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

STRATEGY FOR CROATIA

As approved by the Board of Directors at its meeting on 3 March 2005

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EXECUTIVE SUMMARY

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

Under the coalition government led by Croatian Democratic Union (HDZ), Croatia has achieved its key objective of being given candidate status by the European Council, with negotiations for EU membership scheduled to begin in March 2005. The government of Prime Minister Ivo Sanader has made excellent progress in improving relations with neighboring countries and has improved cooperation with the International Criminal Tribunal for former Yugoslavia (ICTY) at The Hague. The Prime Minister has indicated the intention of the government to join the EU by 2008. This will depend on the country moving rapidly to adopt the *acquis communautaire*. While a start has been made through the Stabilisation and Association Agreement with EU, much remains to be done. To address the outstanding issues, the pre-Accession economic programme for 2005 - 2007 will focus on improving the business climate and support to SMEs, restructuring of public enterprises, acceleration of privatisation, removal of administrative barriers, and achievement of fiscal discipline.

The strong GDP growth over the past two years, with rate of growth of 5.2 per cent in 2002 and 4.3 per cent in 2003, and estimated 3.7 per cent in 2004, was supported by industrial restructuring, by government initiated projects in the road and construction sectors, and by strong private consumption underpinned by growth in lending by the commercial banks. The IMF board approved a new EUR 110 million Stand by Agreement in August 2004, which the authorities intend to treat as precautionary. The programme is intended to help the government with fiscal consolidation and the implementation of structural reforms during the first stage of negotiations for EU membership. The fiscal consolidation process agreed with the IMF should help the government in strengthening fiscal discipline and reducing the external debt. Structural reforms have been resumed and the authorities have the ambitious target of completing small scale privatisation by 2005.

In the coming two years, the Republic of Croatia faces important structural challenges. These include restructuring and privatisation of the remaining state-owned utilities and small enterprises in the tourism sector, and acceleration of reforms in the public administration and the judiciary. To address such challenges, the Croatian authorities should:

1. promote private sector participation in infrastructure both at national and the local municipal levels, whereas at the same time strengthening the independence and capacity of the newly established regulatory authorities;

2. improve the business environment through the simplification of licensing and other legislative requirement in order to attract green-field investments and FDI flows;

3. accelerate the privatisation process of public utilities and small enterprises in the tourism sector, a crucial sector of the economy;

4. initiate restructuring in sensitive sectors, e.g., agriculture and shipbuilding;

5. strengthen efforts to enhance transparency and efficiency of, and to reduce corruption in the judiciary and public administration to meet EU standards;

6. further develop regional cooperation with neighbouring countries in Central and South-East Europe through the enhancement of cross-border trade flows, investment and FDI, promotion of outward trade and investment, and promotion of regional initiatives supported by policy dialogue.

Since the last Country Strategy, the Bank's commitments in Croatia have significantly increased to an aggregate of EUR 1.3 billion, with about EUR 3 billion mobilized from cofinanciers. Croatia is an important partner for the Bank, providing a significant contribution to regional economic growth and stability. Each year since 1999 the Bank has invested an average of EUR 150 million a year in Croatia. The Bank's net business volume as of end December 2004 was EUR 917 million with operating assets of EUR 591.4 million. In line with the previous strategy (2002-2004) the Bank has substantially increased its involvement in infrastructure, including at the municipal level and enterprise sectors. The Bank's operations have had good transition impact through continuous policy dialogue with the authorities, improvement in corporate governance standards at enterprise level, enhancement of regional integration, and introduction of private sector concepts in infrastructure financing. In 2004 the Bank supported regional economic integration by financing the expansion into Serbia of the largest dairy products company in Croatia.

Over the coming two to three years, the Bank has an opportunity to work closely with the Croatian authorities, to support the country's preparation for EU Accession. Focus will be on investment in the following sectors, with highest priority given to infrastructure, SME finance, and tourism:

In *the infrastructure and environment sector,* the Bank will work with a number of large and medium-sized municipalities to develop their infrastructure projects for prospective ISPA co-financing. In addition, the Bank will continue to roll out instruments to reach small municipalities through local banks, promoting investment in environmental infrastructure with donor support (EU and Netherlands). The Bank will continue to support national infrastructure projects in the transport sector in particular. All infrastructure projects to be pursued will need to take account of limited centralized budget resources and sovereign borrowing capacity and therefore use private sector financing structures where feasible. Infrastructure sector financing will be closely co-ordinated with the Croatian authorities and other IFIs, in particular the European Investment Bank and the EU, leading to joint financing arrangements and mobilisation of ISPA funds, where practicable.

In the financial sector, the Bank will pursue SME and micro finance, *inter alia* with the support of Phare under the EU/EBRD SME Finance Facility and Rural Finance Facility. While growth in financial intermediation in Croatia has outpaced many other countries of Central Europe, this expansion in credit has been focused on households – mortgages and consumer credit. SMEs and in particular micro enterprises in rural areas lack access to finance. SME finance – with specific attention to the tourism sector - will be pursued both through banks and leasing companies. The Bank will seek to introduce securitisation of mortgage loans, which would help Croatian banks better manage their balance sheets. Finally the Bank will also consider equity participation in the privatisation of the state-owned insurance company.

With respect to privatisation and the enterprise sector, the Bank's activities are likely to focus on supporting further privatisation of strategic enterprises and restructuring of sensitive industries. The Bank will focus on financing and restructuring of hotels and related enterprises underpinning further development of tourism, a key sector of the economy. The Bank will also aim to increase its activities by supporting regional expansion and further consolidation of leading Croatian corporates and direct foreign investment into the country.

LIST OF ABBREVIATIONS

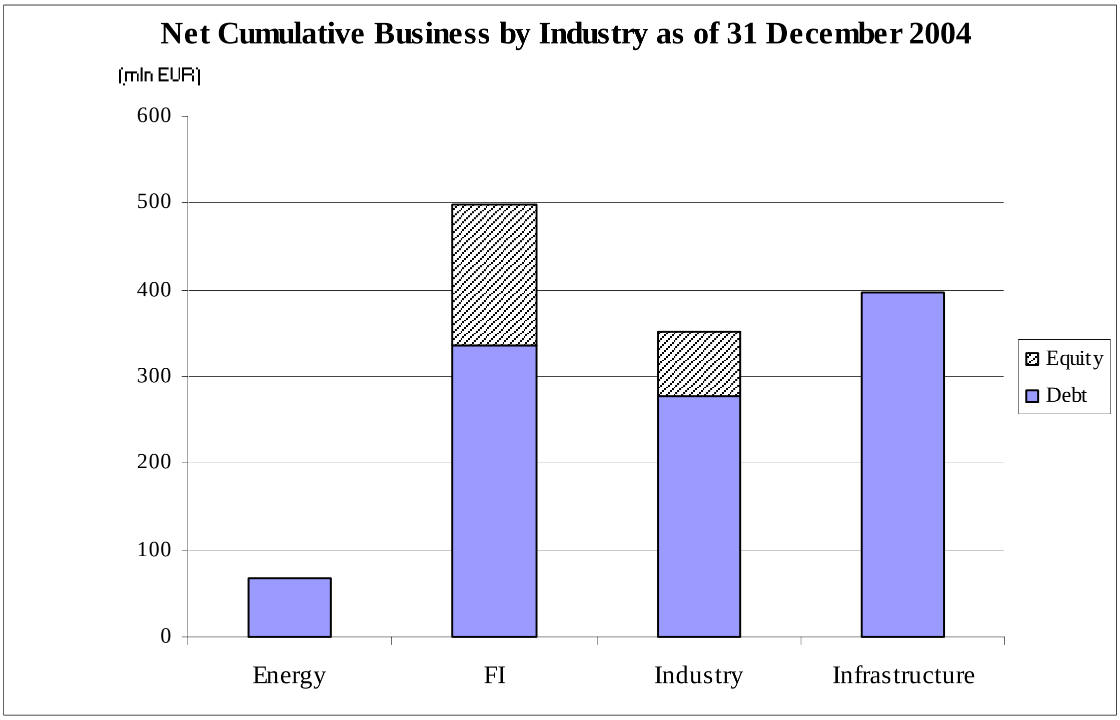
CARDS	Community Assistance for Reconstruction
CEB	Council of Europe Development Bank
EC	European Commission
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HBOR	Croatian Bank for Reconstruction and Development
HDZ	Croatian Democratic Union
HERA	Croatian Energy Regulatory Agency
ICTY	International Criminal Tribunal for former Yugoslavia
IFIs	International Financial Institutions
IMF	International Monetary Fund
MOL	Hungarian Oil Company
OECD	Organisation for Economic Cooperation and Development
PBZ	Privredna banka Zagreb
PED	Project Evaluation Department
SAA	Stabilisation & Association Agreement
SME	Small and Medium-sized Enterprise
SMM	Small and Medium-sized Municipality
VRED	Vijece za Regulaciju Energetskih Djelatnosti

1. THE BANK'S PORTFOLIO

1.1 Overview of Activities to Date

As of 31 December 2004, the Bank had made commitments in total of EUR 1,317 million. The net business volume was EUR 917 million across all sectors of the Croatian economy, with a concentration in financial sector and infrastructure. The portfolio currently consists of 42 operations of which 67 per cent of commitments are in the private sector. Infrastructure accounts for the majority of the state portfolio. Operating assets at EUR 591.4 million lag commitments due to the staged nature of investments in many infrastructure projects.

As illustrated by the table below, the Bank's portfolio is well distributed among the sectors of the economy, with large volumes of business in financial institutions and infrastructure, balanced by nearly one third of commitments in industry (including energy). Business has continued to grow at a strong pace over the past two years, while quality of the portfolio has remained strong. Private sector commitments make up 67 per cent of the portfolio. The pipeline of future business will maintain the private sector share of the portfolio near this figure.



1.2 Implementation of the previous country strategy

The last Country Strategy, approved in November 2002, outlined the following strategic priorities for the Bank in Croatia:

(1) support of national and local level infrastructure and environmental projects in co-operation with other IFIs, with emphasis on reaching small municipalities working jointly with the EU;

(2) financing the development of the tourism sector and support to FDI, especially in greenfield investments. Continue working with strong local companies supporting their further investment needs and expansion across borders;

(3) further support to the financial sector by providing resources for on-lending to SMEs and mortgage financing and by strengthening the non-bank financial sector with medium-term finance.

During the past two years, 12 projects were signed representing commitments of EUR 276,5 million. The Bank has continued to play an important role in Croatia providing finance to private companies and local banks, and working with the national government and local governments in developing the country's infrastructure. The CARDS programme and other donors, in particular the Netherlands, have supported technical cooperation needed for project preparation and implementation.

Infrastructure has been a very important part of operations in the period from end 2002 – 2004. Projects signed include a loan for the regionally significant Corridor 10 motorway connecting Croatia with Serbia, and municipal operations including refinancing the Zagreb Solid Waste Management programme, the Dubrovnik urban transport project and Rijeka sewerage service project.

Bank credit lines have continued to be a key product for the **financial sector**. Loans have been used for financing SMEs, for residential mortgages and for the infrastructure investments of small municipalities. Although the Bank has offered credit lines for financing of small municipalities to several leading institutions, so far only Zagrebacka Banka signed the loan. This is due in large part to the obligation imposed by the Croatian National Bank of reserve requirements for net new foreign borrowings by banks from June 2004. Nevertheless, the Bank renewed the grain warehouse receipts programme with Zagrebacka banka. The Bank made an equity investment of 21 per cent of share capital in Privredna Banka Zagreb (PBZ), owned by Intesa BCI of Italy. Three other bank equity investments were exited during the period. Finally, the Bank did not progress plans for increased activity in the non-bank financial sector; however, this remains a promising business for development by the Bank during the coming strategy period.

Finance in the **enterprise sector** supported regional expansion of Nasice Cement, Lura and of Agrokor, a leading food company. In addition, the Bank supported national growth of the retailer, Getro, with debt and equity. The Bank's objective to support foreign direct investment in Croatia has not met the same degree of success as the objective to support local companies. Part of the reason for this is the considerable success on a regional basis enjoyed by many leading family-owned Croatian companies. And while the country has a high level of foreign direct investment on a per capital basis, it appears to be concentrated in a few key sectors (e.g., investments by MOL, Deutsche Telecom). The tourism sector in particular has had very limited investment by the leading international operators, making it difficult for the Bank to find appropriate partners for investing in key tourism assets in the country. The proportion of equity in the portfolio is large relative to many other markets at 17 per cent. As a result of this, together with the relatively large share of family-owned companies in the Bank's portfolio, the Bank has focused on improvement of corporate governance, deepening management teams with financial expertise and enhancing transparency through better quality of information provided to creditors and shareholders.

1.3 Transition impact of the Bank's portfolio and lessons learned

1.3.1 Relevance and transition impact of previous country strategies

A major source of the Bank's transition impact has been its contributions to the ongoing institution-building process in a wide range of sectors and reform areas. Such an impact has been tangible both through the Bank's actual investment activities and its policy dialogue with the Croatian authorities.

The Bank's significant involvement in the City of Dubrovnik urban transport sector is a clear example of this impact in the infrastructure sector. Through this project the City will develop a Public Service Contract, introducing performance-related incentive mechanisms, increasing efficiency and reducing operational costs. The technical cooperation will support completion of a Sustainable Transport Strategy, with a clear parking policy, with provide a framework to attract private sector participation in the parking sector. Institution-building at the level of individual economic entities have been especially strong in the context of the creditworthiness enhancement and institution-strengthening programmes with a number of Croatian municipalities.

Providing examples of successful restructuring and setting high corporate governance and business standards have been the key transition impact targets in the enterprise sector. The Bank's investments in this sector typically contribute to post-privatisation restructuring (efficiency improvements, better corporate governance, focus on core business), and the prospect of greater competition in the sector, both nationally and in a regional context. The Bank's support for Getro has helped the company to become one of the recognised leaders in the Croatian retail market promoting best industry practices and setting a trend for other Croatian retailers by introducing private label products. The Bank's equity participation in Getro (a family-owned company) has already had an effect on corporate governance and transparency levels within the company. In particular, the Bank has been instrumental to re-register the enterprise as a joint stock company, to install separate management and supervisory boards and to start benchmarking with industry best practice in a number of areas such as financial reporting, operational performance, etc. The Bank's loan to Lura has assisted it to become the first foreign investor in the Serbian dairy sector. The Bank is suggesting specific improvements in the corporate governance of Lura, aimed to increase the independence, scope and role of the Supervisory Board and to protect minority rights.

More generally, the Bank has also assisted in promoting entrepreneurship through its technical assistance operations. *Inter alia* this has been achieved through studies prepared by the Turnaround Management Group which has established Business Advisory Services in the country.

Despite these successes, the Bank has had difficulties in achieving other objectives of past strategies in the enterprise sector. As noted above, the Bank has had few opportunities to invest in the tourism sector in particular, and in general, in support of foreign direct investment. This has largely been the result of circumstances in the local environment. There are two lessons for the Bank: expectations should be realistic; and, if there are not good opportunities to invest directly (e.g., in tourism assets) the Bank can assist development of the sector by many other means (e.g., policy dialogue and investment in essential infrastructure or SME finance).

With regard to the transition agenda of the financial sector, the Bank's most important contribution during the previous Strategy period has been the demonstration effects associated with new ways of financing including through mortgage finance, warehouse receipts, and improving access to credit of small and medium-sized municipalities (SMMs) to implement infrastructure investments needed to meet EU Accession requirements (especially for environment), and to improve the investment climate for business development. In the agribusiness sector the Zagrebacka Banka Grain Warehouse Facility has had important demonstration effects of introducing commodity-based lending techniques and skill transfers to banks in Croatia to provide increased financing of the agribusiness sector. This will be followed by financing based on actual warehouse receipts once the system is fully functional. Through the provision of Technical Cooperation and the application of the SMM investment criteria, the Bank is strengthening the ability of the partner banks to lend to municipalities, and will encourage the use of standardised lending criteria for municipal projects, leading to increased consistency and a more systemic understanding of the credit risk involved. In addition, technical cooperation is provided to small municipalities to better prepare and implement their investment projects; this ensures that municipalities improve their financial and management practices and offers demonstration effects to other market participants.

1.3.2 Lessons learned

One of the key lessons the Bank has learned from its own activities is that despite substantial progress in macroeconomic policies and performance the Croatian economy is still facing structural and institutional challenges. These relate in particular to the newly established regulatory authorities for utilities and infrastructure and the public administration, including the judiciary, which has also failed to resolve crucial issues, including the protection of land ownership rights. Acceleration of privatisation of the remaining state-owned enterprises particularly in the crucial tourism and infrastructure sectors, together with the strengthening of key regulatory and administrative institutions will help to accelerate the path to EU accession. It will also improve the investment climate in general and the prospects for individual investments, through broader policy dialogue with the EU and IFIs (including tailoring the key messages drawn under the joint studies conducted in co-operation with the World Bank and OECD).

Creating and maintaining strong leverage over the Bank’s clients also remains an important consideration in project design and structuring. Reforms work only if the authorities and/or our clients take ownership of them. This is key for both policy dialogue and specific investment operations which depend to a large extent – either regarding their commercial viability or their transition impact – on the progress in the implementation of the specific reforms in question. As reported in the recent Country Strategy Evaluation conducted by PED in the Croatian banking sector, the large wave of privatisations, mergers and acquisitions were helped by continuous and intensive informal policy dialogue on related financial sector reforms between the Croatian authorities and EBRD and other organisations, notably the IMF and USAID. In the utility sector the establishment of a private concession was established under the authority of the city of Zagreb for the construction of a waste water treatment plant on a build-operate-transfer basis, and this could not have been achieved without intense informal policy dialogue on new institution building within the sector.

PED has noted lessons learned in their Evaluation of the Country Strategies for Croatia as follows:

- The Bank should distinguish in its Strategy between short term goals and long term interventions depending upon the government’s commitment to reform in a given sector.
- The Bank should focus on key sectors where multiple goals can be reached at the same time.
- Technical Assistance is a strategic instrument and should be allocated among sectors and projects in such as way to maximise the potential transition impact.
- The Bank should focus on its comparative advantage by financing projects with a direct impact on the private sector and to the extent possible, reduce the share of public sector projects in its portfolio.
- Better coordination with IFIs is important to increase overall efficiency of EBRD and harmonisation of its interventions with other members of the international community.
- Better coordination with the Croatian authorities, in particular the Ministry of Finance, will help the Bank to achieve its goals. The activity of the Bank and use of donors’ funds should be more transparent for the Croatian authorities.

These lessons will be applied going forward (including where applicable, the distinction between short term goals and long term interventions in the Strategy). However, the Bank will maintain its involvement in a limited number of strategic public sector projects as this is critical for maintaining a strong day-to-day relationship with the national authorities. The Bank will manage TA strategically; however, TA is not required for every project. As it is a scarce resource, TA will only be used where and as it is needed, and when applied to sovereign projects will be provided in consultation with the Croatian authorities. Projects which do not require TA will be brought forward without it, regardless of their strategic importance.

- **Overall Assessment and rating**

PED have rated the country strategies in Croatia as follows:

Main components	***Rating***
Relevance of stated priorities	Good
Strategy Implementation	Good
Transition Impact	Satisfactory
Coordination with other IFIs and Donors	Satisfactory

This is a composite rating by PED based on the rating of implementation of investment projects, Technical Cooperation projects and policy dialogue.

1.3.3 Financial performance of the existing portfolio

With 99 per cent of the Bank's assets performing, the quality of the portfolio at present is strong. The average risk rating is 5.09. This may be expected to improve if progress towards EU accession continues at a good pace, and provided the economy does not suffer any unforeseen shocks.

1.3.4 Mobilisation of co-financing

The Bank has had a good track record in raising co-financing for projects in Croatia. Signed commitments are EUR 1.3 billion relative to funding raised of EUR 3 billion, mobilising 2.3 times the Bank's own funding. The Bank has increasingly involved local commercial banks in financing provided to local corporations (e.g., Nasicecement, Getro). There is also scope for increasing commercial and official cofinancing for the Bank's infrastructure projects, both at the local municipal and national level.

1.3.5 Portfolio Ratio

Private sector operations comprise 67 per cent of total operations. While the Bank's pipeline consists of significant infrastructure investments, some of these will be financed as private operations, with the result that the private/public sector ratio may fall slightly but should stay above 60 per cent.

2. OPERATIONAL ENVIRONMENT

2.1 Political environment

The Republic of Croatia meets the conditions specified in Article 1 of the Agreement Establishing the Bank. The Republic of Croatia is a constitutional parliamentary democracy with a single-chamber parliament and an independent presidency. President Stjepan Mesic, first elected in February 2000 and re-elected for a five-year term on 16 January 2005, serves as head of state and commander of the armed forces. He nominates the Prime Minister who leads the government. The Parliamentary elections on 23 November 2003 led to the formation of a coalition government under Ivo Sanader as Prime Minister. Sanader has since April 2000 been leader of the Croatian Democratic Union (HDZ), which was the country's ruling party from 1990 to 1999. The Constitution provides for an independent judiciary. However, despite the government's energetic drive to reform it, the judiciary still remains subject to a certain amount of political interference at the local level. Croatia was recognised as a sovereign state by the EU in January 1992 and the United States in May 1992 when it also became a member of the UN. Croatia applied for EU membership in February 2003, became an official candidate for membership in June 2004 and is scheduled to start negotiations in March 2005. A detailed political analysis of political and social issues is provided in Annex 5.

Legal Environment

While in recent years Croatia has introduced notable reforms to its legal environment, the country continues to face considerable challenges in entrenching the legal rules, institutions, and culture upon which its successful transition to a market-oriented economy will depend. Due to Croatia's commitment to joining the European Union with membership negotiations scheduled to start in March 2005, legislative harmonisation with the EU is now the driving force behind most legal changes.

The existing securities market legislation is relatively advanced compared to some of its central European neighbours, with a new Securities Market Law enacted in 2002. The Bankruptcy Law substantially complies with a number of critical elements of international standards in insolvency, while a large gap remains in practical functioning of the insolvency regime, underscoring the need for further reform to strengthen courts and other institutions that implement solvency legislation.

Areas of commercial law remain in need of substantial upgrading to be in line with international standards to foster foreign and domestic investment (as detailed in Annex 7 - Assessment of Croatia's Commercial Laws). In the area of corporate governance, particular attention should be paid to improving disclosure and transparency requirements concerning company operations. Laws governing concessions need to be dramatically improved in order to meet requirements of modern legal framework facilitating private sector participation, as the existing laws lack clarity on a number of fundamental matters. As to secured transactions, the entanglement of different rules makes the system complex and far from optimal with enforcement being a particular area of concern. 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.

Environment

The Croatian Government has approached environmental challenges by undertaking legal reforms; policy development; and investment planning. During the period 1998-2003 Croatia changed, and is in the process of fully harmonising, its legal framework for environmental protection to comply with the EU legal requirements. The EC has acknowledged that environment is an area where Croatia will require a long transition period to comply with EU regulations.

The House of Representatives of the Croatian National Parliament adopted the Report on the State of Environment in Republic of Croatia on 22 May 1998. The National Environmental Strategy (Official Gazette No. 42/02 dated 29 April 2002), was prepared in co-operation between the Ministry of Environmental Protection and Physical Planning (established in January 2000) and the World Bank through the Project on Environmental Policy Development and Regulatory Capacity Building project. In preparation of the National Environmental Action Plan, a Priority Action Plan (PAP) was prepared and presented at the Donors Conference in Zagreb, 2001.

The PAP comprises an integrated and mutually supportive set of actions to accelerate environmental protection in Croatia over the next five years. It represents an attempt at consensus between decision-makers and experts in both the public and private sectors and in the civil society. It includes actions that the Croatian Government is planning to take in co-operation with the international financial organisation and with the private sector.

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 coastal water quality; and the projects to improve the situation in the protected areas of Plitvice and Mljet National Parks, are of major concern to the Government. Pilot projects for industrial wastewater pre-treatment would also be supported.

Solid waste management is another area with substantial investment is needed (EBRD has financed the solid waste landfill rehabilitation in Zagreb). On 3 December 2004, the Croatian Parliament approved a new Law which is the base for harmonisation with the *acquis communautaire.* Priorities are concentrated on pilot projects for the islands, for separation at source, for organic wastes composting, for municipal waste management, for management of “hot spots” and for financing of regional waste disposal facilities. According to the Government, perhaps the most important project in the PAP refers to the production of cleaner motor fuels: unleaded petrol and low-sulphur diesel and heating oil at the refineries of INA (INA improvement of environmental management was financed by EBRD) – the centrepiece in the government’s strategy to eliminate lead in petrol by 2005. An assessment of capacity of the country to address global warming would also be undertaken.

Biodiversity conservation in Croatia would concentrate on projects to protect the *kras* region. In order to implement the existing obligations according to the Bern Convention and future obligations to the EU Habitat Directive, comprehensive inventory and mapping of biodiversity will be undertaken. An assessment and inventorying is needed of a series of smaller wetlands on the Adriatic islands along the coastal zone, in order to conserve and evaluate threatened habitats. Mljet and Kornati National Parks and the Biokovo Nature Park are in the focus of the Conservation Management of Croatia's Coastal Zone Biodiversity project. Introduction of Strategic Environmental Assessment within the project of a tourism development case study will be implemented (local banks financed by EBRD have been actively involved in financing tourism sub-projects and EBRD has provided environmental risk management training for these banks related to environmental issues associated with the tourism sector). Transport, which is a key to development of tourism in Croatia, is also the focus of environmental concerns. EBRD is currently financing urban transport improvement projects in Dubrovnik and Zagreb. A case study on the town of Varaždin will define all solutions leading to optimisation of the transport system, revision of existing planning as the key point of adopting new physical and detailed building plans.

The cost of implementing the PAP in full is estimated at just over US$ 1.0 billion or an average of $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 financing of pollution reduction.

Croatian international cooperation in the implementation of environmental and nature conservation projects on multilateral and, particularly, on the bilateral basis has been on an increase for the past few years. Projects have been implemented with Germany, Denmark, the Netherlands, Italy, Monaco, Norway and Japan. In addition, the grants of the Global Environment Fund (GEF) and UN bodies, such as UNEP, UNDP, UNIDO and the World Bank have been recognised, alongside with the European Union's Stability Pact through which Regional Environmental Reconstruction Programme for South-East Europe is being implemented, and the EU programmes: LIFE III countries and CARDS programme. Environmental projects are also financed by loans of international financial institutions, such as the World Bank and the European Investment Bank (EIB). (See Section 4 for details.)

Croatia is oriented towards a dynamic tourism industry that depends on a clean coastal environment, implying considerable investment in wastewater treatment. In the area of policy development, new strategies are proposed for air protection, solid waste management, application of cleaner production in industry, soil protection, and coastal zone management to guide the subsequent development of these sectors. Institutional development was focused among others, on the establishment of an Environmental Agency in 2002, strengthening capacities at the local level, and strengthening capacity in environmental data gathering. The availability of funding for environmental investments was enhanced by establishing an Environmental and Energy Efficiency Fund in 2003. The Environmental and Energy Efficiency Fund provided 33 grants for municipal waste disposal facilities and will provide grants and/or loans for priority environmental investments in the public and private sectors, following thorough screening and project preparation. The strategy work and a set of studies on EU approximation and harmonisation will support EU accession.

EBRD's environmental approach to Croatia takes into account that the Croatian government identifies specific environmental investment needs and considers EBRD as an important financial source. Given the advanced economic stage and well-placed environmental planning, the Bank will continue to support Croatian initiatives in environmental investment. All EBRD operations 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.

2.2 Progress in Transition and the Economy's Response

2.2.1 Macroeconomic conditions for the Bank's operations

Since the last Strategy, the macroeconomic environment in Croatia has substantially improved. The economy grew by 5.2 per cent in 2002, 4.3 per cent in 2003 and an estimated 3.7 per cent in 2004. Growth was supported by industrial restructuring and by government initiated projects in the road and construction sectors. Although private consumption has also increased, the growth rate has slowed down over the past year. Inflation has been one of the lowest in the region, with the rate of inflation down from an average value of 2.2 per cent in 2002 to 1.8 per cent in 2003 and 2.1 per cent in 2004. The Stand by Agreement approved by the IMF board in August 2004 is expected to help the government with fiscal consolidation and the implementation of structural reforms during the initial period of negotiations for EU membership. The fiscal consolidation process agreed with the IMF should help the government in strengthening fiscal discipline and reducing the external debt. The implementation of the new IMF Stand-by Agreement programme, described in the Memorandum on Economic and Financial Policies, is monitored through quantitative performance criteria, indicative targets, and structural benchmarks. The fiscal programme is monitored by performance criteria on the general government deficits and HBOR obligations, cumulative changes in the stock of general government debt arrears, the contracting of new non-concessional external debt of the general government and HBOR, and the cumulative issuance of debt guarantees by the general government. To ensure that the operations of public enterprises will not jeopardize fiscal consolidation and to increase transparency, the deficits of selected public enterprises, net of budget transfers, is also monitored on the basis of indicative targets. The implementation of the Central Bank's monetary programme is monitored through performance criteria on the net international reserves and net domestic assets of the Central Bank.

In agreement with the IMF the new government has resumed the fiscal consolidation effort, aiming at a general government deficit of 4.5 per cent of GDP in 2004 and 3.7 per cent in 2005, with a view to containing the external imbalance and keeping the external debt to GDP ratio broadly stable during these two years. This is a very ambitious target, given the derailment of the previous IMF's Stand-By Agreement, when the fiscal deficit reached 6.3 per cent of GDP in 2003 compared with the target of 4.5 per cent. This was caused by significantly over budget capital and current spending, particularly on highway construction, and sizeable off-budget fiscal operations, notably subsidies to Hrvatske Željeznice (the Croatian Railways) in the form of government-guaranteed loans. Fiscal targets are broadly on track, but the ambitious target for 2004 is to be achieved through an increase in revenues and, to a lesser extent, a reduction in investment. The former is expected from one-off revenues (dividend payments and larger-than-expected receipts from the concession of a GSM license amounting almost to 1 per cent of GDP, which were received in late December 2004) and a hike in excise rates on cars and tobacco as of July 2004. The government is also taking a number of permanent measures which, however, would have an impact only starting next year, notably the reestablishment of the Financial Police, limits to borrowing by local governments and measures to control health sector spending, where significant slippages had occurred in 2004. Current spending is expected to be reduced by 1 per cent of GDP reflecting a lower wage bill, as a result of ongoing reductions in personnel (mainly in the defence sector) and cost savings in the administration of public services.

The Parliament has passed at the end of November 2004 the 2005 budget. The projected rate of GDP growth is 4.4 per cent with 2.5 per cent inflation. The central government revenues are set to increase by 5 per cent year on year while expenditures are to increase by 4.6 per cent. Tax revenues should grow by 7.9 per cent year on year and social contributions by 8.3 per cent. The government hopes to be able to cover a large part of state budget deficit from privatisation proceeds, which are expected to exceed HRK 5.5 billion and come mainly from sale of remaining state stakes in oil and gas company INA and Croatian Telecom. The priorities of the budget according to the government are continuation of judiciary reform and infrastructural projects, agriculture, public administration, science and education. Pension expenditures were raised by 5.3 per cent and maternity benefit spending by 22.9 per cent. The 2005 budget also includes a framework for 2006-2007 budgets which envisages the share of budget spending in GDP to decrease in the period. The consolidated revenues will grow in nominal terms but in relation to GDP will drop from 43.5 per cent in 2004 to 42.6 per cent in 2007. In contrast to the past, the government will rely mainly on the domestic capital market. The CNB intends to continue playing a supporting role, managing closely domestic bank liquidity, and working with the Finance Ministry to introduce open market operations to facilitate the planned shift of government financing to domestic sources. Under the IMF agreement the authorities committed to meet at least one-third of the government's borrowing requirement from domestic sources in 2004 and raise this proportion in 2005. This will also allow overcoming the shortfall from privatisation revenues. Funding for payments on previously issued bonds, such as the recent need to pay USD 200 million to retire a Japanese securities market issue, has also be raised on local financial markets.

The current account deficit was estimated at 7.3 per cent of GDP in 2003, down from 8.5 per cent in 2002. During the first ten months of 2004 there was a further improvement as a result of strong export performance - with exports growing by 16.9 per cent - and slower growth of imports. The current account deficit narrowed to USD 479 billion in the 3rd quarter of 2004 from USD 565 million in the same period in 2003. Despite the fiscal challenges and the only partially unsuccessful effort of the CNB to control aggregate demand, abundant tourist receipts and the slowing of private consumption growth eased balance of payment pressures in 2004 and the current account deficit is projected to decline to about 5.6 per cent of GDP. At the end of 2004 external debt reached the record high of USD 30.2 billion, amounting to 88 per cent of GDP. The increase in the dollar value of the debt mainly reflects the weakening of the dollar, as most of Croatia's external debt is denominated in euros. In February 2005 the Croatian National Bank (CNB) adopted additional measures aimed at curbing the growing foreign indebtedness of the banking sector by increasing the minimum level of foreign exchanges reserves for commercial banks from 24 to 30 per cent of the net increase of their foreign liabilities.

The Croatian National Bank (CNB) has maintained a tight monetary policy, achieving the lowest level of inflation over the past few years. Monetary policy can only play a limited role, due to the Croatian National Bank's choice of exchange rate stability, the open capital account, and high degree of euroisation. Due to the goal of monetary policy to stabilise the exchange rate, a significant part of money creation is made through the Central Bank's intervention in the foreign currency market. Hence, the Central Bank has limited room to manage the liquidity of the banking sector, which results in fluctuations of interest rates on the money market. Transmission from money market rates to bank lending rates is weak. In the forthcoming period, it is important to carefully supervise the banking system to ensure that banks' lending decisions remain sound. The administrative measures introduced by the CNB in 2003 included the compulsory purchase of CNB bills if credit loans expand at a quarterly (annual) rate higher than 4 per cent (16 per cent) have expired by the end of 2003. The credit controls may have contributed to slowing household consumption but did not significantly impact enterprises. Bank credit decelerated in 2003, possibly affecting spending by households that do not have easy access to foreign borrowing. Enterprises, however, were able to switch their borrowing from domestic to foreign banks (local banks typically directed corporate customers to their parent banks abroad) and use leasing and other forms of financing. The CNB is expected to introduce a deposit facility for bank liquidity, creating an interest rate corridor with the existing Lombard lending facility and to begin open market operations to guide interest rates within this corridor.

2.2.2. Transition success and transition challenges

<u>**Infrastructure and Environment**</u>

Telecommunications: *Increase competition through new GSM license, and better implementation of secondary legislation and regulation of operators.*

The telecommunications sector is currently governed by the 2003 Law on Telecommunications (the “2003 Law”). The 2003 Law provided that the existing Institute for Telecommunications and the Council for Telecommunications be replaced by a new Agency for Telecommunications. The 2003 Law further provides that the Authority is an independent body, which has been established in September 2004, after the Parliament nominated its five members. The new Law was designed to improve the transposition of the 2002 *acquis* and open the market to competition.

Opening of the market to competition has been hindered by a lack of commitment together with a poorly designed regulatory framework. Notably, the fixed line incumbent operator, T-Hrvatski Telecom (T-HT), has enjoyed exclusivity in providing public fixed voice telephony until recently. This is later than was agreed under the

WTO/GATS commitment to abolish the exclusivity by January 2003. However, a second fixed line telephony license has been issued. In addition, competition is permitted in a number of areas outside fixed voice telephony, such as the provision of data services, mobile, VSAT and paging. However, for competition to seriously take hold secondary legislation on interconnection rules need to be fully implemented and enforced.

Deutsche Telekom is T-HT's strategic partner, currently holding a controlling interest of 51 per cent in the company. The government's plans to float its remaining holdings in HT through an initial public offering (IPO) has been on hold since May 2001 owing to unfavourable market conditions.

There are currently two mobile operators competing in Croatia, T-Mobile (the mobile arm of T-HT) and, since September 1998, VIP-Net a consortium led by Mobilkom of Austria. Several opportunities to introduce a third mobile operator have passed without one being introduced. A new international tender was launched in October 2004 and the third mobile operator (consortium led by Tele-2 of Sweden) was awarded the license in January 2005. Given the high mobile penetration rate (close to 60 per cent), the delayed introduction of a third operator makes it increasingly difficult to challenge the existing duopoly in the market.

Energy: *Restructuring and effective implementation of secondary legislation.*

The government approved three revised amendment to the energy sector legislation in November 2004. According to these amendments, the power distribution and the management of the power transmission system will be unified again. They were split in 2001 in line with the then started restructuring process, which was expected to be completed by July 2002. Although separate companies of the HEP group were created on paper, unbundling has never been implemented. A new regulatory body - Hrvatska Energetska Regulatorna Agencija (HERA) was established under the new Energy Regulation Law at the end of 2004. In terms of introduction of competition in the wholesale market, the amendments envisaged the lowering of the criteria for opening the market to alternative supplies from 40GWh to 20GWh of annual consumption. Further liberalisation of the market is expected to be implemented gradually. From 1 July 2006 the option will be available to all business users with annual consumption of more than 9GWh, as of 1 July 2007 for all business users, and as of 1 July 2008 for all residential users. The key transition challenges in the sector include: (i) strengthening the independence and enforcement capacity of the regulator; (ii) implementation of separate tariff methodology related to generation, distribution and transmission, particularly in light of the move towards a vertically integrated structure which can substantially hinder the development of competition; (iii) supporting the development of renewable energy sources.

Transport: *Prioritise investments, using public private financing structures where possible and begin the crucial process of restructuring of railways and shipyards*

The Croatian government has made substantial progress into its transportation infrastructure, thanks to the generous public investments together with regulatory improvements in the sector with support of IFIs. Progress has varied by sector but overall has been significant. One of the key transition challenges is to move away from traditional public sector financing and devise innovative public-private sector partnership in the sector.

Most significant investments have gone into the motorway and national road network. This has been accompanied by establishment of separate government agencies in charge of tolled and non-tolled roads. As a result of these institutional strengthening activities, Croatia has achieved the highest score of the Infrastructure Transition Indicator for roads across all EBRD countries of operation following an upgrade in this indicator provided in 2003, granted since the sector has been almost entirely funded from road-user charges.

Insufficient attention has been so far devoted to port infrastructure, which will become of growing importance, particularly for the development of tourism, a crucial sector in the Croatian economy. Key transition challenges will be the expansion of the port infrastructure of the key ports to accommodate more and larger cruise ships. The Bank's first port project in Croatia, signed in Dubrovnik in February 2005, will meet this key transition objective. This project, like some others in the sector, requires a sovereign guarantee in order to provide assurance of payment in case of force majeure. The port authority has been recently established and its capacity is being strengthened with an institutional building TC project.

The railways and shipyards are currently overseen by the Minister for Sea, Tourism, Transport and Development. These enterprises still receive a very high level of government subsidies to continue their operations. Both are in need of restructuring to reduce costs and increase efficiency of their operations. In the rail sector the separation of accounts between the infrastructure management and the railway operations has been adopted. The EU rail legislation has been incorporated into the legislation in this area which will be implemented in 2005, including non-discriminatory access to the national network. With respect to the shipyards, such restructuring could assist with privatisation. These sectors are among priorities of the government in the Pre-Accession Economic Programme 2005 – 2007. Their restructuring, together with gradual removal of state aids, would provide significant benefits for the budget in the medium term. Given the political sensitivities, the government will be careful about the timing of initiating any restructuring of either railways or shipyards. Finally, further investment is needed in urban public transport, such as the Bank's loan to the City of Dubrovnik for a fleet of busses.

Municipal/Environment: *Prepare to utilise EU investment grants and to improve laws for operation of municipal services by concession.*

Croatia has become one of the Bank's most active markets for municipal finance, with several new structures and approaches having been introduced into the market.

Croatia has a good legal base for financial activities of municipalities, with suitable borrowing limits established by law. The regulatory structure for the water sector is quite advanced, as there is a national water authority in place, making Croatia the country with the highest score on the transition indicator for water and waste water. The national-level authority will need to help solve co-ordination problems since there are many parties involved in determining the priority investments to be proposed for funding under the EU ISPA programmes. Good preparation is critical given the limited time in which Croatia may benefit from this programme, and the vast improvements needed to be undertaken to meet environmental *acquis*.

Significant challenges remain related to waste management, including the establishment of recovery, recycling and disposal facilities. Donors have been generous in supporting technical cooperation to benefit small municipalities in preparing their environmental infrastructure projects. This is an area where donor funded programmes, including the Global Environmental Facility, may also start to develop projects.

Enterprise Sector:

Enterprise performance: *Consolidate growth and rationalize expansion to form stronger platform for sustained regional development.*

Leading Croatian companies continue to grow rapidly. At the same time, some companies have expanded into varied sectors and markets through acquisition, and would benefit from rationalising their corporate structures and financing. Such rationalisation would enable them to better manage their costs, increase operating margins, and strengthen their base to sustain their regional development objectives.

Croatian employees enjoy higher average wages, as in Slovenia, Hungary and the Czech Republic, relative to others in South and Central European countries. To maintain these high wages companies need to increase productivity of labour. This is not easily achieved by reducing labour, as Croatia still lacks flexible labour market legislation and has very strong trade unions, which make it costly and difficult for companies to make employees redundant. Despite the adoption of a New Labour Law in 2003, there are still significant steps that need to be implemented to improve the flexibility of the labour market.

Small and Medium sized enterprises: *Improve access to finance and ease of establishment of operations.*

The SME sector continues to play an increasingly important role in the Croatian economy. In 2003, there were some 64,000 SMEs in the country employing approximately 430,000 workers, according to the Central Bureau of Statistics. SMEs account for 98.8 per cent of all registered enterprises, 55 per cent of employment, 44 per cent of total income and 60 per cent of income from exports.[1] The latter is important given the need to increase exports to achieve a better trade balance and sustained economic growth.

Since the beginning of its operations until today, the Business Advisory Services (BAS) Programme has undertaken 165 projects, out of which 155 are completed. Total programme subsidy budget is € 1,121.847, out of which € 1,109.733 is committed to 165 projects. Through these projects, 156 enterprises were assisted as some of the companies benefited from more than one project. The BAS programme will continue to

[1] IMO, Stability Pact: Enterprise Policy Performance Assessment 2004 Croatia.

operate in Croatia in the future subject to availability of TC funding. The TAM Programme has carried out 10 projects in Croatia utilising a total of €576,503 from several bilateral donors.

As noted by recent review of performance under the European Charter for Small Enterprises, Croatia remains a challenging place to establish a new company. The length of time and number of permits required are excessive. This is representative of other changes needed in the business environment and streamlining of public administration, to encourage inward and foreign direct investment.

There is tremendous scope for SMEs to play a larger role in the development of the Croatian economy. The majority of tourist overnight stays in the country are offered by SMEs, including families offering rooms for rent. However, tourism is a sector where the lack of ancillary SME activity (e.g., craft shops, restaurants and snack bars, boat rides, etc.) is often noted by visitors. Thus, the opportunities to offer services and goods to the millions of tourists visiting the country each year could be significantly further exploited by SMEs.

The government has a plan to improve the business environment for SMEs through establishment of a "one-stop shop" for business registration. When this becomes available, it would potentially reduce the excessive number of permits and length of time required to establish a business. However, it does not address other difficulties for SMEs including access to finance. While part of the problem is in cautious attitude of banks, there is a need for significant improvement to the judicial system so that court cases, including bankruptcy process and realization of collateral are smooth and rapid. This is one of the most important areas for improvement to strengthen the position of SMEs in the country, together with a stable and reasonable tax regime.

Finally, proposals have been noted regarding the transformation of the government-owned Postal bank into an SME bank. This sort of conversion is not easy due to the need for SMEs to be served by motivated, specialised personnel. The Croatian banking sector is highly professional and with some special incentives and training would be able to fill the market gap of finance towards SMEs without creation of a government bank.

Foreign Direct Investment: *Need to improve the business environment for investment given relatively high wages and low labour flexibility.*

FDI in Croatia is generally among the highest on a per capital basis of CEE countries. However, FDI inflows are limited to privatisations in banking, telecom, pharmaceutical and agribusiness-retail sectors so far. Significant FDI has been noted only in telecommunications and the oil and gas sector (privatisation of 25 per cent of INA). Greenfield investments have been small and typically in sectors such as retailing, which have not brought significant job creation to the country.

Croatia would benefit from efforts to increase FDI in particular in sectors, such as tourism, where consumers are willing to pay more for higher quality services and introduction of well known brands. Foreign investors were often not selected in the privatisation of tourism assets. However, the Privatisation Fund is making significant attempt to re-start the process of privatisation after the programme was stalled over the last few years. The extent to which the Government can make the process more transparent and remove any perception that there is discrimination towards foreign investors will encourage new opportunities for FDI.

A Foreign Investment Council was recently established together with participation of local enterprises, to present coordinated views on issues related to inward investment, business legislation and regulation to the government. The FIC has highlighted in recent discussions that the lack of effectiveness of the court system is a major problem to doing business, as courts cannot be relied upon for dispute resolution.

Business environment: *Pursue public administration and judiciary reform to improve attractiveness of the business environment.*

Reform of the judicial system and improvement of public administration will be important for making Croatia a more attractive environment in which to do business. The country has a natural advantage following EU accession to be the market of entry to former Yugoslavia, given the recently signed free trade agreements with all neighbouring countries. This advantage will be difficult to exploit, however, if certain key improvements to the business environment are not addressed.

The judiciary system is one of the key obstacles to enterprise development. With regard to the courts, there is a need both to improve the qualifications of judges – underway through training programmes, and to reduce the huge backlog of cases which cause delays of years to reach a settlement in many jurisdictions. The government is aware and has made the improvement of the judiciary a key element of the reforms planned as part of accession to the EU.

With respect to public administration, the business environment would benefit from greater transparency and accountability for decisions and improving the functioning of the cadastre and the land registry. Reduction of corruption should continue to be a priority.

Privatisation: *Pushing ahead with complete privatization of large companies in sensitive sectors is essential to improve economic performance.*

While considerable progress was made in privatisation in Croatia from the start of the decade, much remains to be done including many of the more challenging privatizations. With respect to privatization, there are several types of companies to address. Firstly, are "strategic" companies which are not utilities. These include the national insurance company and several agribusiness combinats. Some of these are partially privatized but would benefit from passing majority ownership and control out of the hands of the state to private operators who will not be subject to political pressures. The impact would be to increase privatization receipts to the government and to improve the operations of the firms, bringing increased tax receipts over time.

Other firms among this group require restructuring. As long as they remain in government hands, they are a burden on the budget and effectively, offer "on the job unemployment" protection to many employees whose jobs would not be retained by a private investor. Restructuring of such enterprises, particularly where they are the main employer in a town or region, is a very politically sensitive task. However, there is considerable experience in other CEE countries in dealing with such situations and the accession process will enable Croatia to take advantage of this. Until shares are offered for sale it is difficult to assess the companies' attractiveness to commercial investors.

Tourism, a key sector of the economy has suffered from the slow pace of privatisation of tourism assets. In 2002/2003 the Bank initiated in conjunction with the Government and DEG of Germany a Tourism Privatisation Framework with the goal of selecting up to four hotels that could benefit from pre-privatisation financing conditional on eventual privatisation to brand name strategic investors. The results of the assessment study prepared by consultants demonstrated that such financing could be only undertaken if the Government would be prepared either to write-off existing debt or provide sovereign guarantees for new financing. The Government did not accept such a concept and the project stalled. Recently, several tenders failed to attract bidders due to requirements to pay off debts incurred before privatisation.

The Bank will address its goals by continued policy dialogue with the state authorities and will try to identify opportunities to participate in privatisation of state tourism property assets. In implementing this the Bank will maximise private sector involvement in tourism investment.

<u>Financial Sector:</u>

Banking and non-bank financial sectors: *Improve supervision of non-bank financial intermediaries and finish privatisation.*

The Croatian banking sector is 91 per cent foreign-owned, stable and competitive. The Bank has strong working relationship with all prominent Croatian banks, in particular with Zagrebacka Banka (largest, majority owned by Unicredito Italiano), Privredna Bank Zagreb (2nd largest majority owned by Itesa BCI Group), HVB Bank Croatia (Splitska Banka), Raiffeisen Bank Croatia, Erste Banka and the state owned Croatian Bank for Reconstruction and Development. The Bank owns a 21 per cent stake in Privredna Banka Zagreb having exited from three other banks in the past three years (HVB Bank, Hypo Alpe Adria Bank, and Varazdinska Banka - now part of the Zagrebacka Banka Group). The CNB has substantially improved on site supervision of the commercial banks, whereas the Government plans to unify supervision of non-bank financial institutions, merging the current two separate supervisory bodies. The remaining challenges in the sector include improved supervisory cooperation between banking and non-banking supervision and between domestic and foreign supervisory agencies. Leasing in companies currently accounts for 5.8 per cent of credit in Croatia. The leading banks are owners of main leasing companies active in the market. The national insurance company, with a dominant market position, is the main institution remaining in public ownership in the sector.

Capital markets: *Market deepening, through more issuers, and broadening, through a wider variety of instruments, is needed.*

There are two exchanges in Croatia, the Zagreb Stock Exchange which is the main exchange, and theVaradzin Exchange, which is where privatisation vouchers are traded. The liquidity of the Zagreb Exchange is quite limited. However, the government has decided to raise more funding for its investment programme locally, in line with recommendations from the IMF. Therefore, Croatian citizens and enterprises would benefit from deeper markets which can offer better terms and conditions to issuers.

With respect to the development of the capital markets, the Bank will seek to support IPOs and local bond issues of enterprises as well as the launch of such products as securitised bonds (e.g. mortgage and real estate bonds). On the legislative side the Bank will work closely with the government, other IFI's and donors to promote legislative changes bringing capital markets regulations in line with international standards.

Venture capital development has had limited success in Croatia. There are a number of equity funds working in Croatia both regional and country specific, including Copernicus Adriatic where EBRD is a shareholder, but to date only a small number of successful investments have been made. Going forward the Bank will assess possibilities of supporting the establishment of new venture regional funds or enlargement of existing operations.

2.3 Access to Capital and Investment Requirements

Croatia's current long-term foreign currency ratings are BBB, Baa3 and BBB- by Standard & Poors, Moody's and Fitch respectively. Standard & Poors upgraded the country's long-term rating at the end of 2004. So far, the sovereign issues on the international debt markets ranged with maturity of up to 10 years (with pricing of 100 basis points above Euroswap for 10 years maturity). The acceptance of Croatia's EU application improved the investment climate therefore the sovereign debt is currently traded much lower, about 50 basis points above the benchmark.

Best banks and large corporates have access to cross border debt financing at reasonable pricing with maturity from 3 to 5 years. Principal borrowers on the international market are banks, e.g. Zagrebacka banka has successfully issued in June 2004 EUR 450 million five-year notes priced at 70 basis points above Euribor) as corporates still find it easier to borrow from foreign owned banks in Croatia. However, large corporates have also tapped the international debt market: Agrokor issued five year bonds with a coupon of 11 per cent and BINA Istra (concession over the motorway in Istria) has issued a twenty year maturity bond carrying a coupon of 8 per cent. Both issues are listed on the Luxembourg Stock Exchange.

The banks' borrowing has slowed down in the second half of 2004 due to the strict Central Bank regulation aimed to slow down the increase of foreign debt. Specifically, the banks are obliged to keep 30 per cent of the amount of the net increase in foreign borrowings at the Central bank as a marginal reserve requirement. No interest is paid on these reserves. The credit supply from local banking sector is marked by strong competition for good customers. Lending margins are continuously under pressure with strong corporates achieving interest rates as low as 6 - 8 per cent per annum. However, the aggregate net interest margin in the sector remains at 4.5 percent, leaving room for rates to fall.

During 2004 the government started more frequently tapping the local market with the results of new bond issues from the Ministry of Finance in local currency linked to the Euro, the latest being 15 years maturity and priced 125 basis points above the Euroswap. In addition, there are regular issues of long-term bonds, the proceeds of which are used for specific government funds e.g. Insured Deposit Scheme Bonds or HBOR issues. Interest rates vary from 3.8 per cent to 8 per cent. In addition there are active issues of Treasury Bills with maturity of up-to 324 days (but also 42 and 91 days maturity) with interest rates between 4.2 - 6.3 per cent.

In the domestic bond market local corporates have been more active. Recent issues are by Podravka (three years maturity with coupon of 5 per cent) and Pliva (seven years maturity with coupon of 5.75 per cent). The City of Zadar issued the first local municipal bond in 2004 with seven years maturity and a coupon of 5.5 per cent. All of these bonds on the local market are issued in local currency but linked to Euro; however, there are two bond issues in 2003 which are purely local currency. One is by Ministry of Finance and the other by Hypo Alpe Adria Bank, carrying coupons of 6.1 per cent and 6.5 per cent, respectively, both with five years maturity.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

Key Short Term Operational Priorities

In the coming two year strategy period, the Bank plans to pursue a range of projects and programmes including *inter alia* involvement in privatisation and restructuring to prepare the economy for EU accession. This will involve close coordination with Croatian authorities and EU institutions in particular. While pursuing the priorities outlined below, the Bank will continue to look for opportunities to support foreign direct investment and will respond to opportunities which may arise. Where appropriate, equity finance will be given priority among the Bank's financial instruments. The Bank's additionality will be demonstrated on a case-by-case basis. The main priorities are the following:

- Financing of infrastructure with a focus on transport (including railways) and municipal and environmental infrastructure with the EU ISPA programme. Where feasible, the Bank will use private sector financing structures to enable productive public assets to pay for themselves. Transport projects will be undertaken within the context of the South East Europe Core Regional Transport Network. Energy projects will be prepared in light of efforts led by the EU to develop a regional Energy Community.
- 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 may be introduced to provide finance to medium-sized enterprises. Assist in capital markets development in particular by supporting the securitisation of mortgage receivables. Participate in privatisation of the national insurance company.
- Privatisation and restructuring of state-owned enterprises, in particular in sensitive sectors and tourism. Continuing support for strong local enterprises regional expansion efforts.

As the Bank's business depends in large part on market developments, actual commitments may vary significantly from the project pipeline. Given the current flow of projects in the pipeline, annual commitments over the next two years may vary between EUR 150 million and EUR 250 million, with the higher figure materialising if the Bank is able to proceed with significant private and public investments.

Policy Dialogue

The Bank will develop further its regular dialogue with authorities, in particular concerning (i) privatisation of large enterprises, (ii) restructuring of sensitive sectors (e.g., railways), (iii) improvement of regulation of utilities, (iv) improvement of laws concerning concessions and the securitisation of financial assets, and (v) improvement of the business climate for local and foreign investors, including SMEs.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 Infrastructure and environment

Transition Goals

Based on the analysis in section 2.2.2 the following Transition Goals are relevant for the Infrastructure and Environment sectors.

- Increase private ownership and competition in the telecommunications market.
- Continue to support restructuring and commercialisation across the transport sector, with particular focus on the railways and other sensitive sectors such as shipyards, which rely on state subsidies to continue operations. Focus on commercialisation at the entity level for state-owned transport entities including, for example, introduction of management and financial systems to international standards, medium-term business planning and other measures to increase operational efficiency, such as performance-based maintenance contracts in the road sector.
- Seek opportunities to promote private sector participation in infrastructure, such as through concessions for development and operation of motorways, ports, airports and municipal services. In operations, promote transparency of operational and financial arrangements and financial sustainability through user pay principles, including through off-budget and off-balance sheet financing.
- Continue to develop operational and financial structures at the regional and small municipality level to ensure that improved and sustainable local service delivery reaches out beyond primary and secondary cities. Maintain close contact and coordination with the EU and national/local authorities responsible for the allocation of EU Instrument for Structural Policies for Pre-Accession (ISPA) programme for Croatia.

Operational Priorities

Telecommunications

- In the short-term, provide finance for investment to new market entrants, either in the fixed line segment or in the mobile segment.

Transport

- In the short-term, support core regional transport networks as agreed with and supported by the EU. Continue investments to support national infrastructure modernisation including roads, motorways, ports and airports. Where a sovereign guarantee is necessary for financial viability, coordinate closely with the government.
- In the medium-term, support reform of the railway sector with potential investments aimed at cost reduction, further commercialisation, and privatization. Involvement in these sectors will be conditional upon agreed reform targets.
- In the medium-term, provide support to improve efficiency and reduce state subsidies to the shipyards to levels sanctioned by the European Commission, through restructuring.

Pipeline – projects with sovereign support

Company	Project	EUR million
Croatian Railways	Fibre optic cable on Corridors X and Vb and double track on selected sections on Corridor X	50
HC	Rijeka bypass project	30
Port of Ploce	Reconstruction of the bulk cargo terminals	30

Municipal/Environment

- In the short-term, promote decentralised financing solutions through the use of local government loans or utility loans with or without local government guarantees to assist reform-minded local administrations with the establishment of successful borrowing track records and utility commercialisation.
- Also in the short-term, continue to work closely with the existing and prospective clients on introducing cost recovery and "user pays" concepts within the limits of affordability constraints and promote transparency regarding transfers and subsidy payments. Support utility companies and local authorities in their efforts to achieve institutional strengthening and financial and operational sustainability through mobilisation of donor funded technical cooperation (TC). Encourage private sector participation where appropriate and feasible and where it contributes to greater operational efficiency, including in structures that combine EU investment grant support with private sector partnership approaches.

The City of Zagreb Solid Waste Management Programme has started off, in 1998, as a loan to the City owned company (ZGOS) with the City of Zagreb Guarantee to rehabilitated the landfill to protect near by water resources and reduce the pollution of air, soil and river.
The project was structured and implemented on full cost recovery basis where a transparent tipping fee system was implemented that ensured that the tipping fee is structured to secure the repayment of the loan and cover the operating costs of the landfill. Following the successful implementation the programme was refinanced, in 2003, replacing the City Guarantee with the Municipal Support Agreement. As a result of the successful implementation of the programme the Bank is at the moment assisting the City and ZGOS to structure and prepare the Solid Waste Incinerator project for financing under the Design-Build-Operate (DBO) model.

Energy

- In the medium-term, to the extent reform in the sector allows, support the development of viable alternative energy and energy efficiency projects with donor support.
- In the medium-term, participate in privatisation of HEP together with an experienced strategic investor able to bring improved operating standards to the sector.

3.2.2 Financial Institutions and SME operations

<u>Transition Goals</u>

Based on the analysis in section 2.2.2 the following Transition Goals are relevant for the Financial Sector:

- Broaden scope of SME finance to cover very small and micro enterprises, including in rural areas.
- Continue to assist banks to effectively manage their balance sheets.
- Strengthen non-banking financial sector, especially leasing, but also through participation in privatisation of the state-owned insurance company.
- Increase availability of finance for high-technology and small environmental projects through the banking system.

<u>Operational Priorities</u>:

- In the short-term, the Bank will support micro and SME financing including through the EU/EBRD SME Finance Facility. The Bank will offer the Rural Finance Facility to develop business on the islands and in rural areas. This will help small farms to meet EU sanitary standards, and offer alternative employment in regions where farm ownership is undergoing consolidation. Continue support for the TAM and BAS programmes. Emphasis will be placed on supporting the *leasing sector*.
- In the medium-term, work with bank partners and the Croatian authorities to develop securitisation of mortgage receivables. This will require improvements to legislation and is expected to have a transition impact both on capital markets development and on the banks' capacity to manage their balance sheets.
- In the medium-term, the Bank is ready to support the privatisation of the dominant state-owned insurance company, Croatia Osiguranje, provided the privatisation process is not cancelled due to lack of interest from potential investors.
- In the medium-term, introduce a project through banks, in partnership with the Global Environmental Facility, to finance environmental projects affecting the quality of water emptied into rivers and the Adriatic. Continue to offer financing for small municipalities' infrastructure investments through banks.

3.2.3 Enterprise Sector, in particular Tourism

<u>Transition Goals</u>

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

- Based on positive experience of working with local companies without a strategic partner the Bank will: (i) further identify strong local companies willing to address corporate governance issues and adopt international best practices standards and work with them in financing their development plans; and (ii) continue working with existing corporate clients in supporting their investment strategies especially for regional development both at the country level and across borders.
- Modernisation of the fragmented tourism sector is a key goal of the Bank which will be achieved in part by providing financial restructuring assistance prior to privatisation of tourism enterprises. Maximising private investment in tourism business is a key goal for improving efficiency and service in the sector.

Getro is the second largest retailer in Croatia with ca.7.3 per cent market share. It is a leading Croatian retailer in large cash & carry store format, operating 15 stores throughout Croatia. In April 2002, the Bank finalised a comprehensive financing package for a total amount of EUR 25 million, consisting of EUR 16 million senior secured debt and EUR 9 million preferred equity (representing 8 per cent of the Company's share capital) supporting Getro's expansion in Croatia. The Bank's financing enabled Getro to construct and open 8 new stores together with a state of the art 13,500 m2 distribution centre in Zagreb.

Getro now intends to complete its Croatian expansion and open a further 11 stores, mainly of smaller format, in the country's regional centres, as well as additional bigger stores in the largest Croatian urban areas. Furthermore, Getro will consider its expansion in the neighbouring countries (Serbia and Montenegro, Bosnia and Herzegovina). Getro has approached the Bank to finance this further expansion and the Bank is considering providing a financing package totalling EUR 35 million to support their investment plan over the next 3-4 years.

Operational Priorities:

- In the medium-term, the Bank will offer support to projects that promote modernisation of the tourism sector working alongside foreign strategic investors with proven track record in this field. The Bank will continue its proactive dialogue with investors and will aim to tailor products specifically designed (e.g. longer maturity structures) to address the seasonality aspects of the sector. Progress and transparency in privatisations will be important to attract foreign investment. The Bank will identify opportunities to support revival of the tourism industry through direct project investment to create a positive demonstration effect for the entire region. Small scale tourism projects will also receive support through intermediaries.
- In the short-term, support the expansion of Croatian companies (including, in particular the agribusiness sector) into neighbouring countries, and, reciprocally, support the expansion of companies from neighbouring countries into Croatia. In implementing these goals, the Bank will be providing targeted companies with wide range of instruments, from pure debt financing to an equity participation, or when estimated beneficial to the Bank and the client, with a combination of these financing instruments. Where needed, the Bank will request enterprises to rationalise their corporate structures to reduce costs and to provide greater transparency, accountability and management.
- In the medium-term, the Bank will work along side foreign strategic investors in promoting new projects and greenfield investment leveraging on the Bank's

strong working relationship with the authorities. The Bank will target in particular foreign medium sized companies able to help Croatia create a vibrant Mittelstand.

4. OTHER IFIS AND MULTILATERAL DONORS

Co-operation with donors and other IFI's is particularly good in Croatia. Joint financing opportunities are constantly discussed and evaluated and to date the Bank has implemented joint operations with all IFI's and is closely working with the EU, the EIB, the Council of Europe's Development Bank and the World Bank.

4.1 European Commission (EC)

In June 2004, the European Council concluded that Croatia is a candidate country and requested the Commission to prepare a pre-accession strategy for Croatia. Accession negotiations are scheduled to start in March 2005, subject to the decision of the European Council. The Commission considers that the reinforced pre-accession strategy for candidate countries decided by the European Council in Luxembourg in December 1997 should be extended to Croatia.

The review procedure aimed at assessing candidate countries' progress towards membership will start to be applied to Croatia as of 2005. This will mean that the Commission will start issuing Regular Reports on Croatia as from autumn 2005. In the context of the Stabilisation and Association Process, the Commission has already proposed a European Partnership, based on the findings of its Opinion on Croatia's application for membership. This document will guide Croatia's accession preparations.

Croatia as a candidate country benefits from all three pre-accession financial instruments as of 2005:

- Phare for institution-building and economic and social cohesion,
- ISPA for environment and transport, and
- SAPARD for rural development.

Taking into account the needs for an adequate preparation of Croatia for accession, €105 million (€80 million for Phare and €25 million for ISPA) are allocated to Croatia in 2005 and €140 million in 2006 (€80 million for Phare, €35 million for ISPA, and €25 million for SAPARD).

The Stabilisation and Association Agreement (SAA) signed with Croatia in October 2001 came into force on 1 February 2005. In order to implement the trade-related aspects of the SAA, an Interim Agreement entered into force in March 2002. The structures of the SAA be used not only to cover issues related to the implementation of the agreement, but also to serve as forums for the explanation of the *acquis communautaire* and to review progress made by Croatia in the alignment of the *acquis* in line with commitments taken in the negotiations.

The framework agreement allowing Croatia's participation in Community programmes and agencies was signed on 22 November 2004 and should come into force in the first half of 2005, after ratification by the EU institutions and Croatia.

In addition to the above mentioned elements for a reinforced pre-accession strategy, an enhanced political dialogue with Croatia should continue in order to tackle the issues highlighted in the Opinion. Such issues include the relations with the International Criminal Tribunal for the former Yugoslavia, minority rights, return of refugees, judicial reform, regional co-operation and the fight against corruption. In particular, Croatia needs to remain committed to regional cooperation within the framework of the Stabilisation and Association Process for the Western Balkans.

4.2 European Investment Bank (EIB)

EIB started operations in Croatia in 2001 and is working closely with EBRD on a number of projects. To date EIB has signed 13 projects, including 7 in infrastructure (road rehabilitation, modernisation of railway sections of Pan-European corridor Vc, completion of Zagreb-Rijeka Motorway, gas pipeline), one municipal infrastructure framework and global loans to banks including PBZ, HBOR, HVB Croatia, and Raiffeisen Bank, for a total commitment of EUR 491 million. Joint operations with EBRD are the financing of the Zagreb-Rijeka Motorway completion and Croatian Air Traffic Control project. A number of other joint projects are under discussion. EIB and EBRD closely co-operate on policy dialogue issues and have regular joint meetings with the authorities.

4.3 World Bank (IBRD)

Croatia became a member of the IBRD in February 1993. World Bank lending has focused on infrastructure, followed by the law, justice and public administration, agriculture and forestry, the finance and enterprise sectors, as well as health and the environment. Up to now the IBRD has committed around USD 1.2 billion for 24 projects and provided a number of grants surpassing USD 27 million. Structure of lending to date is as follows: 63 per cent infrastructure; 22 per cent finance and enterprise sectors, 10 per cent agriculture and forestry and 5 per cent health.

EBRD has a number of joint operations with the IBRD, e.g. the Highway Reconstruction project, the Railway Modernisation and Restructuring project, the Municipal Environmental Investment project as well as working alongside each other in the Pension System reform process. Currently discussions are on going on possible joint financing of the Rijeka Road By-pass and Port Infrastructure Development projects.

The World Bank has been an important actor, with UN organisations, in financing environmental projects. The main projects financed by the World Bank are the following: The “Legislation Gap Analysis” project was the first in the process of harmonisation of the regulations in the competence of the Ministry of Environmental Protection and Physical Planning; Karst Ecosystem Conservation – KEC; The National Environmental Data Gathering Capacity (NEDGC). The following projects are co-financed by UNDP and the World Bank: UNDP/GEF - "Enabling Croatia to prepare its first National Communication in response to its commitments to the UNFCCC"; UNEP-GEF Project Development of National Biosafety Framework.

The World Bank has recently published in Country Assistance Strategy for Croatia for the period 2005 – 2008. The main objective of the Strategy is to support the government’s growth and reform strategy for successful EU accession, while ensuring broad participation in growth and sustainable natural resource management. The focus is therefore on assisting private-sector led growth through rationalisation of the public sector, establishment of a supportive investment climate, and macroeconomic sustainability.

The cabinet and WB are negotiating a series of Programmatic Adjustment Loans (PAL). The PALs should be more flexible than the current Structural Adjustment Loan (SAL), with implementation period expected to be spread among 5 years. The SAL was intended for economy restructuring programme, while the PAL would support reforms in the health, education, and judiciary system, as well as state administration reform. The amount of funds that should be provided through the PAL programme is around USD 350 million. Preparatory work is underway in designing this PAL, which will have three components: (i) governance (public administration reform, legal and judiciary reform, local governance and public expenditure management); (ii) investment climate (preparation of energy sector for EU integration, restructuring/privatisation of agro-combinates, tourist companies and shipyards, continued reduction of barriers to entry of new firms, continued tightening of financial discipline of state enterprises); (iii) building human capital and strengthening social protection (education, health and social protection reforms).

4.4 International Finance Corporation (IFC)

IFC is a member of the World Bank Group. IFC's operations have been focused mainly on the financial and manufacturing sectors with the first project signed in 1995. To date IFC has committed USD 373.2 million (signed USD 203.2 million) in 13 operations, three of which have been joint financing projects with the EBRD. Joint EBRD/IFC operations are: Pliva Research Facility; Copernicus Adriatic Venture Capital Fund and a loan to Alpe Jadran Banka. The Bank is also closely involved in conjunction with IFC in policy dialogue issues concerning the privatisation process of the remaining two state-owned banks.

4.5 International Monetary Fund (IMF)

Croatia became a member of the IMF in December 1992. A 20-month Stand-By Arrangement of SDR 97 million (USD 141.3 million) with the IMF was signed in August 2004 to support Croatia's economic programme. The government's programme is designed, in the short term, to restore order in Croatia's public finances and limit the vulnerability arising from the high current account and external debt burden, and in the medium term, to modernize and reduce the role of the state, promote private sector activity, and prepare Croatia to compete within the EU.

Fiscal policy is the main instrument to achieve the objective of narrowing the gap between domestic savings and investment so as to reverse the trend of the external debt-to-GDP ratio over the medium term. Budget financing will gradually shift to domestic sources, which will help reduce the government's exposure to exchange rate risk, boost the development of the domestic capital market, and help absorb excess liquidity in the private sector in the short run. In addition, the authorities intend to limit the issuance of new government debt guarantees, strengthen financial discipline, and improve the performance of public enterprise.

The government also sees the need for fiscal consolidation in a broader context. Restoring discipline and transparency in the public finances after 2003 is important not only from a macroeconomic point of view, but also for the accountability and credibility, domestically and abroad, of the state. For this reason, the consolidation effort would not only focus on reducing the government deficit, but also encompass quasi-fiscal operations, debt management, and the wider public sector. The government also sees consolidation in 2004-05 as the foundation for future measures to reduce the high tax burden in Croatia.

In regard to monetary policy, the Croatian National Bank intends to pursue its price stability mandate by keeping the exchange rate of the kuna broadly stable against the euro. It will pursue its 2004 targets for reserve and broad money growth at about 8-9 per cent. To achieve these targets and signal its commitment to the external objectives of the programme, the Croatian National Bank introduced on July 1 a new marginal reserve requirement on foreign borrowing, and intends to maintain its Net Domestic Assets below the level of negative HRK 3 billion for the remainder of the year. Further, the Croatian National Bank plans to start open market operations with government paper to enhance liquidity management and facilitate the shift in government financing toward domestic sources.

On public sector reforms, the government is planning to take steps to enhance fiscal transparency and improve expenditure and debt management based on recent IMF and World Bank findings on major weaknesses in these areas. Further, the government plans to set annual budgets in the context of a medium-term fiscal policy framework, and ensure the long-term sustainability of the pension system. The authorities intend to restore momentum in the privatization process. The Privatization Fund (HFP) will aim at privatizing all companies in which the government holds a share of up to 25 per cent by year-end and all remaining holdings in its portfolio by end-June 2005. Outside HFP's portfolio, the government will resume efforts to restructure and privatize large state enterprises. Finally, the government will take steps to improve the business environment, financial sector supervision, and statistics.

4.6 Council of Europe Development Bank (CEB)

CEB has to date financed 10 projects in Croatia for an aggregate of EUR 206 million (EUR 118.0 million disbursed). The projects target health, education, cultural heritage, refugee return and job creation/SME’s. CEB and EBRD have implemented a EUR 20 million SME co-financing facility through HBOR, which is currently disbursing.

ANNEX 1: COMMITTED PROJECTS PER YEAR

(as of 31 December 2004)

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		1		18.8	15.5	15.5	0	
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		7		381.8	154.1	121.8	32.3	
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		8		255.9	106.9	101.9	5.0	
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		5		71.9	24.3	16.0	8.3	
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		Bank Austria Creditanstalt Croatia d.d.	Direct	22.0	4.6	0.0	4.6	Completed
1998		6		480.5	132.7	93.1	39.6	
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		7		372.5	48.3	41.5	6.8	
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		4		251.1	97.7	97.7	0.0	
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		9		780.0	202.6	200.8	1.8	
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	0.0	0.0	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
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		8		667.9	280.0	156.7	123.3	
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	0.0	0.0	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		7		271.1	119.4	119.4	0.0	
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	0.0	0.0	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	20.0	20.0	0.0	Signed
2004		5		267.0	136.0	136.0	0.0	
		GRAND TOTAL		3,818.5	1,317.5	1,100.4	217.1	

ANNEX 2: NET CUMULATIVE BUSINESS BY INDUSTRY

(in million EUR as of 31 December 2004)

Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of Commitments
Energy	Natural Resources	1.0	36	36	36	0	3%
	Power and Energy	1.0	49	32	32	0	2%
Sub-total Energy		**2.0**	**85**	**68**	**68**	**0**	**5%**
Financial Institutions	Bank Equity	5.7	202	146	5	141	11%
	Bank Lending	12.3	360	329	329	0	25%
	Equity Funds	1.3	56	12	0	12	1%
	Non Bank Financial Institutions	1.7	18	11	0	10	1%
Sub-total Financial Institutions		**21.0**	**636**	**499**	**335**	**164**	**38%**
General Industry	General Industry	4.0	218	100	68	32	8%
Sub-total General Industry		**4.0**	**218**	**100**	**68**	**32**	**8%**
Infrastructure	Municipal & Env Inf	6.0	514	125	125	0	10%
	Transport	8.0	802	261	261	0	20%
Sub-total Infrastructure		**14.0**	**1,317**	**386**	**386**	**0**	**29%**
Specialised Industries	Agribusiness	9.6	786	199	160	39	15%
	Property and Tourism	0.2	38	12	10	3	1%
	Telecoms Informatics & Media	3.1	643	45	44	2	3%
Sub-total Specialised Industries		**12.9**	**1,467**	**256**	**213**	**43**	**20%**
CROATIA TOTAL		**53.9**	**3,723**	**1,310**	**1,071**	**239**	**100%**

ANNEX 3: BILATERAL ASSISTANCE

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
AUS-1997-07-03	Municipal Environmental Infrastructure Investment Programme - institutional strengthening	AUS	227,852	227,852	21/07/97	Closed	Covenden P.	Energy	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	TMG
AUS-2002-10-06	BAS Programme/Contract Extention of the BAS Croatia Porgramme Director, Peter Siretz	AUS	40,726	40,726	31/10/02	Closed	McPhee J.	Finance, Business	TMG
BEL-1995-10-01	Agribusiness line of credit - Dalmatinska banka d.d.	BEL	95,532	95,532	25/08/95	Closed	Hume T.	Manufacturing	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
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 Sewage Company - Financial and Operational Improvement Project ("FOPIP")	BRSF	73,075	24,975	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
CANSE-2000-12-01	City of Zagreb Creditworthiness Enhancement Programme	CANSE	67,352	67,352	07/12/00	Closed	Indic D.	Community/ Social Services	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	Committed	McPhee J.	Manufacturing	TMG
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	TMG
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	TMG
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	TMG
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	TMG
CEI-2000-06-05	Business Advisory Service (BAS) Programme in Croatia office rent	CEI	81,600	81,550	20/06/00	Disbursing	McPhee J.	Manufacturing	TMG
CEI-2000-06-06	Business Advisory Service (BAS) Programme in Croatia office equipment & furniture	CEI	20,967	20,967	20/06/00	Closed	McPhee J.	Manufacturing	TMG

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
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	TMG
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	TMG
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	TMG
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	TMG
CEI-2002-08-03	Business Advisory Service (BAS) Programme in Croatia Asst to National Prog. Director - Ana Betica	CEI	6,273	6,273	07/08/02	Closed	McPhee J.	Manufacturing	TMG
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	TMG
CEI-2002-12-05	BAS Programme / Contract Extension of the BAS Croatia Assistant to National Programme Director, Ana	CEI	3,111	3,111	23/12/02	Closed	McPhee J.	Manufacturing	TMG
DEN-1998-01-01	Zagreb landfill rehabilitation programme - municipal finance analysis of the City Zagreb	DEN	38,828	38,828	19/01/98	Closed	Mathiesen J.	Energy	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 Municipalities	ECMF	350,000	0	26/11/03	Committed	Maguire J.	Finance, Business	Municipal & Environmental Infrastructure
FIN-1999-10-12	TurnAround Management Programme (TAM) - Podravka	FIN	48,222	48,222	06/10/99	Closed	McPhee J.	Manufacturing	TMG
FIN-2000-12-09	Hrvatske Zelejeznice, 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.	Energy	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 Sewage Company - Financial and Operational Improvement Project ("FOPIP")	FRA	51,800	33,664	18/04/02	Committed	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
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 Credit Bank for Reconstruction	GERK	36,488	36,488	08/03/96	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
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 the Balkans - Regional Programme Director	GERK	80,000	80,000	09/07/01	Closed	McPhee J.	Manufacturing	TMG
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	TMG
HOL-1995-06-08	Zagrebacka 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
HOL-2000-02-01	TurnAround Management Programme (TAM) - Getro	HOL	29,412	29,412	20/02/00	Closed	McPhee J.	Manufacturing	TMG
HOL-2000-11-10	TurnAround Management Programme - Getro d.o.o. II	HOL	39,601	39,601	01/11/00	Closed	McPhee J.	Manufacturing	TMG
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 the Regulatory Framework of Fresh Produce Wholesale	ICE	9,571	5,553	22/08/01	Committed	Galic S.	Manufacturing	Agribusiness
IRL-1999-10-06	TurnAround Management Programme (TAM) - Podravka	IRL	9,438	9,438	28/10/99	Closed	McPhee J.	Manufacturing	TMG
IRL-2000-02-01	TurnAround Management Programme (TAM) - Getro	IRL	26,739	26,739	23/02/00	Closed	McPhee J.	Manufacturing	TMG
IRL-2000-07-03	TurnAround Management Programme (TAM) - Nasicecement	IRL	9,203	9,203	19/07/00	Closed	McPhee J.	Manufacturing	TMG
IRL-2000-09-04	TurnAround Management Programme (TAM) - Grand Hotel Adriatic	IRL	5,391	5,391	01/09/00	Closed	McPhee J.	Manufacturing	TMG
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
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 the 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	Sjoborg 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

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
JAP-1995-05-17	Highways reconstruction - institutional reform	JAP	244,950	244,950	01/05/95	Closed	O'Grady L.	Construction	Transport
JAP-1995-07-22	Zagrbacka 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
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	Croatia 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
NCSM-2004-09-01F	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-2004-09-02F	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
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	Varzdinska 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	TMG
SWE-2001-11-15	TAM Programme i: MTC Tvornica Carapa DD	SWE	24,903	24,902	22/11/01	Disbursing	McPhee J.	Manufacturing	TMG
SWI-2000-07-05	TurnAround Management Programme (TAM) - Nasicecement	SWI	46,892	46,892	05/07/00	Closed	McPhee J.	Manufacturing	TMG
SWI-2001-08-07	TAM Programme - Koestlin	SWI	32,397	32,397	08/05/01	Closed	McPhee J.	Manufacturing	TMG
SWI-2002-06-15	TAM Programme - Dilj	SWI	48,400	48,400	12/06/02	Closed	McPhee J.	Manufacturing	TMG
TAI-1997-01-01	Vrasdinska banka d.d	TAI	167,325	167,325	21/01/97	Closed	Pilipovic-Chaffey D.	Finance, Business	Financial Institutions

Commitment Number	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Operation Leader	Sector	Team Name
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.	Commerce, Tourism	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 training for Croatian bank - Alpe Jadran Banka, Trgovacka banka.	UKC	37,024	37,024	01/02/97	Closed	King M.	Finance, Business	Environmental Appraisal Unit
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.	Commerce, Tourism	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-2000-11-04	City of Zagreb Creditworthiness Enhancement Programme	UKF	365,000	322,333	29/11/00	Disbursing	Indic D.	Community/ Social Services	Municipal & Environmental Infrastructure
UKF-2003-07-03F	EBRD/TMG BAS Programme in South East Europe	UKF	98,204	66,251	24/07/03	Disbursing	McPhee J.	Manufacturing	TMG
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
			13,652,147	**8,818,009**					
	No of Commitments:		**108**						

ANNEX 4: POLITICAL AND SOCIAL ASSESSMENT

Internal political background

Croatia’s declaration of independence on 25 June 1991 marked the end of its political association in a common state with the other Southern Slav nations. In January 1990, Croatia’s Communist leadership, together with the Slovene one, had left the congress of the Yugoslav Communist Party, never to return. The first free parliamentary elections in April and May had 1990 produced a landslide victory for the newly formed Croatian Democratic Union (HDZ) led by Franjo Tudjman In a referendum in May 1991, 94 per cent of the voters had opted for independence. In July 1991, a month after Croatia’s proclamation of independence, Serb paramilitaries, protected by the Yugoslav People’s Army (JNA) and guided by the government of Slobodan Milosevic in Belgrade, began to expand the area of control they had already established in some predominantly Serb-populated parts of Croatia. The bitter armed conflict that ensued ended with an internationally-brokered ceasefire at the beginning of 1992 that left a third of Croatia’s territory under foreign (Serb) control. The war and the subsequent occupation caused considerable material damage to Croatia’s economy and held back its recovery. In two offensives in May and August 1995 Croatia retook most of the territory occupied since 1991, with the exception of that in the east, including the city of Vukovar on the Danube, first besieged and then destroyed by Serb forces in November 1991. With UN help, those eastern territories were peacefully integrated into Croatia by early 1998. However, military operations in 1995 had led to the exodus of an estimated 150,000 Serbs living there. President Franjo Tudjman, re-elected in 1992 and 1997, died in December 1999. The HDZ, the party he had founded and led for a decade, lost the parliamentary elections in January 2000. In February 2000, Stjepan Mesic, previously a senior member of the HDZ and then of the opposition, was elected president.

The new centre-left coalition government under Ivica Racan, leader of the Social Democratic Party, amended the Constitution in order to reduce the role of President, strengthened the role of parliament and embarked on a series of reforms, notably that of the judiciary. However, continuing disagreements within the six-party coalition made the task of governing more and more difficult. In July 2001, following the refusal of one of the coalition partners to support the ratification of an agreement between Croatia and Slovenia over the jointly-owned nuclear-power plant of Krsko in Slovenia, near the Croatian border, led to Racan’s resignation and the collapse of the government. The government was eventually re-assembled, with fewer parties in it but once again under Racan as PM. However, it continued to be racked by internal conflicts. The early elections eventually called by President Mesic in November 2003 resulted in a massive defeat for the ruling coalition and a victory, albeit a slender one, by a rejuvenated HDZ led by Ivo Sanader. In parliament, his government relies on the support of MPs representing the pensioners and the minorities (including the Serbian one). In the second round of the presidential elections on 16 January 2005, Mesic was re-elected President. The next local elections will take place in May 2005.

International relations

Following President Franjo Tudjman's death in December 1999 and the arrival to power in January 2000 of the centre-left government headed by Ivica Racan, Croatia's relations with the West improved. The new government addressed a number of outstanding issues that included: the state of Croatia's democracy; the country's relationship with Bosnia and Herzegovina; the question of Serb returns; and the cooperation with the International Criminal Tribunal for the Former Yugoslavia (ICTY) at The Hague. The government embarked on a programme of constitutional and media reforms and cut off financial aid to Bosnian Croats while at the same time affirming Croatia's firm support for the territorial integrity of the Bosnian state within its present borders. In response to those and other measures, NATO invited Croatia in May 2000 to join its Partnership for Peace Programme. In October 2001, Croatia became the second country in the region, after Macedonia, to sign a Stabilisation and Association Agreement (SAA) with the EU, seen by the EU as local versions of association agreements that had already been signed with all the other countries of Eastern and Central Europe. The Interim Agreement on Trade and Related Issues, which came into force in March 2002, established an asymmetrical reduction and elimination of trade restrictions between Croatia and the EU, with a six-year transition period for Croatia. EU trade restrictions were eliminated immediately on coming into force of the Interim Agreement. In 2002, Croatia made good progress in tackling a number of economic, social and administrative reforms within the SAA framework. However, the perception by some EU member governments that Croatia's cooperation with the ICTY was not satisfactory led to the postponement of the ratification process of the SAA. In February 2003, the government submitted a formal application for EU membership. In October 2003 the government replied to a comprehensive questionnaire from the European Commission. A number of domestic initiatives by the new Sanader government undertaken as soon as it took power in December 2003 – particularly those towards the Italian and Serb minorities – were welcomed and in June 2004 Croatia was granted EU candidate status. In December 2004 the European Council announced that the official negotiations about Croatia's EU accession would start in March 2005 but on condition that Croatia's cooperation with ICTY was deemed satisfactory.

Ivo Sanader's official visit to Serbia on 15 November 2004, the first by a Croatian PM since independence in 1991, was well received in Brussels and other Western capitals. During the visit Serbia promised to withdraw its armed forces from the border with Croatia and put the border under police control, a promise which still remains to be implemented. It was also made known that the Croatian government would extend the suspension of visa requirements for citizens of Serbia and Montenegro for anther six months from January 2005 and that it was willing to continue talks on full liberalisation until Croatia joins the EU. Vesna Skare-Ozbolt, Croatian Minister of Justice, and Rasim Ljajic, Human and Minority Rights Minister in Serbia/Montenegro, signed an agreement on the protection of national minorities. The two countries also pledged to improve cooperation in investigating the cases of 1,200 Croatian citizens who went missing during the 1991-95 war. Both countries also committed themselves to speed up the process of refugee returns. Croatia's relations with all of its neighbours are satisfactory.

Integrity issues

Croatia's investment climate was badly impaired by the 1991-95 war and the non-transparent relationship between the government and a part of the business community during the 1990-99 period of HDZ rule. The Racan government, which took office in February 2000, attempted to address economic crime and fight corruption. In November 2003 a Programme of Special Measures to Combat Organised Crime was adopted by the government. A specialised body, the Office for the Suppression of Corruption and Organised Crime (USKOK), set up in December 2001, was strengthened and upgraded in June 2004. The National Plan to Combat Organised Crime was adopted in 2004. In the autumn of 2004, a purge was carried out in the Zagreb criminal police department, resulting in a number of senior officers dismissed for maintaining links to organised crime or tolerating them.

The reform and modernisation of the judiciary began in 2001, but continued to suffer from funding problems and inefficiency as well as some political interference at the lower level. As part of the Racan government's programme adopted in July 2002, which had highlighted judicial reform as a priority, another 1,000 judges and other judicial staff were to be taken on, judicial fees were to be reduced, the computerisation programme was to be speeded up and salaries of judges and prosecutors were to be adjusted. The July 2002 plan also aimed to reduce the burden on the courts by transferring some cases to public notaries and by reallocating cases to courts with lower caseloads. Since coming to power in November 2003, the HDZ government of Ivo Sanader has reaffirmed that it regards the pursuit of judicial reform as its top priority. A number of steps have been taken during the past year to reduce the backlog of court cases, still numbering around 1,4 million. A significant part of the backlog is attributable to the (still present) outdated procedural codes and court rules; inexperienced judges and staff; and, primarily in civil cases, to verdicts that had not been executed. A Judicial Academy was set up early in 2004 by Vesna Skare-Ozbolt, the new Minister of Justice, to improve professional standards. Under the Sanader government, the main responsibility for dealing with ICTY at The Hague has been given to the Ministry of Justice. This means that a significant part of the Minister's (and Ministry's) time has been up with issues pertaining to Croatia's relations with ICTY. Nevertheless, there has been an acceleration of the campaign aimed at clearing up of the large backlog in the registration of land and property handled by the land registry offices and municipal courts. In the larger municipalities this backlog extends over three years and deters the development of efficient property markets as well as preventing businesses from accessing collateral finance.

In Transparency International's Corruption Perceptions Index for 2004, which analysed public-sector corruption and took in 146 countries, Croatia is ranked in the 67th place (together with Peru, Poland and Sri Lanka). In 2003, when 133 countries were included, it was ranked in the 59th place (with Colombia, El Salvador, Peru and Slovakia). In 2002 it was in the 51st place out of a total of 102 countries.

Labour issues

The Constitution guarantees the workers the right to form or join unions of their own choosing without prior authorisation, and workers exercise that right in practice. Croatia has an active trade union movement, with one major and four minor trade union federations and an independent association both of blue- and of white-collar workers.

Approximately 64 per cent of the labour force belongs to the trade unions. The unions are independent of government and of political parties. Collective bargaining is protected by law. The Constitution provides for the right to strike with some limitations (members of the armed forces, police, government and public service). Strikes are numerous but usually short. The Government Office for Social Partnership provides administrative and expert support to the Office and facilitates dialogue between the government, the employers and trade unions. Only after submitting to mediation and formally declaring that negotiations are at an impasse is a strike legal. The government is obliged to consult with the trade unions before announcing economic reforms that would result in changes in worker benefits and in layoffs.

Social conditions

Population: According to the 2001 census, Croatia had a resident population of 4.4 million at the end of March 2001, down from 4,5milion at the previous census in 1991. Upheavals caused by the 1991-95 war produced large population swings in the 1990s. There were an estimated 581,663 Serbs (12 per cent of the total population) in 1991. Due to the exodus of some 150,000 Serbs during the military operations in 1995, the total number of Serbs in Croatia had fallen to 201,631, according to the 2001 census. Some Serbs are returning. Demographic trends suggest a continuing tendency towards population decline first noted during the 1970s and 1980s. In the first half of the 1990s, the birth rate dipped below 11 per 1,000 population (the EU average in 1990-95 was 11.5) Birth rates picked up immediately after the war but fell again in 1998. In 2002 Croatia's birth rate was 9 per 1000 population. The death rate was 11.5 per 1,000 population in the late 1990s but dropped slightly in 2001. The Constitution lists 10 indigenous ethnic minorities. Yet, in practice, the constitutional protection is extended to all citizens, including minorities not listed (e.g. Bosniaks, Roma and Slovenes). In 2002, a Constitutional Law on National Minorities was adopted that provided further legal protection for the rights of national minorities. Following its adoption, eight ethnic minority representatives were elected to parliament. International human rights groups report regular discrimination against the Roma.

Trafficking in women is a problem, according to the US State Department Country Report on Human Rights Practices in Croatia, published in February 2004. What little statistical information exists suggests that the country is primarily a transit country for women trafficked to other parts of Europe for prostitution. Women from Hungary, Ukraine, Romania, Bulgaria, Slovakia and other countries are reported to be trafficked through Bosnia and Herzegovina and Montenegro to Croatia, with some remaining to work as prostitutes and others being trafficked to other destinations. In 2002 the Croatian government appointed a National Committee for Combating Trafficking in Persons. The National Committee created a National Action Plan but the implementation has been slow due to a combination of limited resources, a weak organisational structure ands a lack of authority to enforce decisions.

Education: Primary education is compulsory in Croatia between the ages of six and 15. After that, students follow either an academic curriculum in a grammar school (*gimnazija*0 or a vocational education path. There are two types of vocational education: a standard four-year curse or a craft-based system lasting three years. The German system of dual vocational training was introduced between 1995 and 1999. Graduates of grammar schools and some forms of vocational training continue to study at universities in Zagreb, Rijeka, Osijek and Split. During the socialist era, considerable resources were devoted to education. In 1989, primary school enrolment rate was 99.2 per cent. Secondary school enrolment rate was 84.7 per cent (compared with 90-95 per cent in most EU countries). Illiteracy was virtually eliminated, falling to 3 per cent in 1991. Enrolment rate dropped during the 1991-95 war – in primary education to 87.1 per cent in 1996, Education spending was cut, averaging the equivalent of 3.3 per cent of GDP. It rose to 4.2 per cent in 2000, but still remained below the 5-8 per cent level prevailing in both Western and Eastern Europe. Croatia's tertiary education was admitted to the EU 'Tempus' programme in 2001. The programme has approved nearly 30 projects since 2001 intended to strengthen the quality and provision of education in Croatia and to begin the process of integrating Croatian university education into European educational and research networks. In line with the current HDZ government's overriding objective of reducing the country's high rate of unemployment, an effort is likely to be made to increase enrolment in the country's vocational training programmes.

Health: Average life expectancy in Croatia at birth remained steady between 1971 and 1991 at about 66 years for men and increased from 72 to 74 years for women. By 2002 overall life expectancy had risen to roughly 74 years. Infant mortality declined from 20.6 per 1,000 live births in 1980 to 7 per 1,000 in 2002.The main cause of death has in recent years been heart disease. The number of traffic deaths is also very high. At 14 per 100,000 head of population in 2002, Croatia's level of road deaths was more than three times the rate typical of the safest West European countries. Intensive efforts to improve the state of motorways have enhanced safety on the roads, bringing total deaths in traffic accidents down from 716 in 2000 to 639 in 2002. The controversial ban on driving with any alcohol in the blood adopted by the Croatian parliament in the summer of 2004 is also designed to reduce the number of road deaths. The insurance-based healthcare system is built around one state-owned health fund that is financed by payroll contributions from employers and direct transfers from the government. In 2000, public health spending was the equivalent of 8.6 per cent of GDP, much higher than the 4-6 per cent of GDP prevalent in most other East and Central European countries and just below the highest rates in Western Europe. This reflects the authorities' reluctance to cut health spending in line with the country's reduced living standards and also the lack of expenditure controls at the state health fund – particularly with regard to pharmaceuticals. The state health fund has suffered acute revenue shortfalls forcing the government to make up for this shortfall with direct transfers from central government budget.

ANNEX 5: SOCIAL AND ECONOMIC INDICATORS

Croatia

	1998	1999	2000	2001	2002	2003	2004
						Estimate	*Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	2.5	-0.9	2.9	4.4	5.2	4.3	3.7
Private consumption	-0.6	-2.9	4.2	4.6	7.5	4.1	na
Public consumption	1.6	-1.0	-8.9	-4.3	-1.8	-1.8	na
Gross fixed capital formation	2.5	-3.9	-3.8	9.7	10.1	na	na
Exports of goods and services	3.9	0.7	12.0	8.1	1.3	10.1	na
Imports of goods and services	-4.9	-3.5	3.7	9.3	8.8	10.9	na
Industrial gross output	3.7	-1.4	1.7	6.0	5.4	5.0	4.8
Agricultural gross output	10.2	-3.5	2.8	8.7	na	na	na
Employment[1]			*(Percentage change)*				
Labour force (end-year)	-1.5	-1.0	7.2	-5.6	2.7	-0.1	2.5
Employment (end-year)	-3.1	-3.4	4.1	-5.4	4.0	0.6	3.0
			(In per cent of labour force)				
Unemployment (end-year)	11.4	13.6	16.1	15.8	14.8	14.3	na
Prices and wages			*(Percentage change)*				
Retail prices (annual average)	5.7	4.2	6.2	4.9	2.2	1.8	2.1
Retail prices (end-year)	5.4	4.4	7.4	2.6	2.9	2.2	2.7
Producer prices (annual average)	-1.2	2.6	9.7	3.7	-0.5	1.9	3.5
Producer prices (end-year)	-2.1	5.9	11.2	-3.1	2.3	1.0	4.8
Gross average monthly earnings in economy (annual average)	12.6	10.2	7.0	3.9	6.0	4.8	3.1
Government sector[2]			*(In per cent of GDP)*				
General government balance	-1.0	-8.2	-6.5	-6.7	-5.0	-6.3	-4.9
General government expenditure	46.7	56.6	52.7	50.7	51.4	52.7	-51.8
General government debt	37.6	46.4	51.1	50.8	50.7	53.2	54.1
Monetary sector			*(Percentage change)*				
Broad money (M4, end-year)	13.0	-1.2	28.9	45.2	9.5	11.0	9.4
Domestic credit (end-year)	19.1	-1.5	9.3	21.6	28.4	12.3	10.0
			(In per cent of GDP)				
Broad money (M4, end-year)	41.7	40.0	47.9	64.0	64.7	66.8	67.9
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate (3 months)	10.5	11.6	7.0	4.3	2.7	1.2	na
Interbank interest rate (daily)	15.8	12.7	4.5	2.2	1.9	6.8	7.0
Deposit rate[3]	4.1	4.3	3.4	2.8	1.6	1.7	1.7
Lending rate[4]	16.1	13.5	10.5	9.5	10.9	12.0	11.8
			(Kuna per US dollar)				
Exchange rate (end-year)	6.2	7.6	8.2	8.4	7.1	6.1	5.6
Exchange rate (annual average)	6.4	7.1	8.3	8.3	7.9	6.7	6.0
External sector			*(In millions of US dollars)*				
Current account	-1,453	-1,397	-469	-726	-1,920	-2,086	-1,916
Trade balance	-4,071	-3,299	-3,204	-4,101	-5,649	-7,908	-8,227
Merchandise exports	4,581	4,395	4,567	4,759	5,004	6,308	7,542
Merchandise imports	8,652	7,693	7,771	8,860	10,652	14,216	15,769
Foreign direct investment, net	835	1,420	1,085	1,407	591	1,700	1,100
Gross reserves, excluding gold (end-year)	2,816	3,025	3,525	4,704	5,886	8,191	8,700
External debt stock	9,685	9,978	11,055	11,317	15,355	23,548	30,200
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.2	3.7	4.4	5.2	5.4	5.7	5.5
			(In per cent of exports of goods and services)				
Debt service	13.6	22.4	22.9	19.6	23.2	19.5	24.2
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	4.5	4.6	4.4	4.5	4.4	4.4	4.4
GDP (in millions of kuna)	137,604	141,579	152,519	165,639	179,390	193,067	207,747
GDP per capita (in US dollar)	4,805	4,371	4,206	4,458	5,138	6,518	7,789
Share of industry in GDP (in per cent)	21.1	20.7	20.7	20.4	19.6	na	na
Share of agriculture in GDP (in per cent)[5]	7.9	8.1	7.4	7.5	7.3	na	na
Current account/GDP (in per cent)	-6.7	-7.0	-2.5	-3.7	-8.4	-7.2	-5.6
External debt - reserves (in US$ million)	6,869	6,953	7,530	6,612	9,469	15,357	21,500
External debt/GDP (in per cent)	44.8	50.1	60.0	57.0	67.4	81.8	87.7
External debt/exports of goods and services (in per cent)	113.3	122.9	127.6	117.5	145.3	157.7	183.9

[1] Based on labour force surveys.

[2] Consolidated central government. Government expenditures include net lending.

[3] Weighted average over all maturities.

[4] Weighted average over all maturities.

[5] Including hunting, forestry and fishing.

ANNEX 6: ASSESSMENT 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 laws (also referred to as "effectiveness"). All available results of these assessments can be found at 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

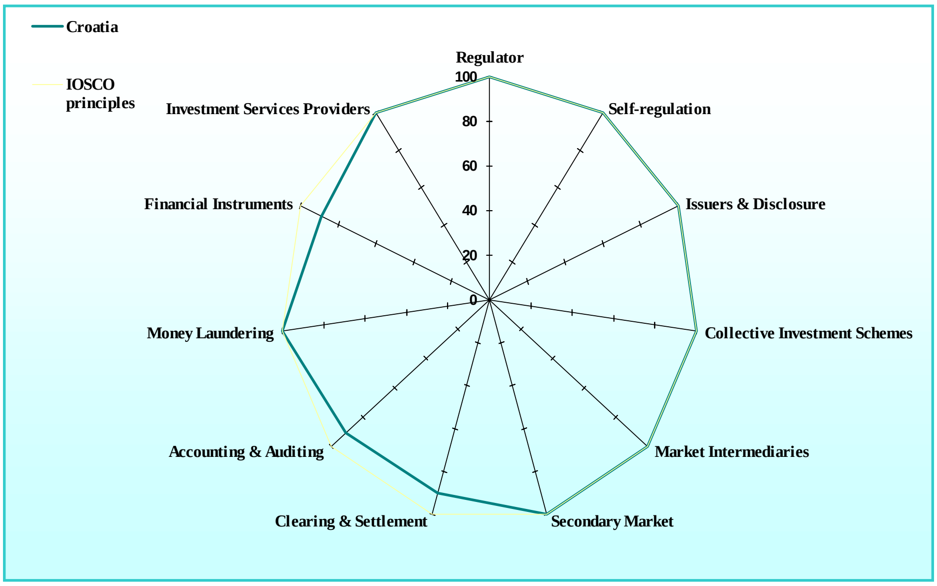
The primary legislation governing the capital market of Croatia includes the Securities Market Law, the Law on the Take-over of Joint Stock Companies, the Law on Companies and the Law on Investment Funds. While both the Securities Market Law and the Law on the Take-over of Joint Stock Companies were promulgated in 2002, the Law on Companies came into force in 1995 and was amended in 2003. The Law on Investment Funds was enacted in 1995 and amended in 2001. The Securities Market Law of 2002 replaced an old law, which was criticised for a lack of clarity on the objectives of securities regulation and for not giving sufficient legal authority (e.g., enforcement powers) to the Securities Commission of the Republic of Croatia (the "CROSEC").

The CROSEC is the principal regulator of the Croatian capital market. The CROSEC was established and became operational in 1996. The CROSEC is an independent legal entity and is not a part of the Ministry of Finance. The CROSEC answers to the Croatian State Parliament, which nominates its members. On the other hand, the Zagreb Stock Exchange (the "ZSE") was incorporated in 1991 as a joint-stock company, and began trading in 1992.

According to the 2004 findings of the EBRD's Securities Market Legislation Assessment, Croatia is a country whose existing securities market legislation (i.e., the "law on the books") is rated as "high compliance" when assessed against relevant international standards. While improvements are still needed in the areas concerning financial instruments, clearance and settlement and accounting and auditing of financial reports, Croatia scored highly in all other assessment categories. In this respect, it is worth noting that Croatia benefited from the EU's "Community Assistance for Reconstruction, Development and Stabilisation Programme (CARDS)" to develop its legislative framework, as well as more tangible economic and physical infrastructure needs. The 2001 Report on the Observance of Standards and Codes ("ROSC") issued by the World Bank and the International Monetary Fund observed that Croatia needed to improve its disclosure of share ownership and control structures, and the independence of auditors. The aforesaid EBRD assessment of 2004 shows that progress has been made by Croatia since the 2001 ROSC Report. Certainly, there are still areas where improvement can be made. For example, shareholders still lack appraisal rights or mandatory cash buy-

outs upon take-overs; take-over disclosure is less extensive than prospectus disclosure requirements; and directors and senior management are not required to disclose compensation or personal benefits they would receive in a takeover. Collective investment schemes could be improved by requiring the on-going professional training of their managers, and the separation a single entity of custodial and investment functions.

Quality of securities market legislation – Croatia (2004)



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 closer the inside line approaches the extremity of the graph, the closer the relevant securities market legislation of the country approximates these principles.

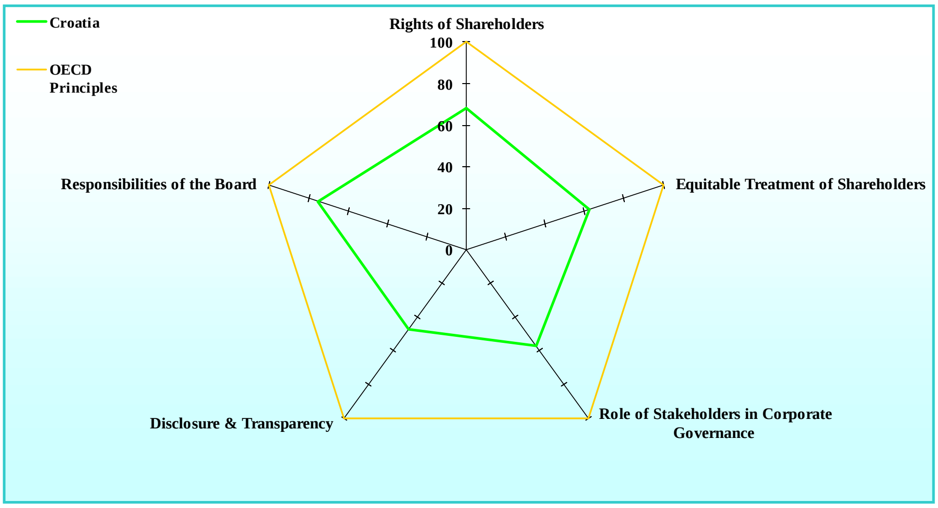
Source: EBRD Securities Market Legislation Assessment 2004

Company Law and Corporate Governance

The existing Law on Companies of Croatia came into force in January 1995 and was subsequently amended in 1999, 2000 and 2003. As a country whose economy is in transition, Croatia is a classic example of a country where the authorities have had difficulties in implementing two sets of corporate governance laws adapted from different foreign legal backgrounds. The Law on Companies is based upon the German model, while Croatia's initial securities market legislation made strong reference to the laws and regulations of common-law countries. Given that the German system of corporate governance is "bank-based" (i.e., driven by creditors) whereas the Anglo-American one is market-oriented (i.e., driven by investors), there have been problems with and a lively debate over the compatibility between the Law on Companies and the then securities market legislation, and on how to implement these conflicting provisions in practice. Although the situation has improved since the adoption of the Securities Market Law and the Law on the Take-over of Joint Stock Companies in 2002, there remains room for improvement.

According to the 2003 results of the EBRD's Corporate Governance Sector Assessment, Croatia is a country whose existing corporate governance related laws (i.e., the "law on the books"), when compared to the OECD *Principles of Corporate Governance*, were rated as "medium compliance". General reform priorities for countries in this category are to improve effective implementation and enforcement of existing legislation, while continuing to refine their existing laws. For Croatia, particular attention should be paid to improving the disclosure and transparency requirements concerning company operations, as can be seen from the graph below. For example, while the Law on Companies has provisions regulating actions taken by a person who has influence in a joint stock company and causing damages to the company, the requirement for interested parties to timely disclose conflicting interests in transactions with the company should be strengthened. In addition, the way that audited financial statements are disseminated should be improved. Oversight of auditors' work also needs to be enhanced.

Quality of corporate governance legislation –Croatia (2003)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The closer the inside line approaches the extremity of the graph, the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2003 assessment

Concessions

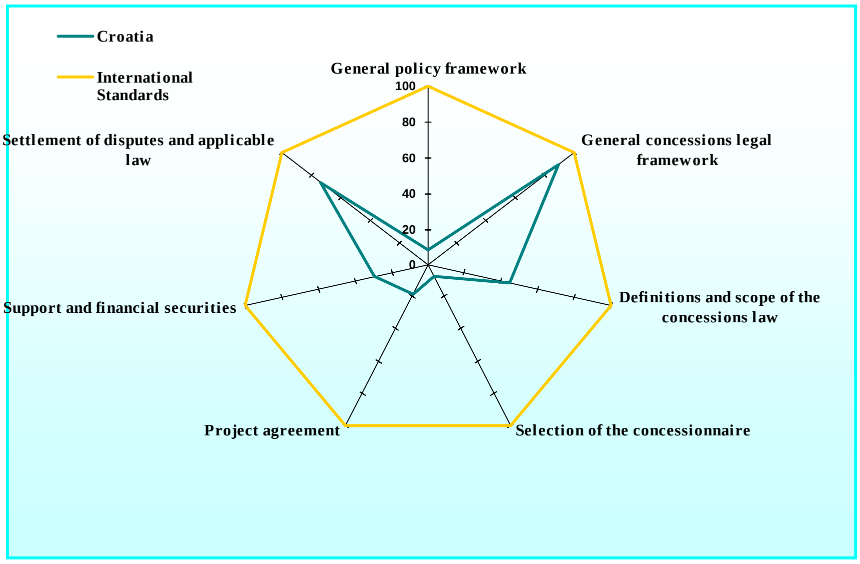
Croatia does not appear to have a clearly defined policy towards the application of public-private partnerships in either infrastructure or public services, at least in a form of a government approved document. The absence of policy for private sector participation in public projects is an obstacle for both central government and municipal authorities in considering particular projects.

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 (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, as amended in 1997 and 1999, 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 (2004)



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.

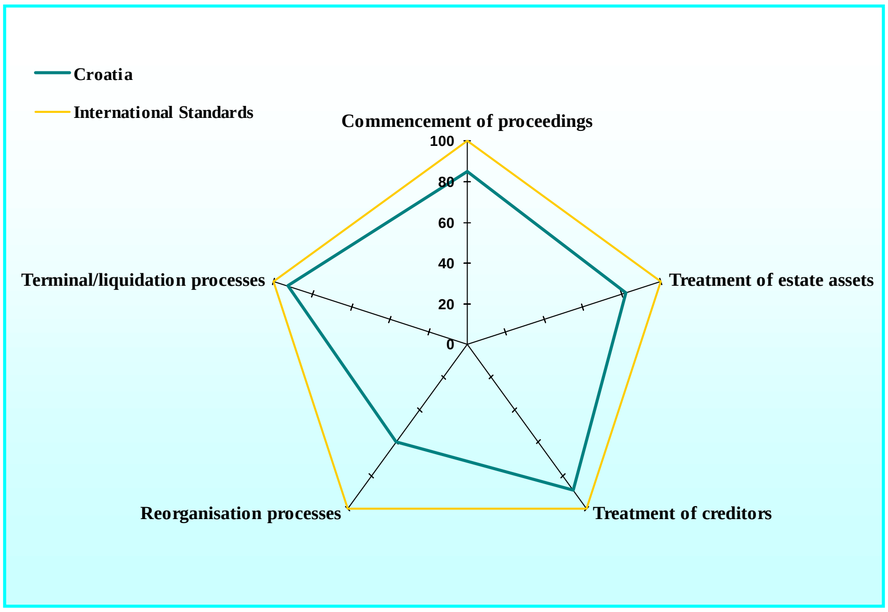
Source: EBRD Concessions Sector Assessment 2004

The 2004 EBRD Concession Laws Assessment undertaken to evaluate applicable regimes in the EBRD's 27 countries of operations (the laws on the books only rather than how they work in practice), revealed that Croatian laws were 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 financial instruments and state support need to be dramatically improved in order to meet requirements of modern legal framework facilitating private sector participation. The Croatian authorities have benefited from advice on the reform of its general concession framework under a World Bank sponsored study, but unfortunately the proposed draft new Law has not yet been adopted.

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, Croatia was one of only 6 EBRD countries of operations to receive an overall score of "high compliance".

Quality of insolvency legislation –Croatia (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The closer the inside line approaches the extremity of the graph, the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment 2004

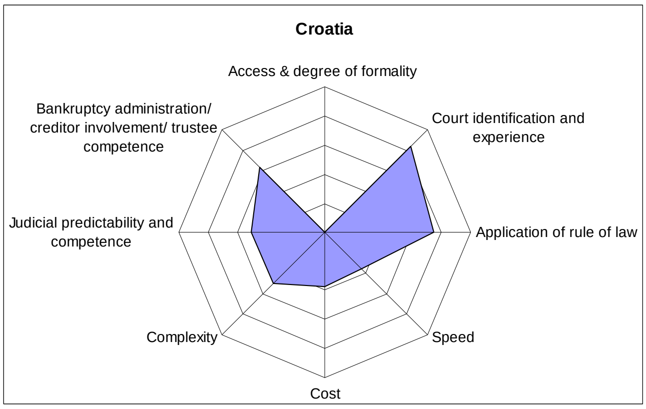
Achieving a high score is not intended to suggest that a given law is perfect but, rather, that it substantially complies with a number of critical elements of international standards in insolvency. Even a law that achieved "full compliance" would still require improvement. Similarly, the Insolvency Law could be significantly improved in a number of ways. The law's relatively poor scoring in the area of restructuring processes (see graph above) relates principally to its failure to provide for independent analysis of a reorganisation plan, absence of reorganisation financing provisions and shortage of stay provisions pending a reorganisation. In addition, this law does not provide a clear evidentiary test upon which a creditor could establish the insolvent status of a debtor. Such tests contribute to the transparency and predictability of an insolvency system and are therefore essential. The Insolvency Law also fails to require parties related to an insolvent entity to deliver property, books and records relating to that entity to the insolvency administrator. This will necessarily impede the administrator's job and will hinder the effective administration of the insolvent estate. More worrisome, however, is the provision requiring insolvency proceedings to terminate if it is determined that there are not enough assets in the estate to fund the insolvency proceeding. Although funding such proceedings can be a great expense to national governments, it is a generally accepted international standard that the final resolution of each estate, however impecunious, should be completed.

Assessing the state of insolvency legislation in Croatia provides only part of the picture. It is also necessary to look at the practical functioning of the insolvency regime (the "effectiveness" of the regime).

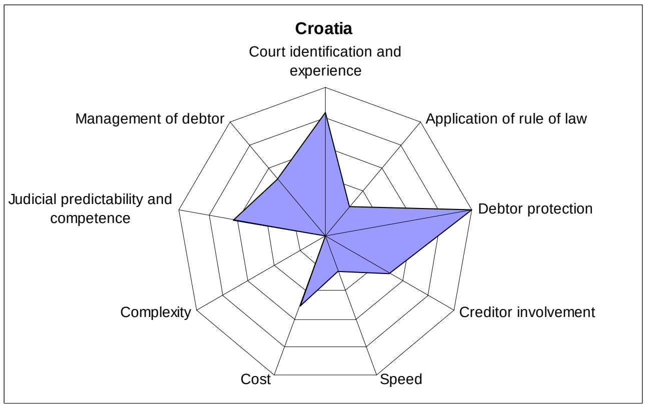
The graphs below display the results of the EBRD 2004 Legal Indicator Survey on Insolvency which examined the effectiveness of insolvency regimes in both creditor-initiated insolvencies (looking at 8 different factors) and debtor-initiated insolvencies (looking at 10 different factors). In particular, the effectiveness of the regime as it relates to the commencement of insolvency proceedings and the granting of an initial insolvency court order (sometimes called the "effective final order") was measured.

Effectiveness of Croatian Insolvency Regime

Creditor-Initiated Insolvency



Debtor-Initiated Insolvency



Note Each axis of the graph represents an aspect of the insolvency regime measured with multiple questions. The fuller the "web" the more effective the local insolvency regime is.

Source: EBRD 2004 Legal Indicator Survey on Insolvency

The above graphs also demonstrate the large "effectiveness" gap (the difference between the quality of the legislation and the effectiveness of the insolvency regime in practice) in Croatia. This gap underscores 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

Secured transactions law in Croatia consists of 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. A mortgage over immovable assets will usually require registration of the right in the Land Registry or at the Court if the immovable is not recorded in the Land Registry. A security right over movable assets will be registered only when the assets are themselves recorded in a specific registry, such as ship, aircraft, or securities. When the charged assets are not registered, possession of the charged movable assets will have to be transferred to the creditor. Alternatively the parties could enter into a voluntary agreement before a court, under which security will be created over the assets to secure the claim. This security is governed by the 1996 Law on Execution but this results in the actual seizure of these assets for security purposes. Finally, the same Law on Execution provides for security created by the transfer of ownership (title) of assets and rights for security purposes. The borrower would remain in possession of the assets. Such a transfer can be made either before a court or a notary public. The transfer of title for security by a notary public is the most popular option.

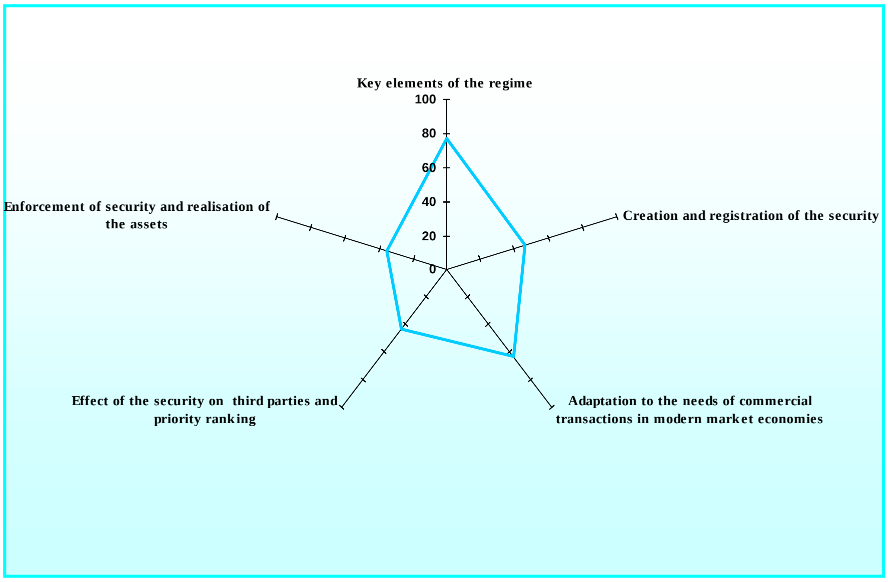
The entanglement of different rules makes the system complex and far from optimal for a number of reasons:

- Creation of a court voluntary charge or court fiduciary transfer of ownership is complex and lengthy as it necessitates a court ruling. Procedure is also costly as court costs or notarial fees must be paid on the basis of the value of the secured claim.
- Charges can only be created over individually determined assets, so general descriptions of charged assets and charges over pools of assets are unacceptable. Moreover, notice to the chargor's debtor is required for the perfection of the charge over receivables. The specificity principle requires identification of all receivables.
- The voluntary court or notary charge is published in the Official Gazette. A similar notice is published in the case of a fiduciary transfer of property, the additional mention that the transfer was done for security purposes. However, this does not provide adequate publicity of the security, as third parties could not easily refer to it.
- The enforcement regime for charges is inefficient, with court enforcement being the default rule (though non-judicial enforcement is available in certain circumstances). Sale takes place at public auction, except in some very limited circumstances. The enforcement procedure is described by practitioners as being slow and ineffective. Fiduciary transfer of ownership, on the other hand, allows the asset to be sold directly by a notary public, provided the parties have included an enforcement title

clause. However, the costs would be quite high, amounting to about 10 per cent of the secured debt.

Chart 1 below gives a snapshot of the legal and practical regime for taking security over movable and intangible property and shows that all the key areas of the regime are deficient, with enforcement being an area of particular concern. In a survey conducted in 2003 by the EBRD on the enforcement of charges, it transpires that the biggest problem faced in practice is the lack of flexibility and simplicity in the scope of the regime (see Chart 2 below).

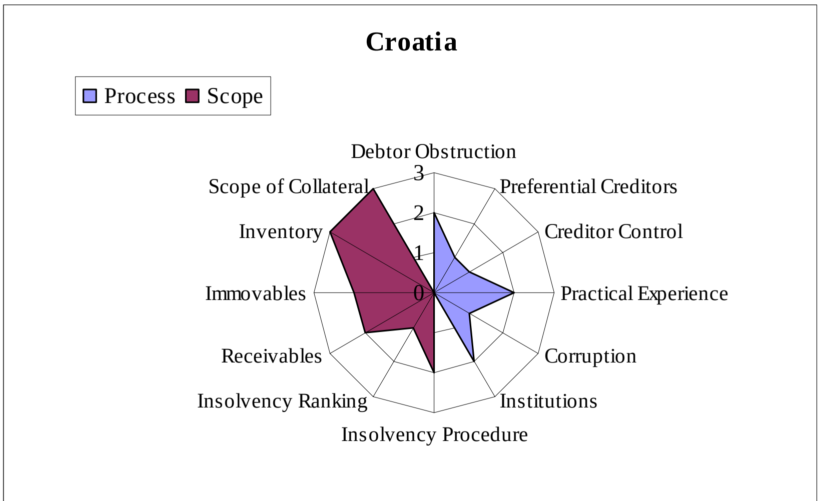
Chart 1: Legal and Practical Regime for Taking Security over Movable and Intangible Property – Croatia (2002)



Note: *Scoring on a scale from 1 to 100, where 100 represents the most advanced legal and practical regime. The fuller the 'web', the more closely secured transactions laws of the country approximate these standards.*

Source: *EBRD Regional Survey of Secured Transactions, 2002*

Chart 2: Obstacles to charge enforcement process –Croatia (2003)



Scoring on scale of 3 (problematic area) to 1 (not problematic)

Note: The fuller the "web" of the graph, the more serious the problems are in each of the respective categories "Process" factors measure the impact of specific incidences on the enforcement proceedings. "Scope" factors relate to the ability of the system to deal with specific situations or items.

Source: EBRD Legal Indicator Survey 2003

Telecommunications

The telecommunications sector in Croatia is currently governed by the Law on Telecommunications of 2003 (the "Telecoms Law"), and was regulated by a two-tier national regulatory authority (the "Authority"). The Authority, accountable to government in exercise of certain functions, is composed of the Institute for Telecommunications (an expert body responsible for all preparatory activity) and a seven-member Council. As per the Telecoms Law, this structure was replaced by a new independent agency for telecommunications in September 2004. The Telecoms Law is part of Croatia's effort to harmonise its legislation with European Union (EU) *acquis* ahead of anticipated membership.

Fixed-line development is among the upper tier of central European nations, with in excess of 40 per cent telephony penetration level and 100 per cent digitisation. Previous sector legislation provided the incumbent operator, Hrvatski Telecom (HT), with a monopoly until the beginning of January 2003. Towards the end of last year, two new licenses were issued for fixed services.

The Croatian mobile market has been liberalised since 1998 with two mobile operators competing - HT Mobile (the mobile arm of HT, formerly called Cronet) and VIP-Net a consortium led by Mobilkom of Austria. VIP-Net has made a significant impact on the market, recently closing the gap on HT Mobile's subscription figures. Both companies were also recently awarded a licence to exploit third generation technology (3G) in Croatia. Recently a third license was awarded to a consortium led by Tele 2 of Sweden.

While there has been significant recent activity aimed at market development and harmonisation of domestic and EU legislation, it is felt that sector reforms are not being implemented quickly enough. Further amendments are still necessary to bring Croatia fully into line with EU standards. *Inter alia*, legislative amendments appear necessary to fully orient the authorisation and universal services provisions towards EU standards. Further, adoption of vital secondary legislation without delay is essential for full liberalisation of the market to take hold as envisaged in 2005.

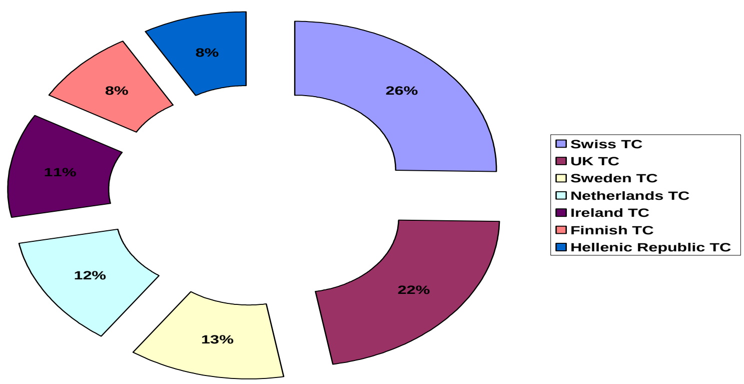
ANNEX 7: TAM AND BAS IN CROATIA

(as at January 31st 2005)

TAM[2]

As at 1st January 2005, TAM had undertaken 10 projects in Croatia utilising a total of €576,503 from several bilateral donors. The last of these projects concluded in mid 2004 and there is currently no further TAM funding available for continued operation in Croatia.

Enterprise	Industry	Status	Funding	Start Date	End date	Amount
Podravka d.d.	Food Manufacturing	Closed	Ireland TC	28/10/1999	28/04/2001	11,600
Podravka d.d.	Food Manufacturing	Closed	Finnish TC	28/10/1999	28/04/2001	48,400
Getro d.o.o.	Food and Beverage Stores	Closed	Netherlands TC	23/02/2000	23/08/2001	30,500
Getro d.o.o.	Food and Beverage Stores	Closed	Ireland TC	23/02/2000	23/08/2001	29,500
Nasicecement	Miscellaneous Manufacturing	Closed	Swiss TC	18/07/2000	18/01/2002	48,400
Nasicecement	Miscellaneous Manufacturing	Closed	Ireland TC	18/07/2000	18/01/2002	11,600
Grand Hotel Adriatic	Accommodation	Closed	Ireland TC	01/09/2000	20/12/2003	11,600
Grand Hotel Adriatic	Accommodation	Closed	Hellenic Republic TC	01/09/2000	20/12/2003	48,400
Getro d.o.o. II	Food and Beverage Stores	Closed	UK TC	31/10/2000	30/04/2002	20,000
Getro d.o.o. II	Food and Beverage Stores	Closed	Netherlands TC	31/10/2000	30/04/2002	40,000
Riviera Holdings d.d.	Accommodation	Closed	UK TC	20/02/2001	30/06/2003	38,400
Riviera Holdings d.d.	Accommodation	Closed	UK TC	20/02/2001	30/06/2003	21,600
Medimurska MTC	Textile Mills	Closed	UK TC	08/05/2001	08/11/2002	11,600
Medimurska MTC	Textile Mills	Closed	Sweden TC	08/05/2001	08/11/2002	48,400
Koestlin dd	Food Manufacturing	Closed	UK TC	07/08/2001	07/02/2003	11,600
Koestlin dd	Food Manufacturing	Closed	Swiss TC	07/08/2001	07/02/2003	48,400
Tvornica Carapa MTC	Apparel Manufacturing	Closed	UK TC	22/11/2001	22/02/2003	11,600
Tvornica Carapa MTC	Apparel Manufacturing	Closed	Sweden TC	22/11/2001	22/02/2003	24,903
Dilj	Miscellaneous Manufacturing	Closed	UK TC	10/06/2002	30/06/2004	11,600
Dilj	Miscellaneous Manufacturing	Closed	Swiss TC	10/06/2002	30/06/2004	48,400
Total						**576,503**

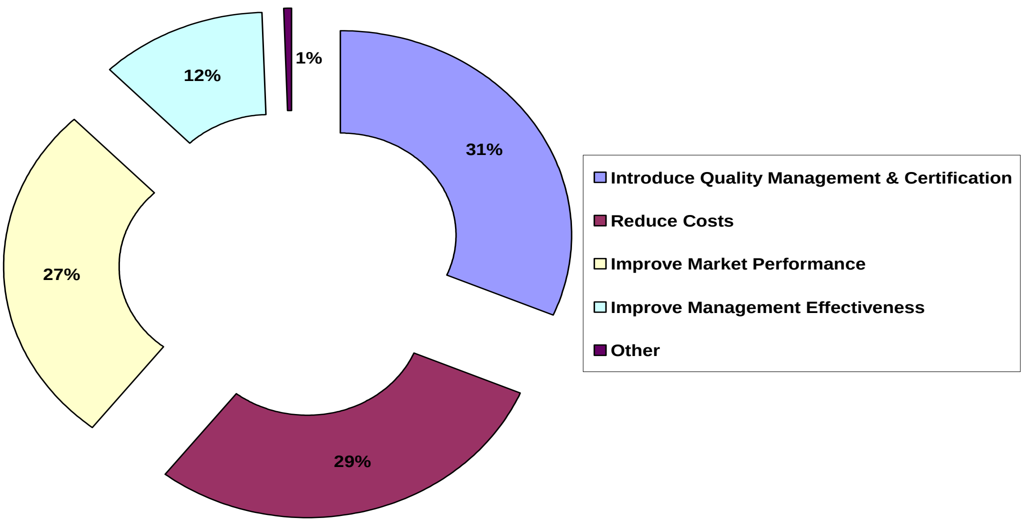


[2] The TurnAround Management (TAM) Programme shares management know-how and develops business skills of chief executives in industrial enterprises. The TAM Programme works directly with individual enterprises on a not for profit basis, advising on management skills, business planning, restructuring, improving products, reducing operating costs and developing local and export markets. In EU accession countries, TAM assistance has helped enterprises meet the requirements of relevant EU directives and standards. The TAM Programme can help bring enterprises to the attention of potential trading partners or investors.

BAS[3]

The BAS office in Croatia was opened in 2000 and has received funding totalling €1,618,338 which, to date, has funded 165 BAS projects. The remaining funding, totalling €79,504.62, is sufficient to maintain operations in Croatia until April 2005.

Donor	Year	Amount	Disbursed	Remaining
CEI (1st tranche)	2000	€1,165,000	€1,164,877.45	€122.55
CEI (2nd tranche)	2001	€73,220	€73,220	€0
CEI (3rd tranche)	2003	€101,775	€100,526	€1,249
UK (1st tranche)	2000	€60,000	€60,000	€0
UK (2nd tranche)	2003	€70,000	€67,727.36	€2,272.64
Austria	2004	€148,342.80	€72,482.37	€75,860.43
Total		**€1,618,338**	**€1,538,833**	**€79,504.62**



3 The Business Advisory Services (BAS) Programme develops the professional capacity of local consultants. These, in turn, supply SMEs with expert advice on business performance. The BAS Programme develops the professional capacity of local consultants. They, in turn, provide SMEs with expert advice on business performance, such as commercial skills and production quality standards. Typical BAS projects are short-term assignments with a rapid pay-back. Examples include upgrading financial IT systems, market research, quality management systems and enterprise reorganisation. The SMEs are required to pay 50-75% of the project cost. The maximum BAS contribution to any project is EUR 10,000.00.