

**The response address by Mr Damir Polančec,
the Vice Prime Minister of the Government of the Republic of Croatia**

Mr. Commissioner,
Ladies and gentlemen,

I would like to thank the commissioner, Mr. McCreevy for his positive assessment of the Republic of Croatia.

Therefore, Mr. McCreevy, your excellencies, ladies and gentlemen,

Permit me to make my own contribution to this positive mood. Keeping in mind the commissioner's Irish nationality, I wish to emphasize that Ireland, as a friendly nation with which the Republic of Croatia has no disputes nor unresolved matters, has always been something of a model and exemplar for us when devising our own priorities for the Croatian economy.

Ireland's economic development model, which made the Irish economy one of the fastest-growing in Europe, certainly constitutes an example worthy of study and emulation. This is particularly true with regard to the attitude toward foreign direct investment, economic openness, the European market orientation, labour force education and reform of public enterprises and the public sector as a whole.

Speaking of the European Union, fulfilment of the conditions for full membership, which is our most important strategic political objective, implies stability of democratic institutions, rule of law and respect for democratic principles, human and minority rights and a fully functional market economy. EU membership is not an end unto itself, rather it is a motivating factor for reform processes to achieve a level of progress that will be felt by all Croatian citizens in their everyday lives.

Reform also implies setting realistic and feasible economic policy objectives: over the medium term they are oriented toward strengthening the economy and raising the level of competitiveness while simultaneously accelerating the country's development and increasing employment. To this end, we are concentrating on maintaining macroeconomic stability and spurring economic growth.

In the interest of achieving these objectives, Croatia is closely monitoring progress in implementation of the Lisbon Strategy and is actively formulating its own future participation in this implementation. The Croatian economy is in step with European trends and is dedicated to the establishment of a knowledge-based economy, which will contribute to further economic development.

As a growing economy in the post-transition phase, we find ourselves confronting several challenges.

Ongoing investment in infrastructure

Infrastructure today accounts for 7% of GDP. This figure pertains first and foremost to energy and roads, as well as rational use of natural resources and systematic environmental protection.

Promotion of active market competition policies with parallel regulation of the system for granting state aid

This objective implies oversight of implementation of adopted legal standards and transparency of aid grants based on unambiguous programmes. Particularly sensitive sectors in this sense include shipbuilding and the national railroad company. Even though these types of subsidies are the least desirable because they are earmarked for individual enterprises and problem sectors which are very "unpopular" in the EU, it must be stressed that in these sectors a process of rehabilitation and restructuring is in full swing.

Promotion of active employment policies

Even though the key indicators are encouraging, lowering the unemployment rate is one of the major priorities of Croatian economic policy. According to data obtained in the Labour Force Survey in 2006, an unemployment rate of 11.2% was recorded, which is the lowest rate in the last eight years. These indicators are a direct result of implementation of the National Employment Action Plan for 2005-2008, which was prepared on the basis of the ten recommendations contained in the European Employment Strategy.

The most recent data from the National Employment Bureau indicate that by the end of August 2007, the number of unemployed at the year-on-year level decreased by over 10.4%.

Completion of the privatization

Further privatization of companies in the Croatian Privatization Fund's portfolio is a priority that shall not forsake. Here I feel compelled to stress that the basic goal of privatization is not and cannot simply be to collect revenues for the central budget, rather it must entail raising the competitiveness of every firm that is to be privatized. The objective is to attract strategic partners that possess the strength to invest, the know-how and access to the global market, where they have already proven themselves.

Judiciary reform

The development of an independent and expertise-based judicial system is more than a crucial prerequisite for Croatia's accession to the European Union, rather it is also a key condition for the country's overall development and for building trust in the Croatian economy, which is in turn an essential prerequisite for investment. The principal conditions for successful reforms are further education and training of judges and public attorneys, and computerization of the entire judicial system.

The four fundamental reform areas are: property registers, education, reduction of the case-load backlog and bankruptcies, with development of alternative avenues to settle disputes. With this we intend to achieve effective legal protection and create a secure legal environment.

These challenges are the same ones we confront in accession negotiations for membership in the European Union, which are a key factor for our future participation in the European Union's internal market.

Speaking of the common market, the most demanding test will be to determine whether the EU can transform its desire for unity into a genuine common market that will stand shoulder to shoulder with world economies such as that of the United States and China. Even though relatively recent, this idea has become an economic reality. If, over the past decade, the Internal Market has generated 2.5 million new jobs, then we want to be a part of it. And if during that same period €877 billion in earnings were generated, then we want a part of this value reflected in the living standards of our citizens. It is not coincidence that Croatia has decided to focus on the legal framework of the internal market as one of the first steps in assuming the EU's sizeable *acquis communautaire*. This is why today investors can enjoy a secure environment that complies with, for example, the provisions of regulations governing the corporate, banking and financial services sectors, accounting standards and intellectual property.

But the struggle to create security for investors does not end here, either. In a situation where **public procurement** accounts for up to 14 % of GDP, we are aware of the dangers of that world-wide plague of corruption in public procurement deals, wherein our basic goal is to achieve the best value for money for our taxpayers. This is why the Government, in cooperation with the European Union, is devising a new legal framework with which we shall not only modernize the rules of public bidding but also introduce new forms of procedures that will raise the level of transparency and assessing bidders and make it possible for them to bid against each other. The new law, based on the European Union's *acquis communautaire*, contains, besides securing a greater degree of procedural transparency and public access, novelties such as:

- Special procurement methods: dynamic procurement system, general framework agreements, framework contracts,
- Electronic delivery of bids,
- Electronic auctions,
- Public opening of bids with the possibility of attendance by each person regardless of whether the bidder is party to the procurement procedure,
- The possibility of oversight of procurement and investment in all procedural phases.

Special attention has been dedicated to public procurement in accession negotiations and we believe that with the cooperation of the European Commission we shall finalize and intensify the process of fulfilling the measures required to open negotiations on this chapter.

In June of this year we also opened negotiations on **Freedom to provide services** with fulfilment of six measures to close this chapter. The measures pertain to alignment of our legislation with the Union's *acquis communautaire*. The complexity of this alignment process and its long-term nature are additionally dictated by the Directive on Freedom of Services, which requires EU member states to align their legislation therewith by 28 December 2009. For Croatia, as a future member, this means that its accession and alignment procedure will run parallel to alignment of legislation by EU member states where this Directive is concerned, and thus exchanges of experiences in efforts to achieve this goal will be possible.

The Croatian Government's economic policy, implemented by means of operative programmes and projects, have generated positive economic results. A system to revitalize Croatian industry has been launched, and special care is being dedicated to exports

By the same token, foreign investment trends have been re-oriented, and now most of such investments involve manufacturing activities. The role of the Direct Investment Promotion Agency must be emphasized in this regard, as it serves as a "one-stop shop" for major investors in Croatia, helping them overcome all barriers and secure all necessary licenses for their investments and exercise their right to incentives.

All of this leads us to the positive trends in the Croatian economy. I would like to cite several illustrative figures which serve as evidence of these trends:

- Real GDP growth in the first quarter of 2007 was 7%, which is the highest growth since the third quarter of 2002. GDP growth in 2006 amounted to 4.8%.
- Per capita GDP in euros has grown from €7,000 in 2005 to €7,700 in 2006.
- The intense fiscal consolidation initiated in 2004 has more than halved the share of the budget deficit in GDP over the past three years, that is, from 6.2% of GDP in 2003 to 3% of GDP in 2006, which constitutes fulfilment of the Maastricht criteria for admittance to the European Monetary Union.
- In 2007 we foresee further reduction of the budget deficit, down 2.6% of GDP to be precise, and this trend will continue over the medium term, wherein we foresee reduction of the budget deficit to 0.5% of GDP by 2010, and possibly even its disappearance altogether.
- Trade deficit growth has been slowed from 31.3% in 2003 to 13.4% in 2006, and to 10.1% in May 2007, and it has today been stabilized to approximately 85% of GDP, and it is important to note that the share of the informal economy has not been calculated as part of GDP.
- The state's foreign debt has been reduced by €156 million in the first five months of 2007.
- By reducing the budget deficit and borrowing on the domestic financial market, the state will contribute to stabilization of the share of foreign debt in GDP over the medium term.

- Inflation was held at a level of 3.3% in 2005, and then reduced to 3.2% in the following year, while in the first six months of this year it has been reduced to roughly 2% despite many negative pressures on the global market.

Ladies and gentlemen,

Europe is undergoing a phase of change, seeking out a competitive edge based on affirmation of the role of science, technology, information and communications infrastructures and services. The objectives of this transformation are highlighted by the Lisbon Strategy.

Croatia has a small economy. It cannot exert a great impact on global economic change, but it can set itself up to take advantage of these trends. Over the next few years, Croatia can establish itself as a regional hub for generating services, particularly in the fields of travel and tourism, transportation, construction and financial services. This is an opportunity that we cannot afford to miss.

In conclusion, as Mr. McCreevy said, Croatia is facing considerable challenges and opportunities, and I am certain that we are capable of meeting those challenges head on.

Thank you.