

CONFORMED COPY

LOAN NUMBER 7330-HR

Loan Agreement

(Programmatic Adjustment Loan)

between

REPUBLIC OF CROATIA

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated September 20, 2005

LOAN AGREEMENT

AGREEMENT, dated September 20, 2005 between REPUBLIC OF CROATIA (the Borrower) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) the Bank has received from the Borrower a letter, dated August 8, 2005: (i) describing its macro-economic framework and a program of actions, objectives and policies designed to achieve and sustain structural adjustment of the Borrower's economy during the period of 2004-2007 (hereinafter called the Program), which Program consists of actions and policies that have already been taken and adopted, in a satisfactory manner, by the Borrower as described in Schedule 2 to this Agreement (hereinafter called the First Phase of the Program), as well as actions and policies that the Borrower intends to take and adopt prior to the subsequent phases of the Program; (ii) declaring the Borrower's commitment to the execution of the Program; and (iii) requesting assistance from the Bank in support of the Program during the execution thereof;

(B) on the basis, *inter alia*, of the foregoing, the Bank has decided in support of the First Phase of the Program to provide such assistance to the Borrower by making the Loan as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Loan and Guarantee Agreements for Fixed-Spread Loans" of the Bank, dated September 1, 1999 as amended through May 1, 2004), with the modifications thereto set forth below (the General Conditions) constitute an integral part of this Agreement:

(a) Section 2.01, paragraph 41, is modified to read:

"'Project' means the First Phase of the Program, referred to in the Preamble to the Loan Agreement, in support of which the Loan is made";

(b) Section 3.08 is modified to read:

"Each withdrawal of an amount from the Loan Account shall be made in the Loan Currency of such amount. The Bank, at the request and acting

as an agent of the Borrower, shall purchase with the Loan Currency withdrawn from the Loan Account the currency or currencies of the deposit account specified in Section 2.02 of the Loan Agreement.”

- (b) Section 5.01 is modified to read:

“The Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in accordance with the provisions of the Loan Agreement and of these General Conditions”;

- (d) The last sentence of Section 5.03 is deleted.

- (e) Section 9.07 (c) shall be modified to read:

“(c) Not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, the Borrower shall prepare and furnish to the Bank a report, of such scope and in such detail as the Bank shall reasonably request, on the execution of the part of the Program referred to in the Preamble to the Loan Agreement, the performance by the Borrower and the Bank of their respective obligations under the Loan Agreement and the accomplishment of the purposes of the Loan.”; and

- (f) Section 9.05 is deleted and Sections 9.06, 9.07 (as modified above), 9.08 and 9.09 are renumbered, respectively, Sections 9.05, 9.06, 9.07 and 9.08.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “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);

(b) “Deposit Account” means the account referred to in Section 2.02 of this Agreement;

(c) “HZ” means Hrvatske Željeznice, the Croatian railway authority, established pursuant to the Borrower’s Railways Law, adopted on June 28, 1994 (Official Gazette 53/94), as amended on December 16, 1998 (Official Gazette 162/98); and

(d) “Land Registry Law” means the Borrower’s law adopted on October 2, 1996 (Official Gazette 91/96) as amended on December 13, 2001, (Official Gazette 114/01) and July 14, 2004 (Official Gazette 100/04).

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, an amount equal to one hundred fifty million Euro (EUR 150,000,000).

Section 2.02. (a) Subject to the provisions of paragraphs (b) and (c) of this Section, the Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in support of the First Phase of the Program.

(b) The Borrower shall open, prior to furnishing to the Bank the first request for withdrawal from the Loan Account, and thereafter maintain in the Croatian National Bank, a deposit account in Euro on terms and conditions satisfactory to the Bank. All withdrawals from the Loan Account shall be deposited by the Bank into the Deposit Account.

(c) The Borrower undertakes that the proceeds of the Loan shall not be used to finance expenditures excluded pursuant to the provisions of Schedule 1 to this Agreement. If the Bank shall have determined at any time that any proceeds of the Loan shall have been used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Bank: (i) deposit into the Deposit Account an amount equal to the amount of said payment; or (ii) if the Bank shall so request, refund such amount to the Bank. Amounts refunded to the Bank upon such request shall be credited to the Loan Account for cancellation.

Section 2.03. The Closing Date shall be June 30, 2006, or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to one percent (1%) of the amount of the Loan subject to any waiver of a portion of such fee as may be determined by the Bank from time to time. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of such fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge on the principal amount of the Loan not withdrawn from time to time, at a rate equal to:

- (i) eighty-five one-hundredths of one percent (0.85%) per annum from the date on which such charge commences to accrue in accordance with the provisions of Section 3.02 of the General Conditions to but not including the fourth anniversary of such date; and

- (ii) seventy-five one-hundredths of one percent (0.75%) per annum thereafter.

Section 2.06. The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, in respect of each Interest Period at the Variable Rate.

Section 2.07. Interest and commitment charges shall be payable semiannually in arrears on March 15 and September 15, in each year.

Section 2.08. The Borrower shall repay the principal amount of the Loan in full on September 15, 2015.

ARTICLE III

Particular Covenants

Section 3.01. (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 Schedule 2 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.

(c) Without limitation upon the provisions of paragraph (a) 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 Schedule 2 to this Agreement.

Section 3.02. Upon the Bank's request, the Borrower shall:

(a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(b) furnish to the Bank as soon as available, but in any case not later than six (6) months after the date of the Bank's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(c) furnish to the Bank such other information concerning the Deposit Account and the audit thereof as the Bank shall have reasonably requested.

Section 3.03. Without limitation upon the provisions of Section 9.01 (a) of the General Conditions, the Borrower shall promptly furnish to the Bank such information relating to the provisions of Article II of this Agreement as the Bank may, from time to time, reasonably request.

ARTICLE IV

Additional Event of Suspension

Section 4.01. Pursuant to Section 6.02 (p) of the General Conditions, the following additional event is specified, namely, that a situation has arisen which shall make it improbable that the Program, or a significant part thereof, will be carried out.

ARTICLE V

Effective date

Section 5.01. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

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

For the Bank:

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)	(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in 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 Seth
Authorized Representative

SCHEDULE 1

Excluded Expenditures

For purposes of Section 2.02 (c) of this Agreement, the proceeds of the Loan shall not be used to finance any of the following expenditures:

1. expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;
2. expenditures for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association shall have financed or agreed to finance, or which the Bank or the Association shall have financed or agreed to finance under another loan or a credit;
3. expenditures for goods included in the following groups or subgroups 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:

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
112	-	Alcoholic beverages
121	-	Tobacco, unmanufactured, 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

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
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)

4. expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;

5. expenditures for environmentally hazardous goods (for purposes of this paragraph the term "environmentally hazardous goods" means 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, and any other goods designated as environmentally hazardous by agreement between the Borrower and the Bank);

6. expenditures: (a) in the territories of any country which is not a member of the Bank or for goods procured in, or services supplied from, such territories; or (b) on account of any payment to persons or entities, or any import of goods, if such payment or import is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and

7. expenditures under a contract in respect of which the Bank determines that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation.

SCHEDULE 2

Actions Referred to in Recital (A) of the Preamble to this Agreement

Macroeconomic Framework

1. The Borrower has implemented prudent macroeconomic policy contributing to solid growth performance, and has maintained and has committed to maintain a satisfactory macroeconomic framework, consistent with the core objectives of the Program, including: (a) a growth rate of 3.8 percent in calendar year 2004 and an estimated growth rate of 3.7 percent for calendar year 2005; (b) a 12-month inflation rate, as of December 31, 2004, of 2.7 percent, and an estimated inflation rate of 3.0 percent as of December 31, 2005 end of period; (c) a fiscal deficit of 4.9 percent of Gross Domestic Product (GDP) for calendar year 2004, and an estimated fiscal deficit rate of 3.7 percent of GDP for calendar year 2005; (d) an external current account deficit of 4.2 percent of the GDP in calendar year 2004 and a target for the external current account deficit of 4.6 percent of GDP for calendar year of 2005; and (e) public debt to GDP of 53.4 percent (including contingent liabilities), as of December 31, 2004, and an estimated public debt to GDP of 55.5 percent as of December 31, 2005.

Improving Investment Climate

2. The Borrower has privatized, through CPF, ten (10) selected companies with majority state ownership, in a manner acceptable to the Bank.

3. The Borrower has adopted a corporate sector subsidy reduction plan with annual targets acceptable to the Bank, and has adequately reflected such targets in the State Budget for the calendar year 2005.

4. The Borrower has amended the Land Registry Law to transfer land registration functions from judges to court registrars, in a manner acceptable to the Bank.

Strengthening Governance

5. The Borrower has adopted a new Civil Service Law, acceptable to the Bank and reflecting European Union (EU) standards.

Enhancing Fiscal Sustainability of Sector Programs

6. The Borrower has caused HZ to prepare a medium-term business plan acceptable to the Bank, and has caused HZ to take actions required for reduction of HZ's

working ratio to two hundred twenty percent (220%) in the calendar year 2005, including the following: (a) HZ has laid-off, through voluntary and involuntary retrenchment, 534 staff from the mother company in accordance with the procedures agreed with the Bank; (b) HZ has ensured that staff eligible for retirement in 2005 has left HZ as per the retirement schedule; (c) HZ has not exceeded a limit of total 80 new staff hiring for 2005; (d) HZ has prepared a time-bound step-by-step plan for privatization of its subsidiaries during 2005-2009, and started its implementation; and (e) HZ has conducted further analysis to reduce services along or close uneconomic lines in 2006-2009.

7. The Borrower has issued a decision establishing an adequate legal framework for HZ subsidiaries' privatization, acceptable to the Bank.