and accruals [4]		0.0	0.0	0.0	0.0	0.0
- Net accumulation of financial assets [5]		0.4	0.1	-0.1	0.3	0.4
<i>of which:</i>						
- Privatisation proceeds		0.0	0.1	0.6	0.2	0.2
- Valuation effects and other [6]		0.7	-1.0	-0.5	-0.2	-0.2
p.m. implicit interest rate on debt [7]		5.7	5.4	5.3	4.3	3.9
Other relevant variables						
6. Liquid financial assets [8]		0.0	0.0	0.0	0.0	0.0
7. Net financial debt (7 = 1 - 6)		41.3	44.9	47.2	48.9	49.4

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

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

[2] Cf. item 10 in Table 2.

[3] Cf. item 9 in Table 2.

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

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

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

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

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

Table 5: Cyclical Developments**Croatia**

% of GDP	ESA Code	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
1. Real GDP growth (%)	B1g	-1.2	0.4	0.8	1.5	2.5
2. Net lending of general government	EDP.B.9	-4.9	-5.5	-3.8	-3.3	-2.6
3. Interest expenditure	EDP.D.41	2.0	2.2	2.3	2.0	1.8
4. One-off and other temporary measures [1]						
5. Potential GDP growth (%)		-1.6	-0.6	0.6	1.6	2.1
Contributions:		n.a.	n.a.	n.a.	n.a.	n.a.
- labour		n.a.	n.a.	n.a.	n.a.	n.a.
- capital		n.a.	n.a.	n.a.	n.a.	n.a.
- total factor productivity		n.a.	n.a.	n.a.	n.a.	n.a.
6. Output gap		-1.3	-0.3	-0.2	-0.2	0.1
7. Cyclical budgetary component		-0.4	0.0	-0.1	-0.1	0.0
8. Cyclically-adjusted balance (2-7)		-4.5	-5.5	-3.7	-3.2	-2.6
9. Cyclically-adjusted primary balance (8+3)		-2.5	-3.3	-1.4	-1.2	-0.8
10. Structural balance (8-4)		-4.5	-5.5	-3.7	-3.2	-2.6

Source: MF

Comments: 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

	Croatia				
	Year	Year	Year	Year	Year
	2010	2011	2012	2013	2014
1. GDP growth (% , yoy)					
Previous update	-1.6	1.5	2.0	2.5	
Latest update	-1.2	0.4	0.8	1.5	2.5
Difference (percentage points)	0.4	-1.1	-1.2	-1.0	2.5
2. General government net lending (% of GDP)					
Previous update	-5.2	-5.6	-3.9	-2.4	
Latest update	-4.9	-5.5	-3.8	-3.3	-2.6
Difference	0.3	0.0	0.1	-0.9	-2.6
3. General government gross debt (% of GDP)					
Previous update	41.6	44.2	46.3	46.7	
Latest update	41.3	44.9	47.2	48.9	49.4
Difference	-0.3	0.7	0.9	2.2	49.4

Source: MF

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

Table 7: Long-term Sustainability of Public Finances**Croatia**

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure ^[1]	42.2	41.9	39.2	40.2	41.1	42.3	
of which:							
- Age-related expenditures [2]	15.2	15.3	14.6	15.3	16.2	17.9	
- Pension expenditure [3]	9.4	8.9	8.8	8.3	8.2	8.7	
- Social security pension	-	-	-	-	-	-	
- Old-age and early pensions	-	-	-	-	-	-	
- Other pensions (disability, survivors)	-	-	-	-	-	-	
- Occupational pensions (if in general government)	-	-	-	-	-	-	
- Health care	5.8	6.4	5.8	7.0	8.0	9.2	
- Long-term care (this was earlier included in the health care)	-	-	-	-	-	-	
Education expenditure	-	-	-	-	-	-	
Other age-related expenditures	-	-	-	-	-	-	
Interest expenditure	1.8	2.0	2.5	2.8	3.1	3.4	
Total revenues	39.8	37.0	35.6	35.6	35.6	35.6	
<i>of which: property income</i>	-	-	-	-	-	-	
<i>of which: from pensions contributions (or social contributions, if appropriate)</i>	5.8	5.7	5.2	5.2	5.2	5.2	
Pension reserve fund assets	-	-	-	-	-	-	
<i>of which: consolidated public pension fund assets (assets other than government liabilities)</i>	-	-	-	-	-	-	
Assumptions							
Labour productivity growth	3.2	2.9	3.1	2.2	1.1	1.1	
Real GDP growth	5.1	-1.2	3.2	1.2	0.3	0.2	
Participation rate males (aged 20-64) ^[4]	70.1	67.2	70.8	71.0	70.3	71.2	
Participation rates females (aged 20-64) ^[4]	56.5	55.9	57.5	57.7	57.2	57.9	
Total participation rates (20-64) ^[4]	63.2	61.5	64.1	64.3	63.7	64.5	
Unemployment rate	9.8	12.1	7.0	7.0	7.0	7.0	
Population aged 65+ over total population	16.7	16.8	19.6	22.6	24.7	27.3	

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

Projections are based on demographic projections for the period 2005-2050, which was published by the Central Bureau for Statistics in 2006.

^[1] Total expenditures according to ESA 95^[2] Pension plus health care expenditures^[3] Total public pension expenditures except pensions of war veterans^[4] Aged (15 - 64)

Table 8: Basic Assumptions on the External Economic Environment

Croatia

	Dimension	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
Short-term interest rate [1]	Annual average	n.a.	n.a.	n.a.	n.a.	n.a.
Long-term interest rate	Annual average	n.a.	n.a.	n.a.	n.a.	n.a.
USD/EUR exchange rate	Annual average	1.32	1.39	1.34	1.35	1.35
Nominal effective exchange rate, index, 2005=100	Annual average	98.2	100.3	101.2	101.4	101.5
Exchange rate vis-à-vis the EUR	Annual average	7.29	7.43	7.47	7.48	7.48
Global GDP growth, in %	Annual average	5.2	3.8	3.3	3.9	n.a.
EU GDP growth, in %	Annual average	2.0	1.6	-0.1	1.2	n.a.
Growth of relevant foreign markets	Annual average	n.a.	n.a.	n.a.	n.a.	n.a.
World import volumes, excluding EU	Annual average	n.a.	n.a.	n.a.	n.a.	n.a.
Oil prices (Brent, USD/barrel)	Annual average	79.03	104.23	99.09	95.55	n.a.

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

[1] If necessary, purely technical assumption.

Annex III Structural Reforms Agenda and Achievements

Structural reforms agenda and achievements show realisation of the measures that were to be implemented in 2011 under the 2011-2013 PEP.

MAIN MEASURES UNDER THE 2011 - 2013 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
ENTERPRISE SECTOR			
Competition and state aid			
Adoption of the Regulation on block exemption granted to agreements in traffic sector Adoption of the Regulation on notification and assessment of concentration of entrepreneurs Adoption of the Regulation on block exemption of agreements between undertakings not operating on the same level of production Adoption of the Regulation on block exemption of agreements between undertakings operating on the same level of production or distribution Adoption of the Regulation on block exemption granted to certain categories of technology transfer agreements Adoption of the Regulation on block exemption granted to agreements on distribution and servicing of motor vehicles Adoption of the Regulation on block exemption granted to insurance agreements Adoption of the Regulation on the definition of relevant market	Yes	January - July 2011	The Regulation on block exemption granted to agreements in traffic sector was renamed the Regulation on block exemption granted to agreements in transport sector; the Regulation on block exemption of agreements between undertakings not operating on the same level of production was renamed the Regulation on block exemption of vertical agreements between undertakings; the Regulation on block exemption of agreements between undertakings operating on the same level of production or distribution was renamed the Regulation on block exemption granted to certain categories of horizontal agreements between undertakings; and the Regulation on the definition of the relevant market was renamed the Regulation on the method and criteria for the definition of the relevant market. In addition to the aforementioned regulations, the Regulation on agreements of minor importance was also adopted in January 2011.
Training on market competition for the employees of the Croatian Competition Agency, other regulatory bodies and the judiciary (through the IPA 2007 twinning project) Raising awareness in the academic community, the local business community, bodies of local authority and the public in general (through the IPA 2007 CroCompete project) Education on state aid for providers of state aid at the central and local level, including training for use of structural funds, through the IPA 2007 twinning project and CroCompete project	Yes	January - December 2011	The CroCompete project was completed successfully: over 500 students and 450 representatives of the business community and local authorities were educated. As part of the twinning project, a series of seminars were held for the employees of the Agency and aid providers. The twinning activities will continue until March 2012.
Completion of the state aid approval procedure for Croatian shipyards	Yes	July - October 2011	In the period between July and October 2011, the Agency adopted decisions finalising the evaluation procedures of the restructuring programmes for individual shipyards (<i>Brodosplit</i> , <i>Brodotrogir</i> , <i>Kraljevica</i> and <i>3. Maj</i>).
Adoption of rules on state aid in accordance with the procedure prescribed by the Regulation on State Aid	Yes	Continuously	During 2011, three decisions were adopted on announcement of rules on state aid (Decision on Amendments to the Decision on publishing rules for training aid, Decision on Amendments to the Decision on publishing rules on state aid for rescue and restructuring, and the Decision on publishing state aid rules in relation to rapid deployment of broadband networks).
Privatisation			
Transformation of the Croatian Privatisation Fund, introduction of new models of privatisation and preparation for sale of companies in majority ownership	Yes	April 2011	On 1 April 2011, the Government Asset Management Agency was established. The Act on Managing the State Property has been adopted.
Privatisation of five shipyards and one subsidiary (announcement of the second round of public invitations to tender)	Yes/No		
Intensifying activities related to the announcement of public invitations to tender with the aim of privatising companies from the portfolio of the Republic of Croatia	Yes	July 2010 - March 2011	Privatisation of 100 enterprises in minority ownership (69 enterprises were sold at the open market, 29 enterprises completed the liquidation procedure, and 2 enterprises were sold to the employees under special terms). In order to speed up the privatisation, calls were published for the election of expert board members in enterprises in which the Republic of Croatia holds a majority. Member appointments are in progress.
Continuation of privatisation of the Croatian Railways	No		No longer under the responsibility of the Government Asset Management Agency (GAMA).
Adopting the Government Strategy for Privatisation of State-Owned Enterprises, along with the List of enterprises eligible for privatisation, and the Privatisation Plan for State-Owned Enterprises	No	2012	Due to the restructuring of the Croatian Privatisation Fund, the establishment of the Government Asset Management Agency (GAMA), institutional changes, and new legislative frameworks, the Government Strategy for Privatisation of State-Owned Enterprises was not adopted. Instead, the draft State Property Management Strategy was drawn up. The draft Strategy was drawn up in accordance with the Act on Managing the State Property, and is planned to be adopted by the Croatian Parliament during 2012.
Drawing up the Government Report on the annual implementation of the Privatisation Plan for State-Owned Enterprises	No	IV quarter 2011	Given that the Government Strategy for Privatisation of State-Owned Enterprises was not adopted, the Report on its annual implementation was not prepared either. After the State Property Management Strategy is adopted, the State Property Management Plan will be drawn up, and Reports on the implementation of the Management Plan will be produced accordingly, and in accordance with the Act on Managing the State Property.

Railway restructuring			
Drawing up subordinate legislation	Yes	2011	The activities are carried out on an ongoing basis. In 2010, 4 new ordinances in the field of railway traffic safety were prepared, and 3 more in 2011.
Drawing up a network report	Yes	2011	A new Network Report is drawn up every year (legislative provision). The Network Report for 2012 is to be finalised soon.
Allocation of routes to operators	Yes	2011	The activities are carried out on an ongoing basis. Currently, two operators are active: <i>HŽ Cargo</i> and <i>HŽ Putnički prijevoz</i> .
Establishment of the Railway Transport Safety Agency	Yes	2011	The Director was appointed and two new employees recruited.
Drawing up the Restructuring Plan for HŽ (Croatian Railways) Group companies	No	2012	The selection procedure is nearly complete for consultants in the preparation of an integral Restructuring Plan for all HŽ Group companies.
Drawing up annual maintenance and modernisation plans	Yes	2011	The activities are carried out on an ongoing basis. Planning is carried out within the framework of annual Business Plans adopted by railway companies.
Restructuring of the shipbuilding industry			
Announcement of the public invitation to tender for the privatisation of companies in the shipbuilding sector	Yes	2011	The invitation to tender was announced on 15 February 2010 for all five shipyards. A new invitation to tender was announced on 3 November for <i>Kraljevica</i> , and on 24 January 2011 for <i>3. Maj</i> . Negotiations are under way with investors for <i>Brodosplit, 3. Maj, Brodetrogir</i> and <i>Kraljevica</i> .
Implementation of the Restructuring Programme (depending on the results of the call for tenders)	No	2012 - 2017	Full implementation of the Restructuring Programme will commence after the privatisation and will continue until the end of the restructuring period.
Energy sector			
Alignment with the Third Energy Package Adjustment of the internal market to European conditions Adjustment of the infrastructure to market needs Refined petroleum products - monitoring oil and refined petroleum products reserves at the EU level and fuel extraction in accordance with EU standards	Yes	In progress/ Continuously	All laws required to enable the implementation of the Third Energy Package are expected to be adopted during 2012. In the field of refined petroleum products, the Croatian Compulsory Oil Stocks Agency (HANDA) continues its activities according to plan. Activities continue for the preparation of the legislative framework related to renewable energy sources and energy efficiency. Furthermore, during 2012 implementation will commence of IPA projects related to the Third Energy Package, i.e. the energy market and security of energy supply. Activities also continue related to the preparation for implementation of infrastructural projects financed by WEBIF.
Small and medium-size enterprises			
Strengthening competitive ability of small businesses Innovation and new products Stimulating fast-growing small business entities Women entrepreneurs Young, beginner and disabled entrepreneurs Entrepreneurship in culture and culture-related industries Clusters Development of crafts and trades Development of cooperatives Use of new technologies and technological procedures Introduction of EU standards Linking SMEs and R&D Marketing and advertising of small business entities Coordination of activities in e-trade and e-business enhancement, public portals for small businesses Promotion of entrepreneurship	Yes	Continuously	These measures were implemented in 2011 in accordance with the 2008-2012 Programme of Incentives to Small and Medium-Size Enterprises of the Government of the Republic of Croatia. The Programme's implementing act is the annual Operational plan for incentives to small and medium-size entrepreneurship in the current budget year. In 2011, the Operational plan was adopted on 17 February. The incentive system is based on the Act on Small Business Development Incentives (Official Gazette 29/02 and 63/07), the adopted budget plan and projection, legislation governing the establishment of small business entities (companies, crafts and trades, cooperatives, profit institutions and other entities of small and medium-size enterprises), the State Aid Act (Official Gazette 140/05) and subordinate legislation governing state aid. The Government of the Republic of Croatia adopted on 30 June 2008 the Decision on the strategic and institutional framework for the use of structural instruments of the EU in the Republic of Croatia. The Decision defines structural instruments of the EU, strategic document use of structural instruments, the bodies in charge of coordination of structural instruments, verification of payments from structural elements and review, and the bodies in charge of preparation and management of certain strategic documents. The strategic documents for the use of structural instruments of the EU to be agreed between the Republic of Croatia and the European Commission are: the National strategic referential framework and the Operational programmes. In the Republic of Croatia, 15 operational programmes have been established for the use of structural instruments. With the entry into force of the Act on the Structure and Scope of Ministries and Other Central Government Administration Bodies (OG 150/11), the Ministry of Economy, Labour and Entrepreneurship was abolished and its activities were transferred to the Ministry of the Economy, Ministry of Entrepreneurship and Crafts, and the Ministry of Labour and the Pension System. Since the Operational programme for regional competitiveness was under the responsibility of the Ministry of Economy, Labour and Entrepreneurship, the required organisational and structural changes will be effected for the managerial and operational structure of IPA, in accordance with the aforementioned new Act on the Structure and Scope of Ministries and Other Central Government Administration Bodies.
Low-cost loans Financial instruments for regional development of entrepreneurship and alternative sources of SME funding EU projects and grants for SMEs Use of the Competitiveness and Innovation Framework Programme Guarantees	Yes	Continuously	
Stimulating the development of the Croatian Agency for Small Business Stimulating regional development agencies Training and development of a network of consultants Support to the development of entrepreneurial centres, technological parks and business incubators	Yes	Continuously	
Project for the National entrepreneurial learning programme in formal and informal education South East European Centre for Entrepreneurial Learning (SEECLE) Students' entrepreneurial incubators Education for crafts and trades and cooperatives Children's entrepreneurship week Co-financing of universities with specialist entrepreneurial programmes Pupils' cooperatives and pupils' enterprises	Yes	Continuously	
Implementation of projects financed from EU IPA funds under the Regional Competitiveness Operational Programme, component IIIc	Yes	Continuously	

Small and medium-size enterprises in tourism			
Reconstruction, valorisation, and revitalisation of cultural, traditional and natural heritage as new tourist products	Yes	Continuously	The measures were continuously implemented in 2011 on the basis of a Government Program to support small and medium enterprises 2008 -2012. The Incentive system is based on the Promotion of Small Business Development Act (OG 29/02 and 63/07), the adopted plan and budget projections, the legislation governing the establishment of small enterprises (companies, crafts, cooperatives, profit institutions and other entities of SMEs), the State Aid Act (OG 140/05) and by-laws of the State Aid Act and the Act on provision of services in tourism (OG 68/07 and 88/10). All of these programs (except the Programme for training of personnel in the tourism and stimulating tourist events) will continue to be encouraged during 2012 under the new enforcement measures.
Selective forms of inland tourism	Yes	Continuously	
Selective forms of seaside tourism	Yes	Continuously	
Stimulating rural tourism	Yes	Continuously	
Programme for the education and training of tourism workers	Yes	2011	
Programme for the stimulation of new tourist products and destination management	Yes	Continuously	
Programme of incentives in tourism - Incentive for Success	Yes	Continuously	
Programme for the co-financing of investment into tourism infrastructure	Yes	Continuously	
Project for the co-financing of hotel and hospitality industry	Yes	Continuously	
Subsidising the programme for loans to small and medium-sized enterprises in tourism	Yes	Continuously	
Stimulating tourist events	Yes	2011	
Stimulating the manufacture of authentic Croatian souvenirs	No	I quarter 2011	The program is not continued in 2011 because it is concluded that it achieved results. The funds were transferred to other programs.
Stimulating the development of tourist theme paths	No	I quarter 2011	The program is not continued in 2011 because the lack of interest in the program. The funds were transferred to other programs.
Stimulating the placement of environmentally friendly products in tourism	No	I quarter 2011	The program is not continued in 2011 because none of the potential beneficiaries of the program did not meet the criteria. Interest in the program and the response to the tender were lower than expected.
Public-private partnership			
Education of employees of the Agency for Public-Private Partnership	Yes	Continuously	During 2011, Agency employees participated in four workshops organised by SIGMA and related to legal and financial aspects of preparation and implementation of public-private partnership projects. In addition to SIGMA, an internal education programme was carried out on an ongoing basis, covering individual topics of importance for public-private partnership. During the first trimester of 2011, the Register of Public Private Partnership Agreements was established, and data has become available to external users in December 2011. The Agency, as an active member of the working groups of EPEC (European PPP Expertise Centre), participated in the study of European practical experiences related to PPP. One of the working groups resulted in the drafting of the manual entitled "Using EU Funds in PPPs - Explaining How and Starting the Discussion on the Future", which was published on the EPEC website in May 2011.
Setting up the Register of Public Private Partnership Agreements	Yes	I quarter 2011	
Scientific analysis of practical experiences	Yes	Continuously	
Education of participants in the preparation and implementation procedures of public-private partnership projects	Yes	Continuously	During 2011, the system of education on preparation and implementation procedures for public-private partnership projects was established, and the first cycle of seminars entitled "The PPP Project Cycle" was held on 9 and 10 November for the public sector bodies responsible for the preparation and implementation of PPP projects.
Implementation of the Regulation on the criteria for assessing and approving public-private partnership projects	Yes	Continuously	Four proposal PPP projects were approved in 2011, and tender documentation was approved for two of these.
Implementation of the Regulation on the supervision of implementation of public-private partnership agreements	Yes	Continuously	
Coordinating the exchange of knowledge and expertise in the field of public-private partnership in SEECF member countries	Yes	Continuously	The two-day international conference, "Strengthening capacity for public-private partnership", was held in February 2011, and the sub-website for the SEE PPP Network was launched on the website of the Agency for Public-Private Partnership.
FINANCIAL SECTOR			
Banking sector			
Further alignment with the acquis	Yes	December 2010	Drafts were prepared for the Act on Settlement Finality in Payment and Securities Settlement Systems and the Financial Collateral Act, which will complete the transposition of Directive 2009/44/EC in 2012. Preparation for amendments to the Capital Requirements Directive (CRR/CRD IV).
EU legislation monitoring	Yes	Continuously	
Presentations to banks, credit unions and savings banks related to new legislation to be adopted in 2011 and to be implemented from 2012 onwards.	Yes	Continuously	Presentations were held in the second half of 2011 related to reporting pursuant to amendments to the Act on Credit Institutions and relevant subordinate legislation. Establishing a database supporting the collection of data for prudential reporting.
Improving the system of prudential reporting of banks (FINREP, COREP)	Yes	Continuously	
Non-banking sector			
EU acquis communautaire monitoring and alignment where necessary	Yes	Continuously	
Supervision of entities - risk assessment based supervision	Yes	2011 - 2012	
Education of the public and investors	Yes	Continuously	

LABOUR MARKET			
Employment stimulation			
Analysis and independent evaluation of annual employment stimulation plans	Yes	Continuously	In late 2011 external evaluation was carried out concerning the active employment policy measures which were carried out by the Croatian Employment Bureau in 2009 and 2010.
Adoption of the new National Employment Stimulation Plan 2011 - 2012	Yes	2012	In February 2011, the Government of the Republic of Croatia adopted the National Employment Stimulation Plan for the period 2011 - 2012. In 2011, 33,972 persons participated in active policy measures, which represents an increase of 160% compared to 2010, when 13,088 persons were involved.
Social security system			
Proposal for the rationalisation of social benefits, definition of the unique concept of family (household), establishing the common methodology to determine the income level and proposing the income limit for social benefits; proposal for the amendment of certain regulations	Yes	May 2011	Implemented as part of the new Social Welfare Act.
Adoption of the new Social Welfare Act	Yes	May 2011	The Social Welfare Act was adopted in May 2011.
Proposal for an administrative rationalisation of the system with the aim of establishing a single focal point for disbursement of social benefits	Yes	May 2011	As part of the Economic Recovery Programme, the Ministry of Health and Social Welfare drafted the Proposal for administrative rationalisation of the social welfare system with the aim of establishing a single focal point for disbursement of social benefits. The same, however, needs to be done in other systems which handle the recognition of rights to certain social benefits and their disbursement.
Drawing up and adopting a Protocol on the procedure in case of serious neglect of a parent, adoptive parent, guardian or another person pertaining to the responsibility to provide for or care for a child	In progress	2012	The Protocol was not adopted within the planned due date since the organisational structure responsible for its preparation was only established with the recent changes in structure of the Ministry of Health and Social Welfare.
Initiating the procedure for signing and ratification of the Convention on Protection of Children and Cooperation in Respect of Intercountry Adoption (the 1993 Hague Convention)	No	2012	The Proposal Act on Ratification of the Convention on Protection of Children and Cooperation in Respect of Intercountry Adoption was drawn up and will be submitted for adoption. This was not carried out within the planned date, since the technical prerequisites for the implementation of the Convention were only achieved with the recent changes in structure of the Ministry of Health and Social Welfare.
Improving the system of family aid in accordance with the Croatian Population Policy (implementation of regulations under the Population Policy)	Yes	2011	Among the measures carried out under the National Population Policy, implementation continued of the Act on Maternity and Parental Benefits and the Act on Child Allowance. In 2011, the Act on Amendments to the Act on Maternity and Parental Benefits and the Act on Amendments to the Act on Child Allowance were adopted. In addition, the Croatia for Children Foundation, established in 2009, continued its activities.
Continuation of work of the established family centres and their subsidiaries	Yes	2011	All previously established family centres (17) continued its activities, and two new centres were formed.
Ensuring the right of the parent or equivalent person who cares for a child to time benefits and financial benefits with the aim of protecting maternity, infant care and upbringing, and the balancing of family and professional life in accordance with the Act on Maternity and Parental Benefits	Yes	2011	In 2011, the Act on Amendments to the Act on Maternity and Parental Benefits was adopted to reach alignment with the acquis.
Ensuring the right to child allowance which is disbursed depending on total household income and other conditions regulated under the Act on Child Allowance	Yes	2011	In 2011, the Act on Amendments to the Act on Child Allowance was adopted to reach alignment with the acquis.
Providing state scholarships to regular students enrolled in university, vocational and postgraduate courses	Yes	Continuously	
Subsidising transportation costs for regular students and disabled students, subsidising meals and accommodation of students in students' and pupils' halls of residence in the Republic of Croatia	Yes	Continuously	
AGRICULTURAL SECTOR			
More efficient distribution of total budgetary funds earmarked for aid within the sector	Yes	Continuously	A policy for rural development in accordance with the Common Agricultural Policy will be an essential part of the future European policy in Croatia.
Adoption of a new Act which will regulate in a comprehensive manner aid for agriculture and rural development throughout the pre-accession period	Yes	4 November 2011	The Act on State Aid for Agriculture and Rural Development (OG 92/2010) was adopted on 15 July 2010 and entered into force on 1 January 2011. In order to take into account the results of the negotiations, still unknown in mid-2010, the Act on Amendments to the Act on State Aid for Agriculture and Rural Development was adopted in November 2011 (OG 124/2011).
Establishment of the Central Veterinary Information System (SVIS)	In progress	July 2012	The SVIS development project was launched in 2010 with the planned completion date in 2011. Since the establishment of SVIS requires the linking and coordination of a large number of users from various institutions, it is planned to be finalised by 1 July 2012.

Establishment of the Phytosanitary Information System (FIS)	In progress	Continuously until 2015	The FIS development project commenced in 2010 with the planned completion date in 2011. Due to the fact that during the development of FIS, new regulations entered into force in EU in June 2011, the system must be upgraded to include new modules, and must be integrated with other information systems in the field of agriculture, so as to ensure integral support to the phytosanitary service.
Concluding agreements on delegation of official inspection tasks to an inspection body	Yes	30 June 2012	In 2011, the Veterinary Administration continued concluding Agreements on delegation of official inspection tasks to veterinary organisations accredited in accordance with HR EN ISO 17020 as inspection bodies with the aim of establishing a system of official inspections of livestock and animal products aligned with the EU. By the end of 2011, agreements were concluded with 30 inspection bodies which employ a total of 171 authorised doctors of veterinary medicine. By 31 June 2012, 33 more veterinary organisations are planned to be accredited and agreements are to be concluded with them.
Establishment of crisis response centres and their furnishing	Yes	Continuously	Each year, the Veterinary Administration reviews, improves and prepares new crisis plans that contain detailed descriptions and organisation of measures implemented in order to control and eradicate serious infectious diseases. In 2011, the Administration prepared the Crisis plan for Vector-Borne Zoonoses, and tested it in a simulated Rift Valley Fever outbreak.
Collection and safe disposal of animal cadavers	Yes	Continuously	In accordance with the Veterinary Act (Article 48, paragraph 1) animal cadavers and animal by-products not intended for human consumption must be disposed properly, so as not to endanger the lives of people and animals or the environment. In Croatia, utilisation activities are carried out by <i>Agroproteinka d.d.</i>
Implementation of the Programme for monitoring, control and eradication of serious animal diseases and diseases of interest to the EU, including zoonoses	Yes	Continuously	Diagnostic examination of animals with the aim of monitoring, control and eradication of serious animal diseases and diseases of interest to the EU, including zoonoses, is being carried out regularly and on an ongoing basis.
Implementation of veterinary examinations at farms	Yes	Continuously	
Programme for the consolidation of agricultural land in the Republic of Croatia in the period 2009 - 2021	Yes	Continuously until 2021	
Drawing up the Food Processing Industry Development Strategy	No	2012	Activities related to the Strategy were dependent on the drafting and adoption of the Economy Development Strategy, under the responsibility of the Ministry of Economy, Labour and Entrepreneurship. The preparation of the Food Processing Industry Development Strategy could not have commenced before such strategic grounds were laid down. In addition, sufficient funds had not been earmarked in the budget for 2011, hence the appointed Committee did not start drafting the strategy.
Adoption of the National operational programme of subsidies for the food processing sector	No	2012- 2014	The Operational programme was not adopted in 2011 since it is closely related to the adoption of the Food Processing Industry Development Strategy, and also dependent on allocated budgetary funds.
Drawing up the National Strategic Plan and Programme for Rural Development	No	2013	In accordance with the results of the negotiations, this will be prepared for the new programme period 2014 - 2020. Amendments to the Act on State Aid ensured adjustment of the legislative framework.
Financing rural development measures from the state budget	Yes	2013	In accordance with the results of the negotiations.
Financing rural development measures from the IPARD programme	Yes	2013	In accordance with the results of the negotiations.
Implementation of animal marking	Yes	Continuously	
Implementation of measures in accordance with the European Fisheries Fund	Yes	Continuously	In accordance with the results of the negotiations.
Providing equipment for the fisheries inspection service	In progress	2012- 2013	
Drawing up the National Strategic Plan	In progress	2012	
Operational Fisheries Programme	No	2012	The legislative basis for the adoption of the Operational Fisheries Programme is the Act on Structural Aid and Fisheries Market Regulation. As the Operational Programme is the implementing document of the National Strategic Plan, it will be drafted during 2012 in consultation with the European Commission.
Acquisition of vessel monitoring devices	No	2012	Appeals were received to the public tender procedure, and the final decision of the State Appeals Committee is pending. Activities will be taken depending on the final decision.
Drawing up and implementation of a national programme for data collection	Yes	2011	The programme was completed using IPA 2009 pre-accession technical assistance.
Construction and furnishing of permanent veterinary and phytosanitary border crossings	In progress	2011 - 2012	Construction of premises for the needs of veterinary and phytosanitary inspection at Zagreb Airport, Bajakovo and Stara Gradiška border crossings commenced in 2011.

PUBLIC ADMINISTRATION REFORM			
Adjustment of the system of public agencies in line with EU standards	Yes	2011	Reorganisation of agencies was completed pursuant to the Decision on the reorganisation of agencies, bureaus, funds and other legal entities with public powers.
Improvement and implementation of the Public Administration Reform Strategy	Yes	2011 - 2013	Implementation of the Public Administration Reform Strategy for the period 2008 - 2011 continued, as the framework for modernisation and rationalisation of government administration, and preparation started for the drafting of the new strategic document for the following period.
Territorial restructuring and decentralisation of local and regional self-government units	Yes	Continuously	The decentralisation process continued, including collection and updating of data and preparation of preliminary analyses.
Alignment of procedural laws and subordinate legislation with the General Administrative Procedure Act and education of employees for implementation of the GAPA	In progress	2012- 2013	Alignment of 62 special laws with the provisions of the Act on Administrative Procedure is in progress, most have been aligned.
Implementation of the Action plan for the implementation of the Development Strategy for Human Resources in Civil Service for the period 2010 - 2013	Yes	May 2011	The Act on Amendments to the Act on Civil Servants entered into force, improving the evaluation system and increasing the mobility of civil servants.
Regulation of salaries in the public sector through laws and subordinate legislation	In progress	2012	
Continued education in the Centre for professional education and training of civil servants and the State School for Public Administration	In progress	2011	Education of civil servants continued at the Centre for professional education and training of civil servants of the Ministry of Public Administration, and the State School for Public Administration started its activities.
Setting up the management body for the Operational Programme: Building of administrative capacity for use of funding from the EU structural funds	Yes	July 2011	In early July 2011 activities were completed for the implementation of the IPA 2007 twinning project Technical Assistance to the Management Body for the ACD OP, aimed at building capacity of the future management body.
Improving the laws regulating the right to access information	Yes	2011	The Act on Amendments to the Act on the Right to Access Information was adopted, expanding the circle of bodies of public authority, and prescribing the introduction of the test of public interest and proportionality in case of withholding of information.
Unification of data on employees in the public sector	Yes	2011	The Act on the Register of Employees in the Public Sector was adopted, the register of employees was established and data entry is under way.
OTHER REFORMS			
Development of a knowledge-based society			
Increasing the number of children and youth in the educational system	Yes	school year 2011/2012	In 2011, 12 new kindergartens and 52 new subsidiaries of existing kindergartens were opened, and approvals were granted for 362 new programmes. During this period, approximately 4000 children were enrolled in pre-school institutions.
Drawing up the National Curriculum	Yes	20 July 2011	The National Curriculum was adopted on 20 July 2011. Subject/inter-subject curricula are being drawn up on the basis of this document.
Carrying out the state matriculation examinations	Yes	summer round (24 May -13 June 2012); autumn round (22 August - 7 September 2012); winter round (13 - 20 November 2012)	State matriculation examinations were carried out successfully, as well as admissions to higher education institutions. The passing grade threshold of 27% was higher in comparison to the previous year. 30,965 students sat for the examinations in the summer round, and 3,730 in the autumn round. The number of applications from vocational school students increased (95%). The average score increased in comparison with 2010.
Implementing the national pedagogic standards in accordance with feasibility coefficients	Yes	school year 2011/2012	Achievement of the Standard coefficients is monitored systematically. The number of students in classes is in accordance with the coefficient, the number of schools operating in three shifts is being reduced, with only 17 out of 873 schools (2.06%) working in three shifts in the school year 2011/2012. All newly constructed objects are in accordance with the criteria of the National Pedagogic Standard.
Increasing the number of participants in adult education programmes in accordance with the demands of the economy	Yes	school year 2011/2012	Primary education was financed for 1,395 participants as part of the project "For a Literate Croatia".
Developing a quality assurance system	Yes	school year 2011/2012	National examinations and state matriculation examinations are being carried out, participation in external evaluation (PISA, PIRLS, TIMMS).
Developing professional and university programmes in line with the demands of the economy and the labour market	Yes	academic year 2011/2012	Accreditation to provide course programmes is being carried out on an ongoing basis.
Improving the guarantees of quality in the higher education system	Yes	academic year 2011/2012	External evaluation of new course programmes is being carried out. Activities are in progress for the introduction of programme agreements.
Strengthening the cooperation between the higher education system and the private sector	Yes	academic year 2011/2012	Connections are being established between accredited course programmes of the private and public sector.
Encouraging and strengthening the integration of universities	Yes	academic year 2011/2012	A series of activities has been carried out, including the pilot project for the introduction of programme agreements, the international conference on management of higher education institutions, participation in the implementation of TEMPUS "ACCESS" project. Preparations for the IPA project related to the reform of financing of the Croatian universities have been conducted.
Carrying out external evaluation of the quality of higher education institutions	Yes	October 2011	The Agency for Science and Higher Education became a full-fledged member of the European Association for Quality Assurance in Higher Education (ENQA).

Encouraging the development of centres of excellence and scientific infrastructure	No		No funds were available for the development of excellence centres. The development of scientific infrastructure was encouraged according to possibilities.
Encouraging the commercial application of research findings, and the transfer of knowledge and technology, to ensure long-term development of the economy	Yes	academic year 2011/2012	Activities related to TEHCRO, POC, IRCRO and EUREKA programmes were carried out. The project for the European Entrepreneurs Network was carried out, and the project for the Biosciences Technology Commercialisation and Incubation Centre was initiated.
Building potential in science and technology	Yes	academic year 2011/2012	Projects are being carried out under the Science and Innovation Investment Fund.
Health care reform			
Restructuring of the hospital system (outsourcing the activities unrelated to health care)	In progress	2015	Outsourcing has already been implemented in some hospitals. Expenditure for staff other than health workers is already rationalised. To be implemented by 2015.
Drawing up and implementation of the "Master Plan" for health care institutions	In progress	2014	A project has been launched aimed at the preparation of the "Master Plan" for health care institutions and the human resource strategy for the health care sector with a plan of investment into human potential in health care.
Supervision of sick leave expenditure	In progress	Continuously	Inspections which were carried out to verify the justifiable need for sick leave in primary health care resulted in reduced rate of sick leave, and consequently lower sick leave expenditure.
Completing the informatization of the primary health care system	In progress	June 2012	The informatization of primary health care is planned to be completed by 1 June 2012. In 2011, ePrescriptions were introduced in pharmacies and general practice/family surgeries, and eReferrals in general practice/family surgeries and biochemistry laboratories in primary health care. Primary health activities in gynaecology, paediatrics and dental medicine were connected to the central IT system of primary health care. In July 2011 an assessment was carried out of the status/level of informatization of the hospital system. The Plan of implementation and integration of existing hospital information systems into the central health care information system is currently being prepared.
Purchasing medical equipment and furnishing hospital premises	In progress	2014	Activities have commenced on renewing old medical equipment, construction of new health care facilities, and finalisation of construction projects under way.
Reorganisation of emergency medical services and construction of unified emergency reception premises	In progress	2013	After completing the first phase of reorganisation of emergency medical services, the process was continued in the entire territory of Croatia.
Reform of the Judiciary			
Enrolment of the first generation of students in the National school for judicial officials	Yes	28 February 2011	The first generation of students in the National school for judicial officials currently numbers 58 candidates (39 candidates for judges and 19 candidates for deputy state attorneys), since 2 out of 60 originally enrolled students withdrew due to personal reasons. In September 2011, the call for applications was published for the second generation of students (20 candidates for judges and 35 for deputy state attorneys).
Carrying out activities for the establishment of two-instance administrative court procedures	In progress	2012	Premises of the Administrative Court in Zagreb are fully furnished and ready for use. According to the plan, by 31 December 2011 judges are to be appointed, staff recruited and all necessary equipment is to be purchased for the remaining administrative courts (Rijeka, Split, Osijek), so that they could commence their activities on 1 January 2012, without delays.
Further rationalisation of municipal and misdemeanour courts and state attorney's offices and rationalisation of the network of county and commercial courts	In progress	2019.	Physical merging of the permanent services have been carried out for 20 municipal courts, all county state attorney's offices and 15 municipal state attorney's offices. Physical merging was also carried out for 9 misdemeanour courts.
Implementing activities for the commencement of public enforcement agents' activities	In progress	2012	71 public enforcement agents have been appointed pursuant to a public selection procedure. In November, the Ministry of Justice announced a new call for applications for a total of 100 public enforcement agents in the entire territory of Croatia.
Strengthening administrative and accommodation capacity of the prison system	In progress	Continuously	Trainees and civil servants of the Prison System Administration are educated on an ongoing basis at the Education Centre. In June 2011, extension and adaptation works were carried out of the Glina correctional facility, which can now accommodate 800 users.
Carrying out activities in order to fully implement the probation system	In progress	2012	Following a public selection procedure, 20 probation officers were recruited and are currently undergoing training under an IPA 2008 funded project. All probation offices are planned to be fully staffed and equipped during 2012.
Introduction of ICMS and CTS in courts and state attorney's offices	In progress	2013	The IPA-funded project for the introduction of ICMS in the remaining municipal courts is planned to be implemented during 2012. Upgrading of the system in the framework laid down by the Act on Criminal Procedure is also planned for this period. The process of upgrades and improvement of CTS started in July 2011 and it will be fully implemented in all state attorney's offices in Croatia by the end of 2013.

Construction of the Justice Square in Zagreb and Split	In progress	Continuously	The construction of the Justice Square in Split is planned to be financed using a World Bank loan, and a call for tenders is expected in the first trimester of 2012. Activities related to the Justice Square in Zagreb comprise the utilisation of a grant by the Kingdom of the Netherlands to carry out geomechanical soil analyses and prepare a study on the financing options for construction.
Construction and remodelling works at the Municipal Court in Karlovac	In progress	2013	Although the project was planned to be carried out in 2012 according to last year's PEP 2011 - 2013, due to changes in the project documentation the call for tenders for the works is planned to be announced in the second trimester of 2012, and completion is planned by the fourth trimester of 2013.
Construction and remodelling works at the premises of the State Attorney's Office/Office for the Suppression of Corruption and Organised Crime (USKOK) in Zagreb	In progress	2012	Works are under way; completion is planned in the second trimester of 2012.
Remodelling works at the Municipal State Attorney's Office in Pula	In progress	2012	Works are under way; completion is planned in the second trimester of 2012.
Purchasing IT equipment for judicial bodies	In progress	2012	In 2011 three calls for tender were published for the procurement of IT equipment for judicial bodies (financed from the State Budget and a World Bank loan). Delivery of equipment is in its final stage.
Entry into force of the new Criminal Procedure Act	Yes	2011	For the purposes of implementing the provisions of this Act, the Ministry of Justice has secured the required equipment financed from the state budget and IPA 2008 funds.
Further strengthening of the free legal aid system	In progress	2012	In July 2011 amendments were adopted to the Act on Free Legal Aid, which eliminated certain deficiencies of the system of free legal aid, and took into consideration the decisions of the Constitutional Court in relation to certain provisions of the Act. In 2011 the IPA 2009 funded project was launched aimed at providing further recommendations for improvement of the free legal aid system.
Implementation of the Action Plan accompanying the Anti-Corruption Strategy	In progress	Continuously	Measures laid out in the Action Plan are being carried out in accordance with planned dates.
Environmental protection			
Assessment of air quality according to the criteria laid down by the new Directive 2008/50/EC on ambient air quality and cleaner air for Europe, and review of the division of the Croatian territory into designated areas and populated areas according to air quality categories. Determining designated areas and populated areas where PM10 limit values could be exceeded due to winter salting.	In progress	2011	The new Air Protection Act (OG 130/11) fully transposes the remaining provisions of Directive 2008/50/EC. Preparation of the draft version of the Air Quality Assessment according to the criteria of the new Directive on ambient air quality and cleaner air is in its final stage. Document is planned to be finished in 2012. Once the document is finalised, the need for a revision of the Regulation on the division of the territory of the Republic of Croatia into zones and agglomerations will be assessed. As part of a G2G project with the Netherlands entitled "Implementation of the CAFE Directive" (deadline: IV quarter 2012), the contribution is being assessed of winter salting and sanding or natural sources to the exceedance of limit values for PM10. The Environmental Protection Agency is the main beneficiary of the project, which is also participated by the Ministry of Environmental Protection, Physical Planning and Construction, and the Croatian Meteorological and Hydrological Service. The project is to be completed in May 2012. Once the document is finalised, the need will be assessed for a revision of the Regulation on the division of the territory of the Republic of Croatia into zones and agglomerations according to categories of air quality, for agglomerations where PM10 limit values are exceeded due to salting or natural sources.
Development and upgrading of the air quality information system (as part of the Environmental Protection Information System)	Yes	2011 - Continuously	
Maintaining the greenhouse gas emission registry	Yes	2011 - Continuously	
Involvement in the greenhouse gas emission trading system	In progress	Full implementation upon accession to the EU	In the last trimester of 2010, amendments were adopted to the 2008 Regulation on greenhouse gas emission quotas and the method of emission allowance trading. From 1 January 2010, operators started monitoring greenhouse gas emissions. The operators report on greenhouse gas emissions from their facilities in accordance with the Regulation on greenhouse gas emission quotas and the method of emission allowance trading (OG 142/08, 113/10) and the legally binding instructions.
Annual assessment of air quality at designated areas and in populated areas on the territory of the state	Yes	2011 - Continuously	
Drawing up the Action Plan for reduction in air pollution by ground-level ozone in designated and populated areas of the Republic of Croatia	In progress	2011	In 2010, the draft Action Plan for reduction in air pollution by ground-level ozone was prepared, and will be submitted for adoption in 2011 after the text is aligned.
Inclusion of airplane activity in the system of greenhouse gas emission and tonne kilometres reporting system (drawing up the monitoring plan, emission monitoring, drawing up emission reports)	Yes	2011 - 2013	
Collecting the Reports on greenhouse gas emissions from industrial facilities	Yes	Continuously	

Development of action plans for the reduction in airborne particulate matters (PM) and NOx for specific areas in the Republic of Croatia	In progress	2012	Under a bilateral project of the Republic of Croatia and the Flemish Government, a project was proposed in 2009 entitled "Support to the preparation of the national Action Plan for the reduction in airborne particulate matters and NOx in the Republic of Croatia (Directive 2008/50/EC)". The project was approved by Belgium in March 2010. The planned project duration is until February 2012. The aim of the project is to provide expert and technical assistance to local self-government units in the adoption of action plans pursuant to the Air Quality Act. The planned deadline for preparation of action plans for designated areas (agglomerations) where PM and/or NOx values are exceeded is by the end of the project.
Training for reporting under the Directive on ambient air quality as part of the G2G project "Implementation of the CAFE Directive in the Republic of Croatia"	Yes	30 June 2012	Project activities have been initiated and will continue in 2012.
Construction of county/regional waste management centres	In progress	Continuously	A total of 102 municipal landfill sites were rehabilitated by the end of 2011, co-financed by the Environmental Protection and Energy Efficiency Fund.
Rehabilitation of municipal landfill sites through transformation for other use, continued use or shutdown	In progress	Continuously	
Drawing up the Report on the status of the environment in the Republic of Croatia for the period 2005 - 2008	In progress	I quarter 2012	The Report was adopted by the Croatian Government and is to be adopted by the Parliament.
Drawing up further guidelines and training for the implementation of EIA and SEA procedures	Yes	Continuously	A part of the training and guidelines related to SEA at the regional and local level is included in the IPA 2010 project "Building capacity for strategic environmental assessments at the regional and local level". The project is planned to start in 2012.
IPA 2007 - Building capacity for the implementation of SAPARD (measures 1 and 2) and IPARD programme (measures 101 and 103)	Yes	1 November 2011	In 2011 tender documentation was prepared and accepted by the Delegation of the EU. The invitation to tender for the project was announced in October 2011, bid evaluation is in progress.
IPA 2010 - Building capacity for the implementation of strategic environmental assessment at the regional and local level	Yes	2011 - 2013	
Development and setting up of the information system on the quantity and quality of waters, and its integration into the Environmental Protection Information System	No	2012 - Continuously	This measure, the measure "Establishment of the reporting system on waste waters", and the measure "Alignment and establishment of the reporting system on the quality, quantity and use of waters and waste waters in accordance with WISE (Water Information System for Europe) requirements", have been reformulated into a single implementing measure, which has been foreseen in the matrix of implementing measures for the upcoming period.
Establishment of the waste water reporting system	No	2012 - Continuously	This measure, the measure "Development and setting up of the information system on the quantity and quality of waters", the integration of the Water Information System into the Environmental Protection Information System, and the measure "Alignment and establishment of the reporting system on the quality, quantity and use of waters and waste waters in accordance with WISE (Water Information System for Europe) requirements", have been reformulated into a single implementing measure, which has been foreseen in the matrix of implementing measures for the upcoming period.
Drawing up and adopting the Water Areas Management Plan	No	2012	The Draft Plan was prepared and adopted in December 2010. The final draft of the Water Areas Management Plan cannot be finalised before the Decision on designating vulnerable areas has been adopted, and the Strategic environmental assessment has been carried out in relation to the Water Areas Management Plan.
Alignment and setting up of the reporting system on the quality, quantity and use of waters and waste water in accordance with WISE (Water Information System for Europe) requirements	No	2012 - Continuously	This measure, the measure "Development and setting up of the information system on the quantity and quality of waters", the integration of the Water Information System into the Environmental Protection Information System, and the measure "Establishment of the waste water reporting system", have been reformulated into a single implementing measure, which has been foreseen in the matrix of implementing measures for the upcoming period.
More intensive implementation of water protection measures, especially with respect to the preparation and implementation of infrastructural water protection projects; rehabilitation and completion of the existing and building of new public drainage systems	Yes	Continuously	Construction projects are under way for new public drainage facilities, co-financed from ISPA and IPA programmes, and projects co-financed from the structural funds are being prepared.
Reduction in losses in the existing water supply systems and an increase in connections to the public water supply systems (regional water supply systems), rehabilitation and completion of the existing and building of new water supply systems	Yes	Continuously	Construction projects are under way for new water supply facilities, co-financed from ISPA and IPA programmes, and projects co-financed from the structural funds are being prepared.
Continued activities to establish spring area sanitary protection zones	Yes	Continuously	The Ordinance on criteria for establishing spring area sanitary protection zones was adopted (OG 66/11).
Renovation of existing and construction of new public irrigation structures	Yes	Continuously	Rehabilitation/reconstruction projects for existing systems, and construction of new systems in accordance with NAPNAV, are under way.

Strengthening/reform of the existing system of water management financing and ensuring an increase in annual allocations (adoption of new subordinate legislation based on the Act on Water Management Financing)	Yes	23 September 2011	Regulation on the maximum amount of the fee for connection of buildings and other property to municipal water facilities (OG 109/11).
Strengthening of water management planning - drawing up and adoption of the Water Areas Management Plan	No	2012	The Draft Plan was prepared and adopted in November 2010. The final draft of the Water Areas Management Plan cannot be finalised before the Decision on designating vulnerable areas has been adopted, and the Strategic environmental assessment has been carried out in relation to the Water Areas Management Plan.
Increasing investment into the construction of water regulation and safety structures and structures for basic melioration drainage	Yes	Continuously	Rehabilitation and construction of water regulation and safety structures and structures for basic melioration drainage is in progress.
Drawing up the annual National Report on Monitoring of the Adriatic Sea	Yes	15 December 2011	Due to insufficient funds, since 2009 only the Report on the quality of sea bathing water in the Republic of Croatia is prepared. The database has been established, aligned with EEA requirements, and is maintained regularly. The Regulation on the establishment of the framework for action in the Republic of Croatia related to the protection of the marine environment has been adopted. In 2011 conditions were fulfilled for the definition of good environmental status by defining the status and pressures on the marine environment. In 2011 conditions were fulfilled for the definition of the series of targets and associated indicators by defining the status and pressures on the marine environment. The database will be aligned with the requirements and ready to support to the System of monitoring and observation for continuous assessment of the marine environment. The activity is foreseen for Phase II of the project and will be carried out by the date of establishment of the System of monitoring and observation for continuous assessment of the marine environment. Phase II of the project is planned to start in May 2012.
Drawing up the annual report, brochure and chart on the quality of beach seawater	Yes	15 December 2011	
Establishing and maintaining the national Database for input, processing and valorisation of data on the quality of sea bathing water, reporting and providing information to the public	Yes	Continuously	
Drawing up the implementing regulation on the establishment of the framework for action in the Republic of Croatia related to the protection of the marine environment	Yes	6 October 2011	
Drawing up the assessment of environmental status and the pressures on the marine environment	Yes	15 June 2011	
Determining the good environmental status of the marine environment	No	15 July 2012	
Establishing the series of environmental targets and associated indicators	No	15 July 2012	
Establishment and further development of the Sea Information System; Database and indicators of the environmental status of the marine environment, mariculture and fisheries; reports on the environmental status of the sea; upgrading of IT support for the purposes of implementation of the Marine Strategy Framework Directive, i.e. the national implementing regulation	No	15 July 2014	
Adjustment of software support and the modelling and monitoring data from Phase I of the Project for protection against seaside water pollution for use by expert institutions and the interested public	No	15 July 2014	
Strengthening the monitoring system for the quality of seaside water (Project for protection against seaside water pollution) phase II	No	15 May 2012	
Improving the nature protection system - alignment of reporting in accordance with the international level	In progress	2012 - Continuously	Activities have been initiated and will continue in 2012.
Protection of natural values - Reporting on protected areas (CDDA)	Yes	2011	The reporting system has been established.
Protection of new areas, revision of the existing areas; Development of the system of protected areas, revision and digitalisation of the boundaries of protected areas	In progress	Continuously	In the reporting period, the management plan for the Krka National Park (February 2011) and the management plan for the Papuk Nature Park (June 2011) were adopted, laying down the management goals, implementation, and monitoring of implementation with a cost assessment for the implementation of planned measures for a ten-year period. Two regional parks were established: the Mura - Drava Regional Park (February 2011) and the Moslavačka gora Regional Park (June 2011). With the aim of establishing an optimal model of preservation of protected areas, activities continue related to improvement of visitor infrastructure in protected areas, and drafting of remaining management plans for national parks and nature parks. For a part of the activities (visitor centres) which are to be financed from the structural funds, project documentation is being prepared. In cooperation with the State Geodetic Administration, activities are carried out related to official spatial databases, registration of special legal regimes, and IT connectivity. A Coordination Board and two Working Committees have been established. The contract was awarded for the delineation of boundaries at the following pilot locations: Trakošćan Park Forest and Castle, Đurđevac Sands, The Old Town of Ružica, and the historical centre of the City of Požega.
Management of areas in the environmental network of the Republic of Croatia, establishing the European environmental network „NATURA 2000“, drawing up the management framework and setting up monitoring of the status	In progress	Continuously	The draft proposal of NATURA 2000 areas (draft proposal of SPA and pSCI areas), prepared by the State Institute for Nature Protection, was updated in June 2011. Results of new research are being integrated into the draft proposal on an ongoing basis. New data is being integrated related to forest habitat types in cooperation with the forestry sector.
Implementation of the Management Plan for Wolf and Lynx	In progress	Continuously	Implementation of the Management Plan for Wolf and Lynx is ongoing.

CITES implementation activities	In progress	Continuously	Further activities were carried out related to strengthening capacity for the implementation of CITES legislation, through further strengthening of inter-sectoral cooperation and primarily through activities of the CITES Committee, and education of the nature protection inspection service was carried out for use of the web database for monitoring trade and international trade in endangered species, with the aim of strengthening control. Representatives of the Ministry of Culture, State Institute for Nature Protection, and Ministry of Finance - Customs Administration participated in EC Committees as observers (The Committee on Trade in Wild Fauna and Flora, Scientific Review Group and the Enforcement Group).
Establishing the fauna and speleology databases (CRO fauna and CRO speleo) as part of the Environmental Protection Information System (IPA TAF 2007)	In progress	2011 - 2012	In the reporting period (the project was launched in January 2011), the Inception report was adopted, the Interim report was prepared, and workshops were held with speleological societies for the CRO speleo database, and with fauna experts for the CRO fauna database. Database development is under way.
Strengthening capacity for preparation of management plans, and strengthening nature protection supervision activities for the proposed NATURA 2000 areas (IPA TAIB 2009)	In progress	2011 - 2013	Analysis and verification of technical specifications for the required equipment was carried out in respect of the component "Development of the national information system for nature protection supervision" (TWL agreement launched in July 2011). For the component Natura MANMON (Natura management and monitoring) (technical assistance agreement launched in October 2011), preparation of the Inception report is under way. The procurement process for the equipment for the nature protection supervision system (SUP agreement) is under way.
World Bank Project Preparation Facility Advance (IBRD P4500-HR) for the Project for the integration into the EU NATURA 2000 network	Yes	19 May 2011	In the upcoming period, implementation will continue of the five-year Project for the integration into the EU NATURA 2000 network (May 2011 – April 2016).
Identification and establishment of marine areas in the NATURA 2000 network (IPA TAF 2007)	Yes	22 December 2011	In the course of project implementation, a detailed programme was prepared for the completion of the marine portion of the NATURA 2000 network in Croatia, a research programme and a programme for monitoring the status in two pilot areas were drawn up, and capacity was strengthened for the cataloguing of biodiversity of the sea and establishment of the marine portion of the NATURA 2000 network.
Act on Amendments to the Chemicals Act (OG 49/11)	Yes	29 April 2011	The IPA 2007 project "Chemical Safety" was launched with an initial meeting in early September 2010, and meetings are still held on an ongoing basis with the technical assistance experts. The ECHA IPA 2009 project, financed by the European Commission with the aim of including representatives of EU candidate countries (Croatia, Turkey, Macedonia) and preparing them for work in committees of the European Chemicals Agency, launched the first round of meetings in March 2010 in Zagreb, the second round in Helsinki in August 2010, and the third round in August 2011 in Zagreb, including Serbia in addition to the abovementioned countries. The projects will continue in 2012.
Ordinance on compilation of safety data sheets (OG 39/09, 74/11)	Yes	30 March 2011	
List of hazardous chemicals prohibited or restricted for marketing (OG 17/06, 39/10, 37/11)	Yes	30 March 2011	
Ordinance on classification, marking, labelling and packaging of hazardous chemicals (OG 23/08, 64/11)	Yes	10 June 2011	
Ordinance on amendments to the Ordinance on the list of existing active substances permitted in biocidal products (OG 28/09, 36/10, 31/11)	Yes	16 March 2011	
Ordinance on amendments to the Ordinance on the list of existing active substances not permitted in biocidal products (OG 28/09, 36/10, 31/11)	Yes	16 March 2011	
List of biocidal products approved for marketing (OG 72/11)	Yes	28 June 2011	
Regulation on amendments to the Regulation on the minimum threshold for genetically modified organisms in products below which the products placed on the market shall not have to be labelled as products containing genetically modified organisms (OG 88/11)	Yes	27 July 2011	
Implementation of the national plan for chemical safety	Yes	2012	
Authorisation procedure for legal entities to perform expert noise protection activities, professional exams in the field of noise protection, and continued development of strategic noise maps and action plans	In progress	Continuously	Due to the prerequisites of accreditation to receive authorisation for legal entities to perform expert noise protection activities.
Review of the National Forestry Policy and Strategy	No		The measure was not carried out due to insufficient funds, and is not planned in the upcoming period.
National Forestry Programme	No		The measure was not carried out due to insufficient funds, and is not planned in the upcoming period.
Programme of measures for data collection and establishment of the registry of forest damage	Yes	Continuously	Construction works were partially carried out in furnishing laboratory premises, and a part of the equipment required for physical and chemical analyses was procured.
Establishing and maintaining a unique information system and registry of forest fires	Yes	Continuously	Taking into account the organisational changes, analysis was carried out of the required modifications and upgrades of the information system.