

**DOCUMENT OF THE EUROPEAN BANK  
FOR RECONSTRUCTION AND DEVELOPMENT**

# **STRATEGY FOR CROATIA**

**As approved by the Board of Directors at its meeting on 14 May 2007**

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## ABBREVIATIONS

CEB	Central Europe & Baltics
CEDB	Council of Europe Development Bank
CFCU	Central Financing and Contracting Unit
EC	European Commission
EIB	European Investment Bank
ESCO	Energy Service Company
ETS	Emissions Trading System
EU	European Union
EU's CAP	The Common Agricultural Policy of the EU
EUR	Euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEF	Global Environment Facility
HAMAG	Croatian Agency for Small Business
HBOR	Croatian Bank for Reconstruction and Development
IAS	International Accounting Standards
IBRD	International Bank for Reconstruction and Development
ICTY	International Criminal Tribunal for former Yugoslavia
IDP	Internally Displaced Person
IFC	International Financial Corporation
IFI	International Financial Institution
ILO	International Labour Organisation
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
IPO	Initial Public Offering
ISPA	Instrument for Structural Policies for Pre-Accession
JSC	Joint Stock Companies
MEI	Municipal and Environmental Infrastructure
MSMEs	Micro, Small and Medium Enterprises
NATO	North Atlantic Treaty Organisation
NBFI	Non-Bank Financial Institutions
OECD	Organisation for Economic Cooperation and Development
OSCE	Organisation for Security and Co-operation in Europe
PAL	Priority Action Plan (re: environment)
PAP	Programmatic Adjustment Loan (IBRD)
PAYG	Pay-As-You-Go (pension scheme)
PPP	Public-Private Partnership
SMEs	Small and Medium Enterprises
TAM	Turnaround Management Programme
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNHCR	United Nations High Commissioner for Refugees
UNIDO	United Nations Industrial Development Organisation
USD	United States Dollar
VAT	Value Added Tax
WWT	Waste Water Treatment

**Exchange Rate      HRK 7.345 = EURO 1**

## **EXECUTIVE SUMMARY**

Croatia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank.

On 3 October 2005 the European Council announced that negotiations for Croatia's EU accession could begin forthwith and talks with the EU duly started. Croatia had already had its candidacy application for EU membership approved at the EU leaders' summit in Brussels on 17 June 2004. However, in December 2004 the European Council, while approving in principle the opening of official talks on Croatia's EU accession, stipulated that the Croatian authorities should be deemed to be fully cooperating with the International Criminal Tribunal for the Former Yugoslavia (ICTY) at The Hague. The October 2005 decision reflected ICTY's confirmation that such cooperation was indeed forthcoming. The arrest in December 2005 of General Ante Gotovina, the fugitive war crimes suspect, and his extradition to The Hague, paved the way to the commencement of accession talks. Croatia may be expected to join later in the decade depending on its own merits and ability to comply with the conditions for EU membership, as well as EU's integration capacity.

Getting EU candidacy status and the opening of EU talks represented a notable political success for Ivo Sanader, Prime Minister since the victory of his centre-right party, the HDZ, in the November 2003 elections. Sanader has continued the previous centre-left government's policy of improving relations with Serbia (as well as the Serbian and other minorities in Croatia). Sanader's minority government continues to rely on the support of parties representing old-age pensioners and national minorities.

The economic outlook remains positive, although the fiscal deficit and high external debt pose continuing risks. Real GDP growth reached 4.3 per cent in 2005, and increased to 4.8 per cent in 2006. Private investment more than offset the impact of declining public investment and exports performed better than expected.

There was some upward pressure on prices in 2005, mainly due to rising energy and food costs as well as higher excise taxes. This led to an increase in annual average inflation from 2.1 per cent in 2004 to 3.3 per cent in 2005. The inflation rate dropped slightly to 3.2 per cent in 2006. The Croatian National Bank (CNB) remains committed to tight monetary policies, mainly aimed at exchange rate stability. The general government deficit in 2005 was below the target of 4.2 per cent of GDP (it was actually 4.0 per cent of GDP), and decreased to the target of 3.0 per cent in 2006 according to the preliminary estimates.

Sustained growth of between 3-5 per cent is forecast for the medium term, assuming some improvement in the external environment. The fiscal consolidation programme, as outlined in the Government's Economic and Fiscal Policy Guidelines 2007-2009, is expected to help the government to strengthen fiscal discipline, further reduce the current account deficit and cut the level of external indebtedness. The main risk to growth stems from the strong expansion in domestic credit and the growing corporate and commercial banks' external indebtedness. These may have a negative effect on the already high foreign debt levels and may create appreciation pressures.

In the coming two years, the Republic of Croatia faces important challenges to prepare for EU Accession. These include restructuring and privatisation of industries which benefit from generous government subsidies. Small scale privatisation - including the tourism sector - needs to be completed. Further reform is needed to improve the effectiveness of the judiciary and to reduce corruption. Significant levels of investment in public infrastructure will be necessary. To address such challenges, the Croatian authorities should:

1. enhance regional trade and development by investing in regional transport infrastructure and continuing support for regional trade initiatives;
2. proceed with restructuring in sensitive sectors, e.g. agriculture and shipbuilding;
3. privatise enterprises in the tourism sector and update and fully implement the existing "Croatian Tourism Development by 2010" strategy adopted by the Government in September 2003;
4. promote private sector participation in infrastructure at national, regional and the local, municipal levels;
5. promote investments in infrastructure to improve security and diversity of energy supply, energy efficiency and put in place legislation to facilitate development of the market for renewable energy;
6. strengthen efforts to enhance transparency and efficiency of the judiciary and public administration to meet EU standards.

Since the last Country Strategy, the Bank's commitments in Croatia have increased to an aggregate of EUR 1.74 billion, with nearly EUR 3 billion mobilised from the Bank's co-financiers and partners. Since 1999 the Bank has invested an average of EUR 150 million a year in Croatia. Gross disbursements totalled EUR 1.3 billion while the Bank's outstanding portfolio as of 31 December 2006 was EUR 840 million. In line with the previous Strategy (2005-2006), the Bank has substantially increased its involvement in the enterprise sector and in infrastructure, including at the municipal level. The Bank's operations have had good transition impact through continuous policy dialogue with the authorities, preparation of projects for ISPA co-financing, improvement in corporate governance standards at enterprise level, enhancement of regional economic integration, and support for capital markets development. In 2006 the Bank supported the largest regional food and beverage company, Agrokor, with an equity investment to assist its preparation for an initial public offering.

Over the coming two to three years, the Bank has an opportunity to work closely with the Croatian authorities, to support the country's further transition to market economy. Focus will be on investment in the following sectors, with the highest priority given to regional support for Croatian corporates, commercial finance of national and municipal infrastructure, SME finance, and tourism.

In *the enterprise sector*, the Bank will focus on privatisation and restructuring of state-owned companies, including in the tourism sector. In addition, the Bank will focus on supporting the further expansion and modernisation of Croatian companies in the region, by providing debt or equity finance as needed. The Bank may also finance acquisitions to support consolidation in local industries. The Bank will

continue to seek investment opportunities in economically-depressed regions of the country.

*In the infrastructure and environment sector*, at the local level, the Bank will work with a number of large and medium-sized municipalities to develop their infrastructure projects for prospective IPA co-financing. The Bank will continue to support national infrastructure projects, typically when such projects can be financed on a commercial basis. The Bank will also work with local and regional authorities to prepare regional infrastructure projects. The Bank will finance infrastructure investments, such as the Port of Gruz project in Dubrovnik, which support tourism. In the energy sector, the Bank will promote energy efficiency and focus on infrastructure needed for security and diversity of supply, including renewable energy projects. Infrastructure financing will be closely co-ordinated with other IFIs, in particular the European Investment Bank, the IBRD and the EU, leading to joint financing arrangements and mobilisation of IPA funds, where practicable.

*In the financial sector*, the Bank will pursue SME finance with the support of the EU under the EU/EBRD SME Finance Facility. The Bank will further develop financing for leasing companies and other non-bank financial institutions, such as factoring companies. The Bank will seek to introduce securitisation of assets, to help the Croatian banks better manage their balance sheets. Finally, the Bank will also consider equity participation in the privatisation of the state-owned postal bank and insurance company.

## **1. THE BANK'S PORTFOLIO**

### **1.1 Overview of Activities to Date**

As of 28 February 2007, the Bank had made commitments in total of EUR 1,739.7<sup>1</sup> million across all sectors of the Croatian economy, with a concentration in the financial sector and in infrastructure. The portfolio currently consists of 78 operations of which EUR 1,035.5 million are commitments in the private sector. Infrastructure accounts for the majority of State sector commitments at EUR 628.5 million. Operating assets at EUR 840 million lag commitments due to the staged nature of investments in many infrastructure projects.

### **1.2 Implementation of previous Country Strategy**

The last Country Strategy, approved in March 2005, outlined the following strategic priorities for the Bank in Croatia:

- (1) financing of infrastructure with a focus on transport (including railways) and municipal and environmental infrastructure with the EU ISPA programme;
- (2) target financing of micro and small enterprises through banks and leasing companies with the introduction of the EU/EBRD SME Finance Facility. Risk-sharing instruments and securitisation of receivables may be introduced;
- (3) privatisation and restructuring of state-owned enterprises, in particular in sensitive sectors, and tourism, as well as continuing support for strong local enterprises in their regional expansion efforts.

During the past Strategy period, 11 direct investments were signed representing commitments of EUR 332 million. Corporate financing included a EUR 110 million equity investment in the food and beverage company, Agrokor, to facilitate its preparation for an initial public offering, and a loan for the Serbian subsidiary of Croatian dairy company Dukat (formerly Lura). Infrastructure operations included a loan of EUR 10 million for the water treatment company of the City of Karlovac, for which EU ISPA funding of EUR 22.5 million was committed, a loan to upgrade the Port of Gruz in Dubrovnik, a loan to Croatian Roads for the Rijeka Bypass, a loan for the completion of Zagreb-Rijeka Motorway, and a loan to Pula Promet to secure new city buses. In the financial sector, the Bank's operations included credit lines to Hrvatska Postanska Banka (HPB) and to S-Leasing and Raiffeisen Leasing for financing SMEs, as well as an increase in the capital of Privredna Banka Zagreb. The Bank continued to focus on improvements in the corporate governance and financial performance of companies where it is a shareholder. The proportion of equity in the outstanding portfolio is large relative to many other markets at circa 40 per cent.

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<sup>1</sup> The figure above excludes committed amounts which were subsequently cancelled. Gross commitments amounted to EUR 1,922 million.

## 1.3 Impact of the Bank's Portfolio and Lessons Learned

### 1.3.1 Transition impact and lessons learned

The Transition Impact Retrospective 2 shows that the impact of the EBRD projects has ranged from significant to minimal over the last review period. Transition impact in each sector is reviewed below.

### 1.3.2 The Financial Sector

#### **Banking**

The Bank's projects aimed at developing new financial instruments including capacity building for lending to small and medium-sized municipalities. Mortgage lending was supported via mortgage credit lines to three banks, Zagrebacka Banka, Privredna Banka Zagreb and HVB Bank Croatia. The banking sector is largely consolidated with 93 per cent of banking assets in foreign ownership and with only two small commercial banks remaining in state ownership. One of the *lessons learned* from the successful cooperation with HVB Bank is the need for a pro-active approach in the field of mortgage reforms. The Bank is advised to address institutional and administrative inefficiencies that currently hinder local mortgage clients' growing needs (PE05-300).

#### **NBFI**

The Bank's activities in Croatia have primarily supported pension reform, leasing and insurance companies, with the investment in Erste Pension Fund to be mentioned in particular. The Croatian pension reform was judged as a policy that should have excellent demonstration effects in the Balkans and beyond. The *lesson learned* from an evaluation in 2004 is that, despite initial delays in motivating and committing both pension fund investors and subscribers, the Bank was right to support the reform and to stick with it throughout this project (PEX04-222).

#### **Private equity funds**

The most notable operation in this field is the Croatia Capital Partnership, established in 1997. It has contributed to the development of the local private equity industry and training of locally based staff. In spite of these efforts, the private equity fund sector remains small, the number of transactions lags behind the new EU member states, and foreign financial investors have not yet shown considerable interest in investing in Croatian equity funds.

#### **SME & MSME**

The Bank has provided substantial funds to several Croatian banks for financing SMEs. However, it proved difficult to distribute and utilise credit lines effectively, as was shown in the case of the Croatian Bank for Reconstruction and Development (HBOR) as well as Raiffeisen Bank. A *lesson learned* from the Bank's engagement at Erste & Steiermärkische Bank points to the need for defining the target sub-borrowers and the average sub-loan size in a more specific way (PE02-218). *Another lesson* is that successful SME lending projects with new partners should involve technical cooperation measures in order to improve the partners' lending skills (PE05-306).

Overall, transition impact within the *Financial Sector* is rated *Significant*.

### ***1.3.3 The Enterprise Sector***

#### ***Agribusiness***

The Bank's operations targeted foremost SME promotion, the attraction of FDI and corporate restructuring. The Bank's project with Vetropack (the leading glass bottle producer in the region) started in 2002 and has supported improved production of glass packaging materials, abiding to best international environmental standards. Vetropack also has strong business links to neighbouring countries, supporting regional linkages in SEE. A *lesson* generated from this project is to conduct a more thorough due diligence through direct contact with a number of the project's customers, which are also clients of the Bank. In the case of Vetropack, this has definitely facilitated the assessment of credit risk and risk to transition impact (PEX03-188).

#### ***Natural resources***

After pursuing policy dialogue with INA, the state owned oil and gas company, about the liberalisation of tariffs, the Bank signed a transaction with the company in 2001. The sales of a 25 per cent plus one share in INA to Hungary's MOL was an unexpected transition impact indirectly related to the Bank's transaction.

#### ***Industry***

The Bank provided continued support to Pliva, one of the largest pharmaceutical firms in Eastern Europe, until the company was sold by bidding process to Barr Pharmaceuticals in October 2006. By promoting the successful stock market listing, associated transparency and governance and corporate development of this high-visibility company, the Bank set standards for the corporate sector as a whole. Another successful operation was with Nasicecement, designed to introduce new financial reporting procedures and consolidated IAS. This project also had resulted in substantial positive changes for the environment.

#### ***Telecommunications***

The Bank's involvement in Croatia has mainly consisted of continuous support of the second mobile operator - VIPnet - in order to enhance competition.<sup>2</sup> The telecoms market has been successfully transformed with only small transition challenges remaining. There was an important *lesson learned* pointing at the risk of creating a duopoly market in the telecom sector (PE04-275). The risk eventually was mitigated, when in 2005 a third mobile operator entered the market.

#### ***Property and Tourism***

Croatia was a target country of the TUI Advanced Payment Facility<sup>3</sup> in the tourism sector. The facility means to support upgrades and expansion of small hotels, bringing them up to modern standards. Croatia has also become a target country for recent regional property funds (Europolis II, TriGranit III). Investment activity in the

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<sup>2</sup> Cronet (now, T-Mobile Croatia) was for some period of time the only mobile operator in the country.

<sup>3</sup> The large Tourism Company TUI is involved as a key party.

country originating from these funds has been rather limited but is growing. In general property sector activities suffer from some legal framework deficiencies, the Secured Transaction Law in particular, and lack of transparency within the real estate market.

### **TAM/BAS**

The TAM Programme has operated in Croatia since 2001 and has carried out 10 projects, utilising EUR 0.5 million from multiple donors, including Switzerland, UK, Sweden, Netherlands, Ireland, Greece and Finland. The BAS Programme has operated in Croatia since 2000 and has carried out over 260 projects, which were financed by the Central European Initiative, Austria, UK, Germany, and the Balkan Regional Special Fund. In recent years the TAM/BAS Programme has been concentrating its efforts to make itself available to more rural communities, and to extend its services to reach enterprises in the regions. Any continued funding will be utilised to reach these underdeveloped regions, although TAM/BAS is slowing down its activities in Croatia and redirecting its focus and resources to the ETC region and less advanced Western Balkans countries.

Overall, transition impact within the *Enterprise* Sector is rated *Significant*.

### **1.3.4 Infrastructure**

#### **MEI**

The Bank has been involved in the water and transport sectors with a view to eliminating cross-subsidies and raising tariffs to cost recovery levels. Activities included solid waste management in Zagreb, rehabilitation of water infrastructure in Karlovac, the BOT model in wastewater treatment (Zagreb) and urban transport in Dubrovnik. The Bank was able to address several city finance issues successfully with city creditworthiness enhancement programmes. In addition, the Bank facilitated the attraction of substantial ISPA grant co-financing to the Karlovac project. Participation of the private sector in public service provision can be further expanded, being limited for now to Zagreb Waste Water Treatment plant.

#### **Transport**

The Bank has had a large presence in the sector with projects for railways, roads, a port, an air traffic control centre and a shipyard. The Bank conducted – among others – the ARZ motorway project which helped to establish the Roads Council. The Croatian government opened up the road sector to private investment, and there are currently two private operators: Bina Istra d.d. (majority owned by French construction group Bouygues) and Autocesta Zagreb-Macelj d.o.o. (majority owned by the German-Austrian construction consortium Walter Motorway). Motorways managed by these two companies represent about 20 per cent of the total motorway network in Croatia. Activities in the railway sector have focussed on the Croatian Railways (HZ) with a view to its restructuring and modernisation accompanied by continuous policy dialogue with the Government on the railway sector reform. A *lesson learned* during the HZ operation is to undertake an assessment of the political and social environment surrounding the sector reforms in order to design the required actions in a more realistic manner (PEX05-261).

Overall, transition impact within the *Infrastructure* Sector is rated *Significant*.

### ***1.3.5 Financial Performance of the Existing Portfolio***

The financial performance of the existing portfolio is excellent with 99 per cent of the Bank's assets performing. The portfolio risk rating is 5.5.

### ***1.3.6 Mobilisation of Co-Financing***

Overall mobilisation of external co-financing for the Bank's projects is 2.75; however, financing raised later, on the back of the Bank's investments, is not recorded, but leads to a higher real mobilisation rate. Going forward, the Bank anticipates good opportunities for co-financing, provided that the Bank targets longer-maturity and/or higher risk (mezzanine or equity) financing components.

## **1.4 Portfolio Ratio**

Private sector operations comprise 72 per cent of total operations. Of the state portfolio, municipal projects are growing in importance by number and for their local impact, though they remain much smaller than the large sovereign-backed infrastructure projects in the transport sector.

## **2. OPERATIONAL ENVIRONMENT**

### **2.1 The General Reform Environment**

#### ***2.1.1 Political Environment***

The Republic of Croatia is a constitutional parliamentary democracy with a population of 4.4 million. Legislative authority is vested in the unicameral parliament (Sabor), which has 152 deputies. (Both the Chamber of Representatives and the Chamber of Counties, established in 1992, were abolished when their mandate expired in April 2001.) President Stjepan Mesic, re-elected on 16 January 2005, serves as head of state and commander of the armed forces, cooperating in the formulation and execution of foreign policy and directing the operations of the intelligence services, and nominates the prime minister, who leads the government. Prime Minister Ivo Sanader was nominated by the President and confirmed by Parliament in December 2003 following the parliamentary elections held in November 2003. He heads a minority centre-right coalition government led by the Croatian Democratic Union (HDZ) and supported by the Croatian Pensioners' Party (HSU), a small Liberal Party (HSL) and ethnic minority representatives. There are 8 parliamentary seats reserved for ethnic minorities. Eleven MPs out of the total of 152 belong to ethnic minorities, of whom 8 were elected as minority representatives. The next parliamentary elections are due in November 2007. Croatia, as an official EU accession candidate, is negotiating with Brussels with a view to joining in 2009 or 2010. Joining the EU is a popular objective with the Croatian public, while joining NATO, another important government objective, is less so. Croatia is the strongest candidate for the next round of NATO enlargement, possibly already in 2008.

## **2.2 Progress in Transition and the Economy's Response**

### **2.2.1 Macroeconomic conditions for Bank operations**

The macroeconomic environment has improved since the last Strategy. Growth in 2006 reached 4.8 per cent, an increase of 0.5 percentage points compared to both 2004 and 2005, and it is expected to continue at about that level in 2007. Private investment more than offset the impact of declining public investment, and exports performed better than expected. The important tourism sector (where more than 20 per cent of GDP is created) continues to develop, with the number of overnight stays in 2006 up 3 per cent on 2005. Industrial output rose by about 4.5 per cent. After a decreasing trend in the inflation rate from 2002 onwards, the average consumer price inflation increased in 2005 to 3.3 per cent, decreased to 3.2 per cent in 2006 and is expected to be around the same level in 2007. The IMF stand-by arrangement was concluded satisfactorily in November 2006 following a third review in October 2006 and Croatia has opted not to draw down on its last three IMF stand-by deals; instead, future consultations with the IMF over economic policy will take place in the context of annual Article IV reviews. The IBRD approved a Country Assistance Strategy for the period of up to mid 2007 in January 2005, but the funding levels have not yet reached the plan due to the delays in implementing the required reforms (privatisation, subsidy reduction, judicial reform, public administration reform).

Fiscal performance improved in 2005 with the general government budget deficit reduced to 4.0 per cent of GDP, compared with 4.8 per cent of GDP in 2004. The government is targeting a further reduction in 2006 to 3.0 per cent of GDP which is considered to be realistic and to 2.8 per cent of GDP in 2007. The pensioner's debt,<sup>4</sup> the repayment of which is secured through the Pensioners' Fund and should not be included in current budgetary operations, is expected to amount to about 1.1 per cent of GDP in 2006. The IMF believes that this is only a one-off debt which will be mostly covered next year, but the government will need to do something about the pension system in the following years. The pension system is designed in a restrictive way: the replacement rate<sup>5</sup> should decline to 30 per cent in the next 10 years and it is currently around 40-42 per cent. The total contribution rate of workers is 20 per cent of gross salary, of which 15 per cent goes into the first pillar - mandatory PAYG (pay as you go) system financed by contributions and state budget revenues and 5 per cent goes into the second pillar - compulsory pension insurance based on individual capitalised savings. The government does not want to reduce the contribution to the mandatory PAYG pillar below 15 per cent, hence it is hard to increase the contribution to the second pillar. This leaves the second pillar insufficiently strong, and it is unlikely that this 5 per cent contribution will increase. New pensioners are hence in a much worse position than the old pensioners. A political solution will need to be reached to solve this problem, as a large proportion (40 per cent) of current pensioners is less than 65 years of age.

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<sup>4</sup> Pensioner's debt was accumulated in the period from 1993 to 1998 due to the failure of the government to adjust the pension in line with the existing laws. The total debt has been estimated at around HRK 11 billion. The first payment of HRK 1.2 billion was made in June 2006 and the second payment of the same amount in December 2006. Pensioners, who chose the fast track, will receive half of their claims over the next two years, whereas the others will receive their claims in full over the next six years. Close to 70 per cent of pensioners chose the fast track of repayment.

<sup>5</sup> Replacement rate is the ratio between the level of pensions and previous individual earnings at the moment of take-up of pensions.

In addition, the government approved a “2006 Christmas bonus” for the pensioners, granted large wage increases to trade unions in the education sector for 2007 and approved a population policy. While the latter proposal will not be implemented in full, measures with a significant fiscal impact to be implemented in 2007 are child benefits and maternity benefit increases, pro-natality allowance and free textbooks, transport and dormitories for primary and secondary students. More of such measures are likely in 2007, an election year. Health sector arrears have increased, and as the Government has not resolved underlying problems in the sector, this problem will continue to recur.

2008 is likely to be the crucial year for the public finances. The government has ambitious plans of reducing the budget deficit further to 2.4 (or, according to IMF’s recommendations, to 1.5) per cent of GDP by 2009. However, this plan relies too heavily on increasing the revenue collection instead of reducing government expenditures, which – at about 47.4 per cent of GDP in 2006 – are among the highest in the region. Savings are possible in implementing the health care reform fully, reforming the civil service, improving the targeting of welfare, family, and health benefits that take into account income and assets of recipients, and implementing the existing medium-term subsidy-reduction plan. State aid itself represented 2.8 per cent of GDP in 2005.

The gross debt of the general government stood at 40.8 per cent of GDP at the end of December 2006 (2.9 percentage points lower than at the end of 2005), with external public debt accounting for about 40.7 per cent of total general government gross debt. The government has increased the proportion of domestically sourced financing and the external portion of the general government debt has decreased by 3.0 percentage points in December 2006 compared to December 2005, reached 16.6 per cent of GDP at the end of December 2006 and is expected to decrease further in 2007. However, the government is still contributing to the external debt indirectly, as around 70 per cent of its T-bills are bought by the banks which in turn take loans from abroad.

The current account deficit increased to 7.7 per cent of GDP in 2006, owing to the impact of higher international energy prices, which have already pushed the current account deficit to 6.3 per cent of GDP in 2005. If the current trend of high oil prices and strong domestic consumption continues, the current account deficit might be even larger next year. Exports surged by 24.0 per cent year-on-year in Euro terms in 2006 (growth of exports in 2005 was 9.1 per cent year-on-year), compared to a 20.9 per cent year-on-year increase in imports in the same period. Inward current transfers will rise as the EU accession process progresses. However, import growth is also expected to remain robust: demand for investment goods is expected to stay strong, consumer import demand will be underpinned by strong credit growth and a one-off increase in disposable income from the government’s payment of pension arrears.

At the same time, Croatia’s external debt stood at 82.5 per cent of GDP (in Euro terms) at the end of 2005, and has since increased to almost EUR 29 billion by the end of December 2006, equivalent to 85.5 per cent of GDP. This is an increase of 13.5 per cent year-on-year and is due to higher borrowing by companies. The majority of the external debt is denominated in Euros, and short term debt represents 17.4 per cent of total external debt. The government and the Croatian National Bank (CNB) are aware of the risks of the large external imbalance which leaves the economy exposed to

external shocks and have stepped up efforts to mitigate them in recent years. The CNB increased the reserve requirements on banks' net increase in foreign liabilities in 2005 three times (the latest, in December, from 40 per cent to 55 per cent). In addition, a 55 per cent mandatory reserve to be paid by commercial banks as a share of issued securities was introduced in February 2006. In December 2006, a further restriction was added. For credit growth in excess of 12 per cent per annum, banks will be required to buy treasury bills from HNB in an amount equal to 50 per cent of excess growth for 0.75 per cent interest per annum. As mentioned above, the government has increased the proportion of domestically sourced financing, and its share of external debt was 4.1 percentage points lower in December 2006 than at the end of December 2005. However, this was more or less offset by the increase in the share of other sectors (mostly corporates). The latter is largely a result of the CNB's decision to limit foreign borrowing by banks, which encouraged large private sector companies to borrow abroad directly, in many cases from the parent banks of the foreign-owned financial institutions in Croatia. In sum, external debt due to banks and other sectors has increased by 13.2 and 30.7 per cent year-on-year at the end of December 2006, increasing the share of these two sectors in external debt to 67.4 per cent, 4.2 percentage points higher than at the end of December 2005.

The CNB has targeted a broadly stable Kuna-Euro exchange rate for several years, which is appropriate given that about 80 per cent of bank loans and time deposits are foreign-currency denominated or indexed. This framework has fulfilled the CNB's primary objective of low inflation: average consumer price inflation was 3.3 per cent in 2005 and 3.2 per cent in 2006. The inflationary risks posed by rapid domestic credit growth to private sector (23 per cent year-on-year in December 2006) and public sector wage settlements will have to be managed by the authorities. Limited exchange rate flexibility is favourable to unhedged borrowing in foreign currencies with potentially negative implications for financial stability. The CNB intervenes regularly in the currency market, usually purchasing foreign currency in order to ease upward pressure on the Kuna, but occasionally also selling Euros in the market. It has also taken a number of appropriate measures aimed at improving banks' management of credit risk, such as increasing risk weights on unhedged foreign-currency denominated and indexed loans, quarterly reporting requirements for such loans, and new guidelines to banks on managing household and currency-induced credit risk. However, rapid credit growth is a cause for concern: Croatian households are building up net liabilities that are sensitive to changes in exchange and interest rates. Higher foreign interest rates may eventually lead to higher domestic interest rates and deterioration in the debt servicing capacity of firms and households. Banks are exposed to foreign currency-induced credit risk which may be high.

### ***2.2.2 Transition Success and Transition Challenges***

#### **Infrastructure and Environment**

**Telecommunications:** *Support the market regulator by ensuring appropriate penalties are assessed for anti-competitive practices.*

Competition in mobile telephony has increased with the entrance in October 2005 of a third operator (Tele 2) in addition to VIP-Net (Vodafone) and T-Mobile (Hrvatska Telekom/Deutsche Telekom). The regulator has implemented portability of mobile

telephone numbers, which has facilitated movement by consumers among the operators. Mobile coverage is extensive with 95 per cent penetration.

Despite liberalisation of the fixed line market with licenses issued to six operators, the market share of the incumbent operator (Hrvatska Telekom, HT) is practically unchanged. The market regulator, which was just created two years ago, can issue significant fines (5 per cent of annual revenues) in cases where anti-competitive behaviour is not remedied following a warning. Up to now, the regulator has started two procedures against HT in response to complaints by competitors. These are now being contested in court. New entrants to the market have complained that the market regulator is not sufficiently proactive to ensure that there is a level playing field for all competitors. HT, which has Deutsche Telekom as a strategic partner with 51 per cent shareholding, is slated for further privatisation through a listing on the Zagreb Stock Exchange (and possibly another international exchange) by mid-year 2007, but this depends on whether the dispute about the ownership of the underground fibre optic cable network (DTK) will be resolved by then.

With competition beginning to heat up in the provision of broadband services, HT purchased Iskon Internet, its main competitor in this field. The acquisition was accepted by the anti-monopoly agency despite strong objections from other, smaller competitors in the sector. However, Iskon Internet was required to reduce prices considered as predatory. In addition, a license for WiMax, which had been issued prior to Iskon's purchase by HT, was revoked. Recently, Iskon has started a legal proceeding against the market regulator to try to reverse this action.

**Transport:** *Continue support for regional trade by investing in transport corridors, proceed with restructuring of shipyards and railways, and involve the private sector in the financing of revenue generating transport infrastructure.*

As the leading economy in South East Europe, Croatia has made a significant contribution to the improvement of regional trade and development. Going forward, the country should continue its support for the Central European Free Trade Agreement and proceed with further investments in regional transport infrastructure. The substantial investment by the Government of Croatia planned for Ploce Port is an excellent example. The Port of Ploce is the entry point for the trade route Corridor 5c to Bosnia and Herzegovina.

Despite a commitment to start privatisation and restructuring of the state-owned shipyards under the EU Stabilisation and Association Agreement (SAA), the Government delayed reform in the sector until recently. During 2006, the Government commissioned a restructuring study and is discussing its conclusions. In any case, the Government has announced plans to commence privatisation of the strongest performing shipyard, Uljanik, in the first half of 2007. The World Bank PAL II envisages the privatisation of a majority of the shares of Uljanik shipyard by the end of June 2007. The Government intends to meet its obligation to apply the EU's competition policy rules for state aid to the industry, commencing in March 2007. However, the strategy for reducing subsidies to the industry and consolidating, or otherwise restructuring the operations of the weaker shipyards, has not yet been made public.

The restructuring of Croatian Railways started in 1998, while important steps were undertaken during 2004 and 2005. This process was intensified specifically in preparation for the privatisation of subsidiary companies of the former public company Croatian Railways d.o.o. in accordance with the accepted obligations of the EU. A new legal framework for the liberalisation of the railway sector has been established and is being applied. In 2006, the plan was to sell three (now increased to six) non-core subsidiaries to the private sector and to break up the Croatian Railways company into five separate legal entities, in line with the EU *acquis communautaire*. Subsidiaries, which exceeded EUR 340 million in 2005, will be reduced significantly. Railways restructuring is also an important part of the IBRD's PAL II, which is scheduled for Board approval in May 2007. The tenders for the first three subsidiaries were published in the beginning of April 2007. The plan envisages they will be followed by a tender for two additional subsidiaries by the end of June. The improvement in the efficiency of the railways is important to ensure that significant new investments planned for the sector are productive.

Future investments by the Government in transport infrastructure should take account of whether projects will generate sufficient revenues to be financed by the private sector. This is a sector which lends itself well to private-public partnerships. For example, the Bank is interested to assist in the expansion and upgrading of Zagreb Airport, which could be financed through a PPP or as a corporate loan without a sovereign guarantee.

**Municipal/Environmental:** *Strengthen implementation unit for EU funds, ensure stable and predictable central-local fiscal relations, adopt new legislation on concessions, and provide guidelines and support for the implementation of public-private partnerships at local level.*

Following the formal opening of EU accession negotiations, the Government opened a Central Financing and Contracting Unit (CFCU) in the Ministry of Finance. This unit is responsible for opening and managing the tendering process, contracting and payments from the Phare and ISPA programme grants, while the Ministry of Finance is responsible for managing decentralised EU programme funds. In order to absorb the larger volume of funds available in the future, the CFCU will need to be strengthened, possibly by improving the terms of employment so as to retain knowledgeable and experienced staff. This was highlighted by the European Commission in its 2006 Regular Report, with the objective of ensuring that Croatia is able to fully benefit from the support available from EU.

In 2006, a new basis for central-local fiscal relations was announced by the Government. The change in allocation of income and profits taxes has profound implications for cities with large corporations' headquarters, particularly Zagreb and Rovinj. There are obvious benefits, especially for financially weaker municipalities, to a wider distribution throughout the country of tax revenues. At the same time, all cities need predictable, stable revenues to be able to plan their investments, especially in long-term infrastructure. Therefore, a transparent and fair approach to central-fiscal relations should be adopted and retained regardless of which political party is governing the country.

New legislation for concessions is under preparation, and should be adopted as a priority in order to facilitate the granting of concessions by both national and local authorities.

The Government has indicated its interest to use public-private partnerships (PPPs) to facilitate investments in municipal infrastructure, including schools and hospitals, which are paid for by the Government rather than the users. It is essential to weigh the costs and benefits to ensure that a PPP is the best approach for a given investment. PPPs are best suited for revenue-generating projects such as water utilities, where users pay the cost of the investment project. The Government has established a specialised unit to be a centre of knowledge on PPPs. This unit should provide local authorities with guidelines on the cost-benefit analysis, legal advice (possibly preparing some standardised agreements), and with support for the procurement processes to ensure that the balance of risks and rewards in PPPs is fair for the public. Up until now there has been little discussion with private companies and financial institutions to confirm their interest in investing in PPPs. This should be a priority.

**Energy:** *Invest to increase security and diversity of energy supply, in particular, by implementing the secondary legislation for renewable energy investments. Encourage households and companies to use energy more efficiently.*

As Croatia uses considerably more energy than it produces, the Government should prepare investments in infrastructure to improve security and diversity of energy supply, including renewable energy. Secondary legislation needed for investments into renewable energy, such as wind power, to proceed has recently been adopted. The Government has limited the level of the feed-in tariff subsidy according to the proportion of “local content” in windmills. Given that such equipment is not currently produced in Croatia, this can only delay project implementation. The Government should also consider legislative or regulatory measures to encourage investments by companies and private persons to increase the energy efficiency of their operations and dwellings respectively. The restructuring of the state-owned power utility HEP is underway but measures to ensure effective functional unbundling of the Transmission System Operator and Distribution System Operators will still need to be put in place.

### **Enterprise Performance**

**Small and Medium-sized Enterprises:** *Improve the business environment.*

The Government has a strong commitment to SMEs, demonstrated by financial support provided through HBOR (the state development bank) in the form of interest rate subsidies for loans and through guarantees offered by HAMAG (the guarantee agency). This support can be further enhanced by administrative measures which facilitate business. Among others, the establishment of the “one-stop-shop” (hitro.hr) for opening a new business has reduced the number of days required to open a business. In addition, the Government has agreed with the National Competitiveness Council to put unnecessary laws and regulations to a “regulatory guillotine” (hitrorez.hr) and prepare an electronic registry of all valid regulations, accessible to all. This is a well-timed initiative which should reduce red tape. Another positive development is the introduction of online VAT forms, and land and property registration, although the coverage of the latter two is not yet complete.

Looking forward, streamlining of licensing should be a priority, as this is inordinately burdensome for small companies. The reduction of case loads in commercial courts is also essential, as SMEs cannot wait some 12 months to settle a dispute; many can go out of business while waiting on the courts. In addition, the “regulatory guillotine” should also, as planned, be applied at the level of the local government.

**Foreign Direct Investment:** *Put more political effort into attracting investors and into educating the population on the benefits of FDI.*

The Government has recently appointed a new director of the Agency for the Promotion of Exports and Investment who is experienced in working with foreign investors, having previously managed the successful business park established in Varazdin (50 km north of Zagreb), and should improve the promotion of Croatia to foreign investors.

The Government needs to better explain to the population the benefits of direct foreign investment. Benefits include bringing capital to reduce the international financing gap; know-how to increase growth; and expanded markets, among other things. Yet recent opinion polls indicate that more than half of the population see FDI as bringing no benefits to the country. Moreover, some influential public figures frequently express the view that Croatian industry and business can develop well without foreign participation. Interestingly, Croatian companies have been among the leaders in investing in neighbouring countries, which has brought economic benefits for both sides. These companies should be among the first to support direct investment into Croatia.

Among other plans to attract more FDI is the Government’s intention to invest more in education. Secondary education in Croatia is not yet mandatory and is necessary for the country to promote itself as a knowledge-based economy. The Government may look to Nordic countries for good models of relatively small but open economies, where knowledge and an excellent business environment attract high levels of direct foreign investment.

**Business Environment:** *Reduce administrative barriers, limit opportunities for corruption, and improve the judiciary.*

Croatia has made great strides over the past two years to become a better place to do business. It was ranked among the top 10 reformers in 2005-06 by the IBRD’s “Doing Business 2007” report. Improvements were in starting a business, registering property, and enforcing contracts. However, business licensing and protecting investors remain areas where further reform is required.

The National Competitiveness Council, a group of leading local businesses, developed a list of 55 recommendations which was presented to the Government in 2004. Many of these recommendations have been adopted or are in the process of implementation. The country is now ranked at 51<sup>st</sup> place in the World Economic Forum’s global ranking.

Still, foreign investors remain concerned about corruption and the lack of transparency and ineffectiveness of the judicial system. There are few prosecutions or arrests following nationally publicised scandals. It is important for foreign investors to

know that they can settle disputes before a fair and impartial judiciary which enforces the laws. The judiciary must clear up the backlog of old cases in order to expeditiously adjudicate the new cases which continue to arise.

**Privatisation:** *Croatia should proceed with the privatisation and restructuring of remaining state-owned industries, including shipyards, steel, aluminium and agriculture (Vupik).*

Privatisation has started moving ahead after a two year lull in which only a few notable companies were sold.<sup>6</sup> About 870 companies remain in state-ownership and completion of privatisation is now slated for 2009 rather than 2007 as announced earlier. Part of the delay has been in response to political pressures from interested parties. In addition, delay was due to the interest of unions in gaining rights for employees of state-owned companies to buy shares in the privatisation process.

Instead of a new law on privatization, incorporating the Employee Stock Ownership Plan (ESOP), the Government has decided to make amendments to the existing Privatisation Act and to regulate the organized employee stock holding in a separate law after months of discussions with unions and with the IBRD. The Government will review, together with the labour unions and the Employers Union, best practices in employee share ownership programmes from different countries, to make a new proposal. In making new legislative proposals, the Government should bear in mind the need to ensure that a single investor can gain control of a company. If large stakes are allocated to managers and employees, the State may not find a strategic investor for the remainder of its stake. Workers and managers usually lack capital to invest. With a few notable exceptions, the companies which remain in state ownership are neither financially strong nor commercially successful. These firms would most benefit from an outsider, whether domestic or foreign, to bring capital and know-how. The tourism sector in particular would perform better if the Government would complete privatisation of the sector.

**Tourism:** *Develop and implement a national tourism promotion strategy, encourage and support sustainable and environmental friendly investments.*

For long-term development of the tourism sector, the Government should implement all of its objectives for the sector identified in the “Croatian Tourism Development by 2010” strategy adopted by the Government in 2003. While the Croatian National Tourist Board Office has as its objective to increase the number of hotel beds relative to accommodation in private houses, the latter could also be upgraded with enforcement of an accreditation scheme setting standards for facilities including cleanliness and basic training in hospitality for the owners. The majority of such units remain in the informal sector, to avoid paying taxes, but tourists are becoming increasingly demanding in the standards expected.

Increased investment is needed in existing tourism facilities – hotels, guest houses, marinas, restaurants, bars and sports facilities - throughout the country. Croatia is fortunate to have one of the most attractive natural environments in the entire

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<sup>6</sup> In 2005 14 companies, which included agrokombinats Pik Vrbovec and Belje, and four hotel companies, were sold by public tender while no sale of a majority stake in a large state-owned company took place in 2006.

Mediterranean region. However, the standard of service and quality of accommodation and entertainment offered to tourists in state-owned hotels is low for the price. Speeding up privatisation, and putting an emphasis on planned new investment in the tender criteria, will help. New investments should be managed carefully so as not to destroy the beautiful natural environment and village atmosphere, and should be accompanied by the necessary infrastructure investments. Planning is underway for development of Brijuni Riviera in Istria, an opportunity for Croatia to demonstrate that it has learned lessons from other Mediterranean countries on how best to develop its coastline in an environmentally-friendly and sustainable way.

## **Financial Sector**

**Banking and non-banking financial institutions:** *Finish privatisation, and continue to strengthen supervision of non-bank financial institutions.*

The banking sector is among the best performing sectors in the country, with a low level of loan losses and excellent range of services available to customers. Approximately 93 per cent of banking assets are controlled by foreign owned institutions, which have brought capital, expertise, technology, and transparency to the sector. The Croatian experience reflects that described in EBRD's 2006 Transition Report. Foreign-owned banks have the technology and experience to successfully lend to retail customers, e.g. households, and they tend to focus on retail lending rather than on SMEs. In Croatia, the household share of domestic credit growth is among the largest in Central Europe. Moreover, when measuring domestic credit to the private sector as a percentage of GDP, Croatia was second only to Latvia of the Bank's countries of operation in December 2006. Meanwhile SMEs and small municipalities have been less interesting to banks, due to the perception that they require more work and are higher risk credits. Competition in the corporate sector should eventually press the banks to address the SME sector more aggressively.

The high level of Euro-isation of bank balance sheets (nearly 80 per cent of assets and liabilities), means that the entire sector is carrying a big foreign exchange risk which would be borne primarily by the borrowers (households and corporations). However, the National Bank is well aware of the risk and is taking measures to enhance the banks' reserves for risks in this area.

Finally, the high level of foreign indebtedness of the country has been a major concern of the IMF and the National Bank. The latter has established a punitive level (55 per cent) of mandatory reserves on net new foreign borrowings. Thus, banks are trying to limit their credit growth from foreign sources, in part by transferring some of their corporate lending to their foreign parents.

A new non-bank financial institutions regulatory agency was established in early 2006. HANFA is responsible for overseeing the stock exchange and securities market participants, leasing companies, and insurance companies. A new law on leasing took effect on 1 January 2007. The law prohibits lending by leasing companies. Better supervision of the insurance sector is a high priority of HANFA.

Generally, transition is nearly complete in the financial sector with privatisation remaining for Hrvatska Postanska Bank and Croatia Osiguranje, the latter of which

has a large though declining market share. The Government is considering options for their privatisation. Earlier, the Government reviewed the possibility of merging the two companies; however, this has not progressed. The Bank is ready to assist with either or both processes, although privatisation would be faster and more efficient without carrying out a merger. The latter carries risks without definite rewards.

**Capital markets:** *Move ahead with legislation to broaden the instruments in which pension funds can invest.*

During 2006 and early 2007, the Zagreb Stock Exchange has flourished. The take-over battle for Pliva resulted in excellent returns for those who held onto the stock and created a high level of interest in the stock market. This was followed in the late autumn with the initial public offering (IPO) of 17 per cent of the shares of INA, the national oil company which has the Hungarian company MOL as a strategic partner. A significant portion of INA shares were set aside for purchase by the population at a discount to the price offered to institutional investors. This has generated considerable enthusiasm on the part of the public for further share issues, which should be met in the first half of 2007 when the Government plans to sell part of its stake in Hrvatska Telekom.

Croatia, like most transition economies, has a bank-dominated financial system. However, as the National Bank has taken measures to restrict the growth of foreign borrowings by commercial banks, companies are increasingly turning to the capital market to raise finance through bonds and commercial paper programmes, in addition to share issues. Still, pension funds are quite limited at present in the instruments in which they are allowed to invest. In early 2007, the Government is expected to adopt a new law broadening the instruments eligible for pension fund investments. At the same time, HANFA, the capital markets regulator, will need to strengthen the technical capacity of its analysts to understand new instruments and the risks they carry. As a new regulator, HANFA is currently finding its way, sometimes taking a very aggressive position *vis-à-vis* market participants. The agency will become more effective as a regulator when it proves that its investigations lead to results.

The Bank has facilitated the introduction of a new Law on Securitisation which should be approved by the Government and submitted to Parliament for passage into law in 2007. The Bank provided a Senior Advisor from the Financial Institutions team to work with the Securitisation Working Group established by the Croatian Banking Association, with the participation of the Ministry of Finance, the National Bank and HANFA. The capital markets would welcome the introduction of asset backed securities and the banking sector would benefit from a more efficient allocation of risk and capital.

Despite improvements in the investment climate, Croatia continues to be under-served by private equity and venture capital funds. Three or more real estate funds are now present in the country and competing for projects. But there are very few equity funds which are active and they tend to focus on very small firms. This leaves a gap of finance in the range of EUR 2 – 5 million, small for the Bank, but a niche that needs to be filled. Until there is a better representation of private equity funds, the Bank will exceptionally consider small investments with promising companies, with strong management.

### 2.3 Access to Capital and Investment Requirements

- **Domestic credit:** Local banks are very liquid and offer very competitive conditions to local borrowers, particularly households and corporates. The Government provides generous interest rate subsidies for loans extended by the Croatian Bank for Reconstruction and Development (HBOR) to SMEs. However, small companies which do not qualify for these loans from HBOR face relatively high rates of interest and inflexible collateral requirements from commercial banks.
- **Capital markets:** The Croatian capital market is small, and offers limited liquidity. Pension funds have been limited to investing in the shares of six companies in the first quotation of the Zagreb Stock Exchange's two-tier system. INA, the national oil company, was listed in December 2006. The Government and several local corporations issued bonds in local currency in 2006. Government bonds make up the vast majority of traded instruments and pension fund holdings. New rules on investments permitted for pension funds will be implemented in 2007, increasing demand for corporate offerings.
- **Foreign direct investment:** In 2006, FDI reached a record high of EUR 2.7 billion due to Societe Generale's acquisition of Splitska Banka, the sale of Pliva to Barr Pharmaceuticals, the IPO of INA and re-investment of earnings or capital increases by investors already present on the market.
- **Local currency funding:** As mentioned earlier, the central bank has targeted a broadly stable exchange rate vis-à-vis the Euro, an objective that is in part motivated by the prevailing currency substitution in the financial system, in which about 80 per cent of both deposits and private sector credit are denominated in Euros or indexed to the Euro. This stability has in turn reinforced incentives for unhedged borrowing in Euros, and the authorities' incentives to develop money and bond markets in local currency are therefore limited. The EBRD's Treasury consulted with the Croatian authorities and financial sector participants in the second half of 2006 in order to determine appetite for local currency funding. Generally, counterparts expressed limited interest in Kuna funding, pointing to the relatively small size of the market, the high degree of Euro substitution, and the unreliability of ZIBOR as a reference interest rate index.

### 2.4 Legal Environment

The prospect of Croatia joining the EU and the commencement of accession talks have been significant driving forces behind recent legislative reforms in Croatia. Amendments to the Bankruptcy Law in July 2006 are expected to expedite and increase transparency of bankruptcy proceedings as well as boost protection of employee rights. Amendments to the Enforcement Act in July 2005 introduced measures to improve creditors' rights and efficiencies in enforcement proceedings. As to secured transactions, a new Law on the Register of Pledges over movable property and rights introduced the concept of floating liens and a register for recording security interests on movable assets and contractual rights.

Areas of commercial laws remain that need to be further upgraded in line with international standards to foster foreign and domestic investment (as detailed in Annex 6 - Assessment of Croatia's Commercial Laws). In the area of corporate governance, particular attention should be paid to improving disclosure and transparency and protection of minority shareholders. Laws governing concessions need to be dramatically improved in order to meet the requirements of a modern legal framework facilitating private sector participation, as the existing laws lack clarity on a number of fundamental matters.

An inefficient judicial system has continued to undermine the enforcement of commercial laws. According to Transparency International Global Corruption Barometer 2006 – Report, the judiciary is identified as the most corrupt sector in Croatia. Judicial reforms are undertaken in a number of fronts with technical assistance from the international community, including technical assistance from the EU for the training of judges. Recent and ongoing reforms include the establishment of a judicial inspection team to monitor court and judicial administration under the new Law on Courts, defining the minimum criteria for practicing law, consolidation of the municipal court system and reform of the land register. In order to improve the implementation of Croatian commercial laws overall, further advancement of reforms to establish a fair and predictable judicial system is essential. The legal environment has improved, particularly with respect to opening a company. However, obtaining necessary licenses remains very difficult.

## **2.5 Environment**

The Croatian Government has approached its environmental challenges by undergoing legal reforms; policy development; and investment planning. In the period 1998 to date Croatia changed many laws and is now in the process of fully harmonising its legal framework for environmental protection to comply with the EU legal requirements.

The Croatian National Parliament adopted the Report on the State of Environment in Republic of Croatia in 1998. The second Report on the State of the Environment was done in March 2007 and is currently in the Government procedure, after which it will be adopted by the Parliament. A National Environmental Strategy has been prepared in co-operation between the Ministry of Environmental Protection and Physical Planning and the IBRD through the projects on Environmental Policy Development and Regulatory Capacity Building. The Croatian Environmental Protection Agency was established in 2002 with the role to collect, put together and process information on the environment. In the process of the National Environmental Action Plan preparation, a Priority Action Plan (PAP) was developed, containing priority projects presented at the Donors' Conference in Zagreb in 2001. The priority projects have been defined (total number of 61), some of them have been completed and some are currently being implemented taking into consideration that priority projects identified in 2001 made the base out of which other new projects evolved.

Croatia is oriented towards a dynamic tourism industry that depends on a clean coastal environment, implying considerable investment in waste and wastewater management. The availability of funding for environmental investments has been

enhanced by the Parliament's approval of the Government proposal to establish the Fund for Environmental Protection and Energy Efficiency in 2003. The Fund was established to enable preparation, financing, implementation and development of programmes and projects in the fields of protection, sustainable use and improvement of the environment, as well as energy efficiency and use of renewable energy sources. The Fund is financed by the environment pollution fee, motor vehicle environment fee and waste production fee. In addition, it benefits from grants from donors and revenues from investing its own funds. The Fund provides grants and/or loans for priority environmental investments in the public and private sectors based on the set criteria.

In the area of wastewater treatment (WWT), investment highlights include: the first phase of WWT for Zagreb (financed by EBRD), to reduce a major source of pollution for the Danube/Black Sea basin; investments for the coastal area to prevent the further pollution and decline of Adriatic coastal water quality; and the projects to improve the situation in the protected areas of Plitvice and Mljet National Parks, which are of major concern to the Government. Currently, the Fund is considering 13 projects for municipal wastewater treatment with EBRD taking part in financing Pula, Karlovac and Sisak municipal wastewater management projects. Municipal solid waste management is another area where substantial investment is needed (EBRD has provided financing of the solid waste landfill rehabilitation in Zagreb). In the period 2005-2008, the Fund intends to finance rehabilitation of more than 229 unattended landfills across the country. The total investment is estimated to be HRK 2.3 billion, of which the Fund's part would be HRK 1.5 billion or 48 per cent. EBRD is currently considering taking part in financing the Primorsko-Goranska regional and Istria regional waste management programmes.

The cost of implementing the PAP in full were estimated in 2001 to be over USD 1.0 billion or an average of USD 200 million per year for the five year period under consideration. To be able to fully finance these projects, the Croatian authorities have identified international financing, State budget, municipality/city budgets, public financing of infrastructure projects, as well as investments provided by GEF for the financing of pollution reduction.

Croatian international cooperation in the implementation of environmental and nature conservation projects on a multilateral and, particularly, on a bilateral basis has been increasing for the past few years. Projects in co-operation with Germany, Denmark, Hungary, the Netherlands, Italy, Monaco, Norway and Japan have been or are currently being implemented. In addition, the grants of the Global Environment Fund (GEF) and UN bodies, such as UNEP, UNDP, UNIDO and the IBRD are being utilised. Croatia works with the Stability Pact on the Regional Environmental Reconstruction Programme for South-East Europe. The environmental projects are also financed by loans of IFIs, such as the IBRD and the European Investment Bank (EIB). The main projects financed by the IBRD are the following: Karst Ecosystem Conservation (GEF); Coastal Cities Pollution Control; Energy Efficiency; and Renewable Energy Resources Project.

EBRD has confidence in the Croatian Government's planning process which identifies specific environmental investment needs and considers EBRD as an

important financial source. The Bank will continue to support Croatian initiatives in environmental investment.

All EBRD programmes/projects in Croatia are subject to the Bank's Environmental Policy and incorporate, where appropriate, Environmental Action Plans into the legal documentation in order to address issues raised during environmental due diligence, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

### 3. STRATEGIC ORIENTATIONS

#### 3.1 Bank's Priorities for Strategy Period

##### Key Short Term Operational Priorities

In the coming two year Strategy period, the Bank will continue to work closely with the Croatian authorities and the business community to support the country's preparation for EU Accession. Focus will be on privatisation and restructuring, investment in infrastructure, SME finance, regional expansion of local companies, consolidation of industry, and tourism. Foreign direct investment and strengthening the capital and corporate governance of local companies are priorities to be pursued through equity investments, as opportunities allow. The Bank will demonstrate additionality on a case-by-case basis. The main priorities for the period are the following:

- **Enterprise Sector** - the Bank is committed to assisting the Government with privatisation and restructuring of sensitive industries, in particular the shipyards, heavy industry, and the tourism sector. The Bank will continue to finance promising Croatian corporate customers in their regional growth and consolidation. The Bank will offer equity finance to small and medium-sized companies, provided they have strong management and good growth prospects. The Bank will seek opportunities to finance both new and existing operators in the tourism sector. The Bank will seek investment opportunities in regions of the country where the economy was damaged by the war and has not recovered.
- **Infrastructure and Environment** - the Bank will focus on projects which can be financed on a commercial basis, without support of a sovereign guarantee. At the level of local and regional governments, the Bank will introduce new instruments and will facilitate development of more efficient regional projects where feasible. The Bank will continue to support the preparation of projects which may benefit from IPA co-financing. The Bank will promote energy efficiency through new mechanisms, including credit lines through banks and energy audits. The Bank will also seek to support improvements in security and diversity of energy supply, with a priority on renewable energy projects.
- **Financial Sector** - the Bank will pursue SME finance with the support of the EU under the SME Finance Facility, focusing on leasing companies. The Bank will seek to finance factoring companies under the TFP. The Bank will promote new products, if possible, securitisation, to assist banks in managing their balance

sheets as well. Finally the Bank will consider equity participation in the privatisation of the state-owned postal bank and insurance company.

During the coming two year period, the Bank's commitments will vary with market demand. However, annual commitments can be expected in the range of EUR 100 – 250 million, with an expected average of around EUR 150 million.

## **Policy Dialogue**

The Bank has regular contacts with the Government and engages in policy dialogue in particular with respect to (1) privatisation and restructuring of enterprises, (2) the financial sector, especially with regard to the Law on Securitisation and on non-bank credit institutions, (3) the handling of concessions (specifically in the case of the ports) and other issues concerning involvement of the private sector in public infrastructure, (4) proposals for handling the development of tourism facilities in the National Parks, (5) the investment climate for SMEs and FDI and (6) laws which impact the competitive environment for business.

## **3.2 Sectoral Challenges and Bank Objectives**

### **3.2.1 *The Enterprise Sector***

*Based on the analysis in section 2.2.2, the following Transition Goals are relevant for the Enterprise Sector.*

#### **Transition Goals**

- Privatised and restructure remaining state-owned enterprises, in particular shipyards and tourism assets.
- Modernise and improve services offered by locally-owned tourism companies, and encourage leading foreign operators to establish operations in the market.
- Facilitate access to capital of leading local companies by providing equity in preparation for IPOs or capital markets products (e.g. as an anchor investor in a bond issue).
- Support regional expansion of Croatian companies and consolidation in local industry through long-term debt or equity, as needed by the clients.
- Seek and develop investment opportunities in economically depressed regions of the country.

#### **Operational Priorities**

- There are several industries, owned by the State, which are at the start of the privatisation and restructuring process. Key among these are the ship-building industry and tourism companies. The Bank is ready to work with the Government, new investors and the companies to facilitate this process, either through debt or equity finance, provided that restructuring plans are agreed in advance. Moreover, recently privatized heavy industry companies, such as the steel works in Split and Sisak, will need new investments for energy efficiency and environmental improvements. The Bank is ready to finance such investments.

- The Bank is planning to support well-managed local tourism companies with a good track record. To encourage FDI in the sector, the Bank will also seek to support experienced international tourism operators entering Croatia where the Bank's financing is additional and where the Bank's participation facilitates political acceptance of the foreign investment. Finally, the Bank is ready to support the privatisation of tourism properties owned by the State. Many of these properties are in need of substantial investment and balance sheet restructuring, which the Bank can provide. Management will also need to be strengthened for the Bank to proceed with such investments. In addition the Bank welcomes the opportunity to support the redevelopment and upgrading of tourism facilities on Brijuni Island and the Brijuni Riviera project, provided that such development is carried out in accordance with applicable legislation and best practices with respect to preservation of natural parks.
- The Bank will continue to develop its good relations with leading Croatian companies, in particular clients in the retail and agribusiness sector, by facilitating their access to capital markets and supporting their expansion and consolidation as regional players. The Bank will seek opportunities to invest equity into growing companies with strong management.

### **3.2.2 The Financial Sector**

*Based on the analysis in section 2.2.2, the following Transition Goals are relevant for the financial sector.*

#### **Transition Goals**

- Broaden and deepen financial services available to SMEs.
- Facilitate efficient balance sheet management by local banks.
- Support privatisation of state-owned financial institutions.
- Encourage consolidation in the sector by investing in small institutions with a view to merging them with others.
- Finance experienced private equity fund managers.

#### **Operational Priorities**

The Bank continues to be active in the field of SME finance in Croatia. During the past Strategy period, the Bank has signed SME Finance Facility loans with Raiffeisen Leasing and S-Leasing as well as Hrvatska Postanska Banka (HPB). Leasing companies are particularly interested in developing their operations with SMEs and appreciate the TC offered under the Facility. HPB, which is owned by the State, has new management and is growing its SME business as a top priority. All of these projects reflect the Lessons Learned in the sector, with precise definitions of eligible beneficiaries and with TC to improve the performance of the intermediaries in managing their SME operations. The larger foreign owned banks, in contrast, are limiting the growth of their balance sheets in response to the measures undertaken by the National Bank. Given the limited interest in borrowing by many of the leading banks, the Bank will offer to share the risk on their SME loan portfolios. This could reduce the capital allocation of such SME loans in their balance sheets. The Bank will

consider finance for factoring companies under the Trade Facilitation Programme. Factoring increases liquidity by making timely cash payments available to SMEs.

As Croatian banks have developed sizeable portfolios of similar assets (e.g. mortgage loans, auto loans), there is a need for legislation on securitisation. A draft law is under discussion by interested parties at present, and is expected to be passed into law later in the year. The Bank is prepared to assist Croatian banks with securitisation of their receivables if and when the legal environment, regulatory treatment and market conditions are supportive of securitisation transactions.

The Bank would consider participating in the privatisation of HPB, the postal bank and the national insurance company, Croatia Osiguranje. The Bank maintains regular dialogue with the Ministry of Finance on their plans for the State shareholding in these companies.

Though market share is concentrated among the largest foreign owned banks, there are still several locally owned banks with small market share. The Bank will explore opportunities to invest in these banks, with a view to merge with other institutions to give them the critical size needed to be competitive.

The Bank continues to seek out experienced fund managers, with a good track record, who are interested in investing private equity in Croatia. The Bank signed four regional private equity funds in 2006 which include Croatia in their investment guidelines; however, no investments have been made to date.

### **3.2.3 Infrastructure and Energy**

*Based on the analysis in section 2.2.2, the following Transition Goals are relevant for the infrastructure sector.*

#### **Transition Goals**

- Introduce new financing instruments, such as revenue bonds, to municipalities.
- Facilitate development of MEI projects on a regional basis, where feasible.
- Increase energy security through diversity of supply including the introduction of renewable energy sources to the power grid, and improve energy efficiency for households and industrial users.
- Improve regional economic integration through transport links.
- Facilitate private financing of public infrastructure.

#### **Operational Priorities**

##### *Municipal and Environmental Infrastructure*

The Bank has a strong pipeline of projects in municipal and environmental infrastructure. In particular, the Bank has begun preparing water and solid waste projects on a regional basis, as these can offer greater efficiency than smaller, local facilities. In addition, the Bank will continue to prepare projects with cities which will be designed to be eligible for co-financing of IPA funds made available by the EU.

With all MEI operations in Croatia, institution building in the form of TC for the Borrower (and in some cases, the local government) will be provided as part of the projects. The Bank plans to introduce new financial instruments, such as municipal revenue bonds, to facilitate the development of the capital market in Croatia. Finally, the Bank is ready to assist the Government in financing infrastructure investments using the PPP/private finance initiative approach. With regard to PPPs, the Bank participated in the first conference offered by the government agency responsible for PPPs (the Agency for Investment Promotion, APIU) in March 2007.

### *Energy*

The Bank has been screening projects in the renewable energy sub-sector, with plans to finance eligible projects in the coming Strategy period. In addition, the Bank will seek to promote energy efficiency both for companies and for households, using instruments that benefit from donor support, such as energy efficiency credit lines supported by the EU. Finally, the Bank will seek to finance infrastructure to improve security and diversity of energy supply on a commercial basis, with both private and public operators.

### *Transport*

The Bank will seek opportunities to finance core regional transport networks and modernisation of national transport infrastructure, where possible on a standalone commercial basis. Some important projects, particularly in the rail sector, can only be financially viable with support from the sovereign. The Bank will coordinate closely with the Government and other IFIs on these and will support sector reform and commercialisation of activities. It will also support restructuring and commercialisation in other sensitive sectors such as shipyards, which rely on state subsidies. The Bank will promote greater participation of the private sector in the development of transport infrastructure through concessions for the development of motorways, airports and ports, in particular.

## **4. COOPERATION WITH OTHER IFIs AND MULTILATERAL DONORS**

The Bank has excellent cooperation with other IFIs and the international donor community in Croatia. In the recent Strategy period, the Bank has signed or approved transactions with both the EIB and the IBRD. In addition, the Bank is working closely with the Government of Croatia and the EU to prepare projects which will fit the priorities and meet the criteria for EU ISPA (now IPA) grant co-financing. The Bank has had strong support from the Governments of the Netherlands and Austria, who have funded Technical Cooperation for MEI projects and the BAS programme respectively.

### **4.1 The European Commission**

In October 2005, the European Union opened accession negotiations with Croatia. The screening process was completed in October 2006 and negotiations have been provisionally opened and closed on the chapters on science and research and on education and culture. Three more chapters were opened in December 2006,

specifically the chapters on Economic and Monetary Union, Enterprise and Industrial Policy and Customs Union.

Details on the *acquis communautaire*, and steps required of Croatia to implement them, are described in the European Commission's first Regular Report on Croatia's progress, issued in November 2006 ([http://ec.europa.eu/enlargement/key\\_documents/reports\\_nov\\_2006\\_en.htm](http://ec.europa.eu/enlargement/key_documents/reports_nov_2006_en.htm)). It concluded that "Implementation of the Stabilisation and Association Agreement (SAA) has largely continued without major difficulty. Notable exceptions include delayed compliance with the state aid provisions and in particular the need to present restructuring plans in the shipbuilding and steel sectors. There are also difficulties with the provisions on access to real estate, where existing rules are not being applied in a full and expedient manner as required by the SAA."

The revised Accession Partnership was adopted in February 2006, which sets out priorities that Croatia should address in its preparations for accession in the short- and medium-term. Croatia has in turn adopted the Strategic Development Framework 2006 – 2013, which defines its economic and social development goals as well as measures necessary for their realisation based, among other things, on the priorities related to the process of EU accession.

Based on the assessment of strategic needs and priorities set out in the Accession Partnership and the Progress Reports for Croatia, the document called "Multi-annual Indicative Planning Document for Croatia" for the period 2007-2009 concentrates on three areas of activity:

- Institutional Capacity Building;
- Cross-border cooperation;
- Preparation for participation in the Community's cohesion policy and rural development instruments.

EC pre-accession financial assistance amounted to EUR 140 million for 2006. The Commission has conferred the management of aid on a decentralised basis to the Ministry of Finance from February 2006, while the Commission maintains *ex ante* approval requirements. Croatia will receive assistance in the amount of EUR 590 million until 2010 from the EU through the IPA (Instrument for Pre-Accession Assistance). In 2007, Croatia will have access to EUR 138.5 million.

The Bank maintains regular contacts with the Delegation, both with respect to policy dialogue on economic reforms and to EC-supported projects. The latter includes projects under preparation for IPA financing, the ISPA-funded Karlovac waste water project, and SME Finance Facility projects.

## **4.2 European Investment Bank**

EIB started operations in Croatia in 2001 and, with the start of accession negotiations, has become a significant lender for public sector infrastructure and the financial sector. EIB has funded a total of EUR 911 million, as follows: EUR 545 million (60 per cent) transport infrastructure; EUR 200 million (22 per cent) urban infrastructure,

EUR 91 million (10 per cent) energy; and EUR 76 million (8 per cent) in lines of credit through local banks. In 2006, EIB and the Bank co-financed the completion of Zagreb-Rijeka Motorway, building on cooperation in co-financing an earlier phase of this project. In addition, the Bank and EIB have co-financed Cro-Control, the air traffic control centre based at Zagreb Airport. Future joint operations are under discussion. EIB and the Bank have regular discussions, and cooperate on policy dialogue.

#### **4.3 International Bank for Reconstruction and Development (IBRD)**

Since 1990, the IBRD has offered support for 32 projects with a total value of USD 1.8 billion and it has approved over 48 grants with a total value of USD 51.5 million. In fiscal year 2006, IBRD commitments to the country totalled USD 370 million. The total active lending portfolio as of February 2007 consists of 13 projects with total commitments of USD 644.2 million. The IBRD's lending has been concentrated in the financing of infrastructure (47 per cent), human and social development (15 per cent) and support for structural reforms (21 per cent). Recently, the Bank and the IBRD have agreed to co-finance the Trade and Transport Integration project, aimed at improving the capacity of the Port of Ploče.

In addition, the IBRD has been negotiating the second Programmatic Adjustment Loan. The first PAL (EUR 150 million) was signed in 2005. PAL II negotiations were prolonged due in part to lengthy discussions on a draft Law on Privatisation, particularly as concerns the terms of Employee Share Ownership Plans. This element of the draft Law has now been removed. The PAL II negotiations took place in mid January 2007. The PAL II is split into two tranches - an initial tranche of EUR 100 million which would be released upon Board approval of the programme. A floating tranche of EUR 50 million would be available at a later stage. Among other things, the IBRD requested that the Government complete privatisation of the steelworks and aluminium plant and advertise the sale of four subsidiaries of Croatian Railways before PAL II is presented to the IBRD Board. By late April these requirements were by and large met. The second tranche should become available upon the completion of majority sale of Uljanik shipyard, and the sale of four and the advertisement for sale of additional two subsidiaries of Croatian Railways.

#### **4.4 International Finance Corporation**

Since Croatia became a member in 1993, IFC has committed some USD 380 million of its own funds and has arranged over USD 97 million in syndications. To date, IFC investments in Croatia typically have been loans in financial markets and general manufacturing projects. Recently, IFC has made loans to Privredna Banka Zagreb and Lidl Croatia; the two projects combined represent close to USD 150 million in IFC loans investments. In 2006, IFC made a USD 49 million loan to the largest food processing and retail company in Croatia, Agrokor, for the post-privatisation restructuring and modernisation of two recently acquired subsidiaries. The Bank and IFC are currently negotiating the first joint investment for the two IFIs in a GS Hotels, a Croatian company, for signing in 2007.

#### **4.5 International Monetary Fund**

During 2006, Croatia concluded its Stand-By Arrangement with the IMF. Consultations under Article IV were held in November 2006. Preliminary conclusions noted that, despite improvement to the fiscal situation over the Stand-By Arrangement period, the deteriorating current account and continued high level of external indebtedness require that the Government continue to improve fiscal discipline. In addition, the Fund emphasised the State's presence in the economy must be reduced, while progress in key structural reforms and improvement in business conditions are needed if Croatia is to gain a higher level of sustainable economic growth. In this respect, the Government's Strategic Development Framework provides a target of GDP growth per annum of 5.1 per cent for the period 2006-2009 and 7.3 per cent for 2010 – 2013, while reducing the fiscal budget deficit continuously to attain a general government deficit of 1.5 per cent of GDP. To attain these objectives the Government will need to adhere closely to the recommendations of the Fund, particularly with regard to reduction of expenditure. This should be achieved through (i) a civil service reform; (ii) further progress in implementing the adopted health reform strategy; (iii) better targeting of welfare, family, and health; and (iv) full implementation of the existing medium-term subsidy-reduction plan, especially as regards the railways, and the shipyard restructuring plan.

#### **4.6 Council of Europe Development Bank (CEDB)**

As of year end 2006, CEDB has signed 15 projects in the total amount of EUR 325.6 million. Its focus has been on health, education and housing (especially for refugees), job creation and SMEs, and restoration of war-damaged sites of cultural and historical importance.

#### **4.7 United Nations Development Programme**

The UNDP is active in Croatia in five key areas. These include local development (the Areas of Special State Concern, affected by the war), business partnerships (focused on corporate social responsibility), environmental governance (energy efficiency and biodiversity), social inclusion, and human and state security (anti-corruption, control of small arms, and justice reforms).

## ANNEX 1: COMMITTED PROJECTS PER YEAR

As of 28 February 2007

Year	Sovereign	Operation name	Direct / Regional	Total Cost	EBRD Amount	Debt	Equity	Stage
1994	x	Air Navigation System	Direct	18.8	15.5	15.5	0	Completed
1994		<b>TOTAL 1994</b>		<b>18.8</b>	<b>15.5</b>	<b>15.5</b>	<b>0.0</b>	
1995	x	Highway Reconstruction Project	Direct	198.1	36.2	36.2	0	Repaying
1995	x	Electricity Network Reconstruction	Direct	49.0	32.2	32.2	0	Repaying
1995		Zagrebacka Banka Loan Facility	Direct	24.3	19.8	19.8	0	Completed
1995		Zagrebacka Banka IT Loan	Direct	3.1	2.5	2.5	0	Completed
1995		Agri Credit Line: Dalmatinska Banka	Direct	10.2	10.2	10.2	0	Completed
1995		Agri Credit Line: Agro-Obrtnicka Banka	Direct	5.2	5.2	5.2	0	Repaying
1995		Pliva Debt Equity	Direct	91.9	48.0	15.7	32.3	Repaying
1995		<b>TOTAL 1995</b>		<b>381.8</b>	<b>154.1</b>	<b>121.8</b>	<b>32.3</b>	
1996		Panonska Pivovara	Direct	62.1	16.9	16.9	0	Completed
1996		Tourism Credit Line (HBOR)	Direct	25.6	25.6	25.6	0.0	Completed
1996		Trgovacka Banka	Direct	5.0	5.0	5.0	0.0	Completed
1996		Varazdinska Banka	Direct	11.9	11.9	10.2	1.7	Repaying
1996		Dalmatinska Banka II	Direct	7.5	7.5	7.5	0.0	Completed
1996		Bank Austria Equity	Direct	10.7	3.3	0.0	3.3	Completed
1996		Alpe Jadran Banka	Direct	5.1	5.1	5.1	0.0	Repaying
1996	x	Municipal Environmental Investment (HBOR)	Direct	128.0	31.6	31.6	0.0	Repaying
1996		<b>TOTAL 1996</b>		<b>255.9</b>	<b>106.9</b>	<b>101.9</b>	<b>5.0</b>	

Year	Sovereign	Operation name	Direct / Regional	Total Cost	EBRD Amount	Debt	Equity	Stage
1997		Hypo Banka Croatia (HBC)	Direct	13.6	2.9	0.0	2.9	Completed
1997		Medimurska Banka	Direct	5.1	5.1	5.1	0.0	Completed
1997		Bjelovarska Banka	Direct	7.7	7.7	7.7	0.0	Repaying
1997		Croatia Capital Partnership (CCP)	Direct	26.7	5.4	0.0	5.4	Disbursing
1997	x	Croatia Wholesale Markets Project	Direct	18.8	3.2	3.2	0.0	Repaying
1997		<b>TOTAL 1997</b>		<b>71.9</b>	<b>24.3</b>	<b>16.0</b>	<b>8.3</b>	
1998		Zagrebacka Banka - Mortgage Finance Facility	Direct	51.1	28.4	28.4	0.0	Repaying
1998		Podravka Restructuring	Direct	149.1	25.5	0.0	25.5	Completed
1998		Slavonska banka	Direct	24.4	14.6	5.1	9.5	Completed
1998	x	Zagreb Solid Waste Programme (ZGOS)	Direct	61.8	32.1	32.1	0.0	Repaying
1998	x	Railway Reconstruction Project	Direct	172.1	27.5	27.5	0.0	Repaying
1998		BankAustria Creditanstalt Croatia d.d.	Direct	22.0	4.6	0.0	4.6	Completed
1998		<b>TOTAL 1998</b>		<b>480.5</b>	<b>132.7</b>	<b>93.1</b>	<b>39.6</b>	
1999		VIP-NET GSM	Direct	341.9	22.4	22.4	0.0	Completed
1999		Uniqa Osiguranje	Direct	1.8	1.8	0.0	1.8	Disbursing
1999		Uniqa Osiguranje	Direct	5.0	1.0	0.0	1.0	Disbursing
1999		Erste Mandatory Pension Fund management Company	Direct	4.0	4.0	0.0	4.0	Disbursing
1999	x	Rijeka sewerage services project	Direct	8.8	8.1	8.1	0.0	Repaying
1999		Trgovacka banka 2nd Loan	Direct	3.6	3.6	3.6	0.0	Repaying
1999		Bjelovarska banka 2nd Loan	Direct	7.4	7.4	7.4	0.0	Repaying
1999		<b>TOTAL 1999</b>		<b>372.5</b>	<b>48.3</b>	<b>41.5</b>	<b>6.8</b>	

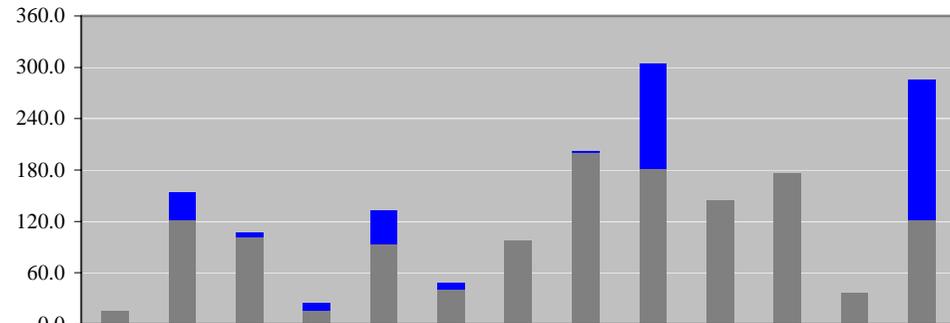
Year	Sovereign	Operation name	Direct / Regional	Total Cost	EBRD Amount	Debt	Equity	Stage
2000		Bank Austria Creditanstalt	Direct	5.0	5.0	5.0	0.0	Completed
2000		Pliva - Research Facility	Direct	81.1	19.7	19.7	0.0	Completed
2000		Agrokor	Direct	150.0	58.0	58.0	0.0	Completed
2000		Nasicecement	Direct	15.0	15.0	15.0	0.0	Repaying
2000		<b>TOTAL 2000</b>		<b>251.1</b>	<b>97.7</b>	<b>97.7</b>	<b>0.0</b>	
2001	x	HBOR SME Facility / CEDB Co-Financing Facility	Direct	20.0	6.0	6.0	0.0	Disbursing
2001	x	INA: Environmental Rehabilitation	Direct	36.0	36.0	36.0	0.0	Disbursing
2001		Internet Framework: Globalnet	Direct	3.3	1.8	0.0	1.8	Disbursing
2001		Loan Extension: VipNet GSM d.o.o.	Direct	154.9	2.1	2.1	0.0	Completed
2001		Vetropack Straza	Direct	67.8	12.5	12.5	0.0	Repaying
2001	x	Rijeka-Zagreb Motorway	Direct	140.0	60.0	60.0	0.0	Repaying
2001		Zagreb Wastewater Treatment Plant	Direct	292.7	35.2	35.2	0.0	Disbursing
2001		Privredna Banka Zagreb - Mortgage Facility	Direct	40.0	40.0	40.0	0.0	Repaying
2001	x	Uljanik Shipyard	Direct	25.3	9.0	9.0	0.0	Signed
2001		<b>TOTAL 2001</b>		<b>780.0</b>	<b>202.6</b>	<b>200.8</b>	<b>1.8</b>	
2002		Raiffeisenbank Austria d.d., Zagreb	Direct	30.0	30.0	30.0	0.0	Repaying
2002		Getro d.o.o	Direct	110.5	25.0	16.0	9.0	Repaying
2002		Zaba Warehouse Receipt Programme	Direct	71.4	25.0	25.0	0.0	Completed
2002		Erste & Steiermärkische Bank d.d	Direct	20.0	20.0	20.0	0.0	Repaying
2002	x	Croatian Air Traffic Control	Direct	54.9	25.0	25.0	0.0	Repaying
2002		Privredna Banka Zagreb – 2nd phase of privatisation	Direct	114.3	114.3	0.0	114.3	Disbursing

Year	Sovereign	Operation name	Direct / Regional	Total Cost	EBRD Amount	Debt	Equity	Stage
2002	x	Croatia Motorway Rehabilitation Project	Direct	123.6	46.5	46.5	0.0	Disbursing
2002		Corporate Loan to VIP-Net GSM	Direct	143.2	19.2	19.2	0.0	Completed
2002		<b>TOTAL 2002</b>		<b>667.9</b>	<b>305.0</b>	<b>181.7</b>	<b>123.3</b>	
2003	x	Rijeka sewerage services project - Loan extension	Direct	0.6	0.6	0.6	0.0	Repaying
2003		HVB Bank Croatia d.d. ("HVB") Mortgage Finance Facility	Direct	15.0	15.0	15.0	0.0	Disbursing
2003		Zaba Warehouse Receipt Programme - Renewal	Direct	71.4	25.0	25.0	0.0	Completed
2003		Zagreb Solid Waste Programme (ZGOS) - Refinancing	Direct	33.0	18.8	18.8	0.0	Repaying
2003		Zagrebacka banka – Small municipality finance facility	Direct	21.1	20.0	20.0	0.0	Disbursing
2003		Nasicecement	Direct	40.0	20.0	20.0	0.0	Disbursing
2003	x	Croatian Motorway - Corridor 10 Motorway Completion	Direct	90.0	45.0	45.0	0.0	Signed
2003		<b>TOTAL 2003</b>		<b>271.1</b>	<b>144.4</b>	<b>144.4</b>	<b>0.0</b>	
2004		Zagrebacka banka – New Mortgage Finance Facility	Direct	100.0	100.0	100.0	0.0	Disbursing
2004		Lura d.d.	Direct	8.5	8.5	8.5	0.0	Disbursing
2004		Zaba Warehouse Receipt Programme – Renewal	Direct	71.4	25.0	25.0	0.0	Signed
2004		Dubrovnik Urban Transport Development Project	Direct	7.5	7.5	7.5	0.0	Disbursing
2004		Getro II	Direct	79.6	35.0	35.0	0.0	Signed
2004		<b>TOTAL 2004</b>		<b>267.0</b>	<b>176.0</b>	<b>176.0</b>	<b>0.0</b>	

Year	Sovereign	Operation name	Direct / Regional	Total Cost	EBRD Amount	Debt	Equity	Stage
2005		Port of Dubrovnik Infrastructure Modernisation Project	Direct	33.7	26.5	26.5	0.0	Disbursing
2005		Karlovac Wastewater Management Project	Direct	20.0	10.0	10.0	0.0	Signed
2005		<b>TOTAL 2005</b>		<b>53.7</b>	<b>36.5</b>	<b>36.5</b>	<b>0.0</b>	
2006		EU/EBRD SME Finance Extension 6-Raffeisen Leasing	Direct	10.0	10.0	10.0	0.0	Disbursing
2006		Agrokor - Equity	Direct	110.0	110.0	0.0	110.0	Disbursing
2006		Pula Urban Transport	Direct	6.6	5.0	5.0	0.0	Disbursing
2006	x	Autocesta Rijeka-Zagreb (ARZ) Project Extension	Direct	260.0	50.0	50.0	0.0	Signed
2006		Privredna banka Zagreb d.d.-Capital Increase	Direct	250.0	53.7	0.0	53.7	Disbursing
2006		Zagreb Wastewater Treatment Plant BOT-Loan increase	Direct	11.0	7.0	7.0	0.0	Signed
2006		EU/EBRD SME Finance Extension 6-Hrvatska postanska banka	Direct	10.0	10.0	10.0	0.0	Disbursing
2006	x	Rijeka Bypass	Direct	114.0	40.0	40.0	0.0	Signed
2006		<b>TOTAL 2006</b>		<b>771.6</b>	<b>285.7</b>	<b>122.0</b>	<b>163.7</b>	
2007		Erste & Steiermaerkische S-Leasing	Direct	10.0	10.0	10.0	0.0	Signed
2007		<b>Total 2007 (Jan – Feb)</b>		<b>10.0</b>	<b>10.0</b>	<b>10.0</b>	<b>0.0</b>	
		<b>OVERALL 1994 – Feb 2007</b>		<b>4,653.8</b>	<b>1,739.7</b>	<b>1,358.9</b>	<b>380.8</b>	

**Total amount committed (debt/equity) per yer**

EUR mm



■ Equity	0.0	32.3	5.0	8.3	39.6	6.8	0.0	1.8	123.3	0.0	0.0	0.0	163.7
■ Debt	15.5	121.8	101.9	16.0	93.1	41.5	97.7	200.8	181.7	144.4	176.0	36.5	122.0

## ANNEX 2: NET CUMULATIVE BUSINESS BY INDUSTRY

(in EUR million, as of 28 February 2007)

Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of Commitments
<b>Energy</b>	Natural Resources	1.0	32	32	32	0	2%
	Power and Energy	1.0	49	32	32	0	2%
<b>Sub-total Energy</b>		<b>2.0</b>	<b>81</b>	<b>64</b>	<b>64</b>	<b>0</b>	<b>4%</b>
<b>Financial Institutions</b>	Bank Equity	6.2	235	199	5	194	13%
	Bank Lending	13.6	370	298	298	0	19%
	Equity Funds	1.9	103	35	0	35	2%
	Non Bank Financial Institutions	1.8	38	31	21	11	2%
	Small Business Finance	0.1	2	2	2	0	2
<b>Sub-total Financial Institutions</b>		<b>23.6</b>	<b>748</b>	<b>565</b>	<b>324</b>	<b>242</b>	<b>36%</b>
<b>General Industry</b>	General Industry	4.0	264	101	69	32	6%
<b>Sub-total General Industry</b>		<b>4.0</b>	<b>264</b>	<b>101</b>	<b>69</b>	<b>32</b>	<b>6%</b>
<b>Infrastructure</b>	Municipal & Env Inf	8.0	597	147	147	0	9%
	Transport	11.0	1,316	369	369	0	23%
<b>Sub-total Infrastructure</b>		<b>19.0</b>	<b>1,913</b>	<b>516</b>	<b>516</b>	<b>0</b>	<b>33%</b>
<b>Specialised Industries</b>	Agribusiness	10.3	861	275	127	149	17%
	Property and Tourism	0.4	44	18	10	9	1%
	Telecoms Informatics & Media	3.1	647	47	46	2	3%
<b>Sub-total Specialised Industries</b>		<b>13.8</b>	<b>1,551</b>	<b>341</b>	<b>182</b>	<b>159</b>	<b>21%</b>
<b>CROATIA TOTAL</b>		<b>62.4</b>	<b>4,557</b>	<b>1,588</b>	<b>1,155</b>	<b>433</b>	<b>100%</b>

### ANNEX 3: PIPELINE STOCK

(in million EUR as of 28 February 2007)

	<b>Structure Review Stock</b>	<b>Final Review Stock</b>	<b>Board Approval Stock</b>	<b>Pipeline Stock</b>
<b>CROATIA</b>	0.0	0.0	73.8	73.8
<b>DEBT</b>	0.0	0.0	48.7	48.7
<b>EQUITY</b>	0.0	0.0	25.1	25.1
<b>PRIVATE</b>	0.0	0.0	62.6	62.6
<b>STATE</b>			11.2	11.2
<b>Non-Sovereign</b>	0.0	0.0	0.0	0.0
<b>Sovereign</b>	0.0	0.0	11.2	11.2
Energy Efficiency	0.0	0.0	0.0	0.0
Natural Resources	0.0	0.0	0.0	0.0
Power and Energy	0.0	0.0	0.0	0.0
<b>Energy</b>				
Bank Lending	0.0	0.0	0.0	0.0
Non Bank Financial Institutions	0.0	0.0	10.0	10.0
Bank Equity	0.0	0.0	0.0	0.0
Equity Funds	0.0	0.0	0.0	0.0
<b>Financial Institutions</b>	<b>0</b>	<b>0</b>	<b>10.0</b>	<b>10.0</b>
General Industry	0.0	0.0	0.0	0.0
<b>General Industry</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Municipal & Env Inf	0.0	0.0	0.0	0.0
Transport	0.0	0.0	11.2	11.2
<b>Infrastructure</b>	<b>0.0</b>	<b>0.0</b>	<b>11.2</b>	<b>11.2</b>
Property and Tourism	0.0	0.0	52.6	52.6
Agribusiness	0.0	0.0	0.0	0.0
Telecoms Informatics & Media	0.0	0.0	0.0	0.0
<b>Specialised Industries</b>	<b>0.0</b>	<b>0.0</b>	<b>52.6</b>	<b>52.6</b>

#### ANNEX 4: BILATERAL ASSISTANCE FOR EBRD PROJECTS

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
AUBA-2004-01-01F	Business Advisory Service (BAS) Programme project grants, staff salaries, office operating expenses*	AUBA	937,340	741,617	08/01/04	Disbursing	McPhee J.	Manufacturing	TAM BAS Programme
AUS-1997-07-03	Municipal Environmental Infrastructure Investment Programme - institutional strengthening	AUS	227,852	227,852	21/07/97	Closed	Covenden P.	MEI	Municipal & Environmental Infrastructure
AUS-2001-08-05	Business Advisory Service (BAS) Programme - BAS Programme Director in Croatia, Peter Siretz	AUS	23,932	23,932	20/08/01	Closed	McPhee J.	Manufacturing	TAM BAS Programme
AUS-2002-10-06	Business Advisory Service (BAS) Programme - BAS Programme Director in Croatia, Peter Siretz	AUS	40,726	40,726	31/10/02	Closed	McPhee J.	Finance, Business	TAM BAS Programme
AUS-2005-09-04	Dubrovnik Public Transport Twinning Agreement	AUS	99,010	84,792	16/09/05	Disbursing	Bruggeman G.	Transport, Storage	Municipal & Environmental Infrastructure
BEL-1995-10-01	Agribusiness line of credit - Dalmatinska banka d.d.	BEL	95,532	95,532	25/08/95	Closed	Hume T.	Finance, Business	Agribusiness
BRSF-2000-12-04	City of Zagreb Creditworthiness Enhancement Programme	BRSF	90,000	90,000	07/12/00	Committed	Indic D.	Community/Social Services	Municipal & Environmental Infrastructure
BRSF-2001-07-04	Uljanik Shipyard	BRSF	47,940	47,940	09/07/01	Closed	Hyslop J.	Manufacturing	Property and Tourism
BRSF-2001-07-05	Uljanik Shipyard	BRSF	34,000	34,000	09/07/01	Closed	Hyslop J.	Manufacturing	Property and Tourism

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
BRSF-2001-11-06	City of Rijeka Creditworthiness Enhancement Programme	BRSF	159,990	148,783	22/11/01	Disbursing	Indic D.	Finance, Business	Municipal & Environmental Infrastructure
BRSF-2002-04-06	Rijeka Water and Sewerage Company - Financial and Operational Improvement Project ("FOPIP")	BRSF	73,075	33,312	18/04/02	Disbursing	Indic D.	Finance, Business	Municipal & Environmental Infrastructure
BRSF-2002-09-07	Croatian Tourism Privatisation Framework	BRSF	75,240	75,240	27/09/02	Closed	Krapotkin A.	Community/Social Services	Property and Tourism
BRSF-2005-09-02F	Business Advisory Service (BAS) Programme project grants, office operating expenses*	BRSF	169,177	49,824	20/09/05	Disbursing	McPhee J.	Manufacturing	TAM BAS Programme
CANSE-2000-12-01	City of Zagreb Creditworthiness Enhancement Programme	CANSE	67,352	67,352	07/12/00	Closed	Indic D.	MEI	Municipal & Environmental Infrastructure
CANSE-2004-02-01	Croatian Railways Network Management: Project Preparation	CANSE	197,000	0	20/02/04	Committed	Lukasik A.	Transport/Storage	Transport
CEI-1998-07-10	Design and supervision consultants for Croatia Wholesale Markets	CEI	1,159,421	737,639	10/07/98	Disbursing	Galic S.	Manufacturing	Agribusiness
CEI-1999-08-03	Business Advisory Service (BAS) Programme in Croatia	CEI	133,130	0	04/08/99	Decommitted	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2000-06-01	Business Advisory Service (BAS) Programme in Croatia - Ana Betica	CEI	24,633	24,633	20/06/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2000-06-02	Business Advisory Service (BAS) Programme in Croatia TAM Management & Support	CEI	37,600	37,600	20/06/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
CEI-2000-06-03	Business Advisory Service (BAS) Programme in Croatia subsidy contributions	CEI	760,000	759,928	20/06/00	Disbursing	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2000-06-04	Business Advisory Service (BAS) Programme in Croatia office operating expenses	CEI	71,600	71,696	20/06/00	Disbursing	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2000-06-05	Business Advisory Service (BAS) Programme in Croatia office rent and OpEx	CEI	86,822	85,944.50	20/06/00	Disbursing	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2000-06-06	Business Advisory Service (BAS) Programme in Croatia office equipment and furniture	CEI	20,967	20,967	20/06/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2000-07-08	Business Advisory Service (BAS) Programme in Croatia - Local Programme Director	CEI	61,431	61,431	07/07/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2000-07-09	Business Advisory Service (BAS) Programme in Croatia - Travel Expenses for Udo Schedel	CEI	9,680	9,680	12/07/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2000-09-11	Business Advisory Service (BAS) Programme in Croatia Project Officer	CEI	36,688	36,688	27/09/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2001-10-04F	Business Advisory Service (BAS) Programme project grants*	CEI	75,000	73,220	18/10/01	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2002-08-02	Business Advisory Service (BAS) Programme in Croatia National Programme Director Kruno Placko	CEI	14,482	14,482	07/08/02	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2002-08-03	Business Advisory Service (BAS) Programme in Croatia Asst to National Programme Director, Ana Betica	CEI	6,273	6,273	07/08/02	Closed	McPhee J.	Manufacturing	TAM BAS Programme

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
CEI-2002-12-04	BAS Programme / Contract of the BAS Croatia National Programme Director, Ana Klaric	CEI	21,965	21,965	23/12/02	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2002-12-05	BAS Programme / Contract Extension of the BAS Croatia Assistant to National Programme Director, Ana Betica	CEI	3,111	3,111	23/12/02	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2003-05-01	Programme evaluation - BAS-SEE-03-30	CEI	9,748	9,748	22/06/99	Closed	McPhee J.	Manufacturing	TAM BAS Programme
CEI-2003-07-01F	Business Advisory Service (BAS) Programme project grants*	CEI	217,781	157,315	17/07/03	Disbursing	McPhee J.	Manufacturing	TAM BAS Programme
DEN-1998-01-01	Zagreb landfill rehabilitation programme - municipal finance analysis of the City of Zagreb	DEN	38,828	38,828	19/01/98	Closed	Mathiesen J.	MEI	Municipal & Environmental Infrastructure
ECMF-2003-08-01F	Croatia - small and medium size municipalities - TA to Commercial Banks	ECMF	150,000	0	29/08/03	Committed	Mrkic T.	Finance, Business	Zagreb (Croatia)
ECMF-2003-08-02F	Croatia - small and medium size municipalities - TA to Commercial Banks	ECMF	150,000	49,650	29/08/03	Committed	Mrkic T.	Finance, Business	Zagreb (Croatia)
ECMF-2003-11-03F	Croatia - small and medium size municipalities	ECMF	350,000	0	21/11/03	Committed	Mrkic T.	Finance, Business	Zagreb (Croatia)
ECMF-2003-11-04F	Croatia - small and medium size municipalities - TA to Commercial Banks	ECMF	350,000	0	26/11/03	Committed	Maguire J.	Finance, Business	Municipal & Environmental Infrastructure

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
FIN-1999-10-12	TurnAround Management Programme (TAM) - Podravka	FIN	48,222	48,222	06/10/99	Closed	McPhee J.	Manufacturing	TAM BAS Programme
FIN-2000-12-09	Hrvatske Zeljeznice, Energy Management Programme - Preliminary Assessment	FIN	13,070	13,070	21/12/00	Closed	McCallion T.	Energy	Energy Efficiency
FLN-1997-13-03	Review of the Jakusevac Landfill Rehabilitation project - feasibility study	FLN	48,960	48,960	22/09/97	Closed	Mathiesen J.	Energy	Municipal & Environmental Infrastructure
FRA-1997-07-03	Municipal Environmental Infrastructure Investment Programme - institutional strengthening	FRA	11,908	11,908	21/07/97	Closed	Covenden P.	MEI	Municipal & Environmental Infrastructure
FRA-1999-10-05	Rijeka Water and Sewerage Project - Kantrida sewerage extension project review, financial due diligence	FRA	13,899	13,899	08/09/99	Closed	Covenden P.	Energy	Municipal & Environmental Infrastructure
FRA-2000-05-03	Diagnostic and guidelines for company restructuring - IPK	FRA	10,243	10,243	25/05/00	Closed	Galic S.	Manufacturing	Agribusiness
FRA-2001-10-01	Wholesale Markets Programme - Improvement of Regulatory Framework of Fresh Produce Wholesale	FRA	6,746	4,663	11/01/01	Committed	Galic S.	Manufacturing	Agribusiness
FRA-2002-04-01	Rijeka Water and Sewerage Company - Financial and Operational Improvement Project ("FOPIP")	FRA	51,800	33,664	18/04/02	Disbursing	Indic D.	Finance, Business	Municipal & Environmental Infrastructure
GER-1994-06-07	Electricity Network Reconstruction procurement advisory services	GER	138,334	138,334	17/06/94	Closed	Sjoborg J.	Energy	SEEC Headquarters

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
GER-1996-07-03	Environmental due diligence training for banks	GER	40,942	40,942	19/07/96	Closed	King M.	Community/Social Services	Environmental Appraisal Unit
GERK-1996-03-02	Environmental training for the Croatian Bank for Reconstruction	GERK	36,488	36,488	08/03/96	Closed	King M.	Finance, Business	Environmental Appraisal Unit
GERK-2000-05-05	Diagnostic and guidelines for company restructuring - IPK	GERK	4,310	4,310	25/05/00	Closed	Mettetal G.	Manufacturing	Agribusiness
GERK-2001-04-02	Zagreb Public Transport Project	GERK	129,621	129,621	12/04/01	Closed	Bruggeman G.	Transport/Storage	Transport
GERK-2001-07-07	Business Advisory Service (BAS) Programme in Croatia - Regional Programme Director	GERK	80,000	80,000	09/07/01	Closed	McPhee J.	Manufacturing	TAM BAS Programme
GRE-2000-05-03	Diagnostic and guidelines for company restructuring - IPK	GRE	12,191	12,191	25/05/00	Closed	Mettetal G.	Manufacturing	Agribusiness
GRE-2000-08-05	TurnAround Management Programme (TAM) - Grand Hotel Adriatic	GRE	47,931	47,931	04/08/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
HOL-1995-06-08	Zagrebačka banka - investment banking due diligence and training	HOL	41,736	41,736	09/06/95	Closed	Burak M.	Finance, Business	Financial Institutions
HOL-1996-03-03	Preparation of MEII programme	HOL	178,906	178,906	28/02/96	Closed	Ligot J.	Energy	Municipal & Environmental Infrastructure
HOL-1999-06-01	Project Management Consultant - Zagreb Solid Waste Management Programme	HOL	454,000	454,000	08/06/99	Closed	Indic D.	Energy	Municipal & Environmental Infrastructure

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
HOL-2000-02-01	TurnAround Management Programme (TAM) - Getro	HOL	29,412	29,412	20/02/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
HOL-2000-11-10	TurnAround Management Programme - Getro d.o.o. II	HOL	39,601	39,601	01/11/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
HOL-2003-06-01	Port of Dubrovnik - Project Preparation	HOL	180,000	147,984	05/06/03	Disbursing	Lukasik A.	Transport/Storage	Transport
ICE-2001-08-01	Wholesale Markets Programme - Improvement of Regulatory Framework of Fresh Produce Wholesale	ICE	9,571	5,553	22/08/01	Committed	Galic S.	Manufacturing	Agribusiness
ICFF-2006-01-01	Karlovac Water and Wastewater Management Project- FOPIP	ICFF	300,000	0	31/01/06	Committed	Schankler. A	Local Authority Services	BG/Op. Teams/MEI
IRL-1999-10-06	TurnAround Management Programme (TAM) - Podravka	IRL	9,438	9,438	28/10/99	Closed	McPhee J.	Manufacturing	TAM BAS Programme
IRL-2000-02-01	TurnAround Management Programme (TAM) - Getro	IRL	26,739	26,739	23/02/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
IRL-2000-07-03	TurnAround Management Programme (TAM) - Nasicecement	IRL	9,203	9,203	19/07/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
IRL-2000-09-04	TurnAround Management Programme (TAM) - Grand Hotel Adriatic	IRL	5,391	5,391	01/09/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
ITA-1993-11-10	Review of draft legislation on securities market	ITA	7,145	7,145	02/11/93	Closed	Pilipovic-Chaffey D.	Community/Social Services	Financial Institutions

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
ITA-1993-11-11	Review of draft banking law	ITA	9,632	9,632	02/11/93	Closed	Pilipovic-Chaffey D.	Finance, Business	Financial Institutions
ITA-1997-01-02	Vrazdinska banka d.d	ITA	98,127	98,127	15/01/97	Closed	Pilipovic-Chaffey D.	Finance, Business	Financial Institutions
ITA-2001-08-09	Wholesale Markets Programme - Improvement of Regulatory Framework of Fresh Produce Wholesale	ITA	7,377	5,529	22/08/01	Committed	Galic S.	Manufacturing	Agribusiness
JAP-1995-03-05	Power investment Master Plan	JAP	297,000	297,000	01/03/95	Closed	Sjoberg J.	Energy	Zagreb (Croatia)
JAP-1995-03-06	Power network tariff study	JAP	61,063	61,063	01/03/95	Closed	Lukac Z.	Energy	SEEC Headquarters
JAP-1995-05-16	Road user charges	JAP	146,242	146,242	01/05/95	Closed	O'Grady L.	Construction	Transport
JAP-1995-05-17	Highway reconstruction - institutional reform	JAP	244,950	244,950	01/05/95	Closed	O'Grady L.	Construction	Transport
JAP-1995-07-22	Zagrebačka banka - environmental due diligence training	JAP	44,131	44,131	01/07/95	Closed	King M.	Finance, Business	Environmental Appraisal Unit
JAP-1995-09-23	Agribusiness line of credit (ACR02)	JAP	163,402	163,402	01/09/95	Closed	Hume T.	Manufacturing	Agribusiness
JAP-1995-09-24	Agribusiness line of credit (ACR03)	JAP	56,155	56,155	01/09/95	Closed	Hume T.	Manufacturing	Agribusiness

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
JAP-1996-02-04	Wholesale market - promotion of private sector	JAP	150,735	150,735	08/02/96	Closed	Mettetal G.	Manufacturing	Agribusiness
JAP-1996-04-10	Tourism Credit Line - Credit Advisor	JAP	180,852	180,852	23/04/96	Closed	McDonald A.	Finance, Business	Financial Institutions
JAP-1997-07-18	Wholesale markets project preparation	JAP	85,038	85,038	25/07/97	Closed	Mettetal G.	Manufacturing	Agribusiness
JAP-1997-11-38	Agri equipment multi project facility - sub-project 1	JAP	12,503	12,503	04/11/97	Closed	Stirling B.	Manufacturing	Agribusiness
JAP-1998-03-12	Wholesale markets - project implementation	JAP	500,000	367,399	31/03/98	Disbursing	Galic S.	Manufacturing	Agribusiness
JAP-1999-01-03	FAO Framework Agreement - Badel	JAP	17,421	17,421	17/01/99	Closed	Mettetal G.	Agriculture, Forestry, Fishing	Agribusiness
LUX-2006-05-06F	Business Advisory Service (BAS) Programme project grants, staff salaries*	LUX	100,000	33,606	27/04/06	Disbursing	McPhee J.	Manufacturing	TAM BAS Programme
NCSM-2004-09-01F	Framework for Technical Assistance to Croatian SMM Municipalities (Dutch funded)	NCSM	1,250,000	0	03/09/04	Disbursing	Indic D.	CEALs, CoFinancing Lines & RVF's	Municipal & Environmental Infrastructure
NCSM-2004-09-01/01	Rijeka Water	NCSM	179,300	167,716	20/01/05	Disbursing	Indic D.	Water	Municipal & Environmental Infrastructure
NCSM-2004-09-01/02	Pula Urban Transport Project Preparation	NCSM	37,000	0	15/05/06	Committed	Bruggeman G.	Urban Transport	Municipal & Environmental Infrastructure

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
NCSM-2004-09-01/03	Pula Waste Water Treatment Development Programme Phase 1 (pre-signing) and Phase 2 (post signing)	NCSM	173,050	0	31/07/06	Committed	Indic D.	Wastewater	Municipal & Environmental Infrastructure
NCSM-2004-09-02F	Framework for Technical Assistance to Croatian SMM Municipalities (Dutch funded)	NCSM	1,250,000	0	03/09/04	Committed	Indic D.	CEALs, CoFinancing Lines & RVF's	Municipal & Environmental Infrastructure
NCSM-2004-09-02/01	Pula Urban Transport Project Preparation	NCSM	29,450	0	04/05/06	Committed	Bruggeman G.	Urban Transport	Municipal & Environmental Infrastructure
NZ-1993-03-01	Power sector reconstruction	NZ	57,536	57,536	18/03/93	Closed	Forbes L.	Energy	SEEC Headquarters
SPA-1997-02-01	Varazdinska banka	SPA	48,919	48,919	24/02/97	Closed	Pilipovic-Chaffey D.	Finance, Business	Financial Institutions
SPA-2001-09-03	Port of Dubrovnik / Passenger Port Development Project	SPA	149,908	70,559	28/09/01	Disbursing	Gutnik S.	Transport/ Storage	Property and Tourism
SPA-2002-09-01	Croatian Tourism Privatisation Framework	SPA	271,951	271,951	27/09/02	Closed	Krapotkin A.	Community/Social Services	Property and Tourism
SWE-1995-04-02	Highway reconstruction project - axle load study	SWE	123,084	123,084	20/04/95	Closed	O'Grady L.	Construction	Transport
SWE-2000-05-04	Diagnostic and guidelines for company restructuring - IPK	SWE	6,771	6,771	25/05/00	Closed	Mettetal G.	Manufacturing	Agribusiness
SWE-2001-05-03	TurnAround Management Programme - MTC Medimurska Trikotaza	SWE	48,400	48,400	09/05/01	Closed	McPhee J.	Manufacturing	TAM BAS Programme

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
SWE-2001-11-15	TAM Programme i: MTC Tvoronica čarapa DD	SWE	24,903	24,902	22/11/01	Closed	McPhee J.	Manufacturing	TAM BAS Programme
SWI-2000-07-05	TurnAround Management Programme (TAM) - Nasicecement	SWI	46,892	46,892	05/07/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
SWI-2001-08-07	TAM Programme - Koestlin	SWI	32,397	32,397	08/05/01	Closed	McPhee J.	Manufacturing	TAM BAS Programme
SWI-2002-06-15	TAM Programme- Dilj	SWI	48,400	48,400	12/06/02	Closed	McPhee J.	Manufacturing	TAM BAS Programme
TAI-1997-01-01	Varazdinska banka d.d	TAI	167,325	167,325	21/01/97	Closed	Pilipovic-Chaffey D.	Finance, Business	Financial Institutions
TCS-1998-01-01	Zagreb landfill rehabilitation programme - municipal finance analysis of the City of Zagreb	TCS	94,948	94,948	19/01/98	Closed	Mathiesen J.	Energy	Municipal & Environmental Infrastructure
TCS-1999-09-01	Rijeka - Kantrida Sewerage Extension Project Review (ii) Financial Due Diligence	TCS	28,803	28,803	08/09/99	Closed	Covenden P.	Energy	Municipal & Environmental Infrastructure
TCS-1999-11-02	Market Study and Strategy Review - Plava Laguna	TCS	66,641	66,641	23/11/99	Closed	Lucaccioni-French C.	Trgovina, turizam	Property and Tourism
UKC-1996-06-15	Slavonska Banka d.d. - due diligence	UKC	175,628	175,628	05/06/96	Closed	Pastor V.	Finance, Business	Financial Institutions
UKC-1997-02-03	Environmental due diligence for Croatian banks - Alpe Jadran Banka, Trgovačka banka, Varaždinska Banka and Hypo Banka	UKC	37,024	37,024	01/02/97	Closed	King M.	Finance, Business	Environmental Appraisal Unit

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
UKC-1997-05-06	Islands Airports / market and institutional organisation study	UKC	182,843	182,843	06/05/97	Closed	Lukasik A.	Transport/Storage	Transport
UKC-1998-01-01	Zagreb landfill rehabilitation programme - municipal finance analysis of the City of Zagreb	UKC	41,340	41,340	19/01/98	Closed	Mathiesen J.	Energy	Municipal & Environmental Infrastructure
UKC-1998-05-03	Dubrovnik municipal services rehabilitation programme	UKC	146,865	146,865	08/05/98	Closed	Walsh I.	Energy	Municipal & Environmental Infrastructure
UKC-1999-09-10	Rijeka - Kantrida Sewerage Extension Project Review (i) Technical Due Diligence	UKC	29,731	29,731	02/09/99	Closed	Covenden P.	Energy	Municipal & Environmental Infrastructure
UKE-1999-11-05	Assessment of Company's Competitive Position and Critical Review of Corporate Strategy - Plava Laguna	UKE	84,543	84,543	29/10/99	Closed	Lucaccioni-French C.	Trgovina, turizam	Property and Tourism
UKE-2001-10-28	Port of Dubrovnik - Passenger Port Development Project	UKE	83,372	41,110	23/10/01	Disbursing	Gutnik S.	Transport/Storage	Property and Tourism
UKF-2000-09-01f	Business Advisory Service (BAS) Programme project grants*	UKF	60,000	60,000	01/09/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
UKF-2000-09-02	TAM Programme - Riviera Holdings	UKF	21,600	21,600	12/09/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme
UKF-2000-11-04	City of Zagreb Creditworthiness Enhancement Programme	UKF	322,333	322,333	29/11/00	Closed	Indic D.	Community/Social Services	Municipal & Environmental Infrastructure
UKF-2001-02-01	TAM Programme - Riviera Holdings	UKF	38,400	38,400	09/05/00	Closed	McPhee J.	Manufacturing	TAM BAS Programme

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
UKF-2003-07-03F	EBRD/TMG BAS Programme in South East Europe	UKF	98,204	83,744	24/07/03	Disbursing	McPhee J.	Manufacturing	TAM BAS Programme
USA-1998-01-01	Zagreb landfill rehabilitation programme - municipal finance analysis of the City of Zagreb	USA	8,415	8,415	19/01/98	Closed	Mathiesen J.	Energy	Municipal & Environmental Infrastructure
USA-1998-05-02	Dubrovnik municipal services rehabilitation programme	USA	35,648	35,648	08/05/98	Closed	Walsh I.	Energy	Municipal & Environmental Infrastructure
USA-2002-07-05	Warehouse Receipt Credit Adviser	USA	27,487	15,596	19/07/02	Disbursing	Bryde P.	Agriculture, Forestry, Fishing	Agribusiness
USSP-2003-12-03	Mikroplus	USSP	188,443	44,611	08/12/03	Disbursing	Pak O.	Finance, Business	Group for Small Business
USTD-2001-12-03	Port of Dubrovnik / Passenger Port Development Project	USTDA	56,242	26,356	05/12/01	Disbursing	Gutnik S.	Transport/ Storage	Property and Tourism
HOL-2005-11-08	Port of Ploce	Dutch	49,950	49,950	08/02/05	Closed	A. Lukasik	Transport Infrastructure	Transport
tbc	Sisak Wastewater Management Project - Feasibility Study	NCSM	200,000	0		to be committed	Tsanova. I	Wastewater	Municipal & Environmental Infrastructure
tbc	Zagreb Holding Company Consolidation and Bond Issuance Programme	NCSM	195,000	0		to be committed	Schankler. A		Municipal & Environmental Infrastructure
tbc	Porec Bypass Project	NCSM	140,000	0		to be committed	Szpak. W	Urban Transport	Municipal & Environmental Infrastructure

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
tbc	Rijeka Municipal Parking	NCSM	125,000	0		to be committed	Indic D.	Parking	Municipal & Environmental Infrastructure
tbc	Istria Regional Waste Management -	NCSM	150,000	0		to be committed	Indic D.	Solid Waste	Municipal & Environmental Infrastructure
tbc	Varazdin Wastewater Development -	NCSM	150,000	0		to be committed	Indic D.	Wastewater	Municipal & Environmental Infrastructure
tbc	Pula Urban Transport - Sustainable Transport Strategy	NCSM	250,000	0		to be committed	Indic D.	Urban Transport	Municipal & Environmental Infrastructure
	<b>TOTAL</b>		<b>17,321,508</b>	<b>10,336,022</b>					

## ANNEX 5: SELECTED ECONOMIC INDICATORS

Croatia	2001	2002	2003	2004	2005	2006 <i>Estimate</i>	2007 <i>Projection</i>
<b>Output and expenditure</b> <i>(Percentage change in real terms)</i>							
GDP	4.4	5.6	5.3	4.3	4.3	4.8	4.7
Private consumption	4.4	7.7	4.6	4.8	3.4	3.5	na
Public consumption	-6.2	4.9	1.3	-0.3	0.8	2.2	na
Gross fixed capital formation	7.1	13.9	24.7	5.0	4.9	10.9	na
Exports of goods and services	8.1	1.3	11.4	5.7	4.6	6.9	na
Imports of goods and services	9.8	13.4	12.1	4.6	3.5	7.3	na
Industrial gross output	6.0	5.4	4.1	3.7	5.1	4.5	na
Agricultural gross output	8.5	7.7	-15.9	11.9	-8.7	na	na
<b>Employment<sup>1</sup></b> <i>(Percentage change)</i>							
Labour force (end-year)	-6.7	1.4	0.1	-0.2	0.7	-2.6	na
Employment (end-year)	-6.0	3.8	0.1	0.5	2.5	-2.0	na
<i>(In per cent of labour force)</i>							
Unemployment (end-year)	16.4	14.5	14.4	13.8	12.3	11.7	na
<b>Prices and wages</b> <i>(Percentage change)</i>							
Consumer prices (annual average)	3.8	1.7	1.8	2.1	3.3	3.2	3.2
Consumer prices (end-year)	2.4	1.8	1.7	2.7	3.6	2.0	2.8
Producer prices (annual average)	3.6	-0.4	1.9	3.5	3.0	2.9	na
Producer prices (end-year)	-3.1	2.3	1.1	4.8	2.7	1.9	na
Gross average monthly earnings in economy (annual average)	3.9	6.0	4.8	6.4	4.4	6.2	na
<b>Government sector<sup>2</sup></b> <i>(In per cent of GDP)</i>							
General government balance	-6.8	-4.9	-6.2	-4.8	-4.0	-3.0	-2.8
General government expenditure	50.7	48.9	51.2	49.7	48.6	47.4	na
General government debt	40.1	40.0	41.0	43.2	43.7	40.8	na
<b>Monetary sector</b> <i>(Percentage change)</i>							
Broad money (M4, end-year)	45.2	9.5	11.0	8.6	10.5	18.0	na
Domestic credit (end-year)	21.6	28.4	12.3	11.8	19.2	18.9	na
<i>(In per cent of GDP)</i>							
Broad money (M4, end-year)	64.0	64.1	65.0	65.1	66.8	72.8	na
<b>Interest and exchange rates</b> <i>(In per cent per annum, end-year)</i>							
Refinancing rate (3 months)	5.9	4.5	4.5	4.5	4.5	4.5	na
Money market rate	2.2	1.9	7.0	6.0	4.0	3.5	na
Deposit rate <sup>3</sup>	2.8	1.6	1.7	1.8	1.6	3.0	na
Lending rate <sup>3</sup>	9.5	10.9	11.5	11.4	9.9	9.1	na
<i>(Kuna per EUR)</i>							
Exchange rate (end-year)	7.4	7.4	7.6	7.7	7.4	7.4	na
Exchange rate (annual average)	7.4	7.4	7.6	7.5	7.4	7.3	na
<b>External sector</b> <i>(In millions of EUR)</i>							
Current account	-818	-2,095	-1,866	-1,404	-1,985	-2,617	-2,836
Trade balance	-4,604	-5,960	-6,974	-6,728	-7,522	-8,364	-9,009
Merchandise exports	5,319	5,293	5,572	6,603	7,217	8,434	9,293
Merchandise imports	9,923	11,253	12,546	13,331	14,738	16,798	18,302
Foreign direct investment, net	1,329	595	1,678	708	1,230	2,670	1,750
Gross reserves, excluding gold (end-year)	5,334	5,651	6,554	6,436	7,438	8,589	na
External debt stock	13,458	15,055	19,811	22,781	25,541	28,998	na
<i>(In months of imports of goods and services)</i>							
Gross reserves, excluding gold (end-year) <sup>4</sup>	5.3	4.9	5.2	4.8	5.1	5.3	na
<i>(In per cent of exports of goods and services)</i>							
Debt service <sup>5</sup>	24.8	22.3	19.7	22.7	25.8	29.2	na
<b>Memorandum items</b> <i>(Denominations as indicated)</i>							
Population (end-year, million)	4.4	4.4	4.4	4.4	4.4	4.4	na
GDP (in billions of kuna)	166	181	198	215	231	251	268
GDP per capita (in EUR)	4,989	5,503	5,906	6,480	7,072	7,686	na
Share of industry in GDP (in per cent)	20.4	19.4	19.5	20.2	20.7	20.5	na
Share of agriculture in GDP (in per cent) <sup>6</sup>	7.5	7.3	6.0	6.5	6.3	6.2	na
Current account/GDP (in per cent) <sup>7</sup>	-3.7	-8.6	-7.1	-4.9	-6.3	-7.7	-7.8
External debt - reserves (in EUR million)	8,125	9,403	13,257	16,344	18,102	20,409	na
External debt/GDP (in per cent) <sup>8</sup>	60.8	61.6	75.5	80.2	82.5	85.5	na
External debt/exports of goods and services (in per cent) <sup>9</sup>	124.6	135.3	150.8	160.0	167.3	170.9	na

<sup>1</sup> Data based on labour force surveys. First half-year for 2006.

<sup>2</sup> Consolidated general government from 2002 onwards.

<sup>3</sup> Weighted average over all maturities.

<sup>4</sup> Ratio calculated in EUR.

<sup>5</sup> Ratio calculated in EUR.

<sup>6</sup> Agriculture includes hunting, forestry and fishing.

<sup>7</sup> Ratio calculated in EUR.

<sup>8</sup> Ratio calculated in EUR.

<sup>9</sup> Ratio calculated in EUR.

## ANNEX 6: ASSESSMENTS OF CROATIA’S COMMERCIAL LAWS

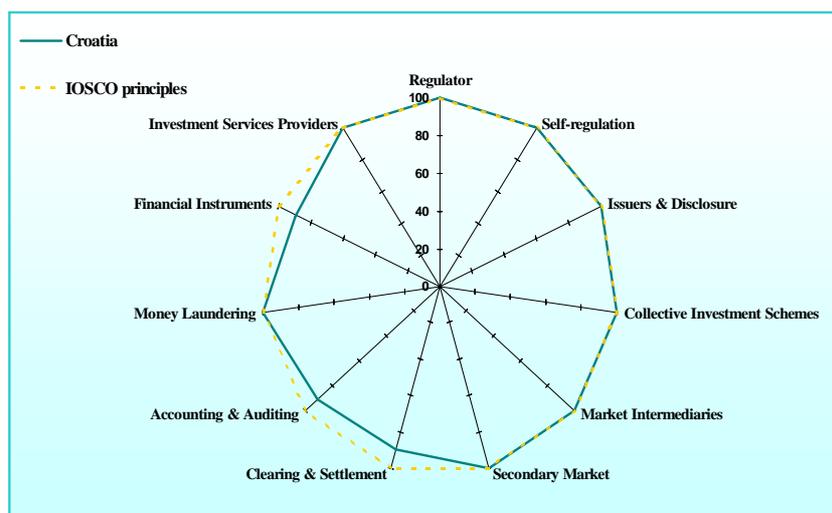
The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). All available results of these assessments can be found at <http://www.ebrd.com/law>. This annex presents a summary of the results for Croatia, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

### Capital Markets

Croatian legislation on capital markets has been largely reformed in the past few years, mainly due to the transposition of the *acquis communautaire*. The primary legislation includes the Securities Market Law, the Law on Take-over of Joint Stock Companies, both issued in 2002, the Law on Investment Funds, enacted in December 2005, and the Act on Croatian Financial Services Supervisory Agency, which entered into force on 1 January 2006.

The oversight of the Croatian capital market is organised under two main bodies: credit institutions are supervised by the Croatian National Bank; the securities market, pension funds and insurance companies are under the supervision of the Croatian Financial Services Supervisory Agency (HANFA). The Agency was established on 1 January 2006 pursuant to the Act on Croatian Financial Services Supervisory Agency. The Act provides for the transfer of the competences of the Insurance Companies Supervisory Authority, the Croatian Securities Commission and the Agency for Supervision of Pension Funds and Insurance, to the new Agency and the dissolution of the three above mentioned bodies.

#### Quality of securities market legislation – Croatia (2005)



*Note:* The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO’s *Objectives and Principles for Securities Regulations*. The fuller the ‘web’, the closer the relevant securities market legislation of the country approximates these principles.

*Source:* EBRD Securities Market Legislation Assessment 2005.

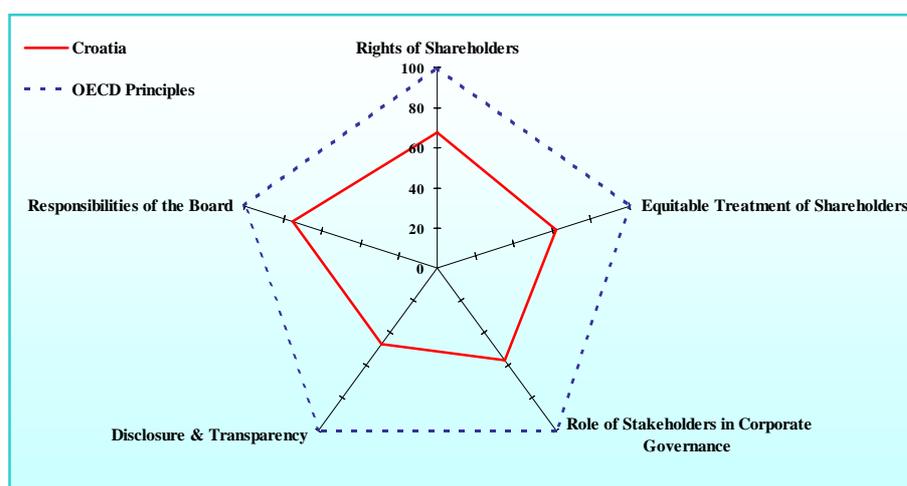
## Legislation Assessment 2005

According to the 2005 EBRD's Securities Market Legislation Assessment, Croatia was found in "high compliance" with the Objectives and Principles of Securities Regulation published by the International Organisation of Securities Commissions (IOSCO). The legislation was found to be sound in all areas under consideration (see chart above). Croatian authorities should now concentrate on improving effective implementation and enforcement issues, while continuing to refine current legislation.

## Company Law and Corporate Governance

The basic corporate governance standards and rules are detailed in the Law on Companies dated 1995 as amended. This law deals with formation, functioning, transformation and winding-up of joint-stock companies and is based on the German two-tier model: the shareholders' meeting elects the members of the supervisory board which in turn appoints the management board.

## Quality of corporate governance legislation – Croatia (2004)



*Note:* The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles.

*Source:* EBRD Corporate Governance Sector Assessment, 2004 assessment.

According to the 2004 EBRD Corporate Governance Sector Assessment, Croatia's legislation was found in medium compliance with the OECD Principles of Corporate Governance. In particular, the assessment revealed the need to improve disclosure and transparency requirements, enhance shareholders' access to information, better detail the functions of the board, introduce independent board members - and define the condition of independence - and establish board committees (e.g. audit committee). Finally, a Corporate Governance Code still needs to be introduced as per Art. 272 of the Law on Companies, which refers to the obligation for listed companies to report on their compliance with the Code.

According to the 2005 EBRD survey dealing with the rights of a minority shareholder vis-à-vis related-party transactions, the better avenue to obtain disclosure is to request an independent audit, but the action can be particularly complex and lengthy. This is also the case when seeking redress as it would take about 3-4 years to obtain an executable judgement. When turning to the institutional environment, the survey revealed that company books are considered reliable but statutory auditors might not be fully independent from

management. The statutory background on related party transaction and the competence and experience of courts, prosecutors and market regulator should be improved. Courts and market regulators are considered impartial but corruption is still reported as a problem. Finally access to case law collections is problematic. As a result, much room for improvement exists.

## **Concessions**

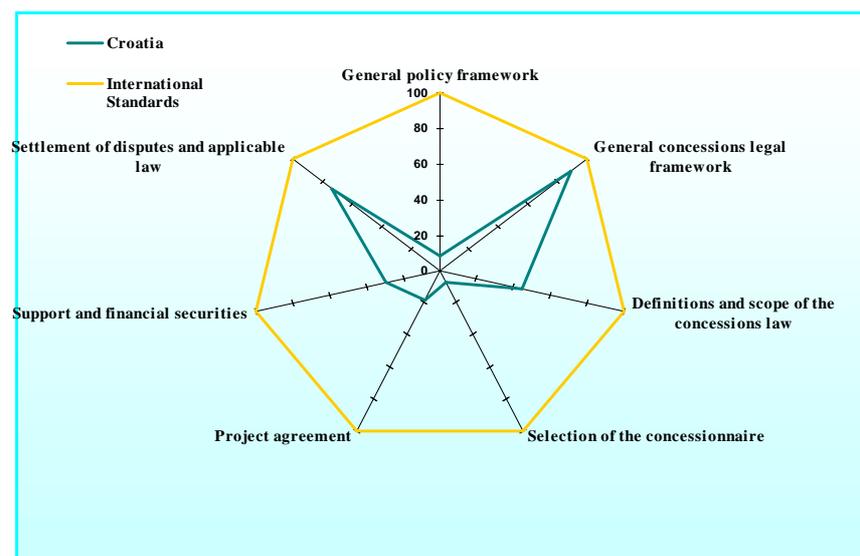
In the last nine months there has been a significant move from the Government in promotion of PPPs (especially PFI models) and that has been supported through the policy and strategy papers produced by the Government. Furthermore the Government has recently introduced the PPP department within the Government Investment Promotion Agency with the prospect to become a separate PPP Agency that would promote and regulate the PPPs in communal infrastructure and public services. As part of the PPP initiative it has been announced that the Concession Law will be amended to secure more clarity and consistency in regulation of PPP initiatives.

Two laws govern the general concession legal framework in Croatia: the *Concession Law* of 1992 (the “Concession Law”) and the *Municipal Activities Law* of 1995 as amended (the “1995 Act”). In addition, concessions in the road and water sectors are regulated by various sector specific laws, such as the Public Roads Law and the Water Law. Both laws are very general and cover only a limited number of issues thus providing insufficient regulation. In fact, the Concession Law and the 1995 Act are considered as subsidiary pieces of legislation compared to the sector-specific legislation and the entire general framework needs to be reformed.

The scope of the application of the Concession Law is not clear. It refers only to resources, property and activities that are of "*interest to the Republic*", such interest being defined by a separate law. The Concession Law does not include a clear definition of a concession as compared to a license or somewhat similar contracts. There are no provisions in the Concession Law regarding tender procedures. The Concession Law does not define the responsibilities of government agencies/ministries in the development and implementation of concessions or licenses and the granting thereof.

The 1995 Act is not entirely clear on some fundamental matters with regard to concessions, such as the authority to grant concessions, the type of services that may be granted through a concession, property rights of a concessionaire, the right to set tariffs and the rights of investors upon termination. The 1995 Act does cover procedural issues, although to a limited extent only. No cross-reference is made in the 1995 Act to the Concession Law or to the various sector specific laws, such as the Public Roads Law or the Water Law.

## Quality of concession legislation –Croatia (2005)



*Note:* The extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The closer the inside line approaches the extremity of the graph, the more closely concessions laws of the country approximate these standards.

*Source:* EBRD Concessions Sector Assessment 2004.

The 2005 EBRD Concession Laws Assessment undertaken to evaluate laws in the EBRD’s 27 countries of operations (as they appear on the books only, rather than how they work in practice), revealed that Croatian laws are in “low compliance” with internationally accepted standards in this sector. As can be seen from the above chart, while settlement of disputes in concession-related arrangements, for instance, is regulated fairly extensively, most other areas, in particular, selection of a concessionaire, project agreement and availability of security instruments and state support need to be dramatically improved in order to meet the requirements of the modern legal framework facilitating private sector participation. The Croatian authorities have benefited from advice on the reform of its general concession framework under an IBRD-sponsored review, but have not yet approved the proposed draft Law.

## Insolvency

Bankruptcy and insolvency in Croatia are governed primarily by the Bankruptcy Law (2000) (as amended) (the “Insolvency Law”), one of the leading insolvency laws in the EBRD’s countries of operations. In the EBRD’s 2004 Sector Assessment, which measured the compliance of insolvency legislation with international standards (extensiveness), Croatia was one of only 6 EBRD countries of operations to receive an overall score of “high compliance”. In July 2006, a significant number of amendments were made, the effects of which should do nothing to reduce this high level of compliance.

The 2006 amendment addresses a number of key problems identified as part of the 2004 Assessment. Third parties can now be required to deliver to the insolvency administrator property, books and records relating to the entity being liquidated. The changes also further refine the test for proving insolvency with the effect being that it may be easier for creditors to establish a presumption that the debtor is insolvent. Creditors will now be required to identify their claims within a specified period, improving on the situation where creditors could identify claims well into the process of the bankruptcy. Additionally, the changes eliminate the requirement that proceedings be terminated when estate assets are insufficient to fund the cost of the liquidation by allowing creditors to advance the costs or, alternatively,

allowing the insolvency administrator to charge his or her fees against a specially created fund while liquidating the estate's assets and paying that money back into the fund.

The changes are less successful in addressing other problems identified by the 2004 Assessment. There is not a clear stay of proceeding provisions, no requirement for independent analysis of reorganisation plans, no provision for restructuring finance and no controls in respect of insider voting.

The 2006 changes make a number of other improvements, specifically in the areas of creditor rights and the oversight and training of insolvency administrators. The amendments allow creditors to appoint and replace administrators while allowing the judge a limited ability to overturn such an appointment, a significant positive step. Creditors are given the right to establish creditor committees and to decide whether or not to retain a committee established by the court. The changes also outline requirements for becoming an insolvency administrator, even requiring lawyers to pass the professional examination.

Clearly, the Insolvency Law is one of the most extensive insolvency laws in the EBRD countries of operations. The 2004 EBRD Legal Indicator Survey measured the effectiveness of insolvency regimes. The Survey demonstrated a large "effectiveness" gap (the difference between the quality of the legislation and the effectiveness of the insolvency regime in practice) in Croatia. This gap underscored the need for further reform work to be done to strengthen courts and other institutions that implement insolvency legislation. For debtors and creditors seeking to commence insolvency proceedings in Croatia, it is relatively easy to determine which court such proceedings should be commenced in and such court is likely to be reasonably adept at dealing with bankruptcy matters. The process, however, is seen as far too expensive, slow and unduly complicated to be truly effective.

### **Secured Transactions**

Taking security in Croatia is a process governed by a complex inter-relation of different acts. The 1996 Law on Ownership and Other Proprietary Rights provides for security rights over immovable and movable assets in a general sense, that is, the security can cover movable as well as immovable assets. In practice however, the transfer of ownership (title) of assets and rights for security purposes by a public notary under the 1996 Law on Execution is the most popular option.

A new Act, the Law on the Register of Pledges (court-ordered and notarised) over movable property and rights was adopted on 11 October 2005 and entered into force eight days later, but was to be applied only six months after this, meaning that the law became effective in mid-April 2006.

The Law provides the legal basis for a register where security rights (pledges) over movable (tangible) property and rights can be registered and made public to third parties. The Law completes the existing legal framework – it is not meant to fundamentally affect the existing system, although it will have important, practical consequences. By way of background, the Croatian legal system had been for some time under attack for not providing practical means by which security rights could be made public. The new Law on Register does not change the substantive law as outlined above (except it seems the possibility to take a charge over generally described assets; however, it now provides a purpose-built institution, the Register, where the security rights and transfers of title can be recorded and searched by third parties.

The Registrar is the Financial Agency (referred as FINA), a new institution born out from the former Yugoslav payment system (so-called ZAP or ZOP). FINA has many functions, in particular it registers the balance sheets and accounts of enterprises, services on behalf and for the account of the commercial banking sector, distribution and processing of cash on behalf of the Croatian National Bank, maintenance of interbank settlement systems, maintenance of the national system for issuance of public keys – Digital Certificate Register (DCR), etc.

It is still too early to fully assess the effects of this reform on the Croatian secured credit market. We can only make a few general remarks, which would need to be confirmed by further assessment from the users. On the one hand, the reform provides a very welcome publicity and transparency to taking security in Croatia. This was long overdue and must be commended. On the other hand, this reform has not simplified or streamlined the substantive law, which is unnecessarily complicated and limiting. Importantly, the Register is construed in quite a bureaucratic fashion: in all likelihood, it will take some time to register and the rules provided as unnecessarily complicated (e.g. rules of jurisdiction of the registration office where registration must be made, which seems unnecessary since the information is entered into a central database). Compared to its neighbours (e.g. Slovakia, Hungary, Bulgaria, Romania, to a certain extent Serbia, and Bosnia), Croatia is setting up a system which is heavy and out-dated. The transitory period of one year will create uncertainty for a substantial period of time: indeed, searching the Register will be inconclusive as to whether previous charges exist or not. So in effect, the benefits of the reform in terms of transparency and certainty will not kick in before April 2007.

## **Telecommunications**

The telecommunications sector in Croatia is currently governed by the Law on Telecommunications, 2003, as amended (the “2003 Telecoms Law”), and is regulated by the Croatian Telecommunications Agency (the “CTA”). CTA is an independent regulatory authority, established in 2004 on the basis of the 2003 Telecoms Law, and is responsible across the sector for the implementation of licensing, interconnection, tariff control, technical standards and other modern regulatory functions. The Ministry of the Sea, Tourism, Transport and Development is the sector policy maker.

Fixed-line teledensity in Croatia remains among the upper tier of central/southern European nations, with approximately 40 per cent, along with 100 per cent network digitisation. While formal liberalisation of the fixed market occurred in 2005, the incumbent, Hrvatski Telekom (HT), partially privatised to Deutsche Telekom, has maintained a strong hold on the market. Competition has, accordingly, been slow to develop. Nonetheless, recent decisions by CTA, such as the adoption of a new reference interconnection offer (RIO) and a reference unbundled offer (RUO) should boost competitive access to the incumbent’s network. Additionally, decisions by CTA identifying dominant operators in relevant individual markets of the sector should, where fully implemented, hasten further opening of the market. Similarly, continued reductions in licence fees to levels, which more mirror European Union (EU) levels, should help eliminate remaining barriers for entry to the market.

The Croatian mobile market has been liberalised since 1998 with healthy competition between the three licensed GSM operators - T-Mobile (the mobile arm of HT), VIP-Net (a consortium led by Mobilkom of Austria) and, more recently, Tele-2 of Sweden. All three

operators have also secured 3G licences, launching 3G services during 2005. Mobile teledensity in Croatia is one of the most developed in the region and currently stands at almost 90 per cent. The arrival of Tele-2 has seen relatively vigorous competition, resulting in apparently genuine price reductions for consumers.

While significant efforts have been made by the authorities to implement an EU reflective competitive environment within the sector in recent years, a number of challenges remain before the full benefits of a competitive market can be reaped by the economy and the consumer. Notable positive developments include the establishment and continued enhancement of capacity at CTA, with CTA recently approving a new RIO and RUO, and declaring a number of operators dominant in the relevant markets, as well as critical tools in breaking the incumbent stranglehold of the local access market. Going forward, CTA should make every effort to ensure that the provisions of the law and the detail of the RIO and RUO are fully and constantly enforced. Additionally, the government, for its part, should ensure that CTA is provided with all necessary resources (financial, legislative and otherwise) to fully implement and enforce the regulatory framework. In the mobile sector, CTA should ensure that recently introduced number portability is fully enforced and that the gains yielded from competition heretofore are not eroded by network roll-out issues. In the area of sector legislation, a completely new electronic communications law is necessary to harmonise with the latest EU *acquis* and provide a coherent and consistent regulatory base for the sector.

## ANNEX 7: ASSESSMENT OF TRANSITION CHALLENGES

CROATIA	Structure	Institutions	Conduct	Comments
<b>Agribusiness</b>	<i>Medium</i>	<i>Medium</i>	<i>Medium</i>	Consolidation and modernization of farms remains a challenge. Although small-scale private farms already existed before independence, there is slow progress with privatization of remaining state-owned farms. Privatization has been undertaken to a large extent, although some companies are still majority state-owned due to a lack of interest from private investors. Commercial banks are actively financing several agribusiness sub-sectors such as processors, food and beverage producers but there is limited finance available to primary agriculture as there is no available security as collateral. Although preliminary work has been undertaken on the development of WHR institutional framework; the draft Law on warehouse receipts has not been approved to date.
<b>Banking</b>	<i>Negligible</i>	<i>Small</i>	<i>Small</i>	The basic regulatory framework is in place. Bank consolidation progressing. Privatisation has been finished, with state-owned banks having no significant asset share. A majority is foreign-owned. Domestic credit to private sector is very high.
<b>Energy Efficiency</b>	<i>Medium</i>	<i>Small</i>	<i>Medium</i>	Energy tariffs have been increased and the industrial sector started to respond to energy price signals. Feed-in tariffs have been proposed to stimulate the renewable sector and a number of wind generators are currently being developed on the Adriatic coast. The ESCO market, however, is at an early stage.
<b>General Industry</b>	<i>Small</i>	<i>Small</i>	<i>Medium</i>	The major transition issues in the sector are related to insufficient progress in reform of judiciary and public administration. Initiatives to strengthen the judiciary were taken in recent years. Restructuring of state owned or formerly state owned enterprises is still pending, but now seems to be moving. Enterprise subsidies are still substantial - state aid amounted to 2.8 per cent of GDP in 2005.
<b>MEI</b>	<i>Medium</i>	<i>Medium</i>	<i>Medium</i>	Municipal services have been transferred to the local authorities and they have mostly been commercialised. Tariffs have been increased and collection is effective, but cross-subsidies persist across the entire sector. Private sector participation remains limited.
<b>MSMEs</b>	<i>Small</i>	<i>Small</i>	<i>Large</i>	Company registration procedures have been significantly simplified with the establishment of a network of “one-stop shops”. Tax system is generally considered transparent. Credit registry has been established in November 2006 and is currently in a testing phase. Collateral and bankruptcy laws are below OECD standards in terms of supporting MSME lending. MSMEs still have very limited access to finance. A number of IFI programmes and TA exist for SME development.
<b>Natural Resources</b>	<i>Small</i>	<i>Small</i>	<i>Medium</i>	A blocking minority in state oil and gas company INA was sold to Hungary’s MOL in 2004. INA has been undergoing restructuring since then. Government sold a further 17 per cent stake in the second stage privatisation in December 2006. INA still remains a vertically-integrated, and dominates the retail sector. Tariff reform, legislative framework and regulation have progressed well. Further measures to enhance EH&S policies are required.

<b>CROATIA</b>	<b>Structure</b>	<b>Institutions</b>	<b>Conduct</b>	<b>Comments</b>
<b>NBFIs</b>	<i>Small</i>	<i>Small</i>	<i>Small</i>	Securities / insurance markets legislation and regulation almost fully meet IOSCO/IAIS standards. Single non-bank financial supervisor, HANFA, has been established in early 2006. Securities markets have been increasing in size but trading volume relative to market capitalisation remains moderate. Insurance penetration is around the level of EU members in CEB although it is small compared to OECD average. State-owned insurance company is yet to be privatised. There are both mandatory and voluntary privately managed pension funds. Leasing market is fully developed although only now expanding into equipment.
<b>Power</b>	<i>Large</i>	<i>Medium</i>	<i>Small</i>	The Croatian power sector is legally unbundled but all main assets remain state owned. An independent regulatory agency was established. Although the government continues to influence tariffs, electricity prices are one of the highest in the region and are characterised by a balanced structure. In line with EU driven market reforms, the power sector is set for gradual liberalisation, in the first step allowing direct imports by large consumers.
<b>Private Equity Funds</b>	<i>Medium</i>	<i>Medium</i>	<i>Large</i>	Sector remains small and the number of transactions falls significantly behind new EU member states. Locally operating funds receive investment capital mostly from domestic government agencies and banks. Increased business activity needed to improve its role in supplying finance to local enterprises.
<b>Property &amp; Tourism</b>	<i>Medium</i>	<i>Medium</i>	<i>Medium</i>	Full tradability of land except foreigners. The real estate sector is developing fast, although focused mostly on the capital and the coast. The major transition issue in the sector is privatisation and restructuring of tourism assets. Transparency in the sector also needs significant improvement.
<b>Telecoms</b>	<i>Small</i>	<i>Medium</i>	<i>Small</i>	Independent, autonomous and not for profit independent regulator established in December 2004. The liberalisation of the telecommunications industry is well advanced. More than 15 fixed line operator licenses were granted to date and 6 new operators are already active; however, Croatia Telekom still has more than 90 per cent market share. As of 2005 there are 3 mobile operators. Number portability in the fixed network became operational in July 2005 and in the mobile network in October 2006.
<b>Transport</b>	<i>Medium</i>	<i>Medium</i>	<i>Medium</i>	In railways, operating and policy setting functions were separated, and core railway businesses, including ancillary services, were unbundled. However, private sector participation is limited to ancillary services. In roads, semi-independent road agencies were established (one for motorways and one for national roads). All contracts for road construction, rehabilitation and periodic maintenance are tendered on a competitive basis to the private sector. There have been a number of road concession projects.

Source: Assessment of Transition Challenges (CS/FP/05-10), 27 April 2005, Annex 1: Country-by-country ratings and rationale synopsis and sector economists.

## ANNEX 8: SOCIO-ECONOMIC ENVIRONMENT

### Socio-Economic Environment

**Human Development and Poverty:** Croatia ranks 45<sup>th</sup> of 177 countries in the world, in terms of human development.<sup>7</sup> Life expectancy at birth for women and men is 79 and 72 years respectively.

There is little absolute poverty in Croatia, however the country has very high levels of wealth disparity and social exclusion exists, particularly between the rural war affected areas and the commercial centres.

Croatia's key challenge is to catch up with time lost in the 1990s in tackling its economic and social transition. It also has to address the legacy of conflict within the former Yugoslavia, particularly on refugee return.

Much has been achieved since the start of the decade in 2000 but significant challenges remain in reforming the public service and the judiciary, and pursuing social policy reforms under the Government's National Poverty Reduction Strategy.

**Human Rights:** The Government generally respects the human rights of its citizens; however, problems remain in areas such as unresolved restitution of nationalised property for all religious communities, incidents of violence and harassment of religious minorities, trafficking of persons and violence and discrimination towards ethnic minorities, particularly Serbs and Roma.<sup>8</sup>

During the year the Government continued to facilitate repossession of illegally occupied homes; however, the property law implicitly favours ethnic Croats over ethnic Serbs. The law gives precedence to the right of temporary occupants, who are mainly ethnic Croats, to that of original owners, predominantly ethnic Serbs. Backlogs in the judicial system further impede the resolution of housing disputes.

Refugees returning to the country have encountered obstacles in obtaining permanent residency status under favourable conditions. The law states that former habitual residents who returned by January 2005 could be reinstated to their pre-war status as habitual residents without further requirements, such as meeting housing and financial criteria, and could subsequently apply for citizenship. The Interior Ministry streamlined the application process after international observers complained that officials varied procedures and criteria for granting permanent residency from case to case. Due to poor communication, many potential claimants have been unaware that they could regularise their status. The OSCE has estimated there were approximately three thousand potential claimants in Bosnia and Herzegovina, Serbia, and Montenegro.

The ability of refugees to return to the country was hampered by limited access to housing, slow resolution of some bureaucratic obstacles, and lack of employment

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<sup>7</sup> UNDP: 2005, Global Human Development Report.

<sup>8</sup> US State Department: Country Report on Human Rights Practices 2005: Croatia.

opportunities. Extremely slow implementation of the Housing Care provision for former occupancy and tenancy rights holders is one of the main problems. However, repossession and reconstruction of Serb houses is now well under way. During 2005, the government processed 9,500 requests for reconstruction assistance. An additional 10,000 owners who were denied reconstruction filed appeals; those appeals remain unresolved.

Authorities have taken an inconsistent and non-uniform approach to minority Internally Displaced Persons (IDPs), making their return difficult. A significant number of IDPs have remained in the country, although not all were under the government's direct care. At the end of November 2005, the UNHCR office reported that there were 4,847 IDPs in the country. Of these, 3,190 were mainly Croats originating from the Danube region, while 1,657 were ethnic Serbs in the Danube region who did not hold official IDP status.

The law prohibits trafficking in persons, but women and minors are trafficked to, from, and within the country. However, the country is primarily a transit country for women and girls trafficked to other parts of Europe for prostitution, as well as a source and destination country for trafficked women. Women from Romania, Bulgaria, Bosnia and Herzegovina, and other countries were trafficked through Bosnia and Herzegovina and Serbia and Montenegro to Croatia, where some remained to work as prostitutes while others were trafficked onward. Women are transported through Croatian territory by truck or boat.

Refugees, displaced persons, and young persons are most at risk of being trafficked. Anecdotal information indicated that international organised crime groups, local groups, and travel or marriage agencies were responsible for trafficking. Victims were subject to violence, intimidation, withholding of documents, and threats by traffickers.

***Equal Opportunities and Gender:*** Croatia has a gender related development index of 40 (out of 177 countries).

The law prohibits sexual harassment in the workplace but it remains an issue.<sup>9</sup> According to trade unions, the problem was most pronounced in the textile and leather, trade, and catering industries. The ombudsman and unions have reported that they worked on sexual harassment cases, although many women were reluctant to take action for fear of reprisal.

The law also prohibits gender discrimination; however, women generally hold lower paying positions in the work force. In July 2005, the government employment bureau found that women comprised 58.8 per cent of the unemployed, an increase from the previous year. Women tend to hold a disproportionate number of low-level clerical, labour, and shop-keeping positions.

The Office for Gender Equality is responsible for implementing the Gender Equality Law and formulating the Government's gender policy; the Office of the Gender Ombudsman monitors implementation of the law, including the submission of mandatory action plans for state institutions and public companies.

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<sup>9</sup> A 2004 survey by Poslovni Forum found that over 17 per cent of female employees reported experiencing sexual harassment in the workplace at some point in their career.

Prior to local elections in May, the gender equality office campaigned through its local and regional networks for fair representation of women on party slates. While women made up over 50 per cent of the population, their representation on party slates ranged from 6.7 to 17.8 per cent. The office also continued to develop a network of local gender equality commissions and in April 2005 established a coordination body of county gender equality commissions.

**Minorities:** The Constitution provides that individuals shall enjoy all rights and freedoms regardless of race, colour, sex, language, political or other opinion, national or social origin, property, birth, education, social status, or other attributes and that members of all national groups and minorities shall have equal rights. While most of these rights are generally observed, it is reported that discrimination against women, ethnic Serbs, and Roma continues.<sup>10</sup>

The failure to address housing rights taken from Croatian Serbs during the war continues to obstruct sustainable return to urban areas. Many Serbs who enjoyed permanent rights to occupy state apartments had these rights terminated when they fled their homes during the war. Government programs designed to provide them with substitute housing have proved ineffective, making return to Croatia difficult or impossible.

Violence and intimidation, including several murders and bomb attacks, against members of the Serb minority, has continued, but to an apparently lesser degree than in the past few years. Some of the incidents are clearly motivated by ethnic hatred, while others suggest such a motive. The Interior Ministry registered at least 48 such incidents in 2005. They have continued in 2006 particularly in the Zadar area. Although the Government established regional focal points to monitor incidents, and stepped up police patrols in some areas, the police failed to apprehend the perpetrators in most cases.

Other concerns include the slow progress in restoring electricity to Serb returnee communities and, in one part of the country, the inability of the Serbs to regain full access to their agricultural land.

### **Labour Issues**

Croatia is an ILO member country and has ratified all eight core ILO conventions.

**Discrimination:** Despite several laws enacted last year to promote public sector employment for Serbs and other minorities, there are few Serbs in state employment in the areas to which they have returned. There are almost no Serb judges in these areas, for example, despite a well-qualified pool of candidates for appointments. The limited number of Serbs in state employment contrasts with the private sector, which has made greater strides in hiring Serb returnees, suggesting that discrimination may be a factor.

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<sup>10</sup> US State Department: Country Report on Human Rights Practices 2005: Croatia & Human Rights Watch, 5<sup>th</sup> September 2006: A Decade of Disappointment: Continuing Obstacles to the Reintegration of Serb Returnees.

It has been acknowledged by Parliament and the OSCE that officials need to plan for the employment of national minorities.<sup>11</sup> This would be based on the implementation of an article of the Constitutional Law on the Rights of National Minorities that guarantees employment of national minorities in the administrative bodies of local and regional self-government units.

**Trade Unions:** Workers are entitled by law to form or join unions of their own choosing. Estimates of union density vary from circa 35 to 65 per cent of the labour force. In general, unions are independent of the Government and political parties. The Labour Code prohibits discrimination on grounds of union membership. The UATC confederation is the sole affiliate to the ICFTU.

### ***Forced Labour***

The Constitution prohibits forced or bonded labour, including by children. However, trafficking, as discussed above, is an issue, with Croatia acting as a corridor, to the European labour market.

**Child Labour:** The Government has a National Action Programme to address and prevent child labour and created a National Ombudsman for Children to ensure effective implementation of the programme. The minimum age for employment of children is 15 years. Workers under the age of 18 are prohibited from working overtime, at night, or under dangerous conditions. On finding incidents of violations of the code in the hospitality, retail, and construction industries, the Government has imposed fines and ordered the cessation of such practices.

**Working Hours:** The Labour Code sets out a 40-hour statutory working week and workers are entitled to receive time-and-a-half for any hours worked beyond that. Workers are entitled to a 30-minute daily break, a 24-hour rest period during the week, and a minimum of 18 days of paid annual leave. The Labour Code stipulates conditions for overtime work, and limits overtime to 10 hours per week.

### **Strategy**

For all projects which involve the purchase and/or transfer of land, EBRD shall pay particular attention to ensure that the title is legitimate. In implementing the Bank's labour requirements, particular attention shall be paid to ensuring that there is no discrimination and that Project sponsors have the capacity to effectively comply. In addition attention will be paid to ensure that no Bank financed project involves trafficked people and/or facilitates this.

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<sup>11</sup> Participants in a roundtable meeting co-organised by the OSCE Mission to Croatia discussion, held in the Parliament: 7.12.06.

## **ANNEX 9: POLITICAL AND SOCIAL ENVIRONMENT**

### **Political Background**

Since Croatia's first democratic elections, held in May 1990 when the country was still part of Yugoslavia, the present ruling centre-right Croatian Democratic Union (HDZ) has had two periods in power. The first lasted from May 1990 till January 2000 when the HDZ was defeated in the parliamentary elections by a centre-left coalition headed by the post-Communist Social Democratic Party (SDP), led by Ivica Racan. The HDZ came back to power after the elections in November 2003 under the leadership of Ivo Sanader, elected as the HDZ's leader in April 2000 as the successor of President Franjo Tudjman, HDZ's founder and Croatia's first president who had died in December 1999. Sanader had worked closely with Tudjman, but had later left to become Deputy Foreign Minister. In December 2003, he formed a minority government but has since then managed to make considerable legislative progress with the support of the Croatian Pensioners' Party (HSU) and ethnic minority MPs.

Despite strong initial opposition from the HDZ's right wing, Sanader opened the dialogue with the country's Serbian minority, included some of its leading members in his government, and introduced an accelerated programme of return by Croatia's ethnic Serbs, especially through addressing their property rights. Some of the Serbs resident on the territory of Croatia had left immediately after it had proclaimed independence in June 1991; more did so after the Croatian Army had, between May and August 1995, re-taken the territories (representing nearly a third of the country's total) that had been under the control of a Serbian rebel regime since 1991.

Since taking office at the end of 2003, the Sanader government had demonstrated increased willingness to prosecute war crimes committed by ethnic Croats in the 1991-1995 period and had increased cooperation with the International Criminal Tribunal for the Former Yugoslavia (ICTY) at The Hague. This cooperation included initiating an inter-agency action plan to locate and transfer to The Hague General Ante Gotovina, indicted by ICTY for command responsibility in the war crimes committed in the 1993-1995 period. This culminated in Gotovina's arrest on 7 December 2005 in the Canary Islands by the Spanish authorities. The operation was carried out with the cooperation of the Croatian intelligence services and the Croatian chief state prosecutor. In October 2006 Branimir Glavas, President of the city council in Osijek in eastern Croatia and a powerful former HDZ figure, now an independent MP, was arrested on suspicion of being responsible for ordering the murder of Serb civilians in Osijek in 1991. Glavas was temporarily released in December following a 37-day hunger strike and re-arrested in April. The investigation against him has been completed and he is expected to be put on trial despite right-wing critics' objections. He is seen by many in his region as a war hero. The controversy over the Glavas case has cost Sanader the tacit support he had enjoyed in parliament from the far-right Croatian Party of Rights (HSP). But Sanader intends to carry on with his smaller majority till the end of his current four-year mandate in November 2007. Sanader's HDZ is running neck-to-neck in opinion polls with the centre-left SDP, the main opposition party, which has been weakened by the death of its founder and long-time leader, former Prime Minister Ivica Racan. Parliamentary elections are due to take place in November 2007. The international community will view the result of the parliamentary elections with equanimity. Whichever political option wins, Croatia

will be expected to pursue the same course of regional responsibility and integration with the EU and NATO.

### **International Relations**

**EU accession**, the main policy priority, both for PM Sanader's government since the end of 2003 and for that of his predecessor Ivica Račan (2000-2003), has provided a solid framework for economic, judicial and administrative reforms. Despite various manifestations of 'enlargement fatigue' within the EU, steady progress in the negotiations over the *acquis* in 2006 has further boosted Croatia's European ambitions. Now that Croatia's cooperation with ICTY is proceeding smoothly, its accession prospects will be determined by its success in meeting the range of technical criteria for membership and, not least, by the readiness of existing EU member states to accept Croatia as a new member. On the technical side, the experience of Bulgaria and Romania, which joined the EU on 1 January 2007, suggests that judicial reform and tackling corruption are likely to be significant challenges for Croatia too. This message was underscored in the report on Croatia by the European Commission published in early November 2006. The Report praised Croatia for 'its continued progress in terms of the political and economic *acquis* criteria and implementation of its Stabilisation and Association Agreement' and singled out as the main challenge in 2007 'to build on the progress made, and to accelerate the pace of reforms, notably in the key areas of judicial and administrative reform'. The Report also stressed that Croatia should maintain the momentum towards EU integration 'through rigorous implementation of its obligations, notably in the areas of state aid and real estate.' The Report stressed that 'good neighbourly relations and regional cooperation remain key'; that 'priority should be given to finding solutions to outstanding bilateral issues, especially on border demarcation'; and that 'minority rights and refugee return will need continued attention'. Continuing disagreements with Croatia's closest EU neighbours, Slovenia and Italy, occasionally come out into the open. However, none of this seems sufficiently serious to disrupt the EU accession process. Unresolved border issues with Slovenia look likely to be dealt with by international arbitration, either in the context of Croatia's EU talks or outside of them. The Croatian authorities' recent announcement that Italian citizens living in Croatia will be free to buy real estate has been welcomed by Italy as a positive development.

The Sanader government's efforts to play a constructive role in the region of South-Eastern Europe, by taking an active part in fostering **regional cooperation**, is seen positively by the international community. In July 2006 the Croatian government hosted a regional summit in Dubrovnik attended by the Prime Ministers of Albania, Bosnia and Herzegovina, Montenegro and Serbia. The Croatian government has also played a leading role in the expansion of the Central European Free Trade Area (CEFTA). Croatia's recent progress towards its EU and NATO integration has increased the country's confidence in its dealings with the Balkan states, dispelling fears that the country might be consigned to a Balkan 'slow lane' with regional laggards. The country's participation in several international peacekeeping efforts around the world has made a favourable impression, not least in Washington, and has boosted its NATO prospects. As part of its effort to present itself as a responsible international player, the Zagreb government is applying to be a non-permanent member of the UN Security Council for 2008-2009.

## **Integrity Issues**

A number of recent incidents of corruption among politicians, members of the judiciary, in the health service and in public procurement have drawn attention to corruption as a serious issue in Croatia. The arrest of a heart surgeon in Rijeka in August 2006 on a suspicion of having accepted a bribe to speed up an operation highlighted the problem of corruption in the public health sector. A survey carried out by a local market research firm in April 2006 suggested that 15 per cent of Croatian citizens think corruption had increased in the past three years; 37 per cent think it will increase further in the next three years; 40 per cent think it will stay the same; and only 14 per cent expect it to decrease. Corruption is a matter of serious concern to the public, particularly in the health service and land registration, according to the US State Department's Bureau of Human Rights report on Croatia, published on 8 March 2006. According to the latest survey carried out by Transparency International (TI), published in November 2006, its corruption perceptions index (CPI) for Croatia remained unchanged at 3.4 (on a scale of 0 which is highly corrupt to 10 which is clean), and the country moved one position up to 69 among 163 surveyed countries. A recent World Bank study covering 27 transition economies in Europe and Central Asia put Croatia in the 11<sup>th</sup> place in terms of the percentage of firms surveyed indicating that corruption is a problem for the operation and growth of their business.

Successive Croatian governments have launched a series of initiatives to crack down on corruption but the results of the World Bank study suggest that Croatia's anti-corruption efforts have not yet fully taken root. The government's National Anti-Corruption Programme for 2006-2008, recently approved by parliament, builds on earlier efforts, including the establishment of the Office for the Prevention of Corruption and Organised Crime (USKOK) in 2001 and its strengthening in 2005. The government is pushing forward with land registry reform. The Ministry of Justice, with help from the international community, introduced in May 2005 a digitalised land registry to increase public access to records and thus remove a source of potential corruption. The law provides for an independent judiciary, but the judiciary continues to suffer from some political influence and a backlog of approximately 1.6 million cases.

The law forbids trafficking in persons, but women and minors are trafficked to, from and within the country. The country is, according to the US State Department's 2006 human rights report on Croatia, a transit country for women and girls trafficked to other parts of Europe for prostitution, as well as a lesser but increasing source and destination country for trafficked women. Refugees, displaced persons and young persons were most at risk of being trafficked. There were no reports of government officials being involved in trafficking. The government has a national committee for the suppression of trafficking in persons and a national co-ordinator for trafficking in persons issues who is the head of the Office of Human Rights. Police participate in international investigations through the Southeast European Cooperation Initiative regional centre in Bucharest. Police awareness of the problem of trafficking in persons continues to improve according to the US State Department report. The government has a legal framework to provide for victim assistance and there are support services available for trafficking victims.

## Social Assessment

**Population:** According to the 2001 census, Croatia had a resident population of 4.44 million, down from 4.51 million in the previous 1991 census. There was an exodus to Western Europe in 1991-92 due to the war but that was offset by the influx of refugees from Bosnia and Herzegovina. The 1991 census estimated the ethnic Serb population at 581,663 (12 per cent of the total). A large number of Serbs fled in 1991 and again in 1995. By 2001, the ethnic Serb population had dropped to 201,631 (under 5 per cent of the total). Since then the Serbs have been returning in increasing numbers from Serbia and Bosnia and Herzegovina. The birth rate dropped below 11 per 1,000 people during the second half of the 1990s. By 2004 it was 9 per 1,000 people. In mid-2005 the size of the labour force was 1.8 million but only 50 per cent of the population aged 15 and over was economically active (either in work or trying to find it). Those in work amounted to around 55 per cent of the population of working age (15-64). Only 47 per cent of those aged between 50 and 64 were participating in the labour force in the first half of 2005. Firms made widespread use of early retirement in the 1990s in response to the need for industrial restructuring, but recent labour market reforms have helped to boost the participation both of the oldest and the youngest workers. About 64 per cent of workers are members of trade unions. Strikes are numerous but mostly of short duration. Trade unions in Croatia are independent of the government and political parties and exercise stronger influence on policy than the employers' associations.

**Education:** Primary education is compulsory in Croatia between the ages of 6 and 15. Afterwards, there is the choice between a grammar school (gimnazija) or vocational training of two kinds: a standard system lasting four years and a craft-based system lasting three years. High enrolment rates dropped during the 1991-95 war – primary education from 99.2 per cent in 1989 to 87.1 per cent in 1996. They have since recovered. In 1998-2002 primary school enrolment rates were over 95 per cent and secondary school ones 88 per cent. Education spending was cut back in 1995-98 to 3.3 per cent of GDP but rose to 4.5 per cent of GDP in 2002/03 and has continued to rise. The quality of business and management education is relatively poor, with no university providing an internationally recognised MBA programme. Efforts have been intensified in recent years to increase employment in the country's vocational training programmes. In 2005 the government got a EUR 68 million loan from the World Bank, with one-fifth of the sum to be used for the building of new schools. The government's education development plan for 2005-10 envisages a 30 per cent increase in the number of university graduates and a 20-25 per cent increase in the number of teachers.

**Health:** Average life expectancy at birth for men was 66 years in 1991, the same as in 1971. It increased from 72 to 74 for women. By 2003 overall average life expectancy had risen to 74 years. Infant mortality declined from 20.6 per 1,000 live births in 1980 to 6 per 1,000 in 2003. The main cause of death in recent years has been heart disease. The number of traffic deaths is also very high. At around 17 per 100,000 head of population in 2003, the level of road deaths in Croatia was more than three times the rate of the safest West European states. The insurance-based healthcare system is built around the state-owned health fund paid for by payroll contributions from employers and direct transfers from the government. Public health spending is the equivalent of 8.7 per cent of GDP, higher than in most East European states and just below the

highest rate rates in Western Europe. The health sector has accumulated significant arrears in recent years, primarily because of high costs, low or non-existent payments and overconsumption. In 2005 the authorities introduced benchmarking of drug prices in line with other European countries and unified public procurement of drugs and other supplies for hospitals. In 2005 the government began to renegotiate long-term procurement contracts. However, over-consumption remains a serious problem in the health service.