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**LOAN NUMBER 7450 HR**

# **Loan Agreement**

**(Second Programmatic Adjustment Loan)**

**between**

**REPUBLIC OF CROATIA**

**and**

**INTERNATIONAL BANK FOR RECONSTRUCTION  
AND DEVELOPMENT**

**Dated June 11, 2007**

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## **LOAN NUMBER 7450 HR**

### **LOAN AGREEMENT**

Agreement dated June 11, 2007, entered into between REPUBLIC OF CROATIA (“Borrower”) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (“Bank”) for the purpose of providing financing in support of the second phase of the Program (as defined in the Appendix to this Agreement).

Pursuant to the Loan Agreement dated September 20, 2005 (the Programmatic Adjustment Loan No. 7330-HR, as published in the Official Gazette/International Agreements 12/2005), the Bank has provided assistance to the Borrower in support of the first phase of the Borrower’s Program as such first phase was described in the letter from the Borrower to the Bank, dated August 8, 2005.

The Bank has decided to provide this financing in support of the second phase of the Program on the basis, *inter alia*, of: (a) the actions which the Borrower has already taken under the Program and which are described in Section I.A of Schedule I to this Agreement; and (b) the Borrower’s maintenance of an appropriate macro-economic policy framework. The Borrower and the Bank therefore hereby agree as follows:

#### **ARTICLE I - GENERAL CONDITIONS; DEFINITIONS**

- 1.01. The General Conditions (as defined in the Appendix to this Agreement) constitute an integral part of this Agreement.
- 1.02. Unless the context requires otherwise, the capitalized terms used in the Loan Agreement have the meanings ascribed to them in the General Conditions or in the Appendix to this Agreement.

#### **ARTICLE II - LOAN**

- 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, the amount of one hundred fifty million Euro (EUR 150,000,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.08 of this Agreement (“Loan”).
- 2.02. The Borrower may withdraw the proceeds of the Loan in support of the Program in accordance with Section II of Schedule 1 to this Agreement.
- 2.03. The Commitment Charge payable by the Borrower shall be equal to seventy- five one-hundredths of one per cent (0.75%) per annum from the date on which the Commitment Charge commences to accrue in accordance with the provisions of

- Section 3.01 of the General Conditions, subject to any waiver of a portion of such charge as may be determined by the Bank from time to time.
- 2.04. The Front-end Fee payable by the Borrower shall be equal to one percent (1.0%) of the Loan amount, subject to any waiver of a portion of such fee as may be determined by the Bank from time to time.
- 2.05. The interest payable by the Borrower for each Interest Period shall be at a rate equal to LIBOR for the Loan Currency plus the Fixed Spread, subject to any waiver of a portion of such interest as may be determined by the Bank from time to time; provided, that upon a Conversion of all or any portion of the principal amount of the Loan, the interest payable by the Borrower during the Conversion Period on such amount shall be determined in accordance with the relevant provisions of Article IV of the General Conditions.
- 2.06. The Payment Dates are April 15 and October 15 in each year.
- 2.07. The principal amount of the Loan shall be repaid in accordance with the provisions of Schedule 2 to this Agreement.
- 2.08. (a) The Borrower may at any time request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management: (i) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan from a Variable Rate to a Fixed Rate, or vice versa; and (ii) the setting of limits on the Variable Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on the Variable Rate.
- (b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by the Bank shall be considered a “Conversion”, as defined in the General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.
- (c) Promptly following the Execution Date for an Interest Rate Cap or Interest Rate Collar for which the Borrower has requested that the premium be paid out of the proceeds of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amounts required to pay any premium payable in accordance with Section 4.04 (c) of the General Conditions up to the amount allocated from time to time for the purpose in the table in Section II of Schedule 1 to this Agreement.

### **ARTICLE III - PROGRAM**

- 3.01 The Borrower declares its commitment to the Program and its implementation. To this end:

- (a) the Borrower and the Bank shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program and the actions specified in Section 1.B of Schedule 1 to this Agreement;
- (b) prior to each such exchange of views, the Borrower shall furnish to the Bank, for its review and comment, a report on the progress achieved in carrying out the Program, in such detail as the Bank shall reasonably request; and
- (c) without limitation upon the provisions of paragraphs (a) and (b) of this Section, the Borrower shall exchange views with the Bank on any proposed action to be taken after the disbursement of the Loan which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program including any action specified in Section I of Schedule 1 to this Agreement.

#### **ARTICLE IV - REMEDIES OF THE BANK**

- 4.01. The Additional Event of Suspension consists of the following, namely, that a situation has arisen which shall make it improbable that the Program, or a significant part of it, will be carried out.
- 4.02. The Additional Event of Acceleration consists of the following, namely, that the event specified in Section 4.01 of this Agreement occurs and is continuing for a period of 60 days after notice of the event has been given by the Bank to the Borrower.

#### **ARTICLE V- EFFECTIVENESS**

- 5.01. The Effectiveness Deadline is the date ninety (90) days after the date of this Agreement.

#### **ARTICLE VI - REPRESENTATIVE; ADDRESSES**

- 6.01. The Borrower's Representative is the Ministry of Finance.
- 6.02. The Borrower's Address is:

Ministry of Finance  
Katanciceva 5  
Zagreb, 10000  
Republic of Croatia

Cable address:	Telex:	Facsimile:
Ministry of Finance Zagreb	862-21215 or 862-28133	(385) 1-492-25-83

6.03. The Bank's Address is:

International Bank for  
Reconstruction and Development  
1818 H Street, N.W.  
Washington, D.C. 20433  
United States of America

Cable address:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423(MCI) or 64145(MCI)	1-202-477-6391

AGREED at Zagreb, Republic of Croatia, as of the day and year first above written.

REPUBLIC OF CROATIA

By: /s/ Ivan Suker

Authorized Representative

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT

By: /s/ Anand K. Seth

Authorized Representative

## SCHEDULE 1

### Program Actions; Availability of Loan Proceeds

#### **Section I.      Actions under the Program**

##### **A.      **Actions Taken Under the Program****

The actions taken by the Borrower under the Program include the following:

1.      The Borrower has privatized through CPF, or initiated liquidation procedures for at least forty-eight (48) companies with majority state ownership, including three companies defined in agreement with the Bank as “the large loss makers”, all in a manner acceptable to the Bank.
2.      The Borrower has: (a) reduced enterprise subsidies to 2.78 percent of GDP in the calendar year 2005, and further to 2.44 percent of GDP in the calendar year 2006; and (b) provided for further reduction of enterprise subsidies to 2.2 percent of GDP in the national budget for the calendar year 2007.
3.      The commercial registration procedures have been simplified, and functions of enforcement of court decisions and participation in electoral commissions have been transferred from judges to other judicial personnel or outside the courts, and the Ministry of Justice has adopted new caseload and workload rates per judge.
4.      The Borrower initiated implementation of rationalization programs in one selected ministry and two state administration offices at the county level (including staff retrenchment, reassignment, and budgetary impact) based on functional review results.
5.      The Borrower has:
  - (a)      enacted a new Obligatory Health Insurance Act, acceptable to the Bank, defining a fiscally sustainable basic benefits package, reducing co-payment exemptions, and restructuring the supplementary health insurance;
  - (b)      introduced two lists of drugs – with and without co-payment requirements, with target revenues of HRK 400-500 million per year; and has regularly revised, as necessary, the above-referred lists to ensure achievement of the revenues target;
  - (c)      caused HZOZO to provide, commencing from March 2007, monthly updates of unemployed citizens eligible for exemptions based on the unemployment registry;

(d) caused HZOZO and MOHSW to conduct an assessment of the revenues from the administrative fees (after exemption reimbursements and administrative costs) and, if the cumulative revenues are below HRK 300 million per year target, HZOZO has taken adequate actions to strengthen control mechanisms and fee collection;

(e) caused MOHSW to prepare a draft accreditation legislation for hospitals;

(f) started implementation of the initial DRG model in hospitals at the end of calendar year 2006, and completed an initial evaluation and fiscal impact assessment of this implementation; and

(g) caused MOHSW to complete the first phase of hospital master planning.

6. The Borrower has adopted a strategy and action plan for reform of social benefit spending, has increased the share of benefits going to the most disadvantaged groups of population, and capped total social benefit spending at 4.0 percent of GDP in the calendar year 2007.

7. The Borrower has caused HZ to take actions required for reduction of HZ's working ratio to 220 percent at the end of the calendar year 2005, further to 190 percent in the calendar year 2006, and to 170 percent at the end of the calendar year 2007.

8. The Borrower has caused HZ to enter into a contract with CPF for the sale of four HZ subsidiaries, and has issued tenders for those four subsidiaries.

## **B. Actions to be Taken Under the Program**

The actions to be taken by the Borrower under the Program include the following:

1. The Borrower shall complete privatization of at least three HZ subsidiaries.
2. The Borrower shall sell majority shares of one shipyard, as agreed with the Bank.
3. The Borrower shall: (a) adopt a new job classification system for the civil service; and (b) enact a new Law on Civil Service Salaries, acceptable to the Bank and including, *inter alia*, provisions for decompression and performance-based remuneration.

## **Section II. Availability of Loan Proceeds**

### **A. General**

The Borrower may withdraw the proceeds of the Loan in accordance with the provisions of this Section and such additional instructions as the Bank may specify by notice to the Borrower.

**B. Allocation of Loan Amounts**

The Loan shall be withdrawn in two tranches. The allocation of the amounts of the Loan to this end is set out in the table below:

<b>Allocations</b>	<b>Amount of the Tranche Allocated (expressed in Euro)</b>
First Tranche	100,000,000
Second Tranche	50,000,000
<b>TOTAL AMOUNT</b>	<b><u>150,000,000</u></b>

**C. Payment of Front-end Fee**

No withdrawal shall be made from the Loan Account until the Bank has received payment in full of the Front-end Fee.

**D. Tranche Release Conditions**

No withdrawal shall be made of the Second Tranche unless the Bank is satisfied, after an exchange of views as described in Sections 3.01 (a) and (b) of this Agreement based on evidence satisfactory to the Bank:

1. with the progress achieved by the Borrower in carrying out the Program;
2. that the macroeconomic policy framework of the Borrower is appropriate; and
3. that the actions described in Section I.B of this Schedule have been taken.

If, after this exchange of views, the Bank is not so satisfied, it may give notice to the Borrower to that effect and, if within ninety (90) days after the notice, the Borrower has not taken steps satisfactory to the Bank, with respect to paragraphs 1, 2 and 3 above, then the Bank may, by notice to the Borrower, cancel all or any part of the Unwithdrawn Loan Balance.

**E. Deposit of the Loan Amount**



Except as the Bank may otherwise agree:

1. the withdrawal from the Loan Account shall be deposited by the Bank into an account designated by the Borrower and acceptable to the Bank; and
2. the Borrower shall ensure that upon deposit of the amount of the Loan into this account, an equivalent amount is accounted for in the Borrower's budget management system, in a manner acceptable to the Bank.

**F. Excluded Expenditures**

The Borrower undertakes that the proceeds of the Loan shall not be used to finance Excluded Expenditures. If the Bank determines at any time that an amount of the Loan was used to make a payment for an Excluded Expenditure, the Borrower shall, promptly upon notice from the Bank, refund an amount equal to the amount of such payment to the Bank. Amounts refunded to the Bank upon such request shall be cancelled.

**G. Closing Date**

The Closing Date is June 30, 2008.

## SCHEDULE 2

### Amortization Schedule

1. The following table sets forth the Principal Payment Dates of the Loan and the percentage of the total principal amount of the Loan payable on each Principal Payment Date (“Installment Share”). If the proceeds of the Loan have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined by the Bank by multiplying: (a) Withdrawn Loan Balance as of the first Principal Payment Date; by (b) the Installment Share for each Principal Payment Date, such repayable amount to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

<b>Principal Payment Date</b>	<b>Installment Share (Expressed as a Percentage)</b>
On each April 15 and October 15  beginning October 15, 2012 through April 15, 2022	5%

2. If the proceeds of the Loan have not been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined as follows:
  - (a) To the extent that any proceeds of the Loan have been withdrawn as of the first Principal Payment Date, the Borrower shall repay the Withdrawn Loan Balance as of such date in accordance with paragraph 1 of this Schedule.
  - (b) Any amount withdrawn after the first Principal Payment Date shall be repaid on each Principal Payment Date falling after the date of such withdrawal in amounts determined by the Bank by multiplying the amount of each such withdrawal by a fraction, the numerator of which is the original Installment Share specified in the table in paragraph 1 of this Schedule for said Principal Payment Date (“Original Installment Share”) and the denominator of which is the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such amounts repayable to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

3. (a) Amounts of the Loan withdrawn within two calendar months prior to any Principal Payment Date shall, for the purposes solely of calculating the principal amounts payable on any Principal Payment Date, be treated as withdrawn and outstanding on the second Principal Payment Date following the date of withdrawal and shall be repayable on each Principal Payment Date commencing with the second Principal Payment Date following the date of withdrawal.
  - (b) Notwithstanding the provisions of sub-paragraph (a) of this paragraph, if at any time the Bank adopts a due date billing system under which invoices are issued on or after the respective Principal Payment Date, the provisions of such sub-paragraph shall no longer apply to any withdrawals made after the adoption of such billing system.
4. Notwithstanding the provisions of paragraphs 1 and 2 of this Schedule, upon a Currency Conversion of all or any portion of the Withdrawn Loan Balance to an Approved Currency, the amount so converted in the Approved Currency that is repayable on any Principal Payment Date occurring during the Conversion Period, shall be determined by the Bank by multiplying such amount in its currency of denomination immediately prior to the Conversion by either: (i) the exchange rate that reflects the amounts of principal in the Approved Currency payable by the Bank under the Currency Hedge Transaction relating to the Conversion; or (ii) if the Bank so determines in accordance with the Conversion Guidelines, the exchange rate component of the Screen Rate.
5. If the Withdrawn Loan Balance is denominated in more than one Loan Currency, the provisions of this Schedule shall apply separately to the amount denominated in each Loan Currency, so as to produce a separate amortization schedule for each such amount.

**APPENDIX**

**Section I. Definitions**

1. “Excluded Expenditure” means any expenditure:
- (a) for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association has financed or agreed to finance, or which the Bank or the Association has financed or agreed to finance under another loan, credit, or grant;
  - (b) for goods included in the following groups or sub-groups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

<b>Group</b>	<b>Sub-group</b>	<b>Description of Item</b>
112		Alcoholic beverages
121		Tobacco, un-manufactured, tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitutes)
525		Radioactive and associated materials
667		Pearls, precious and semiprecious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths’ or silversmiths’ wares (including set gems)
971		Gold, non-monetary (excluding gold ores and concentrates)

- (c) for goods intended for a military or paramilitary purpose or for luxury consumption;

- (d) for environmentally hazardous goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party;
  - (e) on account of any payment prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and
  - (f) under a contract with respect to which the Bank determines that corrupt, fraudulent, collusive or coercive practices were engaged in by representatives of the Borrower or other recipient of the Loan proceeds during the procurement or execution of such contract, without the Borrower (or other such recipient) having taken timely and appropriate action satisfactory to the Bank to remedy the situation.
2. “CPF” means the Croatian Privatization Fund, established pursuant to the Privatization Law, adopted on March 1, 1996 (Official Gazette 21/96), as amended on July 1, 1997 (Official Gazette 71/97); and July 19, 2000 (Official Gazette 73/00).
  3. “DRG” means Diagnosis Related Groups.
  4. “GDP” means Gross Domestic Product.
  5. “General Conditions” means the “International Bank for Reconstruction and Development General Conditions for Loans”, dated July 1, 2005 with the modifications set forth in Section II of this Appendix.
  6. “HRK” means Croatian Kuna (*Hrvatska kuna*), the Borrower’s lawful currency.
  7. “HZ” means *Hrvatske zeljeznice*, the Croatian Railways company, established pursuant to the Borrower’s Law on Railways (Official Gazette 123/2003), as amended on March 3, 2004 (Official Gazette 30/2004); the term also includes all legal successors of HZ, established pursuant to the Law on Reorganization of the Croatian Railways dated December 15, 2005 (Official Gazette 153/2005).
  8. “HZOZO” means *Hrvatski zavod za obvezno zdravstveno osiguranje* (Croatian Institute of Obligatory Health Insurance), or any legal successor thereto.
  9. “MOHSW” means the Borrower’s Ministry of Health and Social Welfare, or any legal successor thereto.
  10. “MSTTD” means the Borrower’s Ministry of Sea, Tourism, Transport and Development, or any legal successor thereto;

11. “Program” means the program of actions, objectives and policies designed to promote the Borrower’s economic growth and development and set forth or referred to in the letter dated April 19, 2007, from the Borrower to the Bank declaring the Borrower’s commitment to the execution of the Program, and requesting assistance from the Bank in support of the Program during its execution.
12. “Second Tranche” means the amount of the Loan allocated to category entitled “Second Tranche” in the table set forth in Section II.B of Schedule 1 to this Agreement.

**Section II. Modifications to the General Conditions**

The modifications to the “International Bank for Reconstruction and Development General Conditions for Loans”, dated July 1, 2005 are as follows:

1. The last sentence of paragraph (a) of Section 2.03 (relating to Applications for Withdrawal) is deleted in its entirety.
2. Sections 2.04 (*Designated Accounts*) and 2.05 (*Eligible Expenditures*) are deleted in their entirety, and the remaining Sections in Article II are renumbered accordingly.
3. Sections 5.01 (*Project Execution Generally*), and 5.09 (*Financial Management; Financial Statements; Audits*) are deleted in their entirety, and the remaining Sections in Article V are renumbered accordingly.
4. Paragraph (a) of Section 5.05 (renumbered as such pursuant to paragraph 3 above and relating to *Use of Goods, Works and Services*) is deleted in its entirety.
5. Paragraph (c) of Section 5.06 (renumbered as such pursuant to paragraph 3 above) is modified to read as follows:

“Section 5.06. *Plans; Documents; Records*

... (c) The Borrower shall retain all records (contracts, orders, invoices, bills, receipts and other documents) evidencing expenditures under the Loan until two years after the Closing Date. The Borrower shall enable the Bank’s representatives to examine such records.”

6. Section 5.07 (renumbered as such pursuant to paragraph 3 above) is modified to read as follows:

*Section 5.07. Program Monitoring and Evaluation*

... (c) The Borrower shall prepare, or cause to be prepared, and furnish to the Bank not later than six months after the Closing Date, a report of such scope and in such detail as the Bank shall reasonably request, on the execution of the Program, the performance by the Loan Parties and the Bank of their respective obligations under the Legal Agreements and the accomplishment of the purposes of the Loan.

7. The following terms and definitions set forth in the Appendix are modified or deleted as follows, and the following new terms and definitions are added in alphabetical order to the Appendix as follows, with the terms being renumbered accordingly:

(a) The definition of the term “Eligible Expenditure” is modified to read as follows:

“‘Eligible Expenditure’ means any use to which the Loan is put in support of the Program, other than to finance expenditures excluded pursuant to the Loan Agreement.”

(b) The term “Financial Statements” and its definition as set forth in the Appendix are deleted in their entirety.

(c) The term “Project” is modified to read “Program” and its definition is modified to read as follows:

“‘Program’ means the program referred to in the Loan Agreement in support of which the Loan is made.” All references to “Project” throughout these General Conditions are deemed to be references to “Program”.