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# **Croatia**

## **2005 Progress Report**

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## A. INTRODUCTION

### 1. Preface

Following the conclusions of the Luxembourg European Council in December 1997, the Commission has reported regularly to the Council and the Parliament on progress made by the candidate states in preparing for EU membership. This Progress Report is the first such report on Croatia following the decision of the European Council of 17 and 18 June 2004 that Croatia is a candidate country. In December 2004, the European Council stated that:

*“The European Council noted with satisfaction the progress made by Croatia in preparation for the opening of accession negotiations. Reaffirming its conclusions of June 2004, it urged Croatia to take the necessary steps for full cooperation with ICTY and reiterated that the remaining indictee must be located and transferred to the Hague as soon as possible. It invited the Commission to present to the Council a proposal for a framework for negotiations with Croatia, taking full account of the experience of the fifth enlargement. It requested the Council to agree on that framework with a view to opening the accession negotiations on 17 March 2005 provided that there is full cooperation with ICTY.”*

However, in the absence of confirmation of the above mentioned full cooperation, the General Affairs and External Relations Council (GAERC) of 16 March 2005 decided to postpone the opening of accession negotiations and agreed that a bilateral intergovernmental conference (IGC) would be convened by common agreement as soon as the Council has established that Croatia is cooperating fully with the International Criminal Tribunal for the former Yugoslavia (ICTY). The Council also adopted a negotiating framework for Croatia.

Following a positive assessment on 3 October 2005 from the ICTY Chief Prosecutor that cooperation was now full, the Council concluded on the same day that Croatia had met the outstanding condition for the start of accession negotiations and an IGC opening the negotiations was held. The Council agreed that less than full cooperation with ICTY at any stage would affect the overall progress of negotiations and could be grounds for their suspension.

The structure of the report is largely the same as that used in previous years. The report:

- describes the relations between Croatia and the Union;
- analyses the situation in respect of the political criteria for membership;
- assesses Croatia’s situation and prospects in respect of the economic criteria for membership;
- reviews Croatia’s capacity to assume the obligations of membership, that is, the *acquis* as expressed in the Treaties, the secondary legislation, and the policies of the Union;
- briefly examines the extent to which Croatia has addressed the European Partnership priorities.

This report takes into consideration progress since the Commission Opinion of April 2004 on Croatia’s application for EU membership. It covers the period to 30 September 2005. It looks at whether planned reforms referred to in the 2004 report have been carried out, examines new initiatives, and assesses the overall level of alignment in each of the areas under consideration.

As in previous reports, “progress” has been measured on the basis of decisions *actually* taken, legislation *actually* adopted and measures *actually* implemented. As a rule, legislation or measures which are in various stages of either preparation or parliamentary approval have not been taken into account. This approach ensures equal treatment for all countries and permits an objective assessment of each country in terms of its concrete progress in preparing for accession.

The report draws on numerous sources of information. Croatia has been invited to provide information on progress made in preparations for membership since the publication of the Commission’s Opinion. Additional sources have been: the information Croatia has provided within the framework of the Stabilisation and Association Agreement, the national programme for the Integration of the Republic of Croatia into the EU, and various peer reviews and technical consultations that have taken place to assess its administrative capacity in a number of areas. Council deliberations and European Parliament reports and resolutions have been taken into account in drafting the report. The Commission has also drawn on assessments made by various international organisations, in particular the contributions of the Council of Europe, the OSCE, the international financial institutions, and non-governmental organisations.

## **2. Relations between the EU and Croatia**

### *Recent developments in bilateral relations*

The **Stabilisation and Association Agreement (SAA)** between the European Union and Croatia entered into force in February 2005. The SAA provides the legal framework for relations with the European Union; it also provides a framework for political dialogue and enhanced regional cooperation, promotes the expansion of trade and economic relations between the parties and establishes a basis for Community technical and financial assistance. The institutional framework of the SAA provides a mechanism for implementation, management and monitoring in all areas of relations.

Prior to the entry into force of the SAA, an Interim Agreement was in force from 1 March 2002, having been applied provisionally from 1 January 2002. A third meeting of the Interim Committee was held in May 2004. Following the entry into force of the SAA, first meetings of the Stabilisation and Association Council and the Stabilisation and Association Committee were held in April and July 2005 respectively. A first meeting of the EU-Croatia Joint Parliamentary Committee was held in Zagreb in March 2005. A new system of seven subcommittees has replaced the five-subcommittee structure of the Interim Agreement. These subcommittees continue to serve as useful fora for technical discussions of all issues linked to the implementation of the SAA and to the legal approximation process. Five subcommittee meetings have been held so far under the SAA.<sup>1</sup>

Protocols adapting the Stabilisation and Association Agreement (and the Interim Agreement) to take into account the accession of ten new Member States to the Union have been applied with effect from 1 May 2004. Technical adaptations have been made in various areas, including adapting the trade preferences for agricultural products, both basic and processed, as well as fishery products, with a view to avoiding any disruption of traditional trade between Croatia and the enlarged Union.

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<sup>1</sup> Subcommittee on Agriculture and Fisheries, Subcommittee on Economic and Financial Issues and Statistics, Subcommittee on Innovation, Technological Development, technological development and Social Policy, Subcommittee on Justice and Home Affairs, Subcommittee on Transport, Environment, Energy and Regional Cooperation.

Croatia has to a large degree implemented its obligations under the SAA, as it had done so for the Interim Agreement that preceded it, and it has contributed to the smooth functioning of the various joint institutions. Croatia's internal arrangements for implementation of the agreement seem to operate effectively. However, some difficulties in implementation remain and particular attention needs to be paid to the fulfilment of obligations in the field of competition policy and the supply of services. In the field of competition, for example, considerable delays have occurred in the adoption of a national restructuring programme for the steel industry (deadline 1 March 2004), and work needs to be intensified under the Alignment Programme for existing aid, including completion of the list of existing aid schemes, to meet the alignment deadline of March 2006.

In January 2005 Croatia adopted its third “**National Programme** for the Integration of the Republic of Croatia into the EU”. This strategic document sets out Croatia's ambitions and tasks with a view to meeting the political and economic criteria, bringing the Croatian legal framework into line with the *acquis*, enhancing administrative capacity and informing the Croatian public.

A Council Decision on the principles, priorities and conditions contained in the European **Partnership** with Croatia was adopted on 13 September 2004. With this Report, the Commission proposed to update the Partnership. These revised partnerships provide updated priorities for the preparations of Croatia for accession and can be used as a yardstick to measure progress in the reforms. The Commission has proposed to the Council to change the name of the Partnership in order to reflect the current status of Croatia in its preparations for membership.

### *Trade relations*

The EU is Croatia's main trading partner. Between 2000 and 2004 trade between the EU and Croatia increased substantially. EU-25 imports from Croatia increased by 37%, from EUR 2.86 billion in 2000 to EUR 3.92 billion in 2004. EU-25 exports to Croatia grew by 66% over the same period, from EUR 5.89 billion to EUR 9.78 billion. The EU continued to be the most important destination for Croatian exports, in particular Italy, Germany, Austria and Slovenia, although the share of merchandise exports to the EU declined from 66.93% in 2003 to 64.67% in 2004. Still, Croatia's trade deficit with the EU-25 thus almost doubled between 2000 and 2004, increasing from EUR 3.03 billion to EUR 5.85 billion. Of this figure, approximately EUR 1 billion is accounted for by the trade deficit Croatia has with those countries which joined the EU in May 2004. In 2004 the EU accounted for 68% of Croatia's external trade and is way ahead of Croatia's second main trading partner, Bosnia-Herzegovina (6.2%). Croatia ranks as the EU's 31st partner (0.7% of total EU trade), which makes it the EU's main trading partner in the Western Balkans.

EU imports in 2004 were primarily composed of industrial goods (76.6%), including principally machinery (18.4%), textiles products (13.5%), transport equipment (12.2%) and chemical products (8.9%). EU exports in 2004 were mainly industrial goods (80.3%) including machinery (23.1%), transport equipment (15.1%), of which 11.4% cars and trucks, chemical products (11.9%) and textiles products (6.2%).

Concerning *agricultural trade*, in February 2005 the Council approved directives authorising the Commission to negotiate an amendment to the Stabilisation and Association Agreement with Croatia whereby the existing duty-free access to the Community market for unlimited quantities of sugar and sugar products exported from Croatia would be replaced by a duty-free tariff rate quota. After some delay on the Croatian side, these negotiations began in early October 2005 and are currently ongoing.

Currently there are two **anti-dumping** measures in place against Croatia: one on imports of seamless pipes and tubes of iron or non-alloy steel, which is partially suspended, and

one on imports of urea. An anti-dumping investigation on imports of seamless pipes and tubes of iron or steel was initiated in March 2005. Regarding safeguard measures (*erga omnes*), the proceedings on imports of farmed salmon initiated in March 2004 were terminated in April 2005. A safeguard investigation on imports of frozen strawberries was opened in July 2005.

In June 2005, Croatia announced the launch of an investigation in advance of possible safeguard measures against imports of beef – most of which are from the Community – which had resumed following the lifting of its BSE-related import ban in June 2004. The initiation of this investigation does not appear to be justified in light of Croatia's SAA and WTO obligations.

### *Community assistance*

Overall, between 1991 and 2004 Croatia received EUR 631 million of **Community assistance**. The EU consolidated its assistance in 2000 under the Community Programme for Assistance, Reconstruction, Development and Stabilisation (CARDS), at the same time as launching the Stabilisation and Association process (SAP). In the framework of the CARDS National Programmes, the total financial allocation for the period 2001 to 2004 amounted to EUR 262 million for the following five main priorities:

- Democratic stabilisation;
- Economic and social development;
- Justice and home affairs;
- Administrative capacity building;
- Environment and natural resources.

Since becoming a candidate country in 2004, Croatia has stood to benefit from all three **pre-accession financial instruments**: Phare for institution-building and economic and social cohesion, ISPA for environment and transport infrastructures and SAPARD for agricultural and rural development. Croatia also remains eligible for the CARDS Regional Programme in 2005 and 2006. Pre-accession financing will amount to EUR 105 million in 2005 (Phare: EUR 80 million, ISPA: EUR 25 million) and EUR 140 million in 2006 (Phare: EUR 80 million, ISPA: EUR 35 million, SAPARD: EUR 25 million). The Memorandum of Understanding on the Establishment of the National Fund, which provides a legal basis for the introduction of a decentralised implementation system for EU pre-accession assistance, was signed in May 2005.

Croatia has used its experience in implementing CARDS to adapt and extend the current CARDS mechanism in order to implement **PHARE**. On the programming and monitoring side, the National Aid Coordinator and its secretariat have updated their procedures. Relevant units have been created and their management appointed (National Authorising Officer, Head of National Fund, Director of the Central Financing and Contracting Unit, Internal Audit teams). Croatia submitted a request to the Commission for accreditation of its PHARE decentralised implementation system in June 2005.

In June 2005, the National ISPA Coordinator submitted applications for EC assistance under the **ISPA** instrument, together with final drafts of the National ISPA Strategies for environment and transport. The overall cost of the proposed investment amounts to approximately EUR 125 million, of which approximately EUR 63 million is proposed for ISPA financing while the remaining EUR 62 million is to be financed from national resources (including in part IFI loans). The Central Financing and Contracting Unit has been designated the Implementing Agency for the ISPA programme. Croatia submitted a request for the accreditation of the ISPA decentralised implementation system in July 2005.

For the **SAPARD** programme, Croatia has prepared a Rural Development Plan 2005-2006 identifying four measures to be financed: 1) Farm investment; 2) Processing and marketing of agricultural and fish products; 3) Improvement of rural infrastructure; and 4) Technical assistance, information and a publicity campaign. The legal framework for the SAPARD Paying Agency has been established by government decree. The preparations for Agency and National Fund procedures and check lists are under way, as are recruitment and training of personnel.

A Protocol to the SAA on a Framework Agreement on the general principles for Croatia's participation in **Community Programmes** was signed in November 2004. Croatia currently participates as a third country in various Community programmes such as the 6th Framework Programme for RTD, Youth, Gender Equality, Tempus, Employment, and Life.

A Commission-EU Member States **coordination** mechanism for assistance has been in place on the spot since 2001, to maximise the impact of CARDS and Member States' bilateral aid. In July 2004, the Croatian Government adopted a paper called "Pre-Accession Assistance Needs (PAAN)" which aims at improving donor coordination.

The Croatian government is undertaking a series of activities to improve the current implementation record of EU assistance. In October 2004, the government adopted an Action Plan listing the detailed responsibilities and tasks of individual public administration bodies. A government Coordination Group and a Technical Working Group have been set up to facilitate the coordination of overall assistance received by the Republic of Croatia from foreign sources. Nevertheless, the Croatian administration needs to continue its efforts to meet agreed project **conditionalities**, such as policy decisions; the establishment and strengthening of institutions and the allocation of resources.

### *Twinning*

One of the main challenges facing the candidate countries is the need to strengthen their administrative and judicial capacity to implement and enforce the *acquis*. As of 1998, the European Commission began to mobilise significant human and financial resources to help them with this process, using the mechanism of twinning administrations and agencies.

A total of 27 twinning contracts worth EUR 23 million are currently being contracted and implemented in Croatia. Three twinning contracts under CARDS 2002 are being managed in a decentralised manner by the CFCU. Eighteen contracts under CARDS 2001, 2002 and 2003 are ongoing, three have been finalised. Preparations for contracting a further six twinning contracts are under way. Six twinning contracts under CARDS 2003 and eight under CARDS 2004 with an overall worth of EUR 11.85 million will be launched within the last quarter of 2005.

### *Negotiations and screening*

Following the positive Commission Opinion of April 2004 on Croatia's application and the decision of the European Council in June 2004 that Croatia is a candidate country, the European Council decided in December 2004 that accession negotiations would be opened on 17 March 2005 provided that there was full cooperation with the UN International Criminal Tribunal for the former Yugoslavia in The Hague (ICTY). However, in the absence of confirmation of full cooperation, the General Affairs and External Relations Council (GAERC) of 16 March 2005 decided to postpone the opening of accession negotiations and agreed that a bilateral Intergovernmental Conference (IGC) would be convened by common agreement as soon as the Council has established that

Croatia is cooperating fully with the ICTY. The Council also adopted a negotiating framework for Croatia.

Following a positive assessment on 3 October 2005 from the ICTY Chief Prosecutor that cooperation was now full, the Council concluded on the same day that Croatia had met the outstanding condition for the start of accession negotiations and an IGC opening the negotiations was held. The Council agreed that less than full cooperation with ICTY at any stage would affect the overall progress of negotiations and could be grounds for their suspension.

The Commission started the so-called screening process on 20 October 2005, through which Croatian legislation is compared in detail with EU legislation. The screening will enable the EU to decide upon the opening of individual chapters for negotiations.

Croatia has made good progress with its own organisational preparations for the accession negotiations. In February 2005 the presidents of Croatia's parliamentary parties reached agreement with the Prime Minister on the heads of 13 negotiating groups bringing together the 35 negotiation chapters. This followed the appointment of the Minister of Foreign Affairs and European Integration as the head of the national delegation for negotiations with the EU and the appointment of a deputy head of the delegation as chief negotiator.

In March 2005 a National Committee for the Supervision of Croatia's Membership Talks with the European Union was established in Parliament in order to expedite the EU accession process. This committee, which will include representatives of the parliamentary majority and opposition, employers and trade unions, should help streamline the passage of EU accession-related legislation.



## B. CRITERIA FOR MEMBERSHIP

### 1. Political criteria

The political criteria for accession to be met by the candidate countries, as laid down by the Copenhagen European Council in June 1993, stipulate that these countries must have achieved “stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities.”<sup>2</sup> In the case of Croatia and the other Western Balkan countries, the conditions defined by the Stabilisation and Association Process are also a fundamental element of EU policy. In this section, the Commission therefore also monitors cooperation with the UN International Criminal Tribunal for the former Yugoslavia (ICTY), regional cooperation and other related issues such as developments in war crimes trials and refugee return.

In its 2004 Opinion, the Commission found that:

*“Croatia has stable democratic institutions which function properly respecting the limits of their competences and cooperating with each other. The 2000 and 2003 elections were free and fair. The opposition plays a normal part in the operation of the institutions.*

*There are no major problems over assuring the rule of law and respect for fundamental rights. However, Croatia needs to take measures to ensure that the rights of minorities, in particular of the Serb minority, are fully respected. Croatia should speed up the implementation of the constitutional Law on National Minorities and accelerate efforts to facilitate the return of Serb refugees from Serbia and Bosnia and Herzegovina. Croatia needs to make substantial improvements in the functioning of the judicial system. The effectiveness of the fight against corruption needs further strengthening.*

*Croatia’s cooperation with the International Criminal Tribunal for the Former Yugoslavia has improved significantly in the past months. In April 2004, the Prosecutor stated that Croatia is now cooperating fully with ICTY. Croatia needs to maintain full cooperation and take all necessary steps to ensure that the remaining indictee is located and transferred to ICTY in The Hague. Croatia remains committed to regional cooperation; sustained efforts are needed in this area. In particular to resolve border issues with neighbouring countries in line with international standards for dispute settlement, and issues arising from the unilateral declaration of the protected “Ecological and Fishing Zone” in the Adriatic.”*

The section below provides an assessment of developments in Croatia, seen from the perspective of the Copenhagen political criteria, including the overall functioning of the country’s executive and its judicial system. Such developments are in many ways closely linked to developments regarding Croatia’s ability to implement the *acquis*, in particular in the domains of anti-discrimination and equal opportunities, judiciary and fundamental rights as well as justice, freedom and security. Specific information on progress in

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<sup>2</sup> In the meantime, through the entry into force of the Treaty of Amsterdam in May 1999, the political criteria defined at Copenhagen have been for the most part enshrined as a constitutional principle in the Treaty on European Union. Article 6(1) of the consolidated Treaty on European Union reads: “The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law.” Accordingly, Article 49 of the consolidated Treaty stipulates that “Any European State which respects the principles set out in Article 6(1) may apply to become a member of the Union.” These principles were emphasised in the Charter of Fundamental Rights of the European Union that was proclaimed at the Nice European Council in December 2000.

implementing the *acquis* in these fields can be found in Chapter 19 (social policy and employment), Chapter 23 (judiciary and fundamental rights) and Chapter 24 (justice, freedom and security) of the section dealing with the ability of Croatia to assume the obligations of membership (*see Section B. 3.*).

## **1.1 Democracy and the rule of law**

### *Parliament*

The Parliament (Sabor) has generally functioned satisfactorily since the Opinion.

However, while in 2003 the Parliament adopted a significant proportion of the EU-related legislation relevant to judicial and institutional reform, the work of the Parliament in the year following the Opinion was hampered by a number of political conflicts and a slowdown of legislative activities.

In October 2004 the Head of the Committee for the Prevention of Conflicts of Interest resigned in protest over the alleged irregular replacement of two of its six members. The Committee, which had only recently been established, stopped functioning until parties finally agreed on its membership and Parliament appointed a new Committee on 20 January 2005. The new Committee started its work at a slow pace, however, and appears to have not yet defined its operating procedures. Following the defeat of a no-confidence motion against the then Foreign Minister in November 2004, a disagreement arose on the system of voting. Opposition parties accused the Government of falsifying numbers in order to reach the required majority and boycotted the work of the Parliament. A dispute over voting arose once more in December 2004 when an HDZ member admitted that during the Parliament's session of 8 December, he had used the electronic voting key of an absent HSLs member of Parliament in order to ensure the quorum.

In January 2005 Government and opposition eventually reached a compromise to establish clear regulations for the voting procedure. However no quorum was reached on this occasion. A dispute over the establishment of Parliamentary Investigation Commissions against different party officials was also resolved, with an agreement that all such cases should be reviewed by the Committee for the Prevention of Conflicts of Interest. Despite delays in adopting this committee's operating procedures, two Investigative Commissions were established in February 2005, one to establish the facts concerning the issuance of State guarantees to the creditors of the private shipyard "Viktor Lenac" under the former government, the other to establish whether the former Speaker of Parliament and the former Minister of Development and Construction had a conflict of interest during their mandate. Progress has been slow in both cases, however. There seems, in these cases and more generally, to be no real enthusiasm within Government and Parliament for the investigation of serious wrong-doing for its own sake.

### *Government*

The last *Presidential elections* were held over two rounds on 2 and 16 January 2005, with victory going to the incumbent President Stjepan Mesić who won 66% of the vote in the second round. The HDZ ruling party's candidate and Deputy Prime Minister Jadranka Kosor won 34%. The President of the Republic is elected by direct universal suffrage for a renewable five-year term of office. Turnout in rounds one and two was 50.6% and 51% respectively.

*Local elections* were held on 15 May 2005 for 426 municipal and 123 city councils, 20 county assemblies and a new Zagreb City Assembly. The overall turnout was very low at

under 35%, continuing a trend in recent years. In view of the complexity of the election results and the large number of parties and independent candidates involved, coalition negotiations lasted several weeks. The difficult and sometimes unpredictable process of coalition building appears to have had a negative impact on citizens' trust in the existing political parties and their politicians.

According to the State Elections Committee and local NGO GONG, which observed both elections through a network of a large number of observers, voting in both the presidential and local elections was held in a tolerant atmosphere without major irregularities.

The irregularities observed in the presidential elections mainly concerned out-of-country voting, particularly in Bosnia and Herzegovina, and cases of double voting where the same person voted once in Croatia and once in Bosnia and Herzegovina. These irregularities appear to have arisen due to shortcomings in the voting procedure and the managing of the voters' lists, including for example the absence of any cross check between the diaspora voters' list and the voters' lists of the constituencies.

In March 2005, Parliament adopted Amendments to the Law on Local Elections, the main element of which was the abolition of the provision that members of national minorities can participate in local elections only if they have their registered permanent residence in Croatia and actually reside there. With the aim of introducing a similar provision for all citizens, in March 2005 the Government also submitted draft amendments to the Law on Permanent Residence and Temporary Residence to Parliament in urgent procedure. However, it did not clarify who would check whether a citizen was actually residing at the place of his/her registered permanent residence or how, or according to what criteria. While the Government did eventually withdraw these draft amendments, the way in which they were prepared, submitted to Parliament, changed and, eventually, withdrawn is illustrative of the often ad hoc rather than systematic law-making process in Croatia.

Before and even after the local elections of May 2005 there was a serious lack of clarity on how to implement those provisions of the Constitutional Law on National Minorities concerning the allocation of reserved seats for minority representatives. According to a Government decision of 22 July 2005, it appears that the number of reserved seats for minority representatives was based on the 2001 census lists, without any adjustment to take into account the most recently updated voters lists. With regard to the Serb minority, the difference between the 2001 census and the 2005 voters list is considerable, particularly in return areas. It is therefore vital that the provisions of the CLNM are correctly applied in order to ensure minority rights are fully respected. More generally, there is a need in Croatia for consistent and permanent electoral legislation which regulates issues such as the voters lists, out-of-country voting, and campaign financing in a transparent manner.

### *Public administration*

The structure and tasks of the state administration are defined by the Law on the Organisation and Scope of the Ministries and State Administrative Organisations. This law was revised in February 2005 in view of the Government's decision to merge the Ministry of Foreign Affairs and the Ministry of European Integration, thereby reducing the number of ministries from 14 to 13. The number of state administrative organisations has been increased to nine. The Central State Office for Public Administration created in December 2003 is now operational.

A Law on the Civil Service was adopted by Parliament in July 2005. The amendments address deficiencies in the legal basis of the status of civil servants and other public

employees highlighted in the Opinion, most notably with regard to the depoliticisation of public administration, recruitment, selection, promotion and training policies, as well as the regulation of possible conflicts of interest. Most provisions of the new law will enter into force on 1 January 2006 and are dependent on drafting the necessary implementing legislation. While the new law addresses – to a degree<sup>3</sup> – the need to reduce the number of political appointees in the public administration, these de-politicisation clauses will only take effect upon formal assumption of office of the government established after the first parliamentary elections following the entry into force of the new Law. An important opportunity has thereby been missed to put the professionalisation of the Croatian civil service on a more secure footing. The Law on State Officials, the Law on the Structure of State Administration and the Law on the Transfer of Power will also still need to be amended in order to ensure the de-politicisation provisions can be properly implemented.

As regards training of civil servants, the Civil Service Training Centre established in December 2003 was officially opened in June 2005 but is not yet operational. Besides the Director, the Centre currently has 3 employees, with some additional staff unofficially affiliated to the Centre. The Ministry of Foreign Affairs and European Integration continues in the meantime to implement the already well developed EU training programmes.

Work on the decentralisation of state administration to local and regional authorities has continued, albeit slowly, since the Opinion. In December 2004, the Government set up a Decentralisation Commission tasked with coordinating a new Framework Decentralisation Programme for the period 2004-07. This Commission is expected to set the broad guidelines and principles for the decentralisation process and create expert groups to study and make recommendations on a sectoral basis. By the end of September 2005, the Decentralisation Commission had met twice and no expert groups had been set up. In September 2005, amendments to the Law on Local and Regional Self-Government were pending in Parliament, which include provisions on minority representation in executive and administrative bodies at local level and the transfer of various responsibilities to local government units.

Overall, the issue of public administration reform does not appear to have been a matter of urgent priority for the current Government. The limited progress made has tended to be in a piecemeal manner rather than as part of an overall reform strategy in Croatia. While the recently adopted Law on the Civil Service is important and addresses on paper a number of the critical deficiencies previously highlighted, it remains to be seen to what degree its implementation will lead to the professional, efficient, accountable, transparent and independent public administration Croatia needs, not least to provide an important basis for the successful implementation of the *acquis*.

The army and the police are under civilian control. On-going reform of the **army** has led to a reduction in the number of military personnel by about 10% between April 2004 and mid September 2005. The army is under the control of Parliament and the executive. The law provides for civilian control of the secret services by the Council for the Supervision of the Secret Services. Since the Opinion, the activities of the secret service have been subject to much public scrutiny, mainly but not exclusively in connection with the case of the fugitive war crimes indictee, Ante Gotovina.

In December 2004, the Head of the Counter-intelligence Agency (POA) was dismissed because of alleged misconduct by the Agency in an interrogation of a journalist. The conclusion of investigations carried out by the Council for Civilian Supervision of

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<sup>3</sup> The Directors of State administrative organisations such as the Central Bureau of Statistics will remain political appointees.

Intelligence, endorsed by two Parliamentary Committees, was that the POA did not overstep its competence in interviewing the journalist, but that there were indications of possible violation of her human rights. In this context, on 1 December 2004, the Parliamentary Committee on Human Rights and National Minorities concluded that the journalist's human rights had been violated and recommended that the POA's rulebook be examined as to its compliance with the Constitution with regard to the protection of human rights. Apart from the dismissal of the Head of the POA, there appears to have been no follow-up on this case so far.

Following a probe into the POA's activities against five other journalists in 2003 and 2004, the Parliamentary Committee for Domestic Policy and National Security concluded in March 2005 that while the POA acted in line with the Law on Secret Services and its Rulebook with regard to the surveillance of one of the journalists, there were nevertheless grounds for suspicion that the POA had violated without reason the human rights and freedoms of the journalists in question. Again, there appears to have been no specific follow-up. These cases raise the question of the degree to which the democratic principle of civilian supervision of intelligence services is assured. Particular attention will need to be paid to ensuring that the civil institutions overseeing the work of the POA and other intelligence services can adequately carry out their functions.

As regards the **police service**, efforts to implement ongoing police reform need to be sustained. Progress is particularly called for with regard to recruitment and career management policy within the Police. Also, the under-representation of minorities and women in the police should be tackled.

Croatia has a general **Ombudsman**, as well as an Ombudsman for Children and an Ombudsman for Gender Equality. All three issued reports for 2004, which were adopted by Parliament. One of the main areas of concern highlighted by the Ombudsman in this year's report was the ineffectiveness of the state administration, which, in general, does not act within legal deadlines. This applies in particular to pension claims and housing reconstruction cases, where individuals have been awaiting decisions for several years. The lack of discipline on the part of some administrative bodies in responding to the questions of the Ombudsman was also noted, as was the high proportion of complaints involving repossession of property or termination of occupancy rights, and the generally vulnerable position of the Roma community. Although the Ombudsman has no authority over the judiciary, an increasing number of complaints relate to the unreasonable length of judicial proceedings.

In 2004 the Ombudsman received 2,011 complaints (a slight decrease from 2003 when 2,389 complaints were received) bringing the total number of pending cases in 2004 to 2,710. The Ombudsman also issued opinions on high profile cases, such as in July 2005 when he described the new Mayor of Zagreb's takeover of the management of 23 public companies owned by the City as 'morally and legally questionable'. The Ombudsman is playing an important role, particularly in the protection of minorities. However, despite an increase in funding in 2005, the work of the Ombudsman is limited by a lack of funding and personnel.

### *Judicial system*

The **role and structure** of the Croatian judicial system and the functions and competences of the Constitutional Court have not changed since the Commission's Opinion.

The Constitutional Court continues to face a constant increase in the number of petitions submitted by individuals who consider that their constitutional rights have been violated

by the final acts of state authorities or bodies of local or regional self-government (3,373 in 2003, 3,602 in 2004, 1,286 by the end of April 2005).

Improving the **functioning of the judiciary** remains a major challenge for Croatia. Problems highlighted in the Opinion such as the inefficiency of courts, the excessive length of court proceedings, weaknesses in the selection and training of judges and difficulties with the enforcement of judgements remain. These structural difficulties have contributed to an increase in the already very large backlog of cases before the Croatian courts, thus further weakening judicial capacity. A coherent long-term strategy to tackle systemic problems is crucial if the goal of an independent, reliable, transparent and efficient judicial system is to be achieved.

*Judicial reform* has been the subject of much attention since the Opinion. Several steps have been taken by the Croatian authorities to improve the functioning of the judiciary, including through specific legal amendments and procedural and organisational improvements. (see Chapter 23 – *Judiciary and fundamental rights*). However, several significant reforms which have been planned for several years are still outstanding. These include amendment of the Civil Procedure Code to place a limit on the number of times appealed cases can be remitted back to first instance before a final decision is made; an overhaul of the system of attorneys' fees, linking fees to the value of the dispute regardless of the length of proceedings and number of hearings; introduction of new legal aid legislation extending it systematically to civil as well as criminal cases; creation of an integrated court management system; streamlining of the court document delivery system to speed up proceedings and prevent abuse by the parties; reorganisation of judicial traineeships to include pre-service training at the Judicial Academy and the physical rationalisation of the court network. A comprehensive new judicial reform strategy, addressing in detail the current shortcomings of the Croatian judiciary, was adopted by the government in September 2005. This positive step needs to be followed up with full commitment to its implementation and financing as well as the establishment of precise deadlines, which are currently missing from the Action Plan accompanying the strategy.

The total overall *backlog* of the Croatian judicial system amounts to around 1.6 million cases, up from the 1.38 million cases reported in the Opinion. 17% more cases were dealt with in 2004 than in 2003, but the rate of new cases being brought before the courts is increasing such that the backlog could not be reduced. There remain significant difficulties with the enforcement of judgements in Croatia. The lion's share of the backlog within the Croatian judiciary – amounting to around 540,000 cases at first instance alone – is connected with the enforcement of civil judgements, especially those imposing financial obligations on debtors or requiring certain types of action from them. While some amendments to the Enforcement Act were made in July 2005, changes which would entrust execution procedures to enforcement officers vested with public powers need to be urgently adopted. Moreover, courts and parts of the state administration do not always respect or execute in a timely manner the decisions of higher courts.. However, significant progress has been made in tackling the serious backlogs affecting the Land Registry, which constitutes the second main category of the overall case backlog. In September 2004, there were 325,000 unresolved land registration cases pending nationwide. Following implementation of the amendments made in 2004 to the Land Registration Act, this figure had been reduced to around 257,000 cases by July 2005 (see Chapter 23 – *Judiciary and fundamental rights*).

As regards the *duration of court proceedings*, it should be noted that since the Constitutional Court was given competence in 2002 to hear complaints from parties concerning the excessive length of proceedings, the number of such complaints has been rising rapidly (542 in 2003, 925 in 2004 and 585 in the first third of 2005) and now forms

over one quarter of the Constitutional Court's caseload. A continuation of this trend could jeopardise the Constitutional Court's own ability to act expediently.

With respect to the *impartiality* of the judicial system, some problems remain, most notably in the area of war crimes trials where, despite progress since the Opinion, ethnic bias against Serbs in local courts persists.

In conclusion, positive initial efforts are being made by the Croatian authorities to tackle the systemic weaknesses of the judicial system. However, the challenges faced are immense and not to be underestimated. The reform process is at an early stage and will require constant attention, including appropriate political and financial support, and a coherent long-term strategic approach is called for. Particular attention will need to be paid to reducing the case backlog, ensuring proper enforcement of judgements, improving the case management system and efficiency of courts and introducing transparent procedures for the recruitment and career management of judicial staff, as well as ensuring continuous in-service training. Rationalisation of the court network including case reallocation measures and the closure of some courts should also be pursued.

More details on the judicial system can also be found under *chapter 23 – Judiciary and fundamental rights*.

### *Anti-corruption policy*

Corruption continues to be a serious problem in Croatia that affects various aspects of society. Croatia is one of the few European countries where surveys highlight the public perception that corruption has actually got worse over the past year. The main areas of perceived corruption are the health and construction sectors, as well as the judiciary. Various surveys and reports indicate the prevalence of corruption as a major concern of Croatian citizens. On the other hand, general tolerance of petty corruption appears to be widespread. Public awareness of all forms of corruption as a serious criminal offence needs to be raised.

The legal framework to combat corruption seems to be largely in place, although legislation on the financing of political parties is missing. The Additional Protocol to the European Criminal Law Convention on Corruption was ratified in April 2005 as was the UN Convention against Corruption. In October 2004, amendments to the Criminal Code entered into force, which aim at further harmonising Croatian legislation with international instruments. Amendments to the Act on Prevention of Conflict of Interest in the Exercise of Public Office and to the Act on Financing Presidential Electoral Campaigns, in both cases aimed at improving transparency, entered into force in July and August 2005 respectively. Croatia has been a member of the Group of States against Corruption (GRECO) since 2000. In December 2004 GRECO issued a compliance report on Croatia which concluded that half of the 16 recommendations from its May 2002 Evaluation Report had been dealt with satisfactorily.

Amendments to the Act on the Office for the Prevention of Corruption and Organised Crime (USKOK) strengthening the role and jurisdiction of the Office and providing for better coordination with police and other investigative bodies entered into force in March 2005. The failure of USKOK to successfully prosecute a number of highly publicised cases since its inception was partly explained by shortcomings in the old law. The degree to which USKOK will now become fully operational remains to be seen. In any case, administrative capacity in the fight against corruption needs to be considerably further improved, not only at USKOK, but across the board including the courts, the State Attorney's Office and other bodies and agencies involved in fighting corruption. At the enforcement level, more attention should be given to the effective prosecution of

corruption cases. Action plans to prevent and combat corruption in the relevant law enforcement agencies (border police, police, customs, judiciary) need to be developed.

A new National Strategy against Corruption is still awaited as a successor to the 2002 National Programme to Combat Corruption. It is vital that a new multi-annual anti-corruption strategy and action plan is implemented with the necessary resolve so as to avoid the lack of effective implementation associated with the current programme. This should also clearly build on lessons learnt from the implementation of the 2002 Programme. Attention should be paid to high level and political corruption as well as to prevention and awareness raising on the negative impact of corruption, including on the investment climate. An overall statistical methodology is also needed in order to better monitor corruption.

More details on anti-corruption policy can also be found under *chapter 23 – Judiciary and fundamental rights*.

## **1.2 Human rights and the protection of minorities**

### *Observance of international human rights law*

Croatia has put in place a number of legislative provisions to guarantee respect for human rights and the rights of minorities. The Constitution deals with fundamental freedoms and rights. These rights are underpinned by certain international conventions, foremost of which is the European Convention for the Protection of Human Rights and its main additional protocols, ratified by Croatia in 1997. Individuals may take their case to the European Court of Human Rights if they consider that their rights under this Convention have been violated.

Croatia signed the European Convention on Nationality in January 2005 and in April 2005, it signed Protocol No 12 to the Convention on the Protection of Human Rights and Fundamental Freedoms. The Convention on Action Against Trafficking in Human Beings was signed in May 2005.

Since November 1998, the European Court of Human Rights has delivered 42 judgements concerning Croatia, and there have been 24 friendly settlements. On 40 occasions the Court found that Croatia had violated the ECHR and in 2 cases, no violation was found. Most of the violations have concerned the right to a fair trial and the length of proceedings, under Article 6 ECHR. There are currently 959 applications against Croatia pending before a decision body of the Court.

In December 2004 the European Court of Human Rights Grand Chamber panel accepted the request of Mrs Blečić to review the judgment of 29 July 2004 in the case *Blečić v. Croatia*, which had held that the judicial termination of Mrs Blečić's occupancy/tenancy rights was in accordance with domestic law and did not violate the right to her home or the right to peaceful enjoyment of possessions guaranteed by the Convention. The Grand Chamber's decision to accept Blečić's request to review the case could re-open the issue of terminated occupancy/tenancy rights in Croatia.

### *Civil and political rights*

There have been some developments in the area of civil and political rights since the Opinion. As regards *access to justice*, implementation of a free legal aid scheme introduced in May 2005 has begun for the Roma community, also for those without citizenship. However, foreigners and those without citizenship generally remain ineligible for legal aid in civil cases. In civil cases, currently only the Bar Association provides free legal aid with no state control over the eligibility criteria. There is no legal

aid in civil cases organised by the state. A working group, including representatives from NGOs, has been established by the government to draft a new Legal Aid Act. Croatia should adopt as soon as possible the foreseen legislation and provide the necessary training and funds for its implementation.

There are generally no difficulties reported as regards *arbitrary arrest*, which is forbidden by the Constitution. Despite some progress in the reduction in the number of unfounded charges for war crimes being levelled at members of the Serb minority (*see the section on domestic war crimes trials*), a number of Serb returnees have faced arrest on return to Croatia since the Opinion only for charges subsequently to be dropped.

*Freedom of religion* is guaranteed by the Constitution. There have been no particular difficulties reported as regards violations of this freedom. Some tensions between religious communities remain in certain areas, however.

There have generally been few difficulties reported with respect to the *freedom of expression*. The media remains to a large extent deregulated and generally subject to free market rules. Concerns expressed in the Opinion concerning the possibilities for political influence at the local level remain valid, however, with local electronic and print media in many Croatian municipalities continuing to be partly or fully owned by local authorities. Despite generally fair media coverage of the May 2005 local elections, some difficulties were evident both with respect to political control of the media and in terms of a less than helpful portrayal of minorities. A new Media Law adopted in April 2004 goes some way in meeting the recommendations of the joint Council of Europe/European Commission/OSCE expert mission of February 2004. However, further measures are still needed to ensure transparency in media ownership. Croatian media is also becoming more highly concentrated. In August 2005, Europapress Holding (EPH) took over Split-based Slobodna Dalmacija, bringing EPH's share of the daily market in Croatia to above the 40% market share limit on daily newspaper ownership stipulated in the new Media Law. EPH is therefore obliged to take measures to reduce its total stake to below 40% within six months.

Regarding audiovisual media, a number of adaptations to the legislative framework created in 2003 remain outstanding. No progress has been made in following up the recommendations of the above mentioned joint expert mission for changes to the Law on Electronic Media and to the Law on Croatian Radio and Television. The new Telecommunications Act adopted in May 2005 more clearly defines relations between the Telecommunication Agency and the Council for Electronic Media. Notwithstanding the need for further legislative changes, it appears that the Croatian Radio and Television Council has generally been functioning relatively smoothly. The Council for Electronic Media has on the other hand been facing some teething problems. (*see also Chapter 10 – Information society*).

Changes to the Criminal Code in 2004 allows for a more liberal *libel* regime in Croatia but fall short of full decriminalisation.<sup>4</sup> Since October 2004, four journalists have received suspended prison sentences for libel. The revised libel regime still appears to lead to a certain degree of self-censorship among journalists and could be further improved.

*Freedom of association and assembly* are guaranteed by the Constitution. The relevant law, which entered into force on 1 January 2002, continues to be implemented without reported problems.

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<sup>4</sup> For example, the liability of editors-in-chief for acts of libel has been removed. Also, the burden of proof of defamation has been shifted from the defendant to the plaintiff.

There has been limited progress in the *anti-discrimination* field since the Opinion. The Criminal Code, which makes the violation of human rights through discrimination a criminal offence, has been further strengthened with regard to the categories of discrimination covered. It also contains specific provisions on racism and xenophobia. A comprehensive national strategy and action plan on the suppression of all forms of discrimination has not been adopted yet. Public awareness regarding these issues also needs to be raised. Since the Opinion, a number of apparently racially motivated attacks have been reported, mainly concerning members of the Serb minority. In one case, the attack resulted in the death of the victim. While these attacks have been investigated by the authorities, it appears that these investigations have not produced results in identifying and prosecuting the perpetrators. In general terms, it appears that the level of protection against discrimination is still far from the EU standards requiring the implementation of the principle of equal treatment between persons irrespective of racial or ethnic origin and the establishment of a general framework for equal treatment in employment and occupation, irrespective of religion or belief, disability, age or sexual orientation. (*see the section on minority rights, cultural rights and the protection of minorities, below*).

The *right of property* is recognised by the Constitution. Since the Opinion, there have been no changes to certain limitations on foreigners' ownership of agricultural land, forests, protected parts of nature (national parks, nature reserves, etc.). The principle of reciprocity applies to the acquisition of real estate by non-Croatian citizens, also in the case of inheritance.

The process of *restitution of dispossessed property* that was taken during the Yugoslav communist regime continues to proceed very slowly.

The number of registered *civil society organisations* in Croatia continues to grow and further diversify. The number of registered NGOs has increased, from 23,740 in August 2003 to 27,955 in 2005. NGOs continue to play an important role in the promotion and protection of human rights and democracy in Croatia.

### *Economic and social rights*

There are no significant developments to report in the field of *gender equality*. While in general it appears that the basic legislation is largely in place, a number of legal adjustments will be necessary to align with EU rules (*see Chapter 19 – Social policy and employment*). The enforcement of existing provisions in this field also remains problematic, and is hampered by the absence of gender-segregated statistical indicators and inadequate attention being paid to the Gender Equality Action Plan. The impact of the new National Policy for the Promotion of Gender Equality remains to be seen.

As regards *education*, while there appear to be no general difficulties to report since the Opinion, a number of specific challenges in relation to minority education remain (*see next section, on minority rights, cultural rights and the protection of minorities*).

In the area of *children's rights*, in May 2004 Croatia presented its second periodic report on progress on implementation of the UN Convention on the Rights of the Child. In its concluding observations of October 2004, the Committee on the rights of the Child noted satisfaction with Croatia's adoption of new laws and harmonisation with international standards in this field, but concerns remained regarding the implementation of those laws. The Committee's recommendations included additional measures to ensure education and training of staff working with children, and strengthening of administrative and judicial measures to eliminate discrimination against children belonging to minorities. Croatia has adopted a National Action Programme for Children. Special attention should be paid to issues such as violence against children and the need to

develop quality standards and ensure the proper functioning and monitoring of care institutions and foster care. An investigation into a series of sexual abuses of minors at the Brezovica orphanage run by Caritas, the main Catholic charity organisation, is currently ongoing and was the subject of extensive media attention in June 2005. It appears that the case was known to the competent authorities for some time but that they failed to take the necessary steps. Disciplinary proceedings against the persons responsible within the State Prosecutor's Office for obstruction of the criminal investigation have been initiated. Currently, one male former employee of the orphanage is in custody, while an official investigation has been opened against five female members of staff. The Office of the Children's Ombudsman in Croatia seems to have been functioning well since its creation in 2003. It played an important role in progressing the Brezovica case, for example. In September 2005, however, the Children's Ombudsman resigned for health reasons. Two Deputy Children's Ombudsman resigned at the same time, also for health reasons. According to press reports, the Children's Ombudsman had received threats from an individual related to a case she has been dealing with and was dissatisfied with the proper functioning of the system of childrens' care.

As for the treatment of *socially vulnerable or disabled persons*, budgetary constraints continue to limit the scope of their rights to health and special care and their social integration. The National Plan for the Disabled is mostly unimplemented due to a lack of funds.

As regards *labour rights and trade unions*, there are no particular developments to report.

### *Minority rights, cultural rights and the protection of minorities*

Croatia has ratified all the Council of Europe conventions it had committed itself to, such as the European Convention on Human Rights and Fundamental Freedoms, the Framework Convention for the Protection of National Minorities, the European Charter for Regional and Minority Languages, and the UN Convention on Civil and Political Rights. Furthermore, since the Opinion, Croatia has concluded a bilateral agreement on the protection of national minorities with Serbia and Montenegro, adding to similar existing bilateral agreements with Italy and Hungary.

The Constitutional Law on the Rights of National Minorities (CLNM), adopted in December 2002, sets the domestic legal framework for minority rights in Croatia. Implementation of the CLNM has been far too slow in some key areas, however, and needs to be stepped up. Problems have arisen in connection with the application of those provisions of the CLNM concerning reserved seats for minority representatives in local and regional governments (*see Section B.1.1 Democracy and the rule of law – Government*). Implementation of the CLNM has also been particularly limited with respect to those provisions on minority representation in State administrative and judicial bodies and in the police, where there is clear under-representation of minorities, especially Serbs. Discrimination appears to be commonplace when new vacancies arise and no programme has been developed by the government to ensure implementation of the provisions for minority representation laid out in the CLNM. Croatia needs urgently to take measures to provide statistical data on the representation of minorities in these institutions. Changes to certain legislation such as the Law on State Administration, the Law on Courts, the Law on the State Judicial Council and the Law on the State Prosecutor's Office also still have to be made to bring these laws in line with the CLNM.

Some changes in the right direction were made in the Law on the Civil Service adopted in July 2005. Article 42(2) of this Law requires that the civil service admission plan ascertains the actual status of posts filled by members of national minorities so that representation of minorities in the state administration in line with the CLNM can be

achieved (*see also Section B.1.1 Democracy and the rule of law – Government*). These provisions need to be fully implemented as soon as possible to ensure the current disadvantaged position faced by minority groups is adequately tackled.

Based on the relevant provisions of the CLNM, a Council for National Minorities has been established at national level, as have some 260 local minority councils which have an advisory role at municipal and county council level in Croatia. Misunderstandings and a lack of awareness among both the local authorities and the minority groups are widespread with respect to the role of the local minority councils, despite the good work of the umbrella Council for National Minorities in addressing these difficulties. This is especially the case when it comes to the difference in the role of representatives of minorities elected to the local executive bodies. Financial sustainability of the minority councils is not guaranteed everywhere; some local authorities provide funds, others do not. The umbrella Council for National Minorities has exclusive authority to distribute funds from the State budget to minorities, in line with the CLNM. In 2004, the Council received HRK 23.9 million (EUR 3.19 million) from the State budget, with an allocation in 2005 of HRK 24.5 million (EUR 3.27 million). The allocation of this funding in 2004 appears to have run smoothly on the basis of consensus following consultation with the minority associations concerned.

As regards *citizenship* questions, Serbs from Croatia still face difficulties when applying for citizenship due to the continued application of outdated rules from 2000. According to Article 115 of the Law on Foreigners which entered into force in January 2004, those who had the status of habitual residents of Croatia in the former Yugoslavia are entitled, within a limited period of time, to request its confirmation. Further to this, they are entitled to request citizenship status without having to wait for the 5-year period of residence in Croatia required of other foreigners. Roma also face difficulties but due to different factors, such as problems establishing/proving permanent residence, inadequate knowledge of the Croatian language or low levels of literacy. The National Plan for Roma should address those issues (*see below*).

National minorities are still generally perceived and presented in the *media* as separate entities and not as an integral part of society, with a narrow focus on problems rather than more positive aspects of their integration. Provisions of the CLNM that public radio and TV stations at national and local level have to produce and/or broadcast programmes for minorities in their languages are only being slowly implemented.

As regards *education*, some progress was made when following two years of discussions since the expiry of a moratorium on history teaching in Serb language classes in Eastern Slavonia, a Ministry of Education-appointed Commission of historians including minority members concluded work on a history supplement covering the period from the 1991-95 “Homeland War” until present. This history supplement was introduced as from the school year starting September 2005. Unfortunately, its introduction has not been short of controversy and led to negative reactions among the Croat majority community. In August 2005, the Ministry of Science, Education and Sport and representatives of the Serb minority agreed on the use of standardised history textbooks for all children regardless of their ethnicity as from the school year 2006/07. Implementation of these new provisions will need to be carefully monitored to ensure that minority issues are adequately covered in national curricula. As regards the use of the Serbian language and script in schools, according to a recent Council of Europe report there is a degree of legal uncertainty in the Croatian legislation concerning the conditions and procedures for the implementation of educational models envisaged in the Croatian Law on Education in Languages and Scripts of National Minorities.

As the largest minority in Croatia with 4.5% of the total population (201 631 according to the 2001 census), the **Serb** minority remains in a particular situation. Relations

between the Croatian State and the Serb minority are burdened by the legacy of the 1991-95 war, in particular the question of refugee return and the restitution of these refugees' property.

The position of the Serb minority in Croatia has improved since the Opinion, not least due to progress in terms of repossession and reconstruction of Serb-owned housing. However, a number of incidents in 2005 threatened to undo some of the advances made. For example, in May 2005, an elderly Serb man was murdered in Karin (near Zadar), apparently on account of his ethnicity. Also in May 2005 a bomb exploded in the building of a local Serb organisation in Vukovar followed one day later by two further bomb explosions in front of the Municipal Government buildings in the Serb-majority municipalities of Trpinje and Borovo near Vukovar. The government and all major political parties condemned these acts. Such incidents nevertheless highlight the need for greater efforts towards the objective of peaceful coexistence and reconciliation between ethnic groups. While ethnically motivated incidents are generally being investigated, it appears that prosecutions are few. Shortcomings in the judiciary, particularly as regards ethnic bias in war crimes trials, but also as regards severe backlogs of cases and difficulties accessing justice, weigh particularly heavily on the Serb minority.

There are also still real obstacles to the sustainable return of Serb refugees, such as enduring, hostility in certain localities, and remaining housing concerns, including those involving former tenancy rights holders (*see below*). Serbs, including those who remained in Croatia during the war, face major difficulties regarding access to employment, especially in the war affected areas. There appear to be many cases, particularly in the education area where adequately qualified Serbs were refused jobs even where no non-Serbs had applied. As mentioned above, little has been done to implement the provisions of the CLNM for representation of minorities in State administrative and judicial bodies and in the police. Additional efforts are needed to integrate the Serb community into Croatian society at all levels.

It has to be noted, however, that the existing institutions of the Serb minority (political parties, schools, cultural organisations) can work without any particular obstacles. In the Danube region, most of the provisions of the Erdut Agreement and the Government Letter of Intent have been implemented, with the important exception of proportional representation of Serbs in the judiciary. Despite occasional hiccups, the agreement reached in December 2003 between the then newly elected ruling Government party HDZ and the Serb minority party SDSS remains valid. There is also in general an increasing dialogue between Croatian authorities and national minorities. For example, in July 2004 the first meeting between the Government's Commission for Relations with Religious Communities and the Serb Orthodox Church's Commission for Relations with the State took place, with the discussion focusing on the return of Serb Orthodox Church property, reconstruction of 23 religious monuments and health insurance for Serb Orthodox clergy. Although issues remain open, relations between the Serb Orthodox Church and the Croatian State are improving. Important symbolic gestures such as the Prime Minister's participation at the celebration of the Orthodox Christmas have contributed to an improved atmosphere.

In April 2005 the Coordinating Body of the Serb National Minority held its constituent session in Zagreb. According to the Constitutional Law, local minority councils may establish such a coordination body at State level for the purpose of promoting joint interests. Representatives of the Croat minority in Serbia have welcomed the establishment of a coordinating body of the Serb minority in Croatia and stressed the need for cooperation between the two communities.

The **Roma** minority also deserves particular attention. Making up 0.21% of the population officially but perhaps up to four times that amount in reality (30,000 to

40,000), most of their number are for a variety of reasons not integrated in Croatian society. Recent research indicates that 89% of Roma households do not have a single member with permanent income<sup>5</sup> and more than 50% of Roma are receiving social benefits.

Croatia approved a national programme for the Roma in October 2003 and signed up to the "Decade of Roma Inclusion 2005-2015" initiative, for which the Government adopted an action plan in spring 2005. Implementation of a free legal aid scheme provided for in the action plan and introduced in May 2005 has begun for the Roma community. This legal assistance should be particularly helpful in terms of regulating the basic status of Roma, especially as many are without citizenship. A Roma National Forum was established in June 2005 to coordinate among the numerous Roma associations and to assist the Government in implementing the Government Action Plan. Croatia now needs to ensure implementation of its other obligations and commitments through provision of adequate funding and concerted action from all levels of Government so that real improvements in the Roma's position are achieved. It appears that the financing currently foreseen for implementing measures aimed at improving the position of Roma will not be sufficient.

Despite some positive initial steps since the Opinion to improve the Roma's disadvantaged position, serious difficulties remain, not least in the area of education and employment where discrimination is widespread and the problem of segregation in schools remains. There also seems to be a lack of institutional structures within the relevant ministries, and an unwillingness or inability of some local authorities to finance Roma programs. Improvements in terms of expertise among Roma themselves will also be needed for successful implementation of Roma programmes.

### 1.3 Regional issues and international obligations

The Government has committed itself to complying with its obligations under the *Dayton and Paris Agreements*. It respects the sovereignty and territorial integrity of Bosnia and Herzegovina. Under the *Erdut Agreement*, signed in November 1995, Croatia accepted a number of obligations in order to achieve the peaceful reintegration of the Croatian Danube Region (Eastern Slavonia, Baranja and Western Sirmium) under the sovereign control of the Croatian Government as of January 1998 (when UNTAES, the UN Transitional Authority, withdrew from the territory). This Agreement and its Letter of Intent of January 1997 to the UNSC continue to be legally binding obligations. Some provisions which have been incorporated in the Constitutional Law on National Minorities, are not yet fully implemented. Croatia maintains its commitment to implementing all obligations related to the return of refugees and internally displaced persons (IDPs).

In general terms, Croatia's cooperation with the *International Criminal Tribunal for the former Yugoslavia (ICTY)* since the Opinion has been good, and there have been no difficulties to report in terms of ICTY's access to internal documentation, ability to interview potential witnesses and cooperation with the relevant Croatian authorities on ongoing cases.

However, in the case of fugitive war crimes indictee, General Ante Gotovina<sup>6</sup>, Croatia's cooperation with ICTY deteriorated after the Opinion was issued and Croatia's efforts to locate, arrest and transfer Gotovina to The Hague were not sufficiently robust to yield

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<sup>5</sup> Kusan/Zoon 2004.

<sup>6</sup> General Ante Gotovina, indicted on 8 June 2001 in connection with alleged war crimes that occurred during and after "Operation Storm" in 1995, based on individual and command responsibility, has been at large since the indictment was unsealed.

significant results. Serious weaknesses in the functioning of the concerned services and the lack of results in this case led the ICTY Chief Prosecutor to conclude in March 2005 that Croatia was no longer fully cooperating with the Tribunal. Following the subsequent decision of the Council on 16 March 2005 to postpone the start of accession negotiations, the Croatian Government undertook a number of measures, centred around a newly adopted Action Plan, aimed at ensuring full cooperation with ICTY. While the implementation of these measures did not lead to the arrest of Ante Gotovina, by 3 October 2005, the ICTY Chief Prosecutor was able to conclude that Croatia was fully cooperating with ICTY and was doing everything it could to locate and arrest him. It is crucial that Croatia maintains full cooperation with ICTY and that it takes all necessary steps to ensure the last remaining indictee is located, arrested and transferred to The Hague.

In terms of other ICTY war crimes indictments of against Croatian citizens from the Republic of Croatia (27 Croats from Bosnia and Herzegovina have been indicted for criminal offences committed in the territory of that State), the confirmation of the indictment against retired General Mirko Norac in May 2004 was the sixth such indictment. General Norac is charged on the basis of individual and command responsibility for crimes against humanity and violations of the laws and customs of war, which were committed against Serb civilians during the Croatian military operation “Medak Pocket” in 1993. In July 2004 Norac appeared in front of the Tribunal in The Hague to plead not guilty to all five counts of the indictment. After entering his plea, Norac, on the same day, returned to Croatia where he is currently serving a 12-year sentence in Rijeka for war crimes against Serb civilians in the Gospic region in 1991. The ICTY judge in charge decided that Norac will be detained in Croatia, however, under the supervision of the Tribunal. In September 2005, the ICTY Referral Bench decided to refer the case against Rahim Ademi and Mirko Norac to Croatia (*see below*).

In December 2004, the ICTY Appeals Chamber decided to grant provisional release pending trial to Generals Cermak and Markac who are charged with crimes against humanity and violations of the laws and customs of war during and after the Croatian military operation “Storm”. The indictees surrendered voluntarily to the ICTY in March 2004 and had been held in custody in Scheveningen prison. In December 2004 Cermak and Markac returned to Zagreb. The request for provisional release was the third filed by the defence attorneys. The first two were rejected in April and September 2004. The ICTY Prosecution supported the appeals stating that conditions for granting temporary release had been met, namely (i) voluntary transfer, (ii) full cooperation (e.g. they have been interviewed by the prosecution), and (iii) Government guarantees.

In April 2005, the ICTY issued indictments against the former head of the Croatian military intelligence service and three Croatian journalists charging them with contempt of the Tribunal - punishable under rule 77(A)(ii) of the Rules of Procedure - for publishing the identity and testimony of a protected witness. A similar indictment was issued in September 2005 against two other Croatian journalists. An arrest warrant was issued in only one case, not because of the gravity of the charges, but because the accused refused to appear before the Tribunal. At their initial appearances before the Tribunal, all indictees pleaded not guilty.

As regards the prosecution of **war crimes trials** in domestic courts, Croatia has continued its preparations aimed at ensuring it will be in a position to try cases transferred by the ICTY as part of the ICTY completion strategy. The Special Investigative departments in the four County Courts in Split, Zagreb, Rijeka and Osijek designated for this purpose have undergone reinforcement, including through a number of training measures for judges, prosecutors and court counsellors from these courts. In

May 2004, the Ministry of Justice and ICTY experts organised the first seminar in a series of three training modules on international criminal law and ICTY case law.

As regards legal preparations, the Croatian Parliament amended the Criminal Code in July 2004 to include new offences of crimes against humanity and subsequent assistance to the perpetrator of a criminal act against values protected under international law. The Code also introduces the concept of criminal liability on the basis of command responsibility, with levels of punishment depending on the degree of the commander's subjective knowledge and whether the crime occurred due to "failure to prevent" or "failure to punish" war crimes. While the question of whether these new provisions can be applied retroactively is a matter of debate, an alternative legal solution is available in that command responsibility could be tried on the basis of the old criminal code through the criminal act of omission and with reference to the Geneva Conventions (ratified by Croatia).

In May 2005, the ICTY and the OSCE agreed that the latter would monitor the war crimes trials transferred to Croatia. The ability of Croatia to adequately prosecute transferred war crimes cases remains to be seen. While the experience of locally initiated war crimes trials leaves a lot to be desired (*see below*), the OSCE concluded in April 2005 that a limited number of Croatian courts could possibly deal adequately with one or a limited number of ICTY transferred cases. In September 2005, the ICTY Referral Bench decided to refer the case against Rahim Ademi and Mirko Norac to Croatia. This was the first time that a case in which persons were indicted by the ICTY was transferred to Croatian jurisdiction. The Referral Bench concluded in this case that the conditions of rule 11 *bis* of the ICTY Rules were met and that it was satisfied that appropriate measures were in place to ensure a fair trial and witness protection and that the death penalty would not be imposed. The existence of the above mentioned monitoring mechanism was also of particular relevance.

Croatia has also been active in trying war crimes cases on its own initiative. Until recently the vast majority of these cases had been against Serbs, with little appetite to try Croats, and many cases have been tried in absentia as well as based on unsubstantiated evidence. Croatia has made some progress since the Opinion in tackling the persistent ethnic bias that has tarnished much of its domestic war crimes prosecution. Serbs have been convicted at a lower rate than in previous years and unsubstantiated charges have been dropped at trial in a number of cases, including in about half of the cases brought in 2004. A review of lists of suspected war criminals initiated by the Croatian State Prosecutor has continued, leading to a major reduction in the number of Serbs against whom unsubstantiated charges had been made. The number of fully in absentia trials has remained low, although partially in absentia trials where only some of the defendants are present make up the majority of all trials. There has been noticeable progress on interstate cooperation, in particular on war crimes trials where bilateral agreements have been reached between the Croatian State Prosecutor and his counterparts from Serbia, Montenegro and from Bosnia and Herzegovina. This cooperation needs to be continued, as a number of issues hindering the prosecution of war crimes remain open, such as difficulties with the extradition of one State's nationals to the jurisdiction of another.

Despite the recent progress, ethnic bias in domestic war crimes prosecution persists. In 2004, around 55% of local court verdicts in war crimes cases were reversed by the Supreme Court. In the first seven months of 2005, the figure stands at more than 60%. While a good sign that justice is eventually done, such a reversal rate reflects poorly on what is happening at the local level. Different levels of criminal responsibility are still pursued in domestic cases, with Serbs pursued in large numbers for less serious offences while Croats are pursued almost exclusively for killings. Witness security measures appear to be improving but are still not sufficient; despite the Law on Witness Protection,

which entered into force in early 2004, witnesses, particularly those called to testify against members of the Croatian army, still face intimidation, and further efforts are needed to address witness (particularly minority witness) confidence in police. In a recent case in Osijek, the identity of a protected witness was revealed by the media. Although a criminal offence, it appears no measures have been taken against those responsible.

The risk of facing unsubstantiated charges is still cited by Croatian Serb refugees as an impediment to return. Also, to date it appears that nobody has been prosecuted in Croatia in connection with aiding fugitive indictees nor does it appear that anybody has been prosecuted for aiding in the removal of traces of war crimes.

There have been some important developments in certain war crimes cases since the Opinion. In June 2004, the Supreme Court confirmed the original verdict of the Rijeka County Court in the case of the Gospic Group of 24 March 2003. Tihomir Oreskovic, Mirko Norac and Stjepan Grandic were sentenced to 15, 12 and 10 years of prison, respectively, for war crimes committed against Serb civilians in Gospic in 1991. The conviction of General Norac was the first time that a high-ranking ethnic Croat military officer had been sentenced by a Croatian court for war crimes committed by the Croatian side during the 1991-95 war. Norac is also indicted by ICTY for crimes against Serb civilians during Croatian military operation "Medak Pocket" in 1993.

In the '*Lora prison*' case, the Supreme Court on 19 August 2004 formally annulled the verdict of the Split County Court, which, in November 2002, had acquitted eight Croatian military police officers due to lack of evidence. The Supreme Court ordered a retrial before a completely different panel of judges. However, following serious lapses in the execution of a subsequent detention order in October 2004, four out of the eight defendants managed to escape and have been on the run ever since. The conduct of the retrial, which began in September 2005, will deserve particularly close attention, not least given that Split County Court is one of the four designated courts with exclusive jurisdiction to prosecute war crimes cases transferred from ICTY to Croatia.

Following a ruling of the Supreme Court, the trial against a Croatian police officer accused of killing 13 Serb prisoners of war in 1991 started for the third time at the Karlovac County Court (the "*Hrastov*" case) in September 2004. The same Court had previously acquitted the defendant twice, following the argument of the defence that the killings had been in self defence. The first two trials had been held in a heated and intimidating atmosphere created by the defendant's supporters. The "*Hrastov* case" has been pending for more than 10 years and is illustrative of both the difficulties in achieving unbiased and professional prosecution of war crimes at local level and the important corrective role played by the Supreme Court.

On 8 April 2004 the Osijek County Court convicted Nikola Ivankovic for war crimes against civilians in *Paulin Dvor* near Osijek (Eastern Slavonia) in 1991 and sentenced him to 12 years imprisonment. The other indictee, Enes Viteskic, was acquitted due to insufficient evidence. Ivankovic and Viteskic, former members of the Croatian army, were charged with the killing of 19 Serb civilians in Paulin Dvor on 11 December 1991. In 1997, to pre-empt planned exhumations by ICTY experts, their bodies were transferred to a mass grave near Gospic in the Dalmatian hinterland. This is one of a relatively small number of cases to date where a Croat was convicted for war crimes against Serbs. It is also worth noting that the trial dealt only with the killing of the civilians and not the subsequent transfer of their bodies to cover up the crime, for which no one has been prosecuted to date.

Given the difficulties with war crimes trials at local level and in order to avert the risk of creating a two-speed system of war crime adjudication in Croatia (local versus ICTY indictments), training measures for the four special courts set up to deal with cases

transferred from ICTY should ideally be extended to all judges and prosecutors assigned to county courts trying war crime cases.

As regards **refugees**, as a result of the 1991-95 war, approximately 550,000 Croats and 32,000 Serbs became displaced in Croatia (Displaced Persons – DPs). Some 370,000 Croatian Serbs fled Croatia, mainly in connection with the 1995 operations Flash and Storm. Of this total, around 330,000 found refuge in Serbia and Montenegro and 40,000 in Bosnia and Herzegovina.

The issue of DPs has largely been resolved; on 1 May 2005, the number of DPs was 6,776, including 1,676 of Serb ethnicity. As regards refugees, the results of a re-registration in Serbia and Montenegro and Bosnia and Herzegovina at the end of 2004 and the beginning of 2005 show a substantial decrease in the number of refugees from Croatia as compared to previous official figures. The numbers of refugees from Croatia in Serbia and Montenegro as of July 2005 was 101,875, and 7,566 in Bosnia and Herzegovina, down from a total of approximately 208,000 in both countries in May 2004. The total number of refugees and DPs is therefore currently somewhere in the region of 116,000.

The total number of Croatian Serbs registered as returnees to Croatia is 96,892 or just over one quarter of those who left the country during the war. Approximately 85,002 of these returned from Serbia and Montenegro and 11,890 from Bosnia and Herzegovina. It would appear, based on the latest figures, that a large number of Serb refugees have opted for local integration in the country they reside in. It should also be noted that many of the 96,892 officially registered returnees to Croatia have subsequently left the country. Estimates point to a sustainability rate of return of around 60-70%.

The main issues refugees face upon return relate to housing, a lack of public infrastructure in the return villages, especially electricity; difficulties in terms of economic reintegration and employment, and an often negative atmosphere within some receiving communities. The potential for harassment based on unfounded “war crimes” allegations, has been considerably reduced thanks to an initiative of the Croatian State Prosecutor to review and weed out the numerous unfounded cases against Croatian Serbs (*see also the section on domestic war crimes trials*). Some return areas are also still contaminated by mines. Both refugees who return and those who opt for local integration also often encounter difficulties with access to pension rights in particular with regard to the so-called “convalidation” for rights accumulated in the period 1991-1995.

The principle focus of the Croatian Government since the Opinion has been on housing and de-mining. The latter has been dealt with through Croatian budget resources and is planned to be completed by 2010. In terms of economic reintegration, the Government has put in place some measures for the economic development of the areas of return but no specific measures targeted at returnees. Little has been done to date to improve the atmosphere within the receiving communities.

The housing problem can be divided into three parts which, in order of expected impact on the return process, are: (i) reconstruction; (ii) provision of housing care for former tenancy right holders; and (iii) repossession of property.

To date, the Government has **reconstructed** over 130,000 out of the 200,000 **destroyed houses and apartments**. On 26 March 2004 the Croatian Government decided to re-open the period for requests for reconstruction, between 1 April 2004 and 30 September 2004. As a result, 16,346 new requests were received. At the end of July 2005, 7,092 reconstruction applications had not yet been processed. Also, there were 11,072 pending appeals out of a total of 12,447 against first instance adverse decisions. The Government’s objective is that that all pending requests will be processed by the end of 2005 and the pending appeals by the end of 2006. There appear to be no major delays in

implementing the reconstruction programme for the estimated 10,000 houses currently scheduled. Outstanding cases should be treated expediently and particular care taken that sound reasons are given for adverse eligibility decisions. Completion of the outstanding reconstruction programme should make possible the return of approximately 30,000 people.

Based on amendments to the Law on the Areas of Special State Concern dating from July 2002 and a Government Decision of June 2003, publicly financed **housing care** is available both within and outside the Areas of Special State Concern for those **former tenancy right holders** who wish to return. The deadline for submission of requests from former tenancy right holders outside the Areas of Special State Concern (ASSC) who wish to return was originally set for the end of 2004 but has since been extended twice, with the current deadline of 30 September 2005. There is no deadline for applications inside the ASSC.

By the end of August 2005, there had been 7,521 requests for housing care inside the Areas of Special State Concern, of which 5,320 had not yet been processed. Of the pending requests, about 40% of families were already living in the apartment. Outside the Areas of Special State Concern some 3,628 requests had been received by the end of August 2005, but no decisions at all had been taken, despite EUR 3 million being allocated in the 2004 budget to facilitate the construction/purchase of 400-500 apartments outside the ASSC to cover the first requests. In the 2005 State budget, EUR 6 million is allocated for the same purpose, but to date no apartment has been purchased or allocated. The Government's target has been to meet all requests by the end of 2006.

Thus, the only major remaining housing scheme, more than two years after its adoption, remains at a very early stage of implementation: no apartment has been allocated and the vast majority of requests have not been processed. The Government has been particularly slow in terms of publicity of the housing care programme; the publicity campaign outside Croatia got under way with UNHCR support relatively late in 2004, thereby necessitating a further extension of the deadline to the end of September 2005. Resistance to the programme at local authority level has also hampered progress.

Potential beneficiaries – amounting to around 30,000 families in total, 24,000 of which in urban areas – are also not fully convinced they should apply. It would seem that the majority of them would prefer to be given the opportunity to buy “their” apartment at the same favourable price as in the 1990s and, then, sell. This option is not available to them. The programme does not address the issue of whether the termination of occupancy and tenancy rights was legally justified. There are currently a large number of domestic court proceedings ongoing on this issue. The *Blecic v. Croatia* case will be important in this respect (*see section Human rights and the protection of minorities*).

By August 2005, out of a total of approximately 20,000 applications for **houses to be repossessed**, only around 107 properties remained to be vacated. Over 3,000 housing units were still empty because either the owner had not reacted to the official notice or the owners' whereabouts were unknown. There appears to be only a handful of properties still occupied ‘illegally’ i.e. where the occupation without the owner's consent was not on the basis of the Law on Temporary Take Over and Administration of Specified Property of 1995. The Government's deadlines to finalise the process of property restitution have been consistently missed, having been put back several times from the original deadline of 2002. Since the Opinion there has been some acceleration in dealing with repossession cases, however. The current target is to complete the repossession process in the second half of 2005.

Where repossession does take place, there are still a number of unresolved claims for compensation for damage to and looting of properties before repossession as well as claims by temporary occupants for ‘investments’ they have made without the owner's

consent. A solution through out-of-court settlement has been promised on a number of occasions. However, while some conclusions in this respect were adopted by the Government in July 2005, there are currently no implementing rules that would allow these compensation cases to be adequately dealt with. In any case, it would seem advisable to exclude the possibility of claims for compensation for investments made without the owner's consent being made against the owner.

There remain difficulties with respect to the lack of public infrastructure in the return areas which acts as an obstacle both to refugee return and to the sustainability of return itself. On the basis of a 2004 OSCE survey on the state of electrification in return areas it was established that 189 return hamlets and/or settlements were without electricity. The Croatian Electricity Company and the relevant state authorities have included some of the villages in a priority list for connection with the electricity network. However, a comprehensive action plan for the reconnection of all villages has so far not been adopted.

The validation of documents issued by the so-called "Republika Srpska Krajina" (RSK) is still an outstanding issue. "Convalidation" is necessary for recognition of working years during the 1991-1995 period and, thus, pension rights. The Government accepts the principle that working years should be "convalidated" and pension rights ensured. However, there are a number of specific issues to be resolved. The original deadline for requests for convalidation expired already in 1999 and needs to be reopened for the many potential beneficiaries who could not reasonably have been expected to apply by then, a large number of whom were, and still are, abroad and, thus, could not submit applications. Moreover, all adverse decisions made on the basis of applications submitted after the deadline expired should be reviewed.

There has been relatively good progress in terms of regional cooperation on the refugee issue. A regional ministerial conference on refugee return was held in Sarajevo on 31 January 2005. At that conference, the relevant ministers from Bosnia and Herzegovina, Croatia and Serbia and Montenegro adopted a joint Declaration which now forms the policy basis for dealing with refugee issues at regional level. In so doing, the three countries committed themselves to resolving the remaining population displacement by the end of 2006; to facilitating the return or local integration of refugees, depending on the latter's decision, without any discrimination; to granting refugees the same rights and the same responsibilities as all other citizens; to providing assistance and support to refugees in cooperation with UNHCR, the EU and OSCE; and to ensuring access to all rights and entitlements, including the right to accommodation, in a fair and transparent manner.

According to the Sarajevo Declaration, each country should produce a 'roadmap' for the implementation of the above mentioned goals. These roadmaps would then be unified in a joint implementation matrix. A task force working group has been set up to assist this process and while a certain degree of progress on technical issues has been made, deadlines are slipping and road maps are being finalised with a certain delay. If further delays occur, the deadline set of end 2006 for resolving the refugee issue will become increasingly unrealistic. The Sarajevo initiative is a positive development and an important political opportunity for Croatia: for the first time ever, it is proposed to address not only refugee return but also local integration in Bosnia and Herzegovina and Serbia and Montenegro, such that the refugee file can be closed once and for all.

In conclusion, despite the generally good progress since the Opinion notably on property repossession and reconstruction, the refugee return issue remains a major challenge and Croatia needs to intensify its efforts and provide the necessary financial means. In particular, Croatia needs to accelerate the planned housing care programmes for former tenancy rights holders, and pending reconstruction applications and appeals need to be

treated expediently and actual reconstruction completed according to schedule. More efforts are required to ensure that the conditions for sustainable return for all categories of refugees are created. To this end, local authorities need to engage more actively in the process of refugee return and serious efforts need to be made to improve the general atmosphere in the return areas.

As regards **regional cooperation**, Croatia continues to be an active member of several regional and sub-regional initiatives, such as the Stability Pact, the Adriatic–Ionian initiative, the "Quadrilateral" (between Italy, Slovenia, Hungary and Croatia), the Alps-Adriatic initiative, the Danube Commission and the Adriatic Charter. In October 2004, Croatia became a full member of the South East Europe Cooperation Process (SEECPP). Following the conclusion of a Protocol on the Establishment of the Adriatic Euro-Region, signed in Tremoli (Italy) in September 2004, and sponsored by the Council of Europe, an Adriatic Council with its seat in Pula was established in September 2005. Croatia became a party to the Sava River Basin Agreement in June 2005 (see also Chapter 14 – Transport policy). In October 2005, Croatia signed the Treaty on a Regional Energy Market in South East Europe (*see also Chapter 15 – Energy*).

In Sarajevo in January 2005, Croatia, together with Bosnia and Herzegovina and Serbia and Montenegro, adopted a joint Declaration aimed at settling all refugee issues by the end of 2006 (*see section on refugees*). In early 2005 the Croatian State Prosecutor signed agreements with his counterparts from Bosnia and Herzegovina, Serbia and Montenegro on inter-state judicial cooperation including with respect to war crimes. In June 2005, Croatia agreed in Sofia to a ministerial declaration on trade liberalisation in South East Europe with a view to establishing a regional Free Trade Agreement (*see also Chapter 30 – External relations*). Despite having difficulties with being considered a country of the Western Balkans region, Croatia has generally taken a pragmatic approach to its role in the region and demonstrated a clear understanding that its interests are best served by constructive multilateral cooperation within the region and beyond.

Although all five successor states (Slovenia, Croatia, Bosnia and Herzegovina, Serbia and Montenegro and the former Yugoslav Republic of Macedonia) had ratified the 2001 Succession Agreement on SFRY assets by March 2004, little progress has been made in identifying and determining equitable distribution of rights, obligations, assets and liabilities of the former SFRY amongst its successor states.

Despite occasional hiccups, Croatia has been fairly active since the Opinion in terms of developing bilateral relations with its neighbours in the region.

The improved relations between **Croatia and Serbia and Montenegro** witnessed following the change of regime in both countries after 2000 have continued since the Opinion and numerous meetings have been taking place regularly at working level. At senior political level, Prime Minister Sanader's visit to Serbia and Belgrade on 15 November 2004 was the first official visit of a Croatian Prime Minister since Croatia's independence and constituted an important step towards normalisation of Croatian-Serbia and Montenegro relations. In July 2005, President Mesic paid a three-day visit to Serbia and Montenegro.

The Prime Minister's visit marked the signing of an Agreement on Protection of National Minorities, which has subsequently been ratified by both parties. The Agreement, which had been negotiated for several years, was well received by representatives of both the Croatian minority in Serbia and Montenegro and the Joint Council of Municipalities (i.e. predominantly Serb municipalities in the Croatian Danube region), considering it a "historic step" in the relations of the two countries.

In December 2004, Croatia extended the temporary visa-free regime until 31 December 2005. There is a continued reluctance, however, to put the visa-free regime on a more

permanent basis. Croatian and Serbia and Montenegro police have, apparently, established good cooperation at local level in preventing illegal migration and smuggling. Implementation of the Readmission Agreement, ratified by Serbia and Montenegro in May 2004, has faced some difficulties, mainly due to the interface between the Belgrade authorities and UNMIK with respect to the repatriation of illegal immigrants of Albanian ethnicity.

In February 2005, the Croatian State Prosecutor signed cooperation agreements with the Serbian and the Montenegrin Prosecutors on domestic war crimes prosecution. These agreements will apparently enable direct cooperation between the relevant prosecutors from Croatia, Serbia and Montenegro at all levels of prosecution of war crimes and other serious crimes.

The Free Trade Agreement signed in December 2002 and ratified by the Croatian Parliament in May 2003 was ratified by Serbia and Montenegro (SCG) on 1 July 2004. It entered into force the same day. Bilateral trade and investment between the parties is developing at a fairly positive rate.

Despite the many positive developments in bilateral relations since the Opinion, a number of important open issues remain to be resolved. There has been no progress with border demarcation at the Danube river nor at Prevlaka although the temporary border regime seems to be running smoothly. There has been some progress in cooperation on missing persons. However, there is a need for this issue to be given new impetus. There also remains an unfortunate tendency in Croatia when referring to the total number of missing persons from Croatia only to include those of Croat ethnicity. Other open matters include succession-related issues, Croatia's claim for compensation for war damage, return of refugees and restitution of their property, and property restitution to business entities.

Relations with **Bosnia and Herzegovina** are relatively stable. The HDZ Government continues to pursue the policy of non-interference in Bosnia and Herzegovina internal affairs which was developed under the former Racan Government. Bilateral contacts have been relatively few since the Opinion and until very recently, little progress had been made, often due to Bosnia and Herzegovina internal factors. In 2004, there were no official visits by Prime Ministers. The Chairman of the Council of Ministers of Bosnia and Herzegovina paid an unofficial visit to Zagreb in October 2004, where open questions were discussed (Agreement on the Port of Ploce, dual citizenship and restitution of property) but no agreements reached. However, at their meeting in Zagreb in August 2005, the Croatian Prime Minister and the Chairman of the Council of Ministers of Bosnia and Herzegovina initialled an Agreement on Dual Citizenship. Signature of the Agreement on Property Rights Issues was also expected but could not go ahead because of internal problems in Bosnia and Herzegovina.

There have been mixed results as far as outstanding border issues are concerned. As regards the land and river borders, agreement was reached in 2005 and as of September 2005 was awaiting ratification in both Parliaments. As regards the Port of Ploce, there are no new developments. The Croatian Government has taken the position that the ratification of the Agreement on the Port of Ploce is, for internal political reasons, not possible. The Speaker of Parliament confirmed this position officially during a visit to Sarajevo in October 2004. Instead, the Croatian Government intends to submit a completely new draft agreement, taking into account the new political context of a joint aspiration of EU membership. No such draft has, as yet, been forthcoming.

Recently, Croatian-Bosnia and Herzegovina relations were additionally burdened when, in March 2005, Bosnia and Herzegovina unilaterally suspended parts of the Free Trade Agreement with Croatia. Discussions on the resolution of this issue are ongoing. Also, difficulties with the approval of a new Bosnia and Herzegovina Ambassador to Croatia

and the linked recall of the Croatian Ambassador to Bosnia and Herzegovina lowered the level at which diplomatic communication between the two countries took place for several months..

In January 2005, the Croatian and Bosnia and Herzegovina State Prosecutors signed a Protocol on Combating Serious Crime aimed at facilitating the exchange of relevant information, reports, documents, laws and legal regulations, opinions and data. One month later, both State Prosecutors signed a cooperation agreement on domestic war crimes prosecution. Croatia and the Federation have already signed an Agreement on Legal Assistance in Civil and Criminal Matters.

Relations with **Slovenia**, while generally well developed, continue to be affected periodically by difficulties linked to outstanding border issues and appear to be marked by lack of mutual confidence. On a number of issues (border demarcation, Ljubljanska Banka), momentum towards reaching permanent solutions has been lost; it appears that the two countries, regardless of the Governments in power, are stuck in their respective positions. The border dispute over the Piran Bay has particularly strained Croatian-Slovene relations since summer 2002, and an agreement over the demarcation of the maritime border, a pending issue since both countries gained independence, has not been reached yet.

As already reported in the Opinion, Croatia's decision of 3 October 2003 to expand its jurisdiction in the Adriatic through the Ecological and Fishing Protection Zone with effect from 3 October 2004 has additionally burdened bilateral relations. On 3 June 2004 the Croatian Parliament adopted an amendment to the Parliament Declaration according to which the implementation of the zone, with regard to EU Member States, would start only after the conclusion of an Agreement on Partnership in Fisheries between the European Community and Croatia. This decision took some of the heat out of the issue.

After a new Slovenian Government came to power in October 2004, both countries appeared to enter into a new dialogue. This culminated in a joint session of both Governments in June 2005 on the island of Brijuni and the adoption of a declaration on the avoidance of incidents. However, new tensions emerged already in August 2005 when Slovenia declared a protected environmental zone in the Adriatic which overlaps with the northern part of the Croatian environmental and fishing zone declared in October 2003. However, with the main underlying issue, namely demarcation of the maritime border, still unresolved, both sides are sticking to their interpretation of the relevant international legal instruments. Despite the outstanding issues, Slovenia has given strong support to the opening of accession negotiations with Croatia. Also, in general terms, existing agreements are being implemented smoothly. One notable exception, however, is that the fisheries aspects of the Border Traffic and Cooperation Agreement between Croatia and Slovenia in force since 2001 are currently not being implemented. Work needs to be completed on the necessary implementing rules, the application of which should contribute to reducing the number of incidents in the Piran Bay. Given that there is as yet no agreement on the demarcation of the common maritime border, pragmatic solutions should be sought in finalising these implementing rules.

**Relations with Italy** are intensive and of particular importance, for economic but also for historical reasons. Bilateral relations appear to be very good and have improved considerably since the current Croatian Government came to power in November 2003. It appears that both sides have the political will to close the last open chapters of World War II, namely the various matters related to the "Esuli" question, including the unresolved question of property acquisition.

Relations with the **former Yugoslav Republic of Macedonia** are good and there are no open issues. During Prime Minister Sanader's visit to Skopje in September 2004, a

bilateral agreement on regional cooperation was signed as provided for under Article 12 of the Stabilisation and Association Agreement.

In **conclusion**, Croatia has generally continued to play a positive role in the region. A number of important bilateral visits, agreements and further engagement by Croatia in regional initiatives has contributed towards the aim of further improving relations between Croatia and its neighbours since the Opinion. There remain, nevertheless, a number of outstanding bilateral issues between Croatia and some of its neighbours that require careful attention. Taking into account Croatia's commitment to good neighbourly relations and the strong contribution expected from Croatia to the development of closer regional cooperation in accordance with the Thessaloniki Agenda, it is crucial that Croatia steps up its efforts towards finding mutually acceptable definitive solutions to all pending bilateral issues and on concluding agreements, in particular as regards border issues, with Bosnia and Herzegovina, Serbia and Montenegro, and Slovenia.

#### 1.4 General evaluation

Croatia faces no major difficulties in meeting the **political criteria** for membership. Problems which had arisen since the Opinion<sup>7</sup> with respect to the requirement for full cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY) have meanwhile been solved. Croatia has continued to make progress overall but further sustained efforts are required in a number of important areas.

There has been progress in the area of judiciary, including the adoption of a judicial reform strategy and various procedural and organisational improvements, but the scope and challenges faced in this field will require continued serious attention in particular as regards the large overall case backlog and the need to ensure proper enforcement of judgements. There have been improvements in the prosecution of war crimes trials, but an ethnic bias against Serb defendants persists.

Despite some progress in setting up the necessary legislative and institutional framework, efforts aimed at tackling corruption, which remains a serious problem in Croatia, need to be further stepped up.

In the area of human rights and minorities an appropriate legal framework is in place. The position of minorities has in general continued to improve since the Opinion. However, implementation of the Constitutional Law on National Minorities in particular has been slow. Serbs and Roma continue to face discrimination and the need to improve their situation especially with respect to job opportunities and as well as creating a more receptive climate in the majority community is an urgent priority. Implementation of a new Roma strategy has begun, but major challenges lie ahead. Particular attention should be paid to ensuring all ethnically motivated incidents are properly investigated and those responsible prosecuted.

On regional issues, while there has been good progress on refugee return in terms of repossession and reconstruction of housing, a number of foreseen deadlines have not been met. Progress has been particularly weak in implementing housing care programmes for former tenancy rights holders. On-going efforts to create the economic and social conditions necessary for the sustainability of refugee return need to be accelerated. There has been good progress in the area of regional cooperation, both in terms of improvements in bilateral relations with neighbouring countries as well as regional initiatives. Croatia has signed the South East Europe Energy Community treaty. However, serious efforts are needed to find definitive solutions to all pending bilateral

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<sup>7</sup> COM (2004) 257 of 20 April 2004.

issues, particularly as regards border issues as well as all open property-related questions. Problems arose since the Opinion with respect to the requirement for full cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY), contributing directly to the postponement of the start of accession negotiations foreseen in March 2005. The situation has meanwhile improved, however, allowing the ICTY Chief Prosecutor to conclude in October 2005 that cooperation was full. This subsequently paved the way for the Council to conclude on 3 October 2005 that the outstanding condition for the start of accession negotiations had been met. Negotiations were formally launched the same day. In its conclusions, the Council confirmed that sustained full co-operation with the ICTY would remain a requirement for progress throughout the accession progress. Less than full cooperation with ICTY at any stage could lead to the suspension of negotiations.

## **2. Economic criteria**

In its 2004 Opinion on Croatia's application for EU membership, the Commission concluded:

*“Croatia can be regarded as a functioning market economy. It should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that it continues implementing its reform programme to remove remaining weaknesses.”*

In examining the economic developments in Croatia, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires:

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union.

In the analysis below, the Commission has followed the methodology applied in the Opinion and the previous annual Reports.

### **2.1 Economic developments**

The Croatian economy continued to benefit from moderate, though decelerating growth rates, low inflation and exchange rate stability. In 2004, growth of real GDP decelerated to 3.8%, after 4.3% in 2003 and 5.2% in 2002. This downward trend continued in the first quarter of 2005, before economic activity started to pick up during the second quarter. Inflation remained relatively low, although there has been some upward pressure on prices in the second half of 2004 and in early 2005, mainly due to higher energy and food prices as well as higher excises. This led to a slight increase in annual average inflation from 1.8% in 2003 to 2.1% in 2004 and 3.0% in September 2005. A stable exchange rate of the kuna to the euro continued to help stabilising inflation expectations. The unemployment rate has slightly decreased due to a moderate employment growth. The general government deficit declined from 6.3% of GDP in 2003 to 4.9% in 2004 and the general government debt (excluding contingent liabilities) rose from 42.2% of GDP (end-2003) to 44.8% (end-2004) during the same period. The current account deficit in 2004 at 5.3% of GDP was significantly lower than in 2003 (7.4%), mainly due to an improved performance of exports of goods and services. However, only around 53% of the deficit was financed by net inflows of foreign direct investment in 2004, compared to 95% in 2003.

Some further structural reform progress has been made, but the process of enterprise restructuring and privatisation has been delayed. Privatisation of companies under the portfolio of the Privatisation Fund progressed more slowly than earlier envisaged, partly due to a number of lawsuits against the Privatisation Fund, but gained some new momentum in early 2005. The restructuring and privatisation of large public companies and utilities have also advanced relatively slowly. Company registration procedures have started to be simplified in early 2005, but deficiencies in the public administration and judiciary still hamper private sector development, investment and growth. Some important measures were taken in mid-2005 with a view to improve the financial situation of the health and pension system. The largely foreign-owned banking sector is developing rapidly in terms of credit growth and savings deposits, while the capital market is still underdeveloped.

**Croatia - Main economic trends** (as of 7 October 2005)

		2000	2001	2002	2003	2004	2005	
Gross domestic product	ann. % ch	2.9	4.4	5.2	4.3	3.8	3.5	1st half
Private consumption	ann. % ch	4.2	4.5	7.5	4.1	3.9	3.4	1st half
Gross fixed capital formation	ann. % ch	-3.8	7.1	12.0	16.8	4.4	1.9	1st half
Unemployment <sup>1</sup>	%	16.5	16.3	15.2	14.7	14.2	na	
Employment <sup>1</sup>	ann. % ch	4.9	-5.4	4.4	0.1	1.6	na	
Wages	ann. % ch	7.0	1.3	8.7	5.1	6.1	3.8	Jan-Jul
Current account balance	% of GDP	-2.6	-3.7	-8.6	-7.4	-5.3	-7.0	2nd qu. (3)
Direct investment (FDI, net)	% of GDP	5.7	5.9	2.7	6.9	2.6	3.7	2nd qu. (3)
CPI	ann. % ch	4.6	3.7	1.7	1.8	2.1	2.8	Jan-Aug
Interest rate (3 months)	% p.a.	N.A.	N.A.	4.6	5.4	7.3	6.3	Jan-Sep
Bond yield	% p.a.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	
Stock markets	Index	851.4	971.0	1166.8	1128.9	1284.5	1888.6	Jan-Sep
Exchange rate HRK/EUR	Value	7.63	7.48	7.42	7.58	7.50	7.38	Jan-Aug
Nominal eff. exchange rate	Index	101.4	100.0	97.8	94.9	91.7	90.0	1st half
General government balance <sup>2</sup>	% of GDP	N.A.	-6.5	-4.2	-4.6	-5.2	:	
General government debt <sup>2</sup>	% of GDP	N.A.	40.1	39.9	41.5	44.2	:	

(1): LFS data; (2): Fiscal Notification 2004; (3) four-quarter rolling averages

Source: Eurostat, ECOWIN, national sources, own calculations

**Croatia - Main indicators  
of economic structure (2004)**

Population (average)	Million	4.4
GDP per head <sup>1</sup>	€ PPS	10300 f
	% of EU-25 average	46.0 f
Share of agriculture in:		
- gross value added	% of total	8.2
- employment <sup>2</sup>	% of total	15.9
Gross fixed capital formation	% of GDP	27.6
Gross foreign debt of the whole economy	% of GDP	82.1
Exports of goods and services	% of GDP	47.5
Stock of foreign direct investment	Million €	:
	€ per head	:
Employment rate	% of 15-64 age group	54.7
Long-term unemployment rate <sup>2</sup>	% of labour force	6.9

1: rounded; 2: second half of the year; f: forecast;

Source: Eurostat

Average per capita income further increased to an estimated 46% of the EU-25 average (in purchasing power standards) in 2004 while the labour market situation is slightly improving. Although the Croatian economy began its transition to a market economy from a relatively good starting position, further catching up of income and productivity levels reached elsewhere in Europe remains a major challenge. The participation rate in Croatia remained low at 63.2% in the second half of 2004, slightly higher than in the same period in 2003 (62.4%). The employment rate of the working-age population

increased from 53.2% to 54.3%, and the unemployment ratio decreased from 14.4% to 13.8% during the same period. In 2004, almost 50% of all unemployed were long-term unemployed (i.e. for longer than 12 months), down from around 53% a year before. Unemployment rates for men are significantly lower than for women, and persons between 15 and 24 years recorded the highest unemployment rates (almost 30% for men and almost 40% for women). Regional income differences remained high. According to most recent data (2002), the GDP per capita (PPP) of the least developed county (Vukovar-Sirmium) stood at only 33% of the wealthiest county (City of Zagreb) and at 58% of the weighted average of all counties. Regional differences in unemployment follow a similar pattern with the poorest county registering the highest official unemployment rate of 36% and the county of Istria (the second wealthiest in GDP per capita terms) the lowest (11%).

## **2.2 Assessment in terms of the Copenhagen criteria**

### *The existence of a functioning market economy*

The existence of a functioning market economy requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus about economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

There has been continued support for the fundamentals of a market-based economy, but the government needs to allocate more resources to the design, implementation and communication of economic policies. Stability-oriented monetary and exchange rate policies have been continued in 2004 and 2005 and some important structural reforms have been implemented to improve the business environment. However, progress with the restructuring and privatisation of the enterprise sector has been rather slow. The implementation of economic policy reforms has to some extent suffered from different views on appropriate policies within the present coalition government. A new stand-by arrangement was negotiated with the IMF and adopted in August 2004, setting out policies for 2004 and 2005. Its implementation has not been without problems. Agreed measures have been delayed, in turn leading to a significant postponement of the first review under the programme.

Following a last round of discussions with the IMF in early July, during which agreement was reached on a number of policy issues, the first review was successfully concluded in mid-September 2005. In late 2004, the government adopted a proposal of the World Bank for a Country Assistance Strategy for the period 2005-2008 and agreed on the terms and conditions of a first Programmatic Adjustment Loan (PAL) in the context of this strategy. However, the adoption of the first PAL by the World Bank, initially foreseen for end 2004, has been delayed significantly as the Croatian authorities needed more time with a number of required prior actions, including measures related to the restructuring of the railways, public administration reform and a medium-term subsidy reduction plan. The first PAL was eventually adopted in mid-September. Earlier in 2005, it seemed that economic policy making was devoted a more prominent role within the government with the reported setting up of a group of economic advisors attached to the Deputy Prime Minister in charge of economic policy, but the group has apparently not become fully operational and its future impact on the quality of economic policy making still needs to be seen. There continues to be significant scope for improving economic policy coordination within the government and between the government and other public institutions.

In December 2004, the Croatian authorities submitted their first Pre-accession Economic Programme to the Commission which had been prepared by the Ministry of Finance, following consultations of various government institutions. The programme is a comprehensive economic policy document, outlining a fundamentally sound medium-term macroeconomic framework, but it would have benefited from more detailed information on specific fiscal measures and structural reforms to be taken and their respective fiscal effects. In early 2005, Croatia submitted its third National Programme for EU integration, outlining policies in line with PEP.

In the context of continued macroeconomic stability, real GDP growth decelerated to a moderate level due to a slowdown of domestic demand. During 2004, real GDP growth decelerated to 3.8%, down from 4.3% in 2003, due to a slowdown of domestic demand growth from 6% in 2003 to 3.2% in 2004 as a result of tighter monetary policy. The contribution of gross fixed capital formation to growth declined from 4 percentage points to 1.2 percentage point in the same period, also reflecting the gradual termination of some public investment projects. However, the investment-to-GDP ratio remained relatively high at around 27.5%. For the first time since 2000, net external demand posted a positive contribution to GDP growth in 2004 (0.5 percentage points), reflecting a gradually improving performance of exports of goods and services. In the first half of 2005, real GDP growth slightly declined further to 3.5% year on year, as a result of a marked reduction of investment growth as well as lower private consumption and export growth. However, economic activity seemed to have picked up since the second quarter.

*The current account deficit narrowed considerably in 2004 on the back of strong export growth.* The trade deficit shrank by 3 percentage points from 27.4% of GDP in 2003 to 24.3% in 2004, based on strong growth of merchandise exports which soared by around 18%, while imports increased by only around 6%. A lower surplus in the services and transfer balances were to a large extent offset by a considerably lower deficit in the income balance, partly resulting from one-off factors which led to significantly lower net income payments. As a result, the current account deficit shrank from 7.4% in 2003 to a still relatively high level of 5.3% in 2004. In the second quarter of 2005, the current account deficit increased again to 7% of GDP on a four quarter rolling basis. The year 2004 recorded a significant decline in net capital inflows as compared to 2003. In particular, net FDI shrank to 2.4% of GDP from 6.6% in 2003, reflecting exceptional FDI inflows in 2003, a significantly slower pace of privatisation in 2004 and little greenfield investments. Although the surplus in the capital and financial account dropped by 25% compared to 2003, it still more than offset the current account deficit, leading to further reserve accumulation. At the end of June 2005, official reserve assets of the Croatian National Bank stood at a comfortable level of slightly above EUR 7 billion, equivalent to 5.2 months of 2004 imports of goods and services. Gross external debt in EUR terms jumped from 77.6% of GDP at end-2003 to 82.1% at end-2004, largely due to strong commercial bank borrowing from abroad and partly a result of statistical adjustments in 2004. In the first half of 2005, the external debt-to-GDP ratio has stabilised at around 83%, supported by a shift of government borrowing from external to domestic markets.

*Unemployment remains high and employment growth seems having declined recently.* High unemployment remains one of the most pressing problems of the Croatian economy, although the situation on the labour market improved slightly in 2004. The officially registered unemployment rate fell from 19.5% in 2003 to 18.2% in 2004, but stood at 18.6 on average in the first half of 2005, slightly higher than the ratio in the same period a year ago. The official number of persons in paid employment increased by 2.7% in 2004, but the first half of 2005 has hardly seen any employment growth compared to 2004. However, pension fund statistics suggest a 1% increase in official employment in the first six months of 2005. According to the Labour Force Survey, which is conducted twice a year, the unemployment rate dropped to 13.8% in the second half of 2004, from

14.4% in the second half of 2003. Total employment increased by 1.7% in 2004 and job creation was particularly strong in the private sector. This may have partly been the result of 2003 labour market reforms that came into force in early 2004 and were aimed at relaxing the strict Croatian employment protection legislation. There is no evidence so far on the impact of various active labour market policy schemes, including employment subsidies, on employment creation. A relatively slow pace of enterprise restructuring and implicit labour shedding may have prevented higher unemployment to emerge so far.

*Inflation has remained low, but it has slightly risen since late 2004.* Average CPI inflation increased slightly to 2.1% in 2004 from 1.8% a year before. However, due to increased prices of energy and transport, it accelerated significantly in the second half of the year, leading to an end-of-year inflation of 2.7% in December 2004 (from 1.7% in December 2003). End-of-period inflation increased further to 3.8% in September 2005, following a strong rise of oil and food prices. The overall year-on-year growth of administered prices increased significantly by 5.5% in December 2004 from 0.7% a year before, particularly as a result of higher energy prices. Inflation excluding administered prices was 1.8%.

*Monetary policy in Croatia has continued to be geared towards price and exchange rate stability.* The general policy framework, described as a “managed float”, has not changed. The primary policy objective continued to be price stability. The exchange rate has traditionally been used as a stabilisation anchor, following periods of high and hyperinflation in the early 1990ies. The scope for larger exchange rate flexibility is constrained against the background of a highly euroised economy with a significant share of bank loans and deposits denominated in foreign exchange. However, as borrowers, in particular private households, are often not in a position to hedge foreign exchange risks, the Croatian banking sector is faced with significant credit risks. Against this background, exchange rate stability remained an important intermediate policy objective in the context of monetary policy.

The main instrument of monetary policy continued to be interventions in the foreign exchange market through auctions. Interventions have not been carried out to defend a pre-announced exchange rate or exchange rate band, but to smooth short-term exchange rate fluctuations. Towards the end of 2004, the central bank repeatedly bought foreign exchange to alleviate appreciation pressures resulting from capital inflows. In the context of a continued and strong increase of foreign debt, the Central Bank took also administrative measures aimed at discouraging commercial banks from foreign borrowing. In July 2004, it introduced marginal reserve requirements on commercial banks’ foreign liabilities, which were subsequently increased in February and May 2005. In order to absorb domestic currency liquidity, the central bank increased the share of obligatory reserve requirements to be held in Kuna from 42% to 50% in May 2005. Since April 2005, the central bank became active in open market operations, including repurchase agreements, reverse repos, and direct purchase and sale of securities with a view to fine-tuning liquidity and smoothing short term interest rate fluctuations. However, commercial banks did initially not show much interest and preferred to borrow at lower rates on the inter-bank market. In early 2005, the central bank reduced the share of liquid foreign exchange assets that commercial banks need to hold as a percentage of their foreign exchange liabilities (from 35 to 32%). With this one-off measure the central bank released foreign exchange liquidity that was used to pay back official foreign exchange debt and thus supported a shift of government borrowing to domestic financing. During four quarters starting in the second quarter of 2004, the average monthly Kuna exchange rate to the EUR fluctuated within a margin of 1.4% of the average rate.

The budget deficit was reduced in 2004, but higher than targeted, and further fiscal consolidation remains an important challenge. The 2004 general government deficit declined to 4.9% of GDP, down from 6.3% a year earlier, as compared to a deficit of 4.5% of GDP, targeted under the current IMF programme and officially announced in the first Croatian Pre-Accession Economic Programme. The difference was due in part to some expected one-off revenues from dividend payments which could not be realised in 2004. Moreover, revenues from indirect taxes (VAT, excises) turned out to be significantly lower towards the end of the year as compared to budget plans. Public spending has been broadly in line with the 2004 budget, however payment arrears accumulated further, in particular in the health care system, raising the deficit by almost 0.2 percentage points.

Until 2004, fiscal reporting was based on the accounting standards GFS 1986, before the government introduced GFS 2001 (which is broadly compatible with the European Standard of Accounts ESA 95), also as a basis for the first pre-accession fiscal notification for candidate countries submitted in March 2005. According to the fiscal notification, the general government deficit was almost exclusively generated by the consolidated central government, including various extra-budgetary funds and government agencies, while the local governments continued to remain broadly balanced. Social security funds have to a large extent been financed through central government transfers. Spending ratios on pensions and health care continued to be relatively high in 2004 at 12.7% and 8.5% of GDP, respectively. The authorities have repeatedly announced their intention to reduce the share of social spending to more sustainable levels and have implemented some measures to restore expenditure control in the health system, including the introduction of administrative fees for medical services in July 2005. However, a more comprehensive reform of health financing that includes among else an increase of co-payments, a reduction of exemptions, a shift of the supplemental private health insurance to the private market, as well as a revision of the basic health care package has been significantly delayed, but is foreseen to be adopted in late 2005. Also in July 2005, the government adopted a change in the pension indexation formula to restore the fiscal sustainability of the pension system and reduced housing subsidies. The government also decided on a settlement of state obligations towards pensioners resulting from a 1998 Constitutional Court decision, the fiscal and macroeconomic impact of which remained unclear.

Public finance reforms with a view to enhancing transparency and accountability have continued, but internal audit and financial control functions are still relatively weak and public debt management continued to be exposed to a 'key person' risk. In July, a revised 2005 budget was adopted by Parliament. It foresees a higher than originally planned general government deficit of 4.2% of GDP (instead of 3.7%), mainly explained by lower revenues resulting from lower growth and some overspending in the first quarter of 2005, when the deficit had already reached 80% of the initial annual deficit target. The stock of public debt continued to increase from 42.2% of GDP at end-2003 to 44.8% at end-2004; it has been slightly reduced to 44.1% by end-May 2005. This does not include contingent liabilities of around 8.5% of GDP.

The macroeconomic policy mix has been broadly adequate, but fiscal consolidation needs to be further strengthened and backed by concrete cost saving measures. As the scope for monetary policy discretion is rather constrained due to the high degree of currency substitution, fiscal policy remains the prime instrument for macroeconomic adjustment and stabilisation. Evolving imbalances in the form of a significant current account deficit and rising external debt are a reflection of a savings investment gap of the Croatian economy, to a large extent generated by public finances. Indeed, continued fiscal consolidation and discipline has been repeatedly announced as the core element of the medium-term economic policy strategy of the government. Although the start of

fiscal consolidation in 2004 and the marked reduction of the fiscal deficit have been conducive to addressing macroeconomic imbalance by reducing the economy's demand for foreign savings, it appears that fiscal consolidation needs to be further strengthened to stabilise and eventually reduce the external debt-to-GDP ratio. In 2004, real wages have continued to rise, although to a lesser extent than in the previous year and by significantly lower growth rates in the public than in the private sector. But overall labour costs, adjusted for changes in productivity, increased further as average real gross wages grew stronger than average productivity levels.

*Price liberalisation is advanced and administrative pricing continues to play a minor role for some public services.* Prices for railway and ferry passenger transport, postal services, central heating, water and gas supply, urban sanitation as well as public local transport are administered or regulated. The share of administered prices in the consumer price index came down from 23% in 2003 to 22.6% in 2004, before it slightly increased again to 23.1% in 2005, due to a change in weights within the consumer basket. In August 2004, administered price controls for logs and stack of logs were abolished. Administered prices increased by 5.5% year-on-year, mainly due to higher energy prices and new and higher fees for public services (highway toll, new fee for wastewater treatment).

*Private ownership in the productive sector remains at fairly low levels.* According to the labour force survey, the percentage share of all employees with a labour contract working in the private sector has slightly increased from 65.3% in 2003 to 66.2% in 2004. The private sector's share in gross value added remains to be relatively low at an estimated 60%, reflecting a still dominant position of the state in the productive sector of the Croatian economy, in particular in the agricultural, tourism and shipbuilding sector. According to official data, the share of agricultural land in private hands remained at around 68%. The share of private ownership in housing is estimated at above 80%.

*Progress with privatisation has been slow, but gained some new momentum since early 2005.* The initial objective to sell all minority stakes of the Privatisation Fund by end-2004 and all companies with majority ownership by mid-2005 has not been implemented. Institutional and legal problems have generally delayed the entire privatisation process. Legal problems led to a temporary blockage of the accounts of the Privatisation Fund and to a virtual stalemate for a protracted period in 2004. A lack of investor's interest has apparently also prevented a more rapid progress in some cases. New impetus was expected from the appointment of a new supervisory Board of the Fund in September 2004. Privatisation regained some momentum in early 2005 with the privatisation of three agricultural and food processing companies as well as the successful completion of the tendering of a major tourist resort that had been dragging on for some time. A total of 25 privatisation tenders were launched in 2004 and 14 companies were sold. In the first five months of 2005, 14 companies were tendered and 10 were sold. As a result, the total value of state-owned assets under the responsibility of the Privatisation Fund declined by 3% in 2004, while it shrank by 13% in the first half of 2005. Contrary to earlier announcements, the preparation of a privatisation plan for the biggest insurance company has been delayed due to unresolved issues with former owners, and prospects for its privatisation remained uncertain. The speedier process of privatisation of public companies has also been hampered by the reservations for denationalisation and the intention of the authorities to accommodate interests and claims from employees, pensioners as well as war veterans to retain existing and obtain further equity stakes in the respective companies. In addition, over the past few months, there have been several cancellations of privatisation transaction, apparently lobbied by vested interests.

Market entry and exit are still hampered by deficiencies in the administration and judiciary, but company registration procedures have started to improve. The number of newly established companies (including self-employed) in the Croatian Register of Business Entities increased by 4.7% in 2004, following a growth of 4.6% in 2003. The share of companies that were eliminated from the register decreased from 1.4% in 2003 to 0.3% in 2004. Thus, the net growth of the number of businesses increased from 3.1% to 4.4% in the same period. While these figures indicate a continued modest growth of new enterprises, market entry has still been hampered by the administrative environment. A total of 12 administrative procedures and 49 days were needed by end-2004 before being able to operate a business, though slightly down from 13 procedures and 50 days a year before. Legislative changes have been adopted with a view to speeding up company registration procedures. A first one-stop shop for company registration was established in Zagreb in May 2005, and others are planned to be set up to further reduce the administrative burden. Average registration time is expected to come down to 16 days in 2005, while the number of procedures has been reduced to five. The registration time has already been reduced to three days for crafts and trades. In spite of these improvements, there is still a widespread perception that starting and running a business is difficult because of complex rules and inefficiencies in administrations and courts. The relatively low share of companies that were deleted from the business register may reflect a continued lack of rigour in market exit procedures, and in particular a continued protection of old enterprises regardless of their profitability as well as lengthy bankruptcy procedures.

*The enforcement of property rights remains hampered by an inefficient judicial system.* Slow and inefficient court proceedings, a poor case management and a still low administrative and professional capacity are factors that discourage parties from taking cases to court, undermining an effective enforcement of creditor and property rights. The number of backlogs of court cases has further increased, in particular with respect to enforcement cases. The government has started to develop and implement measures to enhance the professional quality of the judicial administration, but significant improvements for the business community still requires the design and implementation of an overall strategy for judicial reform. Progress has been made on the reform of land registry. Procedures have been simplified and judges have been replaced by authorised land registry clerks in the land registry offices. The backlog of land registry cases was reduced from around 360.000 in mid-2004 to around 270.000 by end-April 2005. However, the remaining backlog and persisting administrative weaknesses still hamper a vivid development of a real estate market and deter greenfield investments.

*The largely foreign-owned banking sector is well developed and generally sound.* The privatisation and consolidation of the Croatian banking sector was already very well advanced in early 2004. It has traditionally played the most important role in financing the economy. Its assets accounted at the end of 2004 for 83.4% of the entire financial system, or around 111% of GDP, slightly up from the 2003 share. Only two banks (postal bank, Croatia Banka), accounting together for 3.1% of commercial banks assets in 2004, have remained state-owned and are expected to be merged and privatised at a later stage. More than 90% of the total assets of the banking sector are foreign-owned. For the size of the market, the number of banks remains rather high at 38 in March 2005, which has however declined from 41 banks a year before. The degree of concentration in the banking sector is moderate with the five largest banks accounting for a market share of around 73% at end-2004, slightly up from the share a year before. Financial intermediation through banks continued to grow. Total domestic credit increased steadily from 59% of GDP in 2003 to 62% in 2004 and further to 65% by March 2005. Credit to the private sector rose from 54.5% of GDP in 2003 to 57.8% in 2004 and to 59.4 in April 2005. The already rather high private sector share in domestic credit grew further slightly

from 92.4% in 2003 to 93% in 2004. The share of credit to enterprises declined from 43.4% in 2003 to 41.4% in 2004 while the share of credit to households continued to increase, from 48.3% to 50.7 % during the same period. The spread between average deposit and lending rates has come down from 7.4% in 2003 to around 7% in 2004, which may point to increased competition in the Croatian banking sector. The spread has stabilised at that level in 2005. The share of non-performing loans continued to decline from 5.1% in 2003 to 4.5% in 2004.

*The non-banking financial sector has further developed.* There are two stock exchanges in Croatia, the Zagreb and Varaždin stock exchanges. Share trading has shown a moderate upward trend with an increase in stock market capitalisation from 19.2% at end-2003 to 29.8% of GDP at end-2004 and 30.4% in April 2005. Bond market capitalisation has also increased from around 7% in 2003 to 12% in 2004 and further to 12.4% by April 2005. Non-banking financial assets continued to grow rapidly from 20.4% of GDP at the end of 2003 to 24.6% at end-2004 and their share in total financial sector assets rose from 16.8% to 18.4% in the same period. The entry of pension funds as large institutional investors has supported the development of the Croatian capital market. Total net assets of four compulsory and 13 voluntary pension funds accounted for 3.9% of GDP at end-2004, up from 2.4% a year before. A total of 24 insurance companies and 1 reinsurance company operated in the country. Their total assets amounted to 7% of GDP at end-2004, slightly higher than at end-2003. Gross insurance premiums collected in 2004 increased slightly to 3.2% of GDP, up from 3.1% a year before. Premiums on life insurance increased stronger (by 16%) than premiums on non-life insurance (7%). The largest insurance company, which is still in majority state ownership, accounted for over 40% of the gross premiums in 2003 (51% of premiums of all non-life and 15% of premiums of all life insurance).

*Supervision of the financial sector has improved and its further strengthening is under preparation.* The Croatian National Bank started to take preparatory measures with a view to implementing the new capital requirements framework based on Basel II. To this effect, a project team was established and tasked with the preparation of necessary regulations. A deposit insurance act was amended in December 2004. As the large majority of banks are in foreign ownership, the supervisory authority has intensified cooperation with home supervisors of those foreign banks. Moreover, a new cooperation agreement between the Croatian National Bank and the Competition Agency was concluded to ensure effective competition in the banking and financial services sector. In October 2004, the Croatian authorities decided to merge the three existing non-banking supervisory institutions into a single independent agency and work on the necessary legislation has started.

#### *The capacity to cope with competitive pressure and market forces within the Union*

The ability to fulfil this criterion depends on the existence of a market economy and a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also requires a sufficient amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union before accession. Both the volume and the range of products traded with EU Member States provide evidence of this.

*Croatia has achieved a considerable degree of macroeconomic stability.* Continued low inflation and a high degree of exchange rate stability have supported the working of market mechanisms. Inflation expectations have been stabilised and economic agents have been able to make decision in a climate of predictability. However, fiscal and external imbalances continued to imply potential risks to macroeconomic stability and need therefore be addressed vigorously.

*Further efforts are needed to increase the efficiency and quality of the education system.* In general, Croatia's overall educational attainment rate is low and many adults have outdated skills. Despite a recent increase of the participation rate, the economy has continued to suffer from a relatively high share of inactive population and very high level of youth unemployment (over 30%), which may signal important skills mismatches. The percentage of the population aged 20 to 24 which completed at least upper secondary school is rather high and has increased in recent years (from 90.7% in 2003 to 92.5% in 2004). The percentage of early school leavers is relatively low and has declined in 2004 (from 8.4% to 6.2). This may suggest a positive development with respect to the level of education of the working age population. However, the Croatian education system still suffers from a number of shortcomings, such as outdated curricula at all educational levels and in particular in VET, inappropriate financing systems, poorly equipped schools and a relatively low average number of total school years.

*The Croatian economy continued to benefit from relatively high investment ratios, while net FDI inflows have slowed.* The ratio of gross fixed capital formation to GDP has remained relatively high at 27% in 2004, also as a result of strong public investment in transport infrastructure. The share of general government gross fixed capital formation in GDP was 6.8% in 2004, slightly up from 6.7% a year before. In 2004, net inflows of foreign direct investment (FDI) had a less important role in private capital formation due to slowdown of the privatisation process. Net FDI inflows were significantly lower at 2.2% of GDP, as compared to 6.5% of GDP in 2003. The financial sector accounts for the largest share of cumulative FDI inflows (24%), followed by manufacturing (22%) and telecommunication (15%). Recent trends in 2004 show a considerable increase in the share of FDI in retail and wholesale businesses, also reflecting a relatively slow pace of privatisation and restructuring in industry. Significant public investment in road infrastructure has continued and the length of the motorway transport network has increased by 100 kilometres to 700 kilometres. No major investments have taken place to improve the existing railway infrastructure and the total length of the rail network has not changed. Total spending on research and development has been relatively high over the previous years. In 2003, it accounted for around 1.1% of GDP, almost the same relative level as in 2002.

*Progress has been made in liberalising the telecommunication market with positive effects on the infrastructure development.* A new and independent regulatory authority was set up in September 2004. With a view to increase competition in the telecom market, the fees for obtaining fixed line licences were reduced radically, which led a number of companies to submit applications. A total of ten new licences have been awarded and two private operators became operational in Spring 2005, putting an end to the monopoly of Croatian Telecom. Competition in the market for mobile phone services has also increased through the granting of GSM concessions to three private mobile phone operators in the second half of 2004 and in early 2005. A fourth licence was tendered in May 2005, but the offer was rejected. The number of cellular phone subscriptions rose by 12% in 2004, and the mobile penetration rate rose from 56% in April 2004 to 64% at end-2004.

*The restructuring and privatisation of large state-owned companies and public utilities has made only limited progress.* The strengthening of financial discipline of state-owned

enterprises remains a particular economic policy challenge, as some of them continued to incur significant losses, in particular the shipbuilding industry and the railway system. The preparation a comprehensive restructuring strategy for the Croatian shipbuilding sector, comprising of five major shipyards, has been further delayed. The privatisation of the shipyard Uljanik has not yet been initiated. With respect to the restructuring of the loss-making Croatian railway system, some important measures have been taken in mid-2005, including staff retrenchment and the preparation of the privatisation of three railway subsidiaries by end-2005. The authorities have delayed the preparation of a comprehensive restructuring plan for the country's steel sector. The withdrawal of a particular investor from one of the two steel plants has further undermined restructuring progress. The second phase of privatisation of the oil company INA, which involves a further 15% stake and was initially foreseen to take place in May 2004, was repeatedly postponed and a new deadline was eventually set for end-2005. The preparation of a restructuring for the state-owned vertically integrated Electricity Company (HEP) has been delayed. A plan was eventually adopted in April 2005 and a foreign consultant was contracted to undertake restructuring activities. The government has repeatedly announced to keep a majority stake in the company and to distribute some shares to pensioners, war veterans and employees, while 20% of shares are planned to be sold in early 2006. The government has further postponed the next step in the privatisation of Croatian Telecom (HT), which is now expected to happen by end-2005.

*Sectoral change is slowly progressing, against the background of an already strong service sector.* The agricultural sector's share of gross value added further declined from 8.4% in 2003 to 8.2% in 2004. While the share of industry (including construction) remained at about 30%, services continued to expand slightly from 61.5% to 61.6% in the same period. According to the Labour Force Survey, the share of employment in agriculture decreased from 16.5% in 2003 to 16.2% in 2004, the share of industry declined from 30% to 29%, and the share of services increased further from 53.1% to 53.5%.

Small and medium-sized enterprises (SMEs) still have to cope with a difficult business environment, despite policy initiatives to support them. The support of a growing SME sector is an important priority of the government's medium-term economic policy strategy in Croatia. In 2004, SMEs accounted for 99.5% of the total number of firms and 60% of employment and their share in GVA has further increased to an estimated 45%. In May 2004, the government adopted the Incentive Programme 2004-2008, which aims to remove administrative obstacles, to reduce the tax burden and to develop up to 400 inter-firm networks and zones. An agency for small businesses, established in 2003, provides consultancy services and financial support to small businesses. However, despite these initiatives, the SME sector continues to be confronted with inefficiencies in the administrative and judicial system as well as difficult, though gradually improving, access to longer term finance, information and management skills. An inefficient land registry and cadastre system continued to be an impediment to a more dynamic SME development and seem to have deterred the entry of new firms.

*State intervention in the productive sector remains significant, partly hampering a more vivid private investment.* According to official data, the importance of state aid schemes has increased and the share of total state aid has continuously risen from 2.8% of GDP in 2002, to 3.2% in 2003 and 3.4% in 2004. Around two thirds of state aid is being provided to the enterprise and service sector. A large part of this support is granted to specific sectors, such as the shipyards, the railways and tourism, while horizontal aid accounts for only a minor share of state aid. In the context of the Pre-Accession Economic Programme 2004, the government announced its intention to reduce subsidies to the enterprise sector significantly over the next few years. It appears that work on a subsidy reduction plan has continued but not yet finalised due to uncertainties about the

magnitude of future state aid related to the restructuring of shipyards. Work on the setting up of a state aid inventory has not yet been completed and a comprehensive and detailed overview of current state support schemes is still missing. Furthermore, it appears that efforts undertaken by the Competition Agency to enhance transparency and enforcement of state aid policy have occasionally been undermined by various line ministries.

*Trade integration of the Croatian economy is fairly high and regional integration has improved.* Croatia is an open economy and its trade has been liberalised to a large extent, the country being a member of the WTO and having signed a number of bilateral Free Trade Agreements, notably with neighbouring countries. The share of imports of goods and services in GDP decreased from 59.5% to 58.7% while the share of exports went up from 51.8% to 52%. Croatia's most important export revenues continued to be tourism, although balance-of payments-data suggest that its share in GDP declined slightly in 2004 to 20.6% of GDP from 22.3% in 2003. The EU continued to be the most important destination for Croatian exports, in particular Italy, Germany, Austria and Slovenia, although the share of merchandise exports to the EU declined from 66.93% in 2003 to 64.67% in 2004.

Outside the EU, the neighbouring countries of the Western Balkans, Russia and the US are the most important clients with increasing export shares (except for the US). On the import side, the share of the EU declined from 72.0% to 69.5%, while the share of imports from the Western Balkans (2.7% to 3.7%) and Russia (4.8% to 7.2%) increased significantly, the latter reflecting a higher value of oil imports. Merchandise exports to the EU consist mainly of machinery, textiles, transport equipment and agricultural as well as chemical products. There has been a clear trend towards intra-industrial trade. The share of low-value-added exports in textiles and agriculture has significantly declined in 2004, while the share of exports of manufactured goods of machinery and transport equipment has increased by more than 10 percentage points. Manufactured goods (in particular transport equipment and machinery) continued to account for a significant share of 80% of imports from the EU.

A real effective exchange rate appreciation and rising real unit labour costs have slightly eroded Croatia's price competitiveness. The Croatian Kuna continued to appreciate by 4% in 2004 in real effective terms, measured on the basis of consumer price developments. Real unit labour costs increased by around 2 % in 2004 compared to 2003, as real wage growth (4.2%) was higher than the growth of average labour productivity (2.2%) as derived from labour force survey data.

### **2.3 General evaluation**

As regards the **economic criteria**, Croatia can be regarded as a functioning market economy. It should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that it continues implementing its reform programme to remove remaining weaknesses. The political consensus on the fundamentals of a market-based economy appears to have remained. Stability-oriented macroeconomic policies have contributed to a relatively low inflation and stable exchange rate. Significant budget and current account deficits have been reduced and some measures have been taken to enhance expenditure control in health care and in the pension system. The privatisation process has regained some momentum in 2005 and business and land registration procedures have been simplified. The banking sector has continued to grow and supervision has been further strengthened. Road infrastructure has improved due to strong investment in the motorway network. Progress has been made in liberalising the telecommunication sector with positive effects on infrastructure development, following the entry of private service providers. Important initial steps

have been taken to restructure the loss-making railway system. Croatia's economy is already well integrated with that of the EU and regional trade integration has strengthened.

However, significant external and fiscal imbalances imply potential risks to macroeconomic stability. Therefore, fiscal consolidation needs to be further strengthened and effectively backed by structural measures, in particular in the area of subsidies and social transfers. The development of a more vivid private sector and foreign direct investment has been hampered by complex rules and deficiencies in public administration and courts as well as by slow market entry and exit procedures. The enforcement of property and creditor rights continues to be undermined by an inefficient judiciary. State interventions in the economy remain significant and little progress has been made with respect to the restructuring of large state-owned enterprises, in particular in the shipbuilding, steel and energy sector. The strengthening of financial discipline of state-owned enterprises remains a particular economic policy challenge. In order to enhance its competitiveness and to improve the prospects for sustained investment and growth, Croatia needs to address the identified weaknesses and problems with determination.

### 3. Ability to assume the obligations of membership

This section examines Croatia's ability to assume the obligations of membership – that is, the *acquis* as expressed in the Treaties, the secondary legislation, and the policies of the Union. It is structured in accordance with the list of the 33 of the 35 *acquis* chapters which are negotiated.

Alongside an evaluation of relevant developments since the 2004 report, the section gives an overall assessment of Croatia's ability to assume the obligations of membership, and of what remains to be done. Where appropriate, it also reviews the fulfilment of Croatia's obligations under the Stabilisation and Association Agreement.

This section also incorporates an assessment of Croatia's administrative capacity to implement the *acquis* in its various aspects. In all areas of the *acquis*, Croatia must bring its institutions, management capacity and administrative and judicial systems up to EU standards, both at national and regional level, with a view to implementing the *acquis* effectively and, if necessary, in good time before accession. At the general level, this requires a well-functioning and stable public administration built on an efficient and impartial civil service, and an independent and efficient judicial system.

In the 2004 report, the Commission found that:

*“Croatia has made significant efforts to align its legislation with the *acquis*, particularly in areas related to Internal Market and trade. These efforts need to be continued vigorously. Administrative capacity is uneven and enforcement of legislation needs to be improved. Croatia needs to continue legislative alignment while at the same time strengthening administrative and judicial structures that are necessary for the effective implementation and enforcement of the *acquis*.”*

#### 3.1 Chapters of the *acquis*

This section opens with an assessment of progress relating to the cornerstones of the internal market which are known as the “four freedoms”, and continues with a systematic review of progress on each of the chapters, covering all aspects of the *acquis*, including sectoral policies, economic and fiscal affairs, regional policy, environment, the area of justice, freedom and security, external policies and financial questions.

##### *Chapter 1: Free movement of goods*

The principle of the free movement of goods implies that products must be traded freely from one part of the Union to another. In a number of sectors this general principle is complemented by a harmonised regulatory framework, following the “old approach” (imposing precise product specifications) or the “new approach” (imposing general product requirements). The harmonised European product legislation, which needs to be transposed, represents the largest part of the *acquis* under this chapter. In addition, sufficient administrative capacity is essential to notify restrictions on trade and to apply horizontal and procedural measures in areas such as standardisation, conformity assessment, accreditation, metrology and market surveillance.

Croatia has made some progress in the field of free movement of goods.

No progress was made as regards alignment on **general principles**. Croatia needs to make sure that its legislation is compatible with Articles 28–30 of the EC Treaty and related jurisprudence of the European Court of Justice. Existing measures that seem incompatible include import licences, advertising campaigns in favour of Croatian-made products, mandatory storage facilities, and compulsory country of origin labelling under

the Consumer Protection Act. In addition, most of the legislation does not include provisions enabling mutual recognition.

As regards **horizontal measures**, governmental decrees issued in October 2004 provide a legislative basis for separation of the regulatory, accreditation, standardisation and metrology functions previously fulfilled by the State Office for Standardisation and Metrology (DZNM). The decrees notably included the foundation in February 2005 of a State Office for Metrology (DZM) as a new Governmental body. They also provided for two new public institutions, the Croatian Standards Institute (HZN) and the Croatian Accreditation Agency (HAA), which started operations in July after their registration at the court and the approval of their statutes. The number of staff transferred from the former DZNM was 30 and 8 respectively for standardisation and accreditation. The Ministry of Finance has approved the employment plans for HZN and HAA, according to which those staff figures would be brought to 50 and 20 by the end of 2007. The DZNM role in European organisations was transferred to these two new bodies, as were the 172 technical committees and 226 subcommittees and working groups involved in standardisation.

As regards *standardisation*, DZNM had transposed 6,969 harmonised European standards (ENs) by mid-February 2005.

In the area of *accreditation* HAA submitted its application for full membership in the European Cooperation for Accreditation (EA) in August 2005. The total number of bodies accredited by June 2005 was 52.

Concerning *conformity assessment*, no particular progress can be reported on the creation of a network of independent certifying bodies and laboratories.

As regards *metrology*, the newly created DZM joined European Collaboration in Measurement Standards (EUROMET) as a full member in May 2005.

Regarding *market surveillance*, the State Inspectorate has defined in coordination with all the relevant authorities a market surveillance strategy in the field of technical products as well as a training needs analysis for market inspectors.

Overall, Croatia has established in the area of horizontal measures some key bases for harmonising its structures with the EU legislation. However, legal efforts should be matched by stable and adequate implementation to enable Croatian institutions to become full members of the relevant European organisations. For example, directors and board members of the newly created bodies for standardisation and accreditation were appointed only on a temporary basis in March 2005. As regards metrology, amendments to the primary legislation will be necessary to establish a Croatian Metrology Institute to deal with scientific and technical metrology. The Standards Institute still has to recruit members following a call for membership launched in September. Conformity assessment bodies still need to be upgraded in order to be designated and notified in accordance with EU criteria. Market surveillance is not yet operational.

As regards sectors covered by the **old approach product legislation**, between August and December 2004 Croatia adopted a set of 17 ordinances aimed at transposing 47 of the motor vehicle type-approval directives. Further implementing legislation was passed during the first half of 2005, which are meant to transpose 10 further directives in this area.

Regarding pharmaceuticals, during the first half of 2005, 13 different ordinances were adopted, with the aim of transposing parts of the 2001 code on medicinal products for human use and of the directives on good laboratory practice and good manufacturing practice. Protection of regulatory data has been introduced, albeit for a six-year term where the *acquis* provides for a ten-year term. For drugs already registered in EU

Member States, a new regulation was adopted in June 2004 which simplifies the marketing authorisation procedure. However, reimbursement decisions and pricing procedures are still not transparent and impartial enough.

Amendments to the chemicals act entered into force in July 2005. This revised act will provide a legal basis for transposition of part of the chemicals *acquis*.

A law on classification of woods in the rough was adopted in December 2004 by Parliament, and an ordinance was issued in April 2005, aiming at transposing the wood classification directive.

Overall transposition and implementation of old approach legislation remains limited to parts of the *acquis* on motor vehicles, pharmaceuticals, and wood classification. Further progress is needed in the areas of chemicals, cosmetics, legal metrology, textile and footwear labelling, crystal glass, and the remaining motor vehicles and pharmaceuticals directives.

As regards **new and global approach product legislation**, an implementation programme for the adoption of technical regulations with a view to harmonising them with the new approach *acquis* was adopted by the government in August 2004. However it merely defines which institution/ministry is responsible for transposing which directive, and lacks coordination mechanisms, timetables, impact analysis arrangements and an investment needs analysis for laboratories.

Implementing legislation aiming at alignment was adopted in December 2004 on non-automatic weighing instruments, on radio and telecommunications terminal equipment, and on electromagnetic compatibility. In February 2005 implementing legislation on recreational craft was adopted. Parliament adopted an act on explosives in December 2004, which is meant to provide a basis for alignment with the *acquis* regarding explosives for civil use. However that legislation, in particular that on electromagnetic compatibility, will need to be amended for full alignment.

Implementing legislation aiming at partial alignment with the *acquis* was adopted in April 2004 and April 2005 on toy safety, in May 2005 on construction products, and in September 2004 on medical devices.. Extensive further amendments are needed to the Croatian legislation on toy safety to achieve full alignment with the *acquis*.

Overall further alignment with the new approach *acquis* will require major efforts. Further amendments to the framework legislation on technical regulations for products and conformity assessment procedures will be necessary in order to fully align the implementing legislation. Transposition and implementation remains to be completed or even started in several sectors.

Concerning **procedural measures**, an ordinance was adopted in March 2004 based on a law adopted in September 2003. It aims at harmonising Croatian legislation with the directive on the *return of cultural objects* unlawfully removed from the territory of EU Member States. Transposition and implementation remains to be started in the other areas.

### *Conclusion*

Regarding the general principles, Croatia needs to make sure that its legislation is compatible with Articles 28-30 of the EC Treaty and related jurisprudence of the European Court of Justice, with special emphasis on the principle of mutual recognition.

Continued efforts are needed to align with the *acquis* regarding horizontal measures. Regulatory, standardisation, accreditation and metrology functions are being separated, albeit incompletely. Further implementing measures and resources are necessary.

Some progress has been made during the reporting period, mainly on horizontal measures and on some sector legislation. Although Croatia has taken first steps to harmonise its national legislation with the *acquis* on the free movement of goods, most elements of the *acquis* are not yet in place. Croatia will have to make considerable and coordinated efforts to align its legislation with the *acquis* and to effectively implement and enforce it.

The framework legislation on technical regulations for products and conformity assessment procedures, which is crucial for progress in the various sectors, still needs to be further harmonised with the *acquis*. Major efforts to transpose sectoral directives will be necessary. Further progress is needed on old approach product legislation. Existing implementing structures must be improved and new implementing structures will also have to be established. Administrative capacity must be reinforced.

Most of the directives laying down procedural measures remain to be implemented.

### ***Chapter 2: Freedom of movement for workers***

The *acquis* under this chapter provides that EU citizens of one Member State have the right to work in another Member State. EU migrant workers must be treated in the same way as national workers in relation to working conditions, social and tax advantages. This *acquis* also includes a mechanism to coordinate national social security provisions for insured persons and their family members moving to another Member State.

Limited progress can be reported in this area.

Concerning **access to the labour market**, in April 2005 the Minister of the Interior adopted a decision establishing a working group to analyse the application of the 2004 Act on foreigners, to bring it further into line with the *acquis*. A number of important adjustments, as outlined in the Opinion, will need to be made to Croatian legislation in order to align it with EU rules on the free movement of workers, mainly as regards non-discrimination against EU migrant workers. This includes the principle that EU citizens will not be subject to a work permit or residence permit regime. The *acquis* pertaining to the rights of family members accompanying EU migrant workers will also have to be implemented: the right of family members to reside in the country, their right to take up employment or self-employment, and the rights of children of Community workers to be admitted to the educational institutions under the same conditions as Croatian nationals. In relation to access to employment, EU citizens may not be discriminated against on the basis of nationality, irrespective of their country of residence. Croatia will also need to pay particular attention to restrictions on access to public sector positions and to legislative requirements on language proficiency.

No progress can be reported on preparations for participation in EURES.

There has been only limited progress as regards the **coordination of social security systems**. Croatia has concluded bilateral social security agreements with 24 countries in total, 15 of which are EU Member States. In the context of these agreements, Croatia has continued to apply the principle of accumulation and transfer of social security rights.

Croatia will have to adopt measures in line with the *acquis*, in particular on supplementary pension rights, in order to cover all supplementary pension schemes, compulsory or voluntary, linked to a person's employment or self-employment, even if, at present, such schemes do not seem to exist in Croatia. While there appears to be adequate knowledge of the mechanisms involved in social security coordination, sufficient administrative capacity needs to be developed to apply Community provisions in this field. Croatia needs the financial stability to meet the extra cost of applying EU provisions, in particular health care provisions. It must also prepare for the introduction of the European Health Insurance Card.

## *Conclusion*

A number of important adjustments will need to be made to Croatian legislation in order to align it with EU rules on access to the labour market, mainly as regards non-discrimination against EU migrant workers.

Mainly technical modifications will therefore be necessary to Croatian legislation in order to take account of the particularities of Croatia's social security system. Moreover, administrative structures will need to be strengthened to coordinate with other social security systems correctly.

### ***Chapter 3: Right of establishment and freedom to provide services***

Member States must ensure that the right of establishment of EU national and legal persons in any Member State and the freedom to provide cross-border services is not hampered by national legislation, subject to the exceptions set out in the Treaty. The *acquis* also harmonises the rules concerning regulated professions to ensure the mutual recognition of qualifications and diplomas between Member States; for certain regulated professions a common minimum training curriculum must be followed in order to have the qualification automatically recognised in an EU Member State. As regards postal services, the *acquis* also aims at opening up the postal services sector to competition in a gradual and controlled way, within a regulatory framework which assures a universal service.

Limited progress has been made in this chapter.

Concerning the **right of establishment**, in March 2005 the government introduced a ministerial decree which applies higher fees to foreign vessels, including those flying the flag of an EU Member State, for entry in the registers of ships, yachts or boats. This difference of treatment raises concerns as to its compatibility with the Stabilisation and Association Agreement and with the general principles of the EC Treaty. A similar concern applies to an amendment in January 2005 of the statutes of the Croatian Bar Association which impedes the establishment of branches and subsidiaries of EU law firms. Overall, Croatia needs to adapt its regulatory framework to ensure that existing barriers are abolished, and to have mechanisms in place to avoid the introduction of new barriers.

As regards **freedom to provide cross-border services**, the Obligations Act was slightly amended in February 2005. The amendments, which will enter into force on 1 January 2006, include provisions meant to align with the *acquis* on self-employed commercial agents. Croatia needs to remove remaining barriers to the provision of cross-border services by EU natural and legal persons. Operators from EU Member States are required to establish a branch or a subsidiary in order to provide services in Croatia on an occasional or temporary basis, and face several restrictive requirements e.g. the need to provide certified translations of documents, the need to obtain a licence for a craft, and the need for both a “manager” and an “authorised representative”.

In the area of postal services, a number of implementing measures pursuant to the Postal Act of 2003 were adopted during the reporting period. Amendments to the Postal Act were adopted in July 2005 which bring the definitions of reserved and universal service closer to those of the directive and amend provisions regarding notifications and procedures. However, courier services are subject to inspection by postal inspectors in accordance with these amendments, even though the amendments do not define courier services as postal services. This raises questions. Limited staff recruitment took place, and ten registrations for the provision of postal services have been notified to the Council, mostly by courier service providers. Overall the legislation needs to be further amended, in particular as regards authorisation and notification procedures and quality of

service, while the operational independence of the Postal Services Council and its interaction with postal inspectors need to be clarified.

As regards **mutual recognition of professional qualifications**, some limited progress has taken place through the setting-up of a centre for academic mobility and recognition of higher education qualifications within the Agency for Science and Higher Education. However, this appears to cover mainly academic recognition, and has limited impact on the recognition of professional qualifications. In general, the Croatian framework only partly meets the *acquis* requirements, especially as regards the recognition procedures and in sectors where directives coordinate training and provide for automatic recognition. A number of clauses on nationality, residence or language should also be repealed or modified in line with the *acquis*.

### *Conclusion*

Limited progress has been achieved in this chapter. The progress made is mainly in specific areas of postal services. The level of alignment remains low in all chapter sectors.

With regard to both the right of establishment and the freedom to provide cross-border services, the Croatian regulatory framework needs to be adapted so as to abolish barriers preventing natural and legal persons from the EU from establishing themselves or from providing services. Effective mechanisms should be put in place in the regulatory process in order to prevent the introduction of new barriers.

In the area of postal services, the legislation should be further amended to align it fully and the operational independence and capacity of the national regulatory agency should be reinforced.

Regarding mutual recognition of professional qualifications, the legislation should still be brought up to standard as regards compliance with the minimum training requirements and the system of recognition of qualifications.

### ***Chapter 4: Free movement of capital***

Member States must remove, with some exceptions, all restrictions on movement of capital both within the EU and between Member States and third countries. The *acquis* also includes rules concerning cross-border payments and the execution of transfer orders concerning securities. The directive on the fight against money laundering and terrorist financing requires banks and other economic operators, particularly when dealing in high-value items and with large cash transactions, to identify customers and report certain transactions. A key requirement to combat financial crime is the creation of effective administrative and enforcement capacity, including co-operation between supervisory, law enforcement and prosecutorial authorities.

Some progress has been made in this chapter.

As regards **capital movements and payments**, further progress has been made in liberalising short-term capital account movements. The Croatian National Bank (HNB) issued decisions in March to liberalise the issuing of securities on the domestic market by non-residents, investment by non-residents in domestic securities and investment funds as well as investment by residents in foreign securities and investment funds. Restrictions remain, however, as regards short-term capital movements. These cover non-resident acquisitions of short-term paper (Treasury and HNB bills), the opening of bank accounts abroad, and operations on domestic accounts by non-residents in excess of certain thresholds. In addition a number of foreign operations of residents must be conducted through authorised intermediaries. Exchange controls on certain short-term operations are retained for precautionary reasons. Important restrictions apply to the acquisition of

real estate by EU persons and companies, while the weaknesses of Croatia's land registration system continues to further hamper investment in this area. In addition, restrictions are applied to investment in specific sectors such as air transport. Investment rules for some institutional investors still favour domestic assets and the government continues to enjoy special rights in certain privatised enterprises.

Progress has been made in the area of **payment systems**. In November 2004, a HNB decision introduced the use of international bank account numbers (IBAN). The HNB adopted a decision in July 2005 which will enter into force in April 2006, with the aim of partly aligning Croatia's legislation with the directive on cross-border credit transfers. Implementing guidelines remain to be adopted.

Regarding the **fight against money laundering**, the Obligations Act was amended slightly in February 2005. The amendments, which will enter into force on 1 January 2006, provide for the abolition of bearer "passbooks". However, in some situations anonymous passbooks in domestic currency are still allowed for Croatian citizens.

In the reporting period, the Financial Intelligence Unit (FIU) recruited an additional number of analysts. However, there is significant staff turnover due to the low salary levels. Guidelines for the use of reporting institutions were produced and an electronic notification system for reporting institutions was established. An inter-ministerial body headed by the Ministry of Finance was established in order to improve coordination in relation to measures to prevent money laundering. The FIU cooperates with several Croatian authorities, including the Croatian Securities Commission and the Directorate for insurance supervision. During the reporting period, some progress was also made in international cooperation. In March 2005, the FIU concluded Memoranda of cooperation with Bosnia and Herzegovina and with Montenegro.

Overall, primary legislation remains to be further amended in order to achieve alignment with the directives, including the Financial Action Task Force, by broadening the scope of activities requiring client identification and reporting and by requiring due diligence in non-face-to-face transactions. As another example the requirements with regard to lawyers, notaries, accountants/auditors and tax advisors appear more limited than in the EU Directives. The enforcement of the anti-money laundering defences needs to be reinforced vigorously. For instance the supervision and monitoring of reporting entities remain insufficient, the resources and powers of the Financial Intelligence Unit, supervisors and law enforcement bodies need to be adequate. The fight against money laundering is seriously hampered by corruption. The enforcement record, in terms of convictions, confiscations, seizures and asset freezes remains limited. While 15 full time staff and several hundred part-time staff deal with this task in the ministries of the Interior, Justice and Finance, only two res judicata convictions were won from 2001-2004, out of 30-40 cases prosecuted per year by the Money Laundering Prosecutor. Coordination between Croatian agencies and with foreign counterparts is also limited. Awareness needs to be increased among members of the banking community and other reporting entities as to what constitutes a money laundering offence.

### *Conclusion*

Some progress has been made in this chapter, in particular as regards financial capital movements. However, alignment remains limited and will require considerable efforts.

Remaining restrictions on capital movements and payments should be abolished, especially on the acquisition of real estate. As regards payment systems, the legislation on cross-border credit transfers should be further aligned and implementation arrangements should be put in place. As regards the fight against money laundering, considerable efforts are needed to align legislation, and to upgrade supervision and enforcement to the level required by the acquis.

## ***Chapter 5: Public procurement***

The *acquis* on public procurement includes general principles of transparency, equal treatment, free competition and non-discrimination. In addition, specific EU rules apply to the coordination of the award of public contracts for works, services and supplies, for traditional contracting entities and for special sectors. The *acquis* also specifies rules on review procedures and the availability of remedies. Specialised implementing bodies are required.

Good progress has been made, essentially as regards approximation of primary legislation with the *acquis* on public contracts.

No particular developments can be reported as regards the compliance with the general principles. While the Croatian public procurement system shares several key concepts with the *acquis*, their practical implementation tends to differ significantly from EU requirements, e.g. regarding the access of EU bidders to Croatian procurement procedures, the procurement activities of defence agencies. Moreover the Concessions Act is not in line with the *acquis* and fails to ensure respect of the general procurement principles.

As regards the **award of public contracts**, in July Parliament adopted amendments to the public procurement act. These are meant to provide a first step towards alignment by removing some of the shortcomings identified in the Opinion. They partially align definitions, as well as the scope and types of procedures, with the *acquis*. They also provide a number of improvements such as enhanced procedural guarantees, and better-defined qualification and award criteria. The Public Procurement Office, (PPO) granted 19 prior approvals during the first five months of 2005 for the use of restricted procedures, and 1 389 for the use of the negotiated procedure by direct dealing. The amendments to the public procurement act have reduced the number of situations in which the PPO's prior approval is necessary, which should allow it to focus its resources on key files and issues. A decree was adopted in August 2005 which reorganises the PPO into three departments with clearly defined missions.

While Croatian law is now partly in line with the *acquis* on the award of public contracts, some important shortcomings remain. In particular, the scope for use of the negotiated procedure is broader than in the *acquis*, and negotiations are still permitted between contracting authorities and actors outside the negotiated procedure. Administrative capacity will need to be strengthened at all levels and coordination between all authorities involved in public procurement will have to be improved. The PPO, which currently employs 13 staff, should be further developed in terms of logistical resources, staff numbers and qualifications in order to be able to efficiently design and implement procurement policy.

Concerning **remedies**, the amendments to the Public Procurement Law adopted in July 2005 have enhanced guarantees. In particular they have widened eligibility for review procedures to all interested parties in line with the remedies directives.

Regarding administrative capacity, the State Commission for the review of public procurement procedures has increased its staff numbers during the reporting period and to 15, and there are plans to recruit more. The State Commission registered 883 appeals during 2004, which represents about 9% of the total number of tenders published in Croatia over this period.

A number of important issues remain to be addressed in the legislation concerning remedies. These include the rights of the parties in procedures before the State review commission. In addition, the bodies involved in the remedies system should also be adequately resourced for proper implementation.

## Conclusion

Progress made during the reporting period has been good, in particular on the award of public contracts where some of the legislative shortcomings have been removed as a first step towards alignment.

An important second legislative step together with implementing measures will be necessary to adopt all the general principles, remove provisions incompatible with the *acquis* on the award of public contracts, and complete the remedies system. In addition detailed rules will need to be enacted in the field of concessions. The administrative capacity of the various bodies will need to be significantly strengthened.

### ***Chapter 6: Company law***

The company law *acquis* includes rules on the formation, registration, merger and division of companies. In the area of financial reporting, the *acquis* specifies rules for the presentation of annual and consolidated accounts, including simplified rules for small- and medium-sized enterprises. The application of International Accounting Standards is mandatory for some public interest entities. In addition, the *acquis* specifies rules for the approval, professional integrity and independence of statutory audits.

Very little progress has been made. However, the level of legislative alignment of company law is already relatively advanced.

In the area of **company law**, amendments to the Court Registry Act were adopted in April 2005. These are meant to speed up the registration procedure and to provide for online availability of documents held by the registry, and for applications to be submitted to the Court register by email.

In terms of administrative capacity, the Croatian administration has launched a project to establish an internet-based one-stop shop to facilitate company registration procedures. However, this involves no changes to the statutory requirements for registering a company and thus no reduction in the total number of steps/forms.. The scope of the service is currently limited to the Financial Agency offices in Zagreb and Split. Company registration in Croatia takes in general between 10 and 20 days.<sup>8</sup> However, additional procedures, including permitting and licensing, require significantly more time. Overall the full transparency of registers should be ensured and the sometimes lengthy procedures should be further reduced.

There were no developments during the reporting period as regards **corporate accounting and auditing**. As regards corporate accounting, a legal basis is still necessary in order to establish the Financial Reporting Council with rule-making powers. While some steps have been taken for the transition to international accounting standards based accounting, corporate compliance with these standards is still not enforced or monitored and companies are subject to various uncoordinated financial reporting obligations.

As regards **auditing**, no developments have been recorded. The regulation and supervision of the audit profession is still lacking; there are some concerns about the issuance of audit licences, which should also provide for free establishment of EU companies.

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<sup>8</sup> See the data presented in the Annual Reports for the European Charter of Small Enterprises, available at [http://europa.eu.int/comm/enterprise/enterprise\\_policy/charter/reports.htm](http://europa.eu.int/comm/enterprise/enterprise_policy/charter/reports.htm).

## *Conclusion*

Progress under this chapter has been limited to procedural improvements regarding company registration. Some further legislative amendments will be needed for full alignment. Significant legislative changes are still required for alignment in the areas of corporate accounting and auditing. Monitoring and enforcement of corporate compliance requires sustained efforts.

## ***Chapter 7: Intellectual property law***

The *acquis* on intellectual property rights specifies harmonised rules for the legal protection of copyright and related rights. Specific provisions apply to the protection of databases, computer programs, semiconductor topographies, satellite broadcasting and cable retransmission. In the field of industrial property rights, the *acquis* sets out harmonised rules for the legal protection of trademarks and designs. Other specific provisions apply for biotechnological inventions, pharmaceuticals and plant protection products. The *acquis* also establishes a Community trademark and Community design. Finally, the *acquis* contains harmonised rules for the enforcement of both copyright and related rights as well as industrial property rights. Adequate implementing mechanisms are required, in particular effective enforcement capacity.

Some progress has taken place.

Implementation capacity in the area of copyright and neighbouring rights expanded in the reporting period. The State Intellectual Property Office (SIPO) has increased its staff by some 15 persons to about 100 employees now. The copyright department now employs 2 staff. In addition, SIPO has developed a robust IT infrastructure, information and communication plan and improved human resource management. As regards the collective management of rights, regulations were issued in June 2004 on the criteria and procedures for authorising collecting societies. On that basis, SIPO issued decisions during the second half of 2004 authorising 4 collective management societies (the Croatian Association for the Protection of Performers' Rights, the Croatian Composers' Society, the Croatian Film Directors' Guild and the Croatian Phonographic Association) to operate in Croatia. These societies are gradually expanding their membership.

Overall, Croatia is a party to the main international instruments in this area and its legislation is largely in line with the *acquis*, although some amendments will be necessary for full alignment. The copyright department of SIPO will need to be further reinforced for proper implementation. Efforts should be continued to ensure that the system of collective management of rights is fully operational.

In the field of **industrial property rights**, the Law Ratifying the Patent Law Treaty and the Patent Regulations have been enacted. Amendments to the Patent Act were adopted in July 2005. As regards trademarks, Croatia acceded to the 1973 Vienna Agreement on the international classification of the figurative elements of marks. An act on patent representatives was adopted in April 2005.

In this field, Croatia's legislation is largely in line with the *acquis* and Croatia is a party to some of the main international instruments. Additional amendments should include biotechnological inventions, and align the timing of the application of the supplementary protection certificate.

Developments regarding regulatory data protection for pharmaceutical products are examined under *Chapter 1: Free movement of goods*.

In terms of administrative capacity, six of SIPO's additional staff mentioned above were allocated to the patent department. This brings the total number of patent examiners employed by SIPO to 14. About 1 200 patent applications were filed in 2004 (a 20%

increase compared to 2003). The backlog of pending patent applications was 2 221 in June 2005, indicating a steady increase from 1 960 in 2004 and 1 721 in 2003. The average time from application to registration of patents is 5 years, while for trademarks and industrial designs it is about 12 months. Overall efforts are needed to simplify procedures and eliminate the backlog of pending applications.

In terms of **enforcement**, Customs have issued 25 temporary suspension measures since the entry into force of the border enforcement regulation at the end of 2003. It has received 15 applications for border measures. In the first half of 2005, nine applications led to border measures, while two ex-officio actions were conducted. No statistics on prosecutions or res judicata convictions (civil/criminal) are available for the reporting period. Overall, effective enforcement remains an important challenge for Croatia. The fight against piracy and counterfeiting requires enforcement officers, prosecutors and judges in sufficient number and with specialist training. It will also necessitate determined involvement and coordination among all relevant public authorities, including ministries, police and customs, State Inspection, and the judiciary.

### *Conclusion*

Progress essentially concerned the incorporation of international instruments on industrial property, and the development of the implementation structures. The legislative framework is already broadly in line with the *acquis* on both copyright and neighbouring rights and industrial property rights, following comprehensive reforms in 2003. Some further amendments will nevertheless be needed.

Efforts should focus on strengthening the enforcement of intellectual and industrial property rights, concerning both the fight against piracy and counterfeiting. This will necessitate resources as well as particular attention and determination, including appropriate backing at political level.

### *Chapter 8: Competition policy*

The competition *acquis* covers both anti-trust and state aid control policies. It includes rules and procedures to fight anti-competitive behaviour by companies (restrictive agreements between undertakings and abuse of dominant position), to scrutinise mergers between undertakings, and to prevent governments from granting state aid which distorts competition in the internal market. Generally, the competition rules are directly applicable in the whole Union, and Member States must co-operate fully with the Commission in enforcing them.

Croatia has made some progress in this area.

In the area of **anti-trust**, including **merger control**, implementing rules for the Competition Act have been adopted, including several block exemption regulations (in the fields of vertical agreements, horizontal agreements, technology transfer, motor vehicles and insurance), a regulation on the notification and assessment of mergers, a regulation on the definition of relevant markets and a regulation on agreements of minor importance. Sector legislation in the fields of telecommunications and energy has been amended to bring the sectors under the jurisdiction of the general competition regime. The Competition Act of 2003 contains the basic rules on restrictive agreements, dominant position and merger control, but important further alignment is still necessary. In addition to the need for general fine-tuning of the provisions, a single competition regime still needs to be created by ensuring that the Competition Act applies to all sectors. The Government's power to overturn decisions on the basis of Article 266 of the General Administrative Procedures Act should cease to be applied.

The Croatian Competition Agency has continued to develop its *administrative capacity* in the field of anti-trust. In addition to the 5 members of its Council, the Agency has increased its staff to 37, of whom 17 are experts working on antitrust and merger issues. Its competences have also been expanded to the sectors of telecommunications and energy. The Competition Agency has benefited from training programmes in 2004 and 2005, including training aimed at administrators and judges and organised in cooperation with the Judicial Academy and the training organised by the European Commission in Brussels. It has also carried out competition advocacy and awareness raising activities and developed a new web site. There is, however, a need to further strengthen capacity as regards staff, budget resources and training, as well as to ensure full independence in decision-making. The judicial system is not functioning satisfactorily in this field, and further development and training of the judiciary in competition matters is necessary.

As regards the anti-trust *enforcement record*, the Competition Agency (together with the Croatian National Bank, for the banking sector) adopted 48 decisions in 2004, including on restrictive agreements (11), abuse of dominant position (2) and merger control (18), but imposing no prohibitions or fines. A number of the decisions (17) were advocacy cases, e.g. commenting on legislation. The enforcement record is still in need of considerable strengthening, including as regards economic and legal assessment. Enforcement efforts should focus more on preventing the most serious distortions of competition, in particular in the field of prohibiting restrictive horizontal agreements and exclusionary abuses of dominant positions. It is also essential to introduce a system a system of fines that is sufficiently deterrent. The liberalisation of the economy and opening up of markets needs to continue, with the active involvement of the Competition Agency.

In the area of **state aid** an ordinance on notification, data collection and maintenance of the State Aid Register, including an amended notification form, was adopted in December 2004. The State Aid Act of 2003 and the State Aid Implementing Regulation represent partial alignment with Community State aid rules, but important further alignment is still necessary. In particular, the current control system is insufficient, since binding decisions are not possible for aid schemes and the Government has the power to overturn decisions on the basis of Article 266 of the General Administrative Procedures Act. There is also a need for general fine-tuning of legislative provisions to increase efficiency of enforcement.

The Competition Agency is developing its *administrative capacity* as Croatia's national State aid monitoring and control authority. The number of expert staff working on State aid issues has been increased to 9 (from 4 in 2004). A number of training activities have been undertaken, in cooperation with external partners. There is a need to further strengthen State aid capacity as regards staff, budget resources and training, and to ensure full independence of decision-making.

The Competition Agency has started to develop a State aid *enforcement record*. In 2004, the Agency concluded 27 State aid cases (decisions and opinions). Whereas most cases resulted in approvals, there was one finding of incompatible aid and 5 findings of conditionally compatible aid. Enforcement is still only in its infancy, and needs to be strengthened considerably, both in relation to its scope and the carrying out of economic and legal assessment. In addition, there is a problem of aid grantors not respecting the notification obligations or providing sufficient cooperation to the Competition Agency, despite several awareness raising measures and seminars which have been organised by the Agency, specifically aimed at educating aid grantors. Under an alignment program of existing aid, a list of existing aid is being completed but work will need to be intensified to meet the alignment deadline of March 2006.

As regards fiscal aid, the Profit Tax Act, Investment Promotion Act and Free Zones Act need to be urgently aligned with State aid rules. Croatia needs to submit a proposal for a regional aid map.

In the shipbuilding sector, viable restructuring plans need to be urgently adopted in order to comply with State aid rules and in view of the importance of the industry in Croatia. As regards the steel sector, Croatia has not fulfilled its obligation under the Stabilisation and Association Agreement (SAA) and the Interim Agreement, to establish a restructuring programme for its steel industry by March 2004 at the latest. The adoption of the necessary restructuring programme has already been considerably delayed and no substantial progress was made in the reporting period. Given the continued State aid provided to both sectors, these programmes need to be urgently adopted in order to comply with State aid rules and with SAA obligations (*see also Chapter 20 – Industry*). A full review of legislation and of other sector-specific aid, including to the textiles and tourism industries, is also needed.

The annual State Aid Report for 2003 was adopted by Croatia in June 2004. The report is based largely on the EU methodology, although the next report will need to be enhanced and based on a complete inventory.

### *Conclusion*

Croatia has continued to make some progress, both as regards anti-trust and State aid, but needs to intensify its efforts. There is a need for important further legislative alignment, strengthening of administrative capacity and more effective enforcement. Special attention is needed in particular as regards State aid to steel and shipbuilding, as well as in the area of fiscal aid.

### ***Chapter 9: Financial services***

The *acquis* in the field of financial services includes rules for the authorisation, operation and supervision of financial institutions in the areas of banking, insurance, supplementary pensions, investment services and securities markets. Financial institutions can operate across the EU in accordance with the ‘home country control’ principle either by establishing branches or by providing services on a cross-border basis.

Limited progress has been made under this chapter.

In the banking sector, the regulatory and supervisory framework has been slightly strengthened by the adoption of several by-laws in the reporting period. Regarding foreign banks, the Croatian National Bank (HNB) adopted in May 2004 a decision concerning the terms and conditions for establishment and operation of their branches in Croatia. This decision lays down a series of restrictive conditions on establishment which are not in line with the *acquis*. Regarding service provision, it provides for the application of the normal conditions of operation stipulated in the Banking Act. A new Deposit Insurance Act was adopted in December 2004, which brought insured deposits up to a value of HRK 100 000 (about EUR 13 333) in full amount. The scheme is managed by the State Agency for Deposit Insurance and Bank Rehabilitation. With regard to enforcement, progress has been made as since the first quarter of 2004 the HNB has been able to conduct on-site supervision and its Banking Supervisory Department has been reorganised.

Overall the current legislation provides a good basis for harmonisation, but further legislative efforts will be necessary. This will require the inclusion of sectors not yet specifically addressed, such as conglomerates, non-bank e-money institutions, and the winding-up of credit institutions. Alignment is also needed as regards savings and loan cooperatives. Some disparities of a more technical nature should also be addressed. The

banking supervision department of the HNB employs 75 staff. Training efforts to develop its administrative capacity should continue, notably for the implementation of the Basel II capital requirements.

In the insurance sector and supplementary pensions, a number of implementing measures entered into force on 1 January 2005, mainly concerning reserve requirements. Their degree of alignment with the *acquis* could not be verified yet. As regards administrative capacity, in October 2004 the government adopted a decision to establish a single supervisory authority for the non-bank financial sector. This Financial Services Authority (FSA) would merge the existing supervisory authorities for the insurance sector (DINADOS), the pensions funds (HAGENA), and securities markets/investment funds (Croatian Securities Commission - CROSEC). The insurance legislation will have to be further amended in order to be in line with the *acquis*. In terms of supervision, the new FSA meant to become the single supervisory authority for the non-bank financial sector does not yet have a legal basis. It should be granted adequate powers, as well as a sufficient number of adequately trained personnel. At present the DINADOS and the CROSEC employ respectively 15 and 27 staff. There is an urgent need to recruit actuaries for insurance supervision, as currently the DINADOS does not include any. A smooth and orderly transition from the old to the new supervisory structures is critical

Concerning investment services and securities markets, CROSEC has reinforced its supervisory and enforcement activities using the reinforced powers granted to it in the 2002 Securities Act. In 2004, its supervision department handled 157 administrative and 31 non-administrative cases. It also issued 53 decisions requiring corrective action to be taken. In addition, it submitted three criminal reports, and 89 offence reports containing 121 offences. During 2004, Croatian courts (mainly misdemeanour courts) issued 91 decisions and judgements based on the CROSEC's reports.

Overall, amendments to the Investment Funds Act will be necessary, together with implementing measures. In terms of supervision, the new FSA should include adequate capacities to supervise this sector alongside the insurance one.

### *Conclusion*

Progress consisted mainly of limited legislative measures in banking and insurance, and in a number of efforts to improve supervision. Alignment in the banking sector appears quite advanced and has continued to progress, although further improvements will be needed. Significant legislative efforts are necessary in the insurance sector as well as in the sector of investment services and securities markets.

Overall the legislation is partially aligned on the *acquis*, and considerable further efforts are needed, especially on legislation and supervision in the sectors of insurance and investment services and securities, and on coordination between all supervision authorities. The establishment of a new integrated supervisory authority for the non-banking sector represents a significant challenge which requires particular attention.

### ***Chapter 10: Information society and media***

The *acquis* includes specific rules on electronic communications, on information society services, in particular electronic commerce and conditional access services, and on audio-visual services. In the field of electronic communications, the *acquis* aims to eliminate obstacles to the effective operation of the internal market in telecommunications services and networks, to promote competition and to safeguard consumer interests in the sector, including universal availability of modern services. As regards audio-visual policy, the *acquis* requires the legislative alignment with the Television without Frontiers Directive, which creates the conditions for the free movement of television broadcasts within the EU. The *acquis* aims to the establishment of a transparent, predictable and effective

regulatory framework for public and private broadcasting in line with European standards. The *acquis* also requires the capacity to participate in the community programmes Media Plus and Media Training.

Good progress has been made under this chapter.

As regards **electronic communications and information technologies**, good progress has been made with the adoption in May 2005 of an amended Law on Telecommunications as well as some secondary legislation which has improved access and interconnection conditions for new entrants in the market and strengthened the regulatory authority.

After several failed attempts, the licence for a third mobile operator was finally granted in February 2005. Also, three UMTS licences have been awarded and 3G services have been launched or are in preparation. Restrictive provisions in privatisation contracts, however, mean that a fourth UMTS frequency licence cannot be granted until 2009. Such restrictive provisions are contrary to the *acquis* as well as to the Stabilisation and Association Agreement with Croatia. With regard to the fixed network, more operators have been licensed and some have become active in the fixed telephony market. Basic market opening rules (carrier selection/carrier pre-selection, number portability, and the reference unbundling offer) entered into force in April 2005, although these are not yet offered in practice. A reference interconnection is available but it includes only offers between a fixed service operator and the incumbent fixed network. In February 2005 licence fees for entering the fixed line market, for Internet service providers and cable television providers were reduced substantially.

For the moment, competition in the telecommunications market is only at an early stage and appears so far to be largely symbolic. Much will depend on the terms and conditions of interconnection agreements with the main incumbent operator, Croatia Telecom (T-HT). In August 2004 Croatia Telecom was designated as a fixed operator with significant market power (SMP). Two mobile operators have also since been similarly designated as having SMP in their market. However, the practical implications of these designations are not yet known as the necessary implementing rules have not yet been adopted.

Although the Telecommunications Agency (TA) was strengthened by the legislative changes made to the Law on Telecommunications in May 2005 and cooperation with the Competition Authority reinforced, the direct appointment of the Director of Services in the Agency by the Minister is a step back from previous arrangements. Moreover, more resources are needed to strengthen the capacity of the TA in particular in the field of economic regulation. In addition, it appears that in practice it has been difficult for the TA to exercise the powers accorded to it by the law and to properly enforce its decisions.

Regarding **information society services**, Croatia has ratified the Council of Europe Convention on Cybercrime and has adopted the Electronic Commerce Act, which partially transposes the *acquis*. Croatia will have to ensure adequate means of supervision in this area and appoint a contact point to cooperate with authorities in other EU Member States. It should take steps to prohibit the production, manufacturing, sale and distribution of pirate smart cards and other devices circumventing the encryption of conditional access services, as well as to ensure adequate sanctions.

There has been limited progress in the area of **audiovisual policy**. A new Media Law adopted in April 2004 goes some way towards meeting the recommendations of the joint Council of Europe/European Commission/OSCE expert mission of February 2004. Only minor issues are now left open in the legislation, e.g. regarding accessibility to public information and disclosure of journalists' sources. However, no progress has been made in following up the joint expert mission's recommendations for changes to the Law on Electronic Media, which regulates the activities of both private and public broadcasters,

and to the Law on Croatian Radio and Television covering the status and activity of the public service broadcaster.

Currently the Law on Electronic Media does not comply with the European Convention on Transfrontier Television and the Television without Frontiers Directive on a number of issues, in particular concerning advertising, “majority rule” of European productions, freedom of reception, and scope for appropriate measures or judicial appeal against decisions of the Council for Electronic Media. Amendments to the Law on Electronic Media as well as the Law on Croatian Radio and Television are also needed to ensure that the procedure for appointing members of the Council for Electronic Media and the Croatian Radio and Television Council respectively guarantees their independence and that safeguards are created against political interference. A broad civil society role in these oversight bodies should also be ensured. Croatia should continue to reinforce the administrative capacity of the Council for Electronic Media.

In order to safeguard the freedom of the press, Croatia will have to ensure that the legislation on defamation reflects European standards (*see also Chapter 23: Judiciary and fundamental rights*).

### *Conclusion*

Good progress has been made in aligning national legislation with the acquis regarding electronic communications. Implementation of the applicable legislation is still in its early phase and needs to be intensified as there appears to be only a limited degree of real competition in the market place. Croatia also needs to ensure that future contracts privatising telecom operators will not contain any restrictive provisions incompatible with Croatia’s national legislation or its commitments vis-à-vis the EU or international organisations. Further amendments to the Law on Telecommunications as well as the strengthening of the Telecommunications Agency are required.

Croatia has made some progress in the area of information society services, but needs to ensure that the rules on electronic commerce and conditional access services are properly implemented.

Regarding audiovisual policy, a number of amendments to the legislative framework created in 2003 remain outstanding. In addition to legislative alignment, attention should be paid to ensuring effective and transparent implementation of the rules and guaranteeing the necessary independence of the regulatory bodies.

### ***Chapter 11: Agriculture and rural development***

The agriculture chapter covers a large number of binding rules, many of which are directly applicable. The proper application of these rules and their effective enforcement and control by an efficient public administration are essential for the functioning of the common agricultural policy (CAP). Running the CAP requires the setting up of management and quality systems such as a paying agency and the integrated administration and control system (IACS), and the capacity to implement rural development measures. Member States must be able to apply the EU legislation on direct farm support schemes and to implement the common market organisations for various agricultural products.

Croatia has made limited progress concerning alignment in the field of agriculture and rural development. Although some progress has been made, the preparatory work for the implementation of the Special pre-Accession Programme for Agriculture and Rural Development (SAPARD), in particular for the accreditation of the SAPARD Agency, is lagging behind the first timetable agreed by the Croatian government in autumn 2004.

Concerning administrative capacity, the Ministry of Agriculture, Forestry and Water Management has increased its staff, which currently numbers 629 employees. Further strengthening, notably with regard to training of staff, is required. Attention will also have to be paid to improving both cooperation between the different departments within the Ministry and management systems.

Concerning land policy and land reform, key challenges for Croatian agricultural reform relate to the need for concentration of properties and incomplete privatisation of state-owned agricultural land. Croatia's farm structure is characterised by many small fragmented farms which are not competitive, and by a large amount of state-owned farmland which remains to be privatised. In April 2005 Croatia amended its legal framework with the intention of improving and accelerating the process of privatising and distributing state-owned agricultural land. Croatia has made significant efforts to update and modernise the cadastre system and the land registry: these efforts, however, have to be continued in order to complete the process of computerisation of the land registry. An additional problem remains the limited access of farmers to credits from commercial banks.

Overall alignment in the area of **horizontal issues** is at an early stage but some progress has been made.

While Croatia has not yet established a *paying agency* consistent with EC requirements, the legal framework for the future paying agency was adopted in February 2005. The Department for Market and Structural Support operating within the Ministry of Agriculture, Forestry and Water Management will become the paying agency in charge of CAP expenditure after accession. The same department will become the Agency responsible for the implementation of SAPARD. Although some progress has been made with regard to the preparatory work for the establishment of this agency, Croatia should make all necessary efforts to avoid further delay in the implementation of SAPARD and the potential impact of such delays on the implementation of the future Instrument for Pre-Accession (IPA).

Only limited progress can be reported concerning the preparation for the *Integrated Administration and Control System (IACS)* as well as for the Land Parcel Identification System. A farm register has been established as part of the control system for agricultural subsidies and contains important information on farmers who are applying for production and income subsidies. The farm register will need to be computerised.

With regard to *trade mechanisms*, a system of import/export licences for agriculture products as existing in the Community is not applied in Croatia.

Concerning *quality policy*, in July 2005 Croatia adopted an ordinance on the designation of origin and geographical indication for food products aimed at alignment with the relevant *acquis*. The certifying and controlling bodies provided for in this act have not yet been approved. Under the previous Croatian legislation nine certificates to protect geographic origin were used.

With regard to *organic farming*, a number of legislative acts are already in force, including the register of organic operators and the technical inspection of organic production. The establishment of a competent authority for the notification of activities as well as of the certifying and controlling bodies is at an early stage.

Preparatory activities for Croatia's participation in the *Farm Accountancy Data Network (FADN)* have been initiated in 2005. Croatia has made some efforts to strengthen the collection and processing of *agricultural statistics* in line with EU standards and methodology. In particular, surveys on agricultural prices have been introduced.

Concerning *direct support schemes*, Croatia broadened its system of income support for non-commercial farmers, which led to an increased number of registrations of such farms.

No developments can be reported in the area of **common market organisations** as far as legislative alignment in the areas of *arable crops*, *sugar* and *fruit and vegetables* is concerned. Regarding *wine and alcohol*, a number of implementing measures were adopted in the wine sector since the adoption of the Croatian Wine Law of 2003. They cover issues such as wine production, designation and protection of geographical indications, wine-growing regions, the national list of recognised wine varieties, testing of must and wine as well as physical and chemical analysis. However, these measures are only partially harmonised with EU regulations and will require further harmonisation, notably with regard to inspection and control. Croatia has made some progress towards the establishment of a vineyard register.

A new system of state incentives for the *milk* and dairy sector has been introduced. The objective is to increase both the size of dairy farms and annual milk production in order to be more competitive. Subsidies are no longer granted to farmers producing less than 6 000 litres per years, thus cutting some 35 000 households off from subsidies.

Concerning *beef*, new rules on the quality of bovine carcasses and half-carcasses entered into force in September 2004 but do not cover the price reporting system. The system of classification of bovine carcasses appears to be in line with EU regulations. An ordinance on *pig* carcasses and half-carcasses was adopted in 2005. No developments can be reported concerning the alignment in the areas of *sheep*, *eggs* and *poultry*.

In the area of **rural development** preparations are at an early stage and limited developments took place.

A Department for sustainable rural development, employing a staff of 14, was set up in 2004 within the Ministry of Agriculture, Forestry and Water Management. While Croatia has officially submitted a draft rural development plan in the SAPARD context, work on devising a consistent and comprehensive approach to rural development in line with EU requirements is still at an early stage.

### *Conclusion*

Croatia has made efforts on setting up an agency to implement the Special pre-Accession Programme for Agriculture and Rural Development (SAPARD), which have to be strengthened so as to ensure it becomes operational according to the timetable agreed by the Croatian Government. Only limited progress can be reported with regard to preparations for the Integrated Administration and Control System (IACS), the management of common market organisations, and rural development activities. Overall, while Croatia has made some efforts, preparations for setting up the basic instruments for managing the Common Agricultural Policy are at an early stage.

The Croatian agricultural sector is still confronted with important structural problems, notably land fragmentation and difficulties with the functioning of the land market. Privatisation of state-owned land has progressed but is not yet complete. Croatia should speed up structural changes concerning land policy, rural development policy and diversification of farm activities in order to promote competitive farms. Due attention should be paid to strengthening administrative and management capacity within the Ministry of Agriculture, Forestry and Water Management.

### ***Chapter 12: Food safety, veterinary and phytosanitary policy***

This chapter covers detailed rules in the area of food safety. The general foodstuffs policy sets hygiene rules for foodstuff production. Furthermore, the *acquis* provides

detailed rules in the veterinary field, which are essential for safeguarding animal health, animal welfare and safety of food of animal origin in the internal market. In the phytosanitary field, EU rules cover issues such as quality of seed, plant protection material, harmful organisms and animal nutrition.

Croatia has made some progress in the area of food safety, veterinary and phytosanitary policy although preparations in this area are still at an early stage.

With regard to **general foodstuffs policy** some progress has been made.

Concerning administrative structures, the Croatian Food Agency started its operational work in January 2005. The Food Agency employs a staff of 13 and its task is to perform risk analysis in the food and feed safety area and to provide information to the public on food safety issues. The Food Act provides for a clear division of responsibilities between the Ministry of Health and Social Welfare and the Ministry for Agriculture, Forestry and Water Management. However, there is no clear overall integrated approach yet to food safety at national level covering the whole food chain. Also the coordination of activities and cooperation between the official bodies involved in the food and feed system is weak. Administrative capacity requires further strengthening, notably by developing management systems and reallocating existing resources to areas such as strategic planning.

Croatia has started the legislative alignment process and, based on the Food Act of 2003, adopted a number of implementing measures notably on general *labelling* of foodstuffs, on food *additives*, on *food contact materials*, on *food for particular nutritional uses*, on *contaminants*, on laboratory conditions required for the testing, control and monitoring of products containing *genetically modified organisms* and on *mineral waters*. In May 2005, Croatia also adopted a law on GMO. Whether these measures comply with the *acquis* remains to be assessed. Transposition of the new EU rules on *hygiene and official control* has not yet started and preparations for Croatia's participation in the Rapid Alert System for Food and Feed are at an early stage.

Croatia has started to make serious efforts in the field of **veterinary policy**.

The *general* legal framework for veterinary policy in Croatia has remained largely unchanged. While Croatia has, in general, adequately functioning veterinary services, they will require strengthening in order to be able to deal with the harmonisation of legislation.

Concerning *transmissible spongiform encephalopathies (TSE) and animal by-products*, Croatia has made efforts to put TSE controls into place and it has also taken important steps to align the relevant rules for imports to the *acquis* in the TSE field. More generally, Croatia has started to transpose the rules concerning the import regime for live animals and animal products. A clear strategy for animal waste treatment and sufficient EU-compliant rendering capacity are needed. A significant development occurred in 2004 when Croatia lifted its far-reaching TSE-related import restrictions to bring them in line with its international obligations.

No developments can be reported as regards *control systems in the internal markets*.

Croatia has taken some steps to put in place a system for the *identification and registration of animals* concerning bovines but it needs to be improved and extended to other animals in order to become fully compliant with EU *acquis*.

As regards *veterinary checks on third country imports and rules for imports*, Croatia has not yet decided on the location of future border inspection posts at land borders. It has provisionally identified three sea ports (Rijeka, Split Ploče) and one airport (Zagreb) as locations for such border inspection posts (BIPs). However, designated BIPs have to be constructed and equipped.

Concerning *animal disease control measures*, in January 2005 Croatia started a new control policy for Classical Swine Fever. This policy now needs to be implemented and its results will have to be assessed. Croatia also adopted other implementing measures, notably with regard to the control and eradication of bluetongue disease and brucellosis.

EU hygiene regulations have not yet been transposed. Concerning rules for placing on the market of food of animal origin (*public health protection*), a large number of agri-food establishments remain to be upgraded to satisfy EU food safety requirements. This will require a comprehensive strategy including timetables as well as considerable investment and a focus on foreseeable problem areas including the structure and layout of establishments. Awareness of EU rules among industry is still low. Some progress can be noted regarding the quality of raw milk delivered to establishments. Laboratories will need to be strengthened.

As regards *common measures*, an implementing measure concerning the monitoring of *zoonoses* was adopted in 2005.

Some developments can be reported in the field of *animal welfare*, where several new implementing regulations have been adopted.

Good progress has been made with regard to **phytosanitary policy**. The legislative framework has been amended with the adoption of two new laws, the Plant Health Act and the Plant Protection Products Act. The Plant Health Act aims at harmonisation with the *acquis* concerning the protection against harmful organisms. The Plant Health Act and the Plant Protection Products Act will apply as of January 2006 and 2007, respectively, as the necessary implementing legislation has not yet been adopted. On the basis of the Act on Seeds, Planting Material and Registration of Varieties of Agricultural Plants of 1997, a number of implementing measures in the field of *quality seeds and propagating material* were adopted. The compliance of Croatian legislation in the phytosanitary sector with the *acquis* will need to be assessed.

In the area of *plant health*, during 2004 and 2005, the Croatian phytosanitary inspection started to conduct the first systematic surveys for certain *harmful organisms*. The Plant Protection Institute remains responsible for diagnostic and laboratory work related to harmful organisms and its laboratory infrastructure will require significant upgrading. More generally, the administrative capacity of the phytosanitary services requires strengthening, including the establishment of IT links between the Plant Protection Institute, the phytosanitary inspectorate at border posts and the central administration in Zagreb.

### *Conclusion*

Some progress has been achieved by Croatia. A food agency has been established and started work. Concerning veterinary issues, Croatia has taken important steps to align the relevant rules for imports to the *acquis* in the TSE field and started to apply a new control policy for Classical Swine Fever. Also two important framework laws in the phytosanitary field were adopted.

However, in overall terms preparations in this sector are still at an early stage. Croatia will need to develop a comprehensive strategy for food safety, veterinary and phytosanitary policy, outlining a timetable for the transposition of the *acquis* in this area, and a plan for strengthening the various official bodies involved, as well as improved coordination between them. This strategy should also cover upgrading agri-food establishments to satisfy EU structural and hygiene requirements, which remains a huge challenge ahead. The legislative framework in the veterinary sector, including that for animal welfare, needs to be further aligned with the *acquis*. The veterinary and phytosanitary inspection services require further strengthening, and the necessary laboratory equipment.

## ***Chapter 13: Fisheries***

The *acquis* on fisheries consists of regulations, which do not require transposition into national legislation. However, it requires the introduction of measures to prepare the administration and the operators for participation in the common fisheries policy, which covers market policy, resource and fleet management, inspection and control, structural actions and state aid control. In some cases, existing fisheries agreements and conventions with third countries or international organisations need to be adapted.

Some progress has been achieved in the field of fisheries.

Concerning **resource and fleet management, inspection and control**, Croatia took an important legislative step by amending the Marine Fisheries Act, which provides the framework for fishery inspection, resource management and protection, data collection, designated landing ports and market organisation. Croatia has started to set up a permanent monitoring system of fish resources. A computerised fishing vessel register, electronic logbooks, and a vessel monitoring system in line with the *acquis* are not yet established. The data collection and statistics systems need to be upgraded. Croatia needs to make substantial efforts in order to properly account for and register small scale fisheries (subsistence fishermen), given their high numbers, the volume of their catches and their impact on marine resources.

The Fisheries Directorate of the Ministry of Agriculture, Forestry and Water Management was reorganised in 2004. A specific department for fishery inspection was created within this Directorate and currently employs ten inspectors. However, administrative capacity, including that of the regional offices, needs to be strengthened considerably, both with regard to the number of staff and equipment, in order to achieve an effective inspection system.

No developments concerning **structural actions** took place during the reporting period.

With regard to **market policy**, Croatia needs to improve the overall marketing system for fish and fisheries products. An important weakness in this regard is the absence of adequate landing facilities. There are no producers' organisations in Croatia.

Croatia operates various **state aid** schemes to the fisheries sector to support fishing, rearing and processing of fish and some of these measures will need to be brought into compliance with the *acquis*. During 2005 Croatia started to implement a fleet construction programme which is not in line with the *acquis*.

Croatia has not concluded new **international agreements** in the field of fisheries. A border traffic and cooperation agreement with Slovenia remains in force. This agreement also covers fisheries aspects which on the EU side – since Slovenia's accession – fall within exclusive Community competence. Work needs to be completed on the necessary implementing rules for the fisheries part of this agreement. Within the General Fisheries Commission on the Mediterranean (GFCM), Croatia should establish a closer coordination with the EU on resource management issues, in particular related to Adriatic small pelagic and demersal shared stocks.

The protected ecological and fishing zone unilaterally declared by Croatia in October 2003 came into force in October 2004. In line with the trilateral agreement between Croatia, Italy and Slovenia of June 2004, it is not applied to EU vessels.

### ***Conclusion***

Croatia has made some progress in the field of fisheries. The legislative framework has been improved with the revision of the Marine Fisheries Act. Also the reorganisation of the central fisheries administration was an important step towards improving inspection and control activities in the future. However, at this stage Croatia's fishery legislation is

only partially aligned with the *acquis* and the administrative structures do not yet meet the requirements of the Common Fisheries Policy.

Major gaps to be addressed concern the establishment of a computerised fishing vessel register and the strengthening of the inspection system, notably at regional level, both with regard to staff numbers and equipment. Croatia also needs to properly account for and register the activities of small-scale fishermen and align its state aid schemes with the *acquis*.

### ***Chapter 14: Transport policy***

EU transport legislation aims at improving the functioning of the internal market by promoting safe, efficient and environmentally sound and userfriendly transport services. The transport *acquis* covers the sectors of road transport, railways, inland waterways, combined transport, aviation, and maritime transport. It relates to technical and safety standards, security, social standards, state aid control and market liberalisation in the context of the internal transport market.

Some progress has been made in this area.

In the land transport sector, steady progress occurred regarding **road transport**. The July 2004 Road Safety Law, which aims to transpose the *acquis* concerning driving licences and roadworthiness testing, became effective in August 2004. A new Law on Transport on Public Roads was adopted in December 2004, aiming at transposing the *acquis* concerning access to the road transport market and licensing. Its alignment with the *acquis* remains to be confirmed. Implementing legislation in line with the *acquis* concerning weights and dimensions, speed limitation devices, tachographs, driving and rest times, and road user charges remains to be adopted.

Since February 2005, Croatia has made the provision of road transport services more restrictive for Slovenian operators by requiring Slovenian haulers to have an ECMT licence when performing transport between Croatia and EU Member States other than Slovenia.

As far as administrative capacity is concerned, the Road Transport Directorate of the Ministry of the Sea, Tourism, Transport and Development consists of four departments: road safety department (8 persons), department for legal matters (5 persons), department for road transport (14 persons) and the inspection department (30 persons). Under the new Road Safety Act, responsibility for supervising the driving and rest periods of drivers is shared between the traffic police (Ministry of Interior) and the road transport inspectorate (formerly of the traffic police only), however a much higher level of cooperation and coordination between both administrations is needed to meet the EU standards in the field of social and technical legislation.

There is limited progress to report in the **railway sector**. The 2003 Railway Act will only become effective on 1 January 2006. A considerable amount of implementing legislation remains to be adopted, and the restructuring of the state railway company is only planned for the longer term. The situation concerning the *administrative capacity* in the Ministry of Sea, Tourism, Transport and Development remains unchanged, with 16 people working in the Railway Transport Directorate and no independent regulatory body. The *administrative capacity* in this sector should be reinforced.

No new legislative developments are to be reported regarding **inland waterways transport**. Legislation on the functioning of the market and access to the profession remains to be aligned. It remains to be confirmed whether Croatia's legislation is fully in line with the *acquis* on technical requirements. *Administrative capacity* in the sector is generally adequate. The Directorate for Inland Navigation of the Ministry of Transport remains responsible for legislative activities and their implementation, while an Agency

for Inland Waterways has been established for operational management tasks. Croatia should consider to establish an inland waterways fund. The Sava Commission, laid down by international agreement between Bosnia and Herzegovina, Croatia, Serbia and Montenegro and Slovenia, was established in June 2005 with its seat in Zagreb. This body aims to facilitate the early revitalisation of the Sava navigation route.

There is significant progress to be reported in the area of **air transport**. The law amending the Aviation Act was adopted in December 2004 and aims at partial alignment concerning incident reporting, aviation accident investigation and licensing of personnel. It provides the legal basis for an independent accident investigation body. Implementing legislation is still needed for the actual establishment of this body as well as in the field of ground handling and slot allocation. Croatia is generally well advanced in aligning with the safety *acquis*, although the establishment of an independent body for accident investigation remains to be ensured.

A horizontal agreement on certain aspects of air services between the Commission and Croatia was initialled in January 2005. Croatia became a full member of the Joint Aviation Authorities in March 2004, which is an indication of Croatia's overall satisfactory level of aviation safety. Croatia is participating in the negotiations on a European Common Aviation Area Agreement (ECAA). Concerning administrative capacity, there is very little progress to report. This area requires considerable strengthening, especially as regards regulatory issues. The recommendations of the ECAA assessment visit carried out in June 2005 should be implemented.

There is some progress to be reported in the area of **maritime transport**. A new Maritime Law was adopted in December 2004 to reflect the new obligations arising from Croatia's adherence to international conventions, recommendations and directives of the International Maritime Organisation. The new law also aims at partial harmonisation with Community legislation in the field of safety, pollution, social conditions, flag state implementation and port state control. Implementing legislation remains to be adopted. Following the adoption of the Maritime Law, an ordinance on transport, handling, loading and unloading of dangerous substances and methods of preventing oil spillages in ports was adopted in April 2005. The ordinance aims to comply with parts of the relevant *acquis* on the transport of dangerous goods and prevention of pollution from ships. Further implementing legislation remains to be adopted. Croatia's new Maritime Law is, however, not in line with the *acquis* concerning maritime cabotage and the principle of freedom to provide international maritime transport services. More particularly, Croatian legislation appears to forbid the use of chartered yachts registered abroad in order to provide international transport of passengers (e.g. cruises). As far as ships operated by EU citizens and/or companies are concerned, such a ban would be in conflict with Council Regulation 4055/86.

Croatia currently has a detention rate which is significantly higher than that of the EU Member States, the highest actually of the 4 acceding and candidate countries (9.38% over 2004 compared to 9.09% over 2003). The country is on the Paris Memorandum of Understanding grey list. It will therefore need to increase its efforts to ensure adequate flag state control. A vessel traffic management information system is not yet in place. Administrative capacity in the maritime sector is sufficient to ensure the required percentage of 25% of foreign ships inspected in Croatian ports (the actual percentage exceeding 40%).

### *Conclusion*

Some progress has been made in the area of transport policy. However, Croatia needs to rigorously continue its legislative process. It remains to be confirmed whether transposed legislation is in line with the *acquis* as the adopted framework legislation is not available

to the Commission at this point. Although a number of important framework laws have been adopted, details are left to implementing legislation, most of which remains to be adopted. This must be considered a priority in order to prepare the ground for effective implementation of laws that are fully compliant with the *acquis*.

### **Chapter 15: Energy**

EU energy policy objectives include the improvement of competitiveness, security of energy supplies and the protection of the environment. The energy *acquis* consists of rules and policies, notably regarding competition and state aids (including in the coal sector), the internal energy market (opening up of the electricity and gas markets, promotion of renewable energy sources), energy efficiency, nuclear energy and nuclear safety and radiation protection.

Some progress has been made in this area.

In the field of **security of supply** and minimum oil stocks, key legislation is in place. Croatia already holds a certain amount of oil stocks. However, compliance with the Community's legal framework remains to be ensured. Croatia has not yet provided information on its current oil stocks calculated in accordance with the EU methodology. Administrative capacity in the sector needs to be strengthened.

For the **internal energy market**, a new legislative framework, aimed at alignment with the *acquis* on electricity, was adopted in December 2004. As regards the *acquis* on gas, no particular progress can be reported. The Gas Market Act remains to be aligned with the *acquis*. A gradual opening of the electricity market is scheduled by law (July 2006 for consumers of more than 9 Gwh; July 2007 for industrial consumers; July 2008 for all consumers). However, a significant amount of implementing legislation remains to be adopted. The new legislative framework foresees the legal and management unbundling of the state-owned electricity company HEP. The independent transmission system operator was legally registered on 4 April 2005, although it does not own assets. Following the adoption of the new Law on the Regulation of Energy Activities, the Council for the Regulation of Energy Activities has become a part of the new Croatian Energy Regulatory Agency (CERA). CERA is responsible for supervising the tariffs for all activities on the (captive) gas and electricity markets. CERA also monitors the independent operation of the transmission system operator and performs other regulatory activities. CERA's operations and independence need to be strengthened. Regulatory bodies must be independent from market participants.

Croatia has played an active role in the Energy Community Treaty process. The treaty is aimed at creating a regionally integrated energy market for electricity and natural gas as part of the wider EU market. It was initialled on 13 May 2005 and has recently been signed.

Croatia does not produce, but imports coal for the firing of a thermal power plant. Croatia's plans to comply with the regulation concerning Community monitoring of imports of hard coal remain to be verified.

Regarding **energy efficiency** and renewable energy sources, further alignment with the *acquis* is needed. Croatia's plans to adopt legislation on energy efficiency in buildings and on energy labelling have been postponed. The extent to which amendments to the Energy Law and the new Electricity Markets Act take into account the *acquis* concerning electricity derived from renewable energy sources remains to be clarified. An ambitious target for renewable electricity consumption for 2010 which could be considered to be in line with the relevant directive still needs to be set. Administrative capacity for the promotion of energy efficiency and renewable energy sources requires significant strengthening.

Concerning **nuclear safety and radiation protection**, the adoption of implementing legislation to the 2003 Act on Nuclear Safety has been delayed. The Act provided for the establishment of an independent nuclear regulatory body as of May 2005. On 1 June 2005 the State Office for Nuclear Safety began its work. The operational capacity, human and financial resources of the institute need to be developed now.

Pursuant to the 2003 Amendments to the Radiation Protection Act, the State Office for Radiation Protection was established as the regulatory body in the field of radiation protection. It became operational in October 2004 and performs tasks in the field of legislation, licensing, supervision and monitoring. It is also in charge of the national plan and programme of ionising radiation protection measures in the case of emergency. Furthermore in October 2004 the Council for Nuclear Safety was established as an advisory body to the Croatian Parliament.

Croatia will need to ensure compliance with Euratom Treaty requirements and procedures. In this respect, due attention will need to be paid to preparing the implementation of Euratom safeguards, in particular regarding the reporting of nuclear material flows and inventories directly by the persons or undertakings operating nuclear installations or storing nuclear materials. This includes small holders like universities and medical facilities.

### *Conclusion*

Some progress has been made in this area. In the field of security of supply and emergency oil stocks, compliance with the Community's legal framework remains to be ensured. In the internal energy market a significant amount of implementing legislation remains to be adopted. The proper functioning of the regulators, the transmission system operator and the market operator has to be ensured. Regarding energy efficiency and renewable energy sources, further alignment to the *acquis* is needed. Overall administrative capacity in the sector requires strengthening.

### *Chapter 16: Taxation*

The *acquis* on taxation covers extensively the area of indirect taxation, namely value-added tax (VAT) and excise duties. It lays down the scope, definitions and principles of VAT. Excise duties on tobacco products, alcoholic beverages and energy products are also subject to EU legislation. As concerns direct taxation, the *acquis* covers some aspects of taxing income from savings of individuals and of corporate taxes. Furthermore, Member States are committed to complying with the principles of the Code of Conduct for Business Taxation, aimed at the elimination of harmful tax measures. Administrative co-operation and mutual assistance between Member States is aimed at ensuring a smooth functioning of the internal market as concerns taxation and provides tools to prevent intra-Community tax evasion and tax avoidance. Member States must ensure that the necessary implementing and enforcement capacities, including links to the relevant EU computerised taxation systems, are in place.

Croatia has made very little progress in the area of taxation.

In the area of **indirect taxation**, no particular developments can be reported on further alignment of VAT. In July 2005, Croatia introduced a uniform VAT rate of 10% for the tourism sector and prolonged the period for VAT refund from 15 to 30 days. The application of a uniform rate on tourism services serves to eliminate an element of discrimination, but the rate of 10% is not in line with the *acquis*. Significant steps are required in the field of indirect taxation, in particular as concerns the elimination of zero VAT rates together with the introduction of VAT refunds to non-established traders and of special schemes provided for in the *acquis*.

As regards *excise duties*, Croatia has increased the rate of duty applied on cigarettes. However, the level of the duties is still significantly lower than the EU requirements. It also introduced new excise duties on coffee. More generally, the excise duty regime requires further substantial alignment with regard to the level and structure of the rates applied and the product coverage. A duty suspension regime must be introduced. Finally, certain exemptions from the VAT and excise regime for free zones must be fully brought into line with the requirements of the *acquis*.

No progress regarding further alignment with the *acquis* can be reported in the field of **direct taxation**. Alignment is at an early stage and Croatia will have to start work on transposing the merger, parent-subsidiary, interest and royalties, and savings directives. Croatia furthermore needs to avoid introducing tax measures which would be against the principles of the code of conduct for business taxation.

As regards **administrative cooperation**, a new division for international cooperation was set up within the Tax Administration, which – once properly staffed – will constitute the initial core of the future Central Liaison Office.

In the field of IT and interconnectivity, Croatia has set up an Interoperability Implementation Strategy, and the business team for the VAT Information Exchange System (VIES) project.

With regard to administrative capacity, inspectors for VAT control of large taxpayers have completed a specialised training course. Some limited strengthening of the excise duties service which remains the responsibility of the Customs Administration has taken place. It is also worth noting that Croatia set up a Financial Police department in December 2004. However, it is too early to assess its impact on the efficiency of tax collection and the size of the grey economy. The collection and control functions of the tax and customs administrations remain insufficient and procedures to effectively prosecute tax fraud need to be simplified.

### *Conclusion*

Given the very limited legislative developments, Croatia's tax legislation remains only partially aligned with the *acquis*. Significant alignment is needed in the area of indirect taxation, both on VAT and on excise duties, as well as in the field of direct taxation.

Only limited steps have been taken to strengthen administrative capacity. Croatia needs to significantly modernise its tax administration, in order to improve tax collection and compliance. Particular attention has to be paid to IT and interconnectivity, where Croatia needs to ensure the necessary ownership of the interconnectivity projects as well as the necessary resources for their execution.

### ***Chapter 17: Economic and monetary policy***

The *acquis* in the area of economic and monetary policy contains specific rules requiring the independence of central banks in Member States, prohibiting direct financing of the public sector by the central banks and prohibiting privileged access of the public sector to financial institutions. Member States are expected to co-ordinate their economic policies and are subject to the Stability and Growth Pact on fiscal surveillance. New Member States are also committed to complying with the criteria laid down in the Treaty in order to be able to adopt the euro in due course after accession. Until then, they will participate in the Economic and Monetary Union as a Member State with a derogation from the use of the euro and shall treat their exchange rates as a matter of common concern.

Some progress has been made in the area of economic and monetary policy.

In the field of **monetary policy**, in April 2005 the Croatian National Bank (HNB) introduced new operational tools which are closer to those in use by the European Central Bank, such as weekly reverse repo operations, structural liquidity provision/absorption operations, and standing facilities.

The *Central Bank independence* appears to be largely in place. However, as regards institutional independence, the reporting of the Croatian National Bank (HNB) to the Parliament should not allow the Parliament to draw special conclusions. In addition the HNB should not have the possibility of explaining in advance to the Parliament the reasons determining its future policy. Further clarifications are also necessary regarding the remaining obligation on the HNB to inform the public of its analysis of several economic and monetary topics. Further alignment is required in the area of personal independence, in relation to which the provisions on grounds for dismissal of Council members should be fully aligned with the *acquis*.

As regards the *prohibition of monetary financing* of the public sector by the Central Bank, while legislation generally forbids extending credit to the Government of Croatia, the possible coverage by public debt securities of the shortfall between income and expenditure in the event that the HNB accumulated losses exceeding the general reserves should be considered as a form of monetary financing and therefore be removed.

Regarding the *prohibition of privileged access* by the public sector to financial institutions, some financial institutions, such as pension funds, insurance companies and savings and loan cooperatives, are required by law to hold a certain share of their assets in the form of Croatian government securities. The relevant provisions in the Insurance Act, the Act on Mandatory and Voluntary Pension Funds and the Savings and Loan Cooperatives Act need to be made compliant with the *acquis*.

Regarding the *ESCB's secondary objective and the EMU provisions related to the integration of the HNB into the ESCB*, the necessary legislative amendments need be introduced into the Act on the Croatian National Bank, even though integration-related provisions will only enter into force as from the date upon which Croatia adopts the single currency.

As regards **economic policy**, progress has been made on policy coordination. In March 2005, the Ministry of Finance sent the Commission its first fiscal notification to the Commission, which generally complies with the required format. However, more focus should be given to sustainable fiscal consolidation and to addressing the fact that data differs in some respects from the EU methodology (ESA 95).

Croatia also adopted its first Pre-Accession Economic Programme (PEP) for the three-year period 2005-2007, in December 2004. The document only partially complies with the content, form and data requested, but it should nevertheless help strengthen Croatia's economic policy making process. The programme's medium-term projections 2005-2007 for growth, inflation and fiscal balances seem rather optimistic, although coherent. While the overall fiscal adjustment envisaged seems appropriate and encouraging, the programme would have benefited from more detailed information on specific fiscal policy measures, their expected budgetary effects and the potential fiscal risks involved, to allow the quality and sustainability of fiscal adjustment to be fully assessed. The structural reform agenda seems ambitious, with reforms planned in a broad range of areas. However, it sometimes lacks a precise description of policy priorities, objectives and key measures to be undertaken, nor cost estimates are provided.

In 2005 Croatia participated for the first time in the multilateral surveillance bodies between the EU and the candidate countries, in June at the level of the Economic and Financial Committee, and in July at ministerial level.

## *Conclusion*

Some progress has been made. Concerning monetary policy, legislative amendments are needed in the area of institutional independence of the HNB, as well as in the area of personal independence of the HNB's Council members. Regarding the prohibition of monetary financing of the public sector, some amendments are needed to the rules applicable in the event that the HNB were to accumulate losses exceeding the general reserves. Legislative amendments are also needed to comply with the prohibition of privileged access by the public sector to financial institutions provisions. The relevant EMU provisions related to the ESCB's secondary objective as well as to the integration of the HNB into the ESCB also need to be introduced. Whereas alignment is rather advanced on monetary policy, sustained efforts will be needed to conceive and implement a consistent set of economic policies. Particular progress has been achieved in the area of economic policy coordination.

## *Chapter 18: Statistics*

The *acquis* in the field of statistics requires the existence of a statistical infrastructure based on principles such as impartiality, reliability, transparency, confidentiality of individual data and dissemination of official statistics. National statistical institutes act as reference and anchor points for the methodology, production and dissemination of statistical information. The *acquis* covers methodology, classifications and procedures for data collection in various areas such as macro-economic and price statistics, demographic and social statistics, regional statistics, and statistics on business, transport, external trade, agriculture, environment, and science and technology. No transposition into national legislation is needed as the majority of the *acquis* takes the form of regulations.

Some progress has been made in this chapter.

Concerning **statistical infrastructure**, the Parliament adopted a Strategy for Development of Official Statistics for the period 2004–2012, as well as a Programme of Statistical Activities for 2004–2007. It also adopted an Annual Implementation Plan pursuant to the Law on Official Statistics. These three policy documents define long-term goals, general principles and criteria regarding the functioning and development of the statistical system. Coordination with other producers of official statistics is strengthened through a Working Group for Programming Document. In June 2005 the Government relieved the Head of the Croatian Bureau of Statistics (CBS) of his duties. The assistant director of business statistics was appointed as acting head of CBS.

Overall, major shortcomings of the statistical infrastructure include the independence of the regional statistical offices from the CBS in administrative terms, the insufficient coordinating role of the CBS in the statistical system, and appointment conditions for senior CBS staff which are not up to EU standards.

As regards **classifications**, a number of European classifications were introduced. A specific department for classifications was established in the CBS to develop and maintain national statistical classifications of activities and products. Further progress is needed for the implementation of other classifications, such as COFOG, Prodcom, ISCED97 and ISCO88.

Concerning demographic and business statistics, the CBS has started preparations for the population register. Migration and population statistics projects started in 2004. The CBS is also currently developing poverty statistics and labour costs statistics.

Regarding regional statistics, the revised classification for statistical regions was approved by the Commission in spring 2005. Based on this regional division, the CBS produced estimates of regional GDP. However the Government decided in July 2005 to

submit a third revision of the classification for statistical regions at NUTS II level, which was rejected. In this context statistics could not be produced on regional level with the correct breakdown.

Concerning macroeconomic statistics, the CBS has further introduced some elements of the European System of Accounts (ESA 95). Annual and quarterly national accounts are regularly published and a project on the non-observed economy is being implemented to improve the quality of national accounts. The Consumer price index (CPI) has been compiled and published since February 2004. The CBS participates in the European Comparison Programme to provide GDP data in PPPs. Regarding annual financial accounts, the CBS should establish arrangements with other producers of statistics in this field. The Consumer Price Index is well developed; it does not totally comply with the European standards (e.g. non-resident households are not taken into account).

Overall, the implementation of ESA95 in national accounts is still in an initial phase in Croatia and needs to be enhanced also through the development of underlying basic statistics.

In the field of **sector statistics**, progress continued as regards business statistics, where CBS conducted surveys on short-term statistics in the fields of energy, transport, tourism and the distributive trade. Some building up of the statistical business register has taken place but this needs to be further developed and maintained for the implementation of business surveys. Moreover, the CBS still needs to create an overall strategy for the development of integrated structural business statistics.

For external trade statistics, good progress can be reported. Regular delivery mechanisms were established with Eurostat for external trade data on goods. Regarding

Concerning agriculture statistics the final results of the agriculture census were published in 2004. The development of the register of agricultural producers based on the 2003 agricultural census is in the final phase. Its completion is a condition of the implementation of the farm structure survey.

### *Conclusion*

Croatia has generally made some progress in the area of statistics. Improvements can be reported in regional, macroeconomic and agricultural statistics. Alignment remains at a relatively early stage and important efforts will be required to fully meet EU requirements.

In order to progress further in the development of the statistical system the CBS still needs to strengthen its central and coordinating role in the production of official statistics for several areas. A major deficiency of the statistical infrastructure is the independence of the regional statistical offices from the CBS in administrative terms, the weak coordinating role of the CBS in the statistical system. Efforts should continue to strengthen the cooperation of the CBS with other ministries and data providers through formal agreements and working arrangements. The appointment conditions for senior CBS staff should be brought up to EU standards.

The implementation of ESA95 in national accounts is still in an initial phase in Croatia and is therefore, a priority for the CBS. It also requires the development of underlying statistics such as the business register, business statistics, and labour statistics.

### *Chapter 19: Social policy and employment*

The *acquis* in the social field includes minimum standards in the areas of labour law, equality, health and safety at work and anti-discrimination. The Member States participate in social dialogue at European level and in EU policy processes in the areas of

employment policy, social inclusion and social protection. The European Social Fund is the main financial tool through which the EU supports the implementation of its employment strategy and contributes to social inclusion efforts (implementation rules are covered under *Chapter 22*, which deals with all structural instruments).

There has only been limited progress in this area.

In the area of **labour law**, there are no new developments to report. The most recent amendments to the Labour Code date from 2003. Several main principles of the *acquis* are in place but further harmonisation is needed, particularly as regards the directives on European Work Councils and the European Company Statute, the sectoral working time directives, and the directive on the posting of workers. A number of shortcomings should be addressed with regard to other directives, such as those concerning fixed term and part-time work, the transfer of undertakings, collective redundancies and on employers' insolvency.

In the area of **health and safety at work**, several pieces of legislation intended to transpose the *acquis* have been adopted, covering, *inter alia*, safety at the workplace in general, safety at work with display screen equipment, provision of safety signs and manual handling of loads. Implementation and enforcement capacity remain a source of serious concern, however, and capacity will need to be substantially improved if the *acquis* in this field is to be properly applied.

There are no particular developments to report as regards **social dialogue**. Social dialogue is quite developed in Croatia, both between the State and the social partners and between the State and other economic and social actors within a multipartite process. There is scope, however, for improved autonomous bipartite social dialogue and greater involvement of social partners in decision-making.

In the area of **employment policy**, in December 2004 Croatia adopted a National Employment Action Plan based on the guidelines of the European Employment Strategy. However, there is scope for improving policy strategy and coordination and for upgrading the administrative capacity of the administration and public authorities involved in employment policy planning and delivery. A process of cooperation between the EU and Croatia was launched in September 2005 with the aim of drafting a Joint Assessment of Employment Policy Priorities (JAP process). In the context of the current labour market, the unemployment rate remains stubbornly high in Croatia (*see also the economic chapter*), despite some reduction in recent years. Also, activity rates remain worryingly low, and there are significant regional disparities in labour market performance.

There are no particular developments in view of preparations for the **European Social Fund**. Croatia will have to adapt its structures and legislation in order to create adequate administrative capacity for the management, implementation, monitoring, audit and control of ESF-type measures at both the national and regional levels.

As regards **social inclusion** and **social protection**, a kick-off meeting for the Joint Inclusion Memorandum process (JIM) between the EU and Croatia was held in September 2005. There remains a need for more specific analysis of social exclusion and poverty in Croatian society as well as the introduction of related internationally comparable qualitative and quantitative indicators, as a basis for future programmes for vulnerable groups such as pensioners, long-term unemployed, people with disabilities, refugees and minority groups. While Croatia adopted measures in March 2005 in support of the employment of people with disabilities, attention should also be paid to centralised and decentralised structures and facilities for people with disabilities and to community-based services as an alternative to institutions. The pension and healthcare systems have been undergoing important changes as regards financing and organisation and the effects

of these changes in terms of their adequacy and sustainability will need to be monitored. There are still geographical disparities in the supply of health care; improving cost control and patient choice are also issues of concern. There has been limited progress in the **anti-discrimination** field. A comprehensive national strategy for the elimination of discrimination has not been adopted according to schedule. Legislation transposing the *acquis* in this field will have to be introduced and implemented. Further efforts will be needed in order to ensure full conformity, including the establishment of the Equality Body required by the *acquis* (*see also Part 1, Political Criteria.*)

There are no significant developments to report in the field of **equal opportunities**. While in general it appears the basic legislation is largely in place, legal adjustments are necessary for example in connection with the removal of overprotection of women as regards night work, physically heavy work, work underground and in a hypobaric atmosphere. Shortcoming with respect to parental leave, maternity benefits and excessive compulsory maternity leave as well as wider difficulties faced by pregnant women and mothers with small children in the field of employment also need to be addressed. Further adaptations appear necessary with respect to different retirement ages for men and women in the police, military and the civil service. Unequal treatment in unemployment benefit needs to be removed and legislation adapted so that associations which have a legitimate interest in ensuring that the principle of equal treatment is applied, may engage, either on behalf or in support of the complainant in any judicial or administrative procedure.

The enforcement of existing rules remains problematic, and is hampered by the absence of gender-segregated statistical indicators. Legal provisions providing for deterrent and dissuasive compensation in case of discrimination will be required

### *Conclusion*

The area of employment and social policy appears to have been rather neglected. Legislative activity has been limited to health and safety at the workplace, without, however, building up the necessary enforcement capacity. Alignment remains far from complete in all areas, while regulatory and administrative capacity is particularly weak, be it in the competent ministries, the labour inspectorates or the Croatian Employment Service. There is a need to significantly strengthen administrative capacity at all levels of the administration in order to enable Croatia to implement the *acquis*. Human resource development policies need to be further developed including through a broad activation approach. Work under the Joint Assessment Papers on employment policies in acceding countries (JAP) and Joint Inclusion Memorandum (JIM) processes should continue. There remains a need for a specific analysis of social exclusion and poverty in Croatian society as a basis for future programmes, in particular for vulnerable groups. Anti-discriminatory and gender equality policies have generally not received the required attention or been pursued with resolve

### ***Chapter 20: Enterprise and industrial policy***

EU industrial policy seeks to promote industrial strategies enhancing competitiveness by speeding up adjustment to structural change, encouraging an environment favourable to business creation and growth throughout the EU as well as domestic and foreign investments. It also aims to improve the overall business environment in which small and medium sized enterprises (SMEs) operate. It involves privatisation and restructuring (*see also Chapter 8 – Competition policy*). EU industrial policy mainly consists of policy principles and industrial policy communications. EU consultation forums and Community programmes, as well as communications, recommendations and exchanges of best practices relating to SMEs aim to improve the formulation and coordination of

enterprise policy across the internal market on the basis of a common definition of SMEs. The implementation of enterprise and industrial policy requires adequate administrative capacity at the national, regional and local level.

Croatia has made little progress with regard to enterprise restructuring, and the adoption of an industrial strategy and privatisation proceeded slower than expected although some progress was achieved in the areas of SME policy and the business environment.

Croatia has not yet adopted a comprehensive **industrial strategy** aimed at improving its industrial competitiveness and general business environment. Work on some sectoral strategies such as textiles has only started.

With regard to **privatisation and restructuring**, overall progress in privatisation was slower than expected and several deadlines, either self-imposed or agreed with international financial institutions, were missed in 2004, for example with regard to the privatisation of companies in which the Government holds less than 25% of the shares. However, some new momentum was gained in 2005, notably with the privatisation of three agricultural and food processing companies. The portfolio of the State Privatisation Fund still comprises more than 1000 companies of which approximately 75 are majority state-owned and around 945 represent minority participation with the state owning less than 50%. In about 900 companies the state holds less than 25%. Very little progress was made with regard to the privatisation of large state-owned companies and utilities outside the portfolio of the State Privatisation Fund. In February 2005, the Government decided to transfer 7% of the shares of the Croatian telecommunications company (HT) to a fund for Croatian War Veterans and now holds 42% of the company. Concerning restructuring, only preliminary steps have been taken to prepare viable restructuring plans for the shipbuilding sector in Croatia where all major yards are loss-making. As regards steel, Croatia is still delayed in adopting the necessary restructuring plans under Protocol 2 to the SAA. Given the continued State aid provided to both sectors, these programmes urgently need to be adopted in order to comply with state aid rules and with SAA obligations (*see also Chapter 8 – Competition Policy*). The two steel companies remain state-owned.

In the field of the **business environment** and **SME policy**, Croatia made progress with the implementation of the European Charter for Small Enterprises. Important steps were taken to simplify and accelerate company registration procedures, notably with the establishment of one-stop shop services and lighter, cheaper procedures for certain trades and crafts. The one-stop-shop (HITRO.HR) serves as a help desk for entrepreneurs as it takes charge of the various formal registration steps on their behalf. Whilst this does not imply that the steps and procedures themselves are rationalised, HITRO does accelerate the process and, moreover, contributes to reducing corruption and the grey economy. HITRO is a practical interim solution on the way to the actual reform of the registration process itself, which should remain the final objective. On-line registration is not yet possible, nor is a “silence is consent” principle regulated for companies.

Regulatory impact assessments were introduced in April 2004 and pilot projects conducted for certain draft laws. The quality and regularity of consultations between the government and the private sector on draft legislation is considered insufficient. Croatia has an increasingly broad support network of local and regional business support centres, technology parks and business incubators.

Concerning access to finance, the Croatian Bank for Reconstruction and Development (HBOR) continues to administer a range of financial schemes for small business. The national SME Agency (HAMAG) issues credit guarantees. Some of the HBOR schemes involve direct lending despite. Given a positively developing banking sector a change of strategy should be considered, where credits are increasingly left to the banking sector and the government concentrating on soft –support (training, advisory etc). Some private

venture capital is under development but still very limited, as are other financial services such as venture capital provided by other entrepreneurs (business angels) and micro-credit funds.

Generally, the business environment improved, but further efforts are needed in a number of areas notably with regard to increasing the transparency and legal certainty of the state administration and the judicial system. Moreover, business representatives remain sceptical of government reform efforts, a credibility gap which the government should more effectively start closing.

Croatia has currently two significant SME information internet-portals under development – the BIZNET of the Croatian Chamber of Commerce and the portal of the Osijek Entrepreneur Centre under the auspices of the SME Policy Center (CEPOR). Co-ordination between both should be ensured.

Regarding **administrative capacity**, the Ministry for the Economy, Labour and Entrepreneurship continues to be responsible for the formulation and coordination of enterprise and industrial policies as well as for the design and coordination of SME policy, the latter in conjunction with the Croatian Small Business Agency (HAMAG). A National Competitiveness Council has provided for dialogue between public and private stakeholders on issues affecting the competitiveness of the Croatian economy and the business sector in particular. However, such dialogue between policy makers and business organisations and the wider business community does not appear to take place on a regular and systematic basis.

Overall, administrative capacity and the broader support network appear to be satisfactory, and the state allocates a substantial budget for the implementation of its policy.

### *Conclusion*

Croatia has made little progress with regard to enterprise restructuring and has not yet adopted a comprehensive industrial strategy. Some progress was achieved in the areas of SME policy and the business environment, notably faster and simpler registration procedures.

Major challenges for Croatia in the area of enterprise and industrial policy remain the adoption of viable restructuring programmes for the shipbuilding and steel sectors without further delay. These sectoral strategies should be complemented by a comprehensive industrial strategy. Dialogue between policy makers and business organisations and the wider business community could be strengthened further.

### *Chapter 21: Trans-European networks*

This chapter covers the Trans-European Networks policy in the areas of transport, telecommunications and energy infrastructures, including the Community guidelines on the development of the Trans-European Networks and the support measures for the development of projects of common interest. The establishment and development of Trans-European Networks and the promotion of proper interconnection and interoperability of national networks aim to take full advantage of the internal market and to contribute to economic growth and the creation of employment in the European Union.

Some progress has been made in this area.

As regards **transport networks**, Croatia's core network has been agreed in the framework of the development of the regional core transport network for the Western Balkans, and is based in particular on Pan-European Corridors V, X and VII. Croatia

signed the relevant Memorandum of Understanding in June 2004. Croatia is also a participant in the High Level Group on the extension of the major trans-European transport axes to the neighbouring countries and regions which was established in 2004. Regarding inland waterways transport, Croatia has developed a master plan to develop the intermodal (river, rail, road) function of the port of Slavonski Brod.

As regards road transport, the motorway from Zagreb to Split was recently opened. Regarding rail transport, the Croatian railway company HZ and the Slovenian railways holding signed an agreement in February 2005 concerning cooperation to enhance cargo and passenger transport and to improve the railway infrastructure on the relevant part of Pan-European Corridor X. No new developments are to be reported regarding air transport and maritime transport infrastructure.

With regard to **energy networks**, Croatia is part of two axes for priority projects which have been established under the trans-European networks energy guidelines. In the electricity sector, this is axis “EL.4 Greece/Western Balkan countries/Union for the Coordination of Transmission of Electrify (UCTE): System development of electricity infrastructure to connect Greece to the UCTE System”. In the gas sector, this is axis “NG.3 Caspian Sea countries/Middle East/European Union: a new gas pipeline network to the European Union from new sources, including the Turkey/Greece, Greece/Italy and Turkey/Austria gas pipelines.”

In October 2004, the electricity substation in Ernestinovo, destroyed in the 1990s, was reopened, and the synchronisation of the two European electricity zones was thus effectively restored.

### *Conclusion*

Some progress has been made in this area. Croatia should develop and implement a long-term transport and energy infrastructure development programme, based on the priorities established in the framework of the trans-European networks. These programmes should contain clear and realistic timetables and financing strategies. In this respect funding through the Instrument for Structural Policies for Pre-Accession (ISPA) and the preparation for the use of future structural funds should be incorporated.

### *Chapter 22: Regional policy and coordination of structural instruments*

The *acquis* under this chapter consists mostly of framework and implementing regulations, which do not require transposition into national legislation. They define the rules for drawing up, approving and implementing Structural Funds and Cohesion Fund programmes reflecting each country’s territorial organisation. These programmes are negotiated and agreed with the Commission, but implementation is the responsibility of the Member States. Member States must respect EU legislation in general, for example in the areas of public procurement, competition and environment, when selecting and implementing projects. Member States must have an institutional framework in place and adequate administrative capacity to ensure programming, implementation, monitoring and evaluation in a sound and cost-effective manner from the point of view of management and financial control.

Limited progress has been made in this area.

Regarding the **territorial organisation**, the Croatian Central Bureau of Statistics (CBS) has proposed 4 NUTS II regions and 21 NUTS III regions for Croatia in March 2005. The Croatian Government still needs to approve this proposal. The current NUTS II proposal establishes 4 statistical and planning regions at NUTS II level with no administrative functions. Regional disparities between the different regions at NUTS II level are generally very large, with the GDP per capita more than doubling from the

richest to the poorest NUTS II region. There continues to be a lack of adequate regional statistics.

With regard to the **legislative framework**, no new developments are to be reported, except in the area of public procurement, where amendments to the public procurement act have been adopted (*see also Chapter 5 - Public procurement*)

Regarding the **institutional framework**, an “inter-ministerial coordination group” and a “national partnership structure” were established within the framework of an EU technical assistance project. Continuity of these types of structures will need to be ensured. The coordination between central ministries as well as between the central and local levels also needs to be organised and a decision on future managing authorities or future key bodies for the implementation of the EU’s planned Integrated Pre-Accession (IPA) instrument and structural intervention should be taken as early as possible. Furthermore the allocation of responsibilities and division of tasks between ministries as well as coordination procedures will need to be clearly established.

No specific actions to improve the **administrative capacity** of the bodies involved are to be reported. Progress with regard to designating managing and paying authorities and with strengthening administrative capacity is urgently needed for Croatia to be able to benefit effectively from the regional and human resources development components of the IPA instrument from 2007.

With regard to **programming**, Croatia has not yet prepared a national Development Plan. In March 2005, a planning document on national development for Croatia for the period 2005-2009 was finalised by the central government's Office for Development Strategy and submitted to the government and all ministries for comments. However, this document can not be considered the outcome of a development planning effort as requested by the EU. A description of the procedures in place or foreseen for ensuring inter-ministerial coordination and wide and effective association of all relevant partners is needed. At local level, several counties are in the process of preparing regional programmes with EU technical assistance. These local level programmes are not directly relevant for future Structural Fund programming but may serve as an input to the national programming process. They also introduce participatory planning methods at local levels which are important for increasing overall planning and absorption capacity.

No new developments are to be reported in the area of **monitoring and evaluation and financial management and control**. Most ministries involved in national and regional development actions do not yet have clear objectives, proper monitoring and evaluation mechanisms or sufficient financial control systems.

### *Conclusion*

Very limited progress has been made in this area. Croatia needs to make substantial efforts to establish the necessary framework and structures for the implementation of the Structural and Cohesion Funds in accordance with EU rules. Croatia needs to adopt framework legislation to implement the *acquis* in this area. Simultaneously, Croatia has to define the institutional structure for the management of pre-accession funds and the Structural Funds, in order to provide more clarity on the specific tasks and responsibilities, the required levels of staffing and the training needs of these bodies. In addition, Croatia should continue the preparation of the EU programming documents with a strong linkage with the process of national investment and budget planning. Particular attention should be paid to arrangements for financial management and control.

## ***Chapter 23: Judiciary and fundamental rights***

EU policies in the area of judiciary and fundamental rights aim to maintain and further develop the Union as an area of freedom, security and justice. The establishment of an independent and efficient judiciary is of paramount importance. Impartiality, integrity and a high standard of adjudication by the courts are essential for safeguarding the rule of law. This requires a firm commitment to eliminating external influences over the judiciary and to devoting adequate financial resources and training. Legal guarantees for fair trial procedures must be in place. Equally, Member States must fight corruption effectively, as it represents a threat to the stability of democratic institutions and the rule of law. A solid legal framework and reliable institutions are required to underpin a coherent policy of prevention and deterrence of corruption. Member States must ensure respect for fundamental rights and EU citizens' rights, as guaranteed by the *acquis* and by the Fundamental Rights Charter.

The Constitution regulates the **independence and impartiality of the judiciary**. It provides that judicial power is autonomous and independent and the Courts Act forbids any form of influence on the decision-making of the courts, including any use of public authority or means of public communication aimed at influencing the outcome of court proceedings. Judges may not belong to any political party or to take part in their activities, nor carry out any other service or job which may influence their autonomy, impartiality or independence.

The State Judicial Council (SJC) is responsible for the *appointment and dismissal* of judges, and for *disciplinary proceedings*. It is appointed by the Croatian Parliament and composed of eleven members, of whom seven are judges, two attorneys and two academics. Each county court also has its own judicial council. Presidents of courts are appointed for a renewable four-year term by the Minister of Justice, upon nomination by the judicial council of their respective courts. The President of the Supreme Court is appointed by the Parliament upon a proposal from the President and following the approval of the general session of the Supreme Court.

Entry qualifications for the profession include the bar exam and a completed two-year judicial traineeship (trainees are appointed by the Ministry of Justice). The SJC's appointments are made on the basis of candidates' written applications and the opinions received from the judicial council of the court where the vacancy arises. The introduction of a competitive, objective examination for entry into the judicial profession should be considered, in order to ensure that transparent and uniform standards are applied when appointing both judicial trainees and judges.

Disciplinary proceedings may be brought by the SJC on the initiative of the President of the court where a judge serves, the President of a higher court or the President of the Supreme Court, and in certain cases by the Minister of Justice (although this has never occurred). The SJC has the power to issue reprimands or fines, or to dismiss a judge from office. Its decisions can be appealed to the Constitutional Court. The grounds on which proceedings may be brought include abuse of position, failure to perform duties, acting in conflict of interest or conduct which is damaging to the reputation of the judicial office or court. Around 60 cases have been initiated since 2001, and sanctions were imposed in 20 cases, including 5 dismissals which were upheld by the Constitutional Court.

The Croatian Constitution guarantees the *permanence of judicial office*, although judges are initially appointed for a five-year term and only assume office permanently thereafter, following a positive assessment. Judges may be *transferred* to another court on a temporary basis with their consent, at the request of the President of the destination court. Judges enjoy *immunity* in accordance with the Constitution and the Courts Act, which provides that a judge may generally not be detained or have criminal proceedings

instituted against him or her without the approval of the SJC. The SJC can lift a judge's immunity upon a proposal from the State Attorney's Office. It would be advisable to reassess the provision on penal immunity in the light of the need for transparency and accountability within the judiciary. Judges' *salaries* at basic level are around twice the national average.

A Code of Judicial Ethics was adopted by the Association of Croatian Judges in 1999, however not all judges are members. A *code of ethics* covering the entire judiciary still needs to be adopted, and should include provisions on corruption. A Code of Ethics for State Attorneys and Deputy State Attorneys entered into force in 2003.

With respect to the *impartiality* of the judicial system, some problems remain, most notably in the area of war crimes trials where, despite progress since the Opinion, ethnic bias against Serbs persists in local courts. While there does not appear to be evidence of ethnic bias in other types of hearings, steps need to be taken to eliminate any suggestion of ethnic bias in war crimes trials before the domestic courts. (*see Section B.1.3 – Domestic war crimes trials*).

In relation to the **efficiency and quality of the judiciary**, a Judicial Academy was established in March 2004 with the task of providing continuous professional *training* for the judges, state prosecutors, judicial advisors and trainees, however it is still in the process of becoming fully operational. There are currently 13 staff members including the Director (a significant increase since the Opinion). In addition to the central administration in Zagreb, two fully equipped regional centres have been set up within the County Courts in Zagreb and Rijeka, but three further regional centres still have to be established. The workshop-based curriculum is in place but undergoing further development. Standard and specialised programmes have been created with EU assistance and by mid-2005, 1,054 participants had attended the former and 715 the latter. A "train the trainers" programme has been carried out, covering 40 judges from Zagreb and Rijeka, and in June 2005 the Judicial Academy launched its website. The budget allocation for the Judicial Academy has almost doubled since last year, to EUR 0.4 million in 2005.

Continued funding should be secured and the independent status of the Academy should be guaranteed. Particular attention needs to be paid to providing specialised training to judges and prosecutors on issues such as economic crime, money laundering, the fight against corruption and management training. Also, a coordinated professional training system comprising both theoretical and on-the-job training needs to be introduced for trainee judges and prosecutors, with the close involvement of the Judicial Academy. Currently, traineeships are organised by the individual courts and prosecutors' offices; there is no common framework for the supervision of training and clearer guidance and support needs to be given to both trainees and mentors. Consideration should also be given to developing an objective, uniform system of ongoing professional evaluation, which covers not only efficiency but also competence, and links career advancement with professional achievement.

The total *budget* of the Croatian judicial system (including the prosecution and prison services) was approximately EUR 297 million in 2005, compared with EUR 256 million in 2004. The increase has been targeted mainly at court premises and IT.

As regards *infrastructure and equipment* of courts, the Croatian government has committed considerable capital investments in the past year to the purchase and renovation of several new court buildings, including the Administrative Court and the High Commercial Court, however significant further investment in court premises is urgently needed and should continue to be one of the highest priorities. The WAN infrastructure of the judiciary was upgraded in 2004 to establish a single network linking up the court register departments of the commercial courts, the land registry departments

of the municipal courts and the Ministry of Justice. In January 2005, Zagreb County Court was equipped with a videoconference room for the protection of witnesses and mutual legal assistance. A database of the case law of the High Commercial Court has been developed and is accessible to judges by intranet since April 2005. Digitalisation of the land register is ongoing, with the aim of making all of Croatia's land registers accessible by internet by the end of the year. The system went live in May 2005, and so far 59 of the 107 land registry departments within the municipal courts have been digitalised and are accessible on-line. However, the integrated case management system which is planned for Croatian courts is still only at the development stage and will not be rolled out until 2007-2008. Administrative capacity needs to be strengthened to secure this process.

The total *number of judges* in Croatia currently stands at 1,907. There are 234 judicial trainees, 451 judicial advisers and over 6,000 court clerks. The total number of prosecutors and deputy prosecutors is 558. Understaffing is not a concern within the Croatian judiciary – on the contrary, the number of judges is relatively high in relation to the total population. However, the current distribution of caseload is uneven across the country, meaning that the largest courts are extremely overloaded and accordingly suffer from backlogs, whereas smaller courts are not always used to their full capacity.

In 2004, the total number of court rulings (for all instances, but excluding the Constitutional Court) was 1.83 million, of which 1.31 million were at first instance. The inflow of new cases during the same period was 1.93 million, of which 1.4 million were at first instance. The total *backlog* of unresolved cases was 1.64 million (over 30% of this figure was accounted for by enforcement cases and 20 % by land registry cases).

In the past year steps have been taken to reduce the backlog, including the redistribution of nearly 26,000 cases from over-burdened to less burdened courts throughout the country by special decisions of the President of the Supreme Court in 2004; the temporary transfer of judges to work in higher instance courts; the introduction of voluntary paid overtime work for judges, specifically with a view to processing 'old cases'; increased competences for judicial advisors to assist judges with their work and the transfer of competence for undisputed inheritance cases from the courts to notaries public (around 63,000 cases were transferred in 2004, of which almost 51,000 were resolved by the end of the year). In particular, significant progress has been made in tackling the serious backlogs affecting the Land Registry, which forms part of the municipal court system. The Land Registration Act was amended in July 2004, allowing 221 authorised court officials with special qualifications to assist judges in handling land registration cases, and digitalisation of both the Land Register and cadastre are underway. In September 2004, there were 325,000 unresolved land registration cases pending nationwide, mainly before the largest municipal courts, in Zagreb, Split and Rijeka. This number had been reduced to around 257,000 by July 2005.

However, by far the greatest single cause of the backlog, the enforcement cases (meaning both the enforcement of civil obligations and the subsequent execution of judgements), still remain largely un-addressed. In 2004, enforcement cases constituted 44% of the backlog at first instance (544,377 cases). The Enforcement Act was amended in July 2005, but it is too early to assess the impact that these measures will have.

Global statistics indicating the *average duration* of proceedings before the Croatian courts, at different levels, are currently not available, however serious delays are experienced in proceedings before some courts, and there are clear links with the ongoing struggle to reduce the backlog. Since March 2002, dissatisfied parties have been able to make a complaint to the Constitutional Court concerning the excessive length of court proceedings before the ordinary courts. In 2004, 925 such complaints were received (compared to 542 in 2003 and 64 in 2000). In the first four months of 2005, 585

complaints were received, indicating a continuing rise. In 2004 and 2005, the European Court of Human Rights issued several judgements against Croatia for unreasonable length of proceedings before domestic courts. A system of comparable data and a detailed analysis of the duration of proceedings before the different courts should be developed, identifying the types of cases which have been pending for excessive periods, and the reasons for the delay.

In September 2005, the Croatian government adopted a comprehensive new strategy for the reform of the judicial system setting short-, medium- and long-term objectives, together with an action plan for its implementation. The strategy builds on the reforms already undertaken and provides a generally sound basis for improving the administration of justice. However, full commitment to implementation, and in particular financing, of the reform strategy as well as the establishment of precise deadlines, which are currently missing from the action plan, will be of crucial importance in the coming period (*see also section 1.1 Democracy and the rule of law*).

As far as **access to justice and legal guarantees** are concerned, no problems connected to *arbitrary arrest* have been reported in Croatia in the reporting period. The average duration of *pre-trial detention* is currently 7 months. A maximum of 3 years is prescribed by the law for offences punishable by long term imprisonment.

Under Article 28 of the Constitution, every person is *presumed innocent* and may not be considered guilty of a criminal offence until his guilt has been proved by a final court judgement. The *right of defence* is guaranteed by Article 29 of the Constitution. Care should be taken to further develop the legal framework for witness protection, in such a way as to ensure that the safety of vulnerable witnesses is appropriately balanced with the accused's right of defence.

A number of statutory provisions provide for court hearings to be *public*, subject to certain restrictions. Croatia has made a reservation to Article 6(1) of the ECHR in relation to the Administrative Court, which makes its decisions on the legality of individual acts of administrative authorities in closed session. The Constitutional Court ruled in November 2000 that the Administrative Court is not a court of full jurisdiction in accordance with the Convention.

Under the Constitution, free *legal aid* is only guaranteed in criminal cases where the defendant lacks the means to engage counsel. The Criminal Procedure Act stipulates that the court will appoint an attorney in those cases where defence counsel is mandatory (where the defendant is mute, deaf or otherwise incapable of defending himself, or in detention, or where the offence is punishable by more than 8 years' imprisonment). Court-appointed defence lawyers are paid from the State budget, at 50% of the regular pay scale. There are no provisions for legal aid in civil cases, but it may be provided by the Croatian Bar Association on a *pro bono* basis. Priority needs to be given to putting in place an integrated legal aid system for both criminal and civil proceedings, as this is a crucial element of the right of access to justice. Both Croatian citizens and foreign nationals who are party to criminal or civil proceedings have the right to have documents served on them in the *language* they understand and, during oral hearings, to have access to an interpreter paid for by the state budget.

Article 31 of the Constitution and Article 2 of the Criminal Code provide for the *legality of criminal offences*, stating that no one shall be punished for an act which is not defined as a punishable offence by law or international law, nor sentenced to a penalty not defined by law.

The *proportionality of penalties* to the criminal offence committed is ensured by Article 1(2) of the Criminal Code. Article 31 of the Constitution and Article 11 of the Criminal Procedure Act incorporate the principle of *ne bis in idem*, stating that no one may be tried

or punished in criminal proceedings for an act for which he has already been acquitted or sentenced by a final court judgement.

As regards legislative developments related to **anti-corruption policy**, the Croatian Parliament ratified the UN Convention against Corruption in February 2005 and the Additional Protocol to the European Criminal Law Convention on Corruption in April 2005. It is important that these instruments are now implemented. Croatia had previously already ratified the Criminal and Civil law Conventions of the Council of Europe. In October 2004, amendments to the Criminal Code entered into force, which aim at harmonising Croatian legislation with the Criminal Law Convention on Corruption and its Additional Protocol. The law now proscribes the criminal offence of corruption in the business sector (accepting or offering a bribe in economic business), criminalises corruption offences with a foreign element and expands the definition of predicate offences in money laundering. In July 2004, amendments to the Act on Prevention of Conflict of Interest in the Exercise of Public Office and to the Act on Financing Presidential Electoral Campaigns were adopted. Still lacking from the legislative framework, however, is the development and implementation of legislation on the financing of political parties, making their assets and financial supporters more transparent.

Croatia should considerably step up efforts in this field, in particular by following up the 2002 National Programme to Combat Corruption with a new national anti-corruption strategy and action plan, which should contain clear benchmarks, designate responsible institutions, provide adequate financial resources and a timetable for implementation. It would be advisable that the current anti-corruption policy of Croatia be subject to an independent audit, the results of which could serve to better focus activities. An inter-institutional body should monitor its implementation. Croatia also needs to deploy greater efforts to detect and combat high-level corruption, including specific measures in the national strategy.

As regards implementing capacity, amendments to the Act on USKOK (the Office for the fight against Corruption and Organised Crime) entered into force in March 2005 which strengthen the role and jurisdiction of the Office, and more clearly define the Office's activities. However, so far only one of the Office's four departments is operational and it remains to be seen whether these amendments will be effectively implemented. USKOK must be made fully operational as soon as possible and needs to take on the leading role in the fight against corruption, including improved co-operation with the police, especially at local level.

There should in general be greater attention paid to prevention, awareness raising, internal control and supervision of the public administration. In this respect, it would be useful to conduct a coordinated awareness-raising campaign involving the media, non-governmental organisations and the public, in order to inform about the danger of corruption, measures taken to fight it, sanctions that may be imposed and the institutions involved in fighting corruption. A more pro-active approach towards investigating and effectively prosecuting corruption should be established. Specific action plans for preventing and fighting corruption in law enforcement agencies should be developed. Also, Croatia should establish in every part of the public administration a body in charge of investigating corruption, working on the basis of accountable and transparent rules. Aside from investigation, there is also a need for a targeted approach towards corruption prevention in all parts of the administration. Finally, an overall statistical methodology should be developed in order to better monitor the fight against corruption.

As a member of GRECO, Croatia is currently in the second round of evaluation of the implementation of anti-corruption legislation. In December 2004 GRECO issued a

Compliance Report confirming that around half of 16 recommendations made in the first round evaluation had been implemented satisfactorily by Croatia.

As regards **fundamental rights**, Croatia acceded to the Council of Europe in 1996 and ratified the European Convention on Human Rights in 1997. Protocols 1, 4, 6, 7, 11, 12 and 13 to the Convention have been ratified. Under Article 140 of the Constitution, international Treaties are part of the internal legal order of the Republic of Croatia and apply over ordinary national legislation (*see also Section B.1.2 – Observance of international human rights law*).

There is no single specific national body charged with the general protection of human rights in Croatia. The Office for Human Rights, created by the government, is a central coordinating body responsible for developing a comprehensive system of human rights protection. Croatia has an Ombudsman, as well as an Ombudsman for Children and an Ombudsman for Gender Equality. All three issued reports for 2004, which were adopted by the Parliament. The Office of the Ombudsman currently lacks adequate financial and material resources. Although the Ombudsman has no authority over the judiciary, an increasing number of complaints relate to the unreasonable length of judicial proceedings.

The Constitution prohibits the *death penalty* (Article 21) and *forced or compulsory labour* (Article 23). The Criminal Code criminalises trafficking in human beings and *slavery* and makes these offences punishable by up to 10 years' imprisonment. No problems have been reported in the implementation of these provisions. The prohibition of *torture and inhuman or degrading treatment or punishment* is foreseen by the Criminal Code (Article 176), which makes these offences punishable by up to 8 years' imprisonment. Training curricula for police and prison officers include training on the main international instruments in this field.

As regards *prison conditions*, a range of complaints procedures are available, and execution judges from the county courts make weekly visits to the prisons in their respective counties, with a view to protecting prisoners' rights, the legality of the execution of sentences, and equality of prisoners before the law. While there are no indications of systemic problems, the question of overcrowding should be monitored and infrastructure improvements, as well as adequate training of prison staff, should be secured. It should also be noted that conditions in the Lepoglava State Prison have been the subject of complaints to the Constitutional Court and the European Court of Human Rights.

As regards the protection of the *integrity of the person*, the 2003 Healthcare Act safeguards a number of rights of citizens, including free choice among medical interventions offered, confidentiality of medical data, the right not to be subject to scientific research without consent, and the right to accept or refuse surgical interventions. The implementation of these rights is monitored by the healthcare inspectorate of the Ministry of Health and Social Welfare. In December 2004 the Patients' Rights Act entered into force. Complaints Commissions are being established throughout the country, although a national network is not yet operational. In December 2004 the Act on Extraction and Transplantation of Human Organs for Medical Purposes was adopted, which establishes a system of presumed consent. Croatia has ratified the Convention on the Protection of Human Dignity and Dignity of Human Beings with regard to the Application of Biology and Medicine, the Additional Protocol Prohibiting the Cloning of Human Beings and the Additional Protocol on Transplanting Organs and Tissues of Human Origin.

The *right to privacy* (including respect for private and family life, home and communications) is governed by the Constitution (Articles 34, 35 and 36). The Criminal Code supplements this right by including as offences the violation of a person's home,

unlawful search, unlawful deprivation of freedom, violation of privacy of correspondence, unauthorised recording, disclosure of professional secrets and unauthorised use of personal data.

As regards *the right to protection of personal data*, Croatia ratified the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data and the Additional Protocol regarding supervisory authorities and trans-border data flows, in May 2005. Two regulations, one on records on personal data filing systems and one on technical protection for special categories of personal data, were passed in 2004. Croatia should complete alignment of its legislation in this field with the data protection Directive.

The Croatian Data Protection Agency, established to supervise the processing of personal data, became operational in April 2004 and has 14 employees. The Agency has completed around 30 supervision reports on banks, credit card companies, hospitals etc. A Central Register became operational in July 2005, including electronic delivery of records on data files by data controllers. In the past year, the Agency has cooperated with its counterparts in Member States on several occasions, with a view to developing its experience.

The *right to marry* and the *right to found a family* are governed by the Family Act of 2003. The Act defines marriage as the union of a woman and a man regulated by the law, entered into by consensual declaration in either civil or religious form. Croatia passed an Act on Homosexual Unions in July 2003, which governs such unions by analogy with non-marital partnerships between persons of the opposite sex.

*Freedom of thought, conscience and religion* is guaranteed by several provisions of the Constitution, in particular Articles 38, 40 and 41. The latter provides that all religious communities shall be equal before the law and shall be separated from the State. Conscientious objection is allowed under Article 47 of the Constitution and regulated by the Defence Act. Conscientious objectors are obliged to perform other duties specified by the Act on Civilian Service.

As regards the *freedom of expression*, Article 38 of the Constitution covers in particular freedom of the press and other means of communication, freedom of speech and public performance as well as freedom to establish institutions of public information. Censorship is forbidden and journalists have freedom to report and access to information. With effect from October 2004, the Criminal Code was amended, repealing or reducing certain provisions related to the criminal liability of journalists for libel, and placing the burden of proof on the prosecutor (*see Section B.1.2. – Civil and political rights*).

*Freedom of assembly* and peaceful protest in conformity with the law is guaranteed by Article 42 of the Constitution. *Freedom of association* is guaranteed for everyone by Article 43, for the purposes of protecting their interests or promotion of their social, economic, political, national, cultural and other convictions or objectives. Everyone may freely form trade unions or other associations, join them or leave them. Freedom of association is regulated by the Associations Act and the Act on Foundations and Endowments, both from 2001. There are currently 23,744 associations, 70 foundations and 120 foreign associations registered in Croatia. The Register of Associations is public and can be searched on the website of the Ministry of Justice. The right of association extends to the civil service, army, police and judiciary, but may be restricted by law in the case of the army and police. No problems have been reported in the implementation of these provisions in practice.

The *right to property* is guaranteed by Article 48 of the Constitution. The law governing the acquisition of property by foreigners is different from that applicable to nationals. (As

regards issues related to restitution of property and repossession, reconstruction and occupancy and tenancy rights (*see the relevant sections of the Political Criteria*).

The principle of *non-discrimination* on the basis of race, colour, gender, language, religion, political or other belief, national or social origin, property, birth, education, social status or other characteristics, is laid down in Article 14 of the Constitution. The Criminal Code makes the violation of human rights on the basis of discrimination punishable by imprisonment for 6 months to 5 years, and also contains provisions on racism and xenophobia. The national strategy on suppression of all forms of discrimination (and its action plan) needs to be adopted, and sufficient funding allocated for its implementation. Public awareness regarding these issues also needs to be raised (*see also Chapter 19 – Social policy and employment*).

The Constitution contains several provisions on the protection of the *rights of the child*. The competences of the Ombudsman for Children include monitoring the level of harmonisation of national legislation with the Convention on the Rights of the Child. A number of action plans and programmes have been adopted in this field, also covering the prevention of violence among children and adolescents, and domestic violence. In January 2005, the Attorney General adopted a Mandatory Instruction on the procedure in penal cases for the protection of children and adolescents (protection of privacy of juvenile victims). Further efforts are needed to protect children who are the victims of crime and subjected to domestic violence. Public and media awareness has been raised as regards the problem of sexual abuse of children. However, there is a lack of experienced professionals working in social welfare centres, schools and children's homes.

As regards **EU citizens' rights**, the *right to vote and stand as a candidate at elections*, only citizens have the right to vote under the Constitution. When the time comes, citizens of the Union residing in the country but who are not nationals will have to be allowed to vote and to stand as a candidate in elections to the European Parliament and in municipal elections. Legislation will also have to be enacted to transpose the relevant *acquis* on voting rights to European parliamentary and municipal elections.

Regarding *residence rights*, EU citizens are treated in the same way as other third country nationals as regards residence and work permits, and must register with the police for stays of longer than three months under the Law on Foreigners. In due time, the legislation will have to be amended in order to ensure compatibility with the *acquis* on free movement of persons, notably on the formalities and conditions for entry and stay of EU citizens in the territory.

### *Conclusion*

The Croatian judiciary is formally independent and also appears to act independently in practice. Efforts are needed to ensure that doubts concerning impartiality in war crimes trials are eliminated. Adequate support needs to be given to the Judicial Academy, including developing the system of pre-service training, and further investments are needed in court premises and IT. Although several successful measures have been introduced to reduce the court backlog, this is still a significant problem, and no progress has been made regarding the biggest cause of the backlog, enforcement cases. The legal aid system needs to be urgently reformed, and extended systematically to civil cases. As regards corruption policy, there has been considerable progress on the legislative front, but this must now be matched with pro-active enforcement, preventive and awareness-raising measures, yielding demonstrable results. The situation as regards fundamental rights in Croatia is generally satisfactory, although further improvements can be made in various fields. The main exception is the backlog of cases before the courts and the excessive duration of legal proceedings, which currently affect access to justice and the right to an effective remedy within a reasonable time.

## ***Chapter 24: Justice, freedom and security***

EU policies aim to maintain and further develop the Union as an area of freedom, security and justice. On issues such as border control, visas, external migration, asylum, police cooperation, the fight against organised crime and against terrorism, cooperation in the field of drugs, customs cooperation and judicial cooperation in criminal and civil matters, Member States need to be properly equipped to adequately implement the growing framework of common rules. Above all, this requires a strong and well-integrated administrative capacity within the law enforcement agencies and other relevant bodies, which must attain the necessary standards. A professional, reliable and efficient police organisation is of paramount importance. The most detailed part of the EU's policies on justice, freedom and security is the Schengen *acquis*, which entails the lifting of internal border controls in the EU. However, for the new Member States substantial parts of the Schengen *acquis* are implemented following a separate Council Decision to be taken after accession.

Good progress has been made in this field.

In the field of **Schengen and external borders**, the government adopted a National Strategy for Integrated Border Management and an Action Plan for its implementation, as well as a Strategy for Border Police Development, in April 2005. These documents provide a good framework but will need to be implemented consistently and without delay, and the stage of implementation should be monitored on a continuous basis. The next step should be to develop specific concepts on sea border surveillance, land border surveillance, human resources and training and to establish a Schengen Action Plan. In general, the legal framework will need to be harmonised and brought in line with the EU rules and best practices. An important step in this direction has been to set up the border police as a separate directorate within the Ministry of Interior in order to further foster specialisation, but this also needs to be reflected at the local level. In January 2005, a mobile unit for state border control was put into operation to combat illegal transfers across the border.

As regards administrative capacity, there are serious staff shortages in the border police (currently 3 900 of the 8 500 positions are filled) which has a negative impact on the capacity of Croatia to control its land and sea borders. Recruitment and training of additional staff should receive the highest priority. A new specialised border police training programme has been developed and implemented since May 2005. However, an estimated 4-5 000 additional border police need to be recruited and trained by 2009, and the current annual training capacity of the Police Academy is only 400, of which a part will become border police. Infrastructure and equipment for control and surveillance at land and sea borders need to be upgraded, including the purchase of computers which can provide quick and secure connections to national databases. The development of a multi-annual investment plan may be useful in this respect. All border crossing points should at least be fully equipped with first line equipment, as identified in the Schengen best practices catalogue. In order to comply with the Schengen *acquis*, all persons, together with their means of transport and objects in their possession, must be submitted to systematic and harmonised checks at all border crossing points.

As regards inter-agency cooperation, in August 2004 the government established a coordinating body to improve the surveillance and protection of the maritime state border, including representatives of the border police, customs and the phytosanitary and veterinary inspectorates. Further regional and international cooperation should be fostered, including through exchanges of information, joint actions and common training to prevent and combat illegal immigration and cross-border crime. This would also be a fruitful basis for developing and implementing tactical risk analysis along the border. Moreover, intensified efforts are needed to agree on the delimitation of borders with

neighbouring countries. The borders with Serbia and Montenegro, Bosnia and Herzegovina and Slovenia are not yet demarcated.

Croatia's **visa policy** is broadly in line with the EU's but alignment with the Visa Regulation 539/2001 will need to be gradually completed. A new regulation stipulating the visa requirements for Croatia took effect in June 2004. Croatia currently has no visa requirement for four countries on the EU visa negative list: Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Turkey and Ecuador. Furthermore, there is a temporary suspension of the visa regime for citizens of Serbia and Montenegro until end-2005, and in certain cases Russian citizens may enter Croatia without a visa (provided that they possess a certified letter of invitation or a voucher for a paid tourist arrangement). 30 diplomatic missions and consular offices are now linked by online connection to IKOS, the information system of the Ministry of Foreign Affairs and European Integration which also includes a national visa register shared with the Ministry of Interior. In February 2005, a new visa sticker with improved security features was introduced. There is an urgent need to deliver equipment to detect forged and falsified documents in diplomatic missions and consular offices, and to recruit and train staff in this respect. Priority should be given to countries with a high migration potential.

In the field of **migration**, during 2004 over 30 000 permanent residence permits were issued, and over 10 000 temporary ones. Around 3 000 work permits and almost 4 000 business permits were issued. The legal framework for dealing with both legal and illegal migration is in place. Work should continue to complete alignment with the *acquis* and to prioritise steps to be taken to improve implementation capacity. In particular, an overall strategy on migration (including an action plan encompassing timeframes, financial and human resource implications) needs to be adopted and implemented. An overarching gap analysis for generic training needs across departments should be made. Technological infrastructure needs to be modernised, including computers with access to the central database, hardware for mobile border units, as well as a longer-term planning for the integration of systems that are compatible with the Visa Information System and Schengen systems. In particular, as regards the fight against illegal migration, detection technology is needed for operational surveillance of blue, green and air borders. In 2004, 4 438 illegal border crossings were detected, although there are signs that only a fraction of actual numbers are detected due to inadequate technology. Inter-agency cooperation between law enforcement agencies and agencies involved in migration should be further enhanced. Readmission agreements have entered into force with Albania, the Czech Republic, Norway and Serbia-Montenegro, bringing the total in force to 18.

The new **Asylum** Act entered into force in July 2004 which brings the legislative framework closer into line with the *acquis*. However, the new Act does not foresee subsidiary protection and further alignment is needed. Secondary legislation implementing the Asylum Act was adopted during 2004, by means of three regulations concerning record keeping, accommodation and financial support in respect of asylum seekers, refugees and aliens under temporary protection. Currently, asylum decisions of the Ministry of Interior Department of Foreigners can be appealed, with suspensive effect, to the Government Commission deciding Asylum Appeals. The latter's decisions are subject to judicial review by the Administrative Court, without suspensive effect. A review of the asylum appeals process may be necessary to enhance the transparency and independence of the administrative appeal, and further efforts should be made to ensure professionalism of the decision-making process, in particular as regards the training and level of specialisation of the members of the Government Commission hearing appeals.

An Information and Documentation Centre for collection and analysis of country of origin information was established in April 2005 and currently has two permanent staff. Additional resources will need to be allocated to make the best use of the system in the

long term. A permanent national reception/accommodation centre for asylum seekers is needed as a matter of priority, and should have sufficient numbers of well trained staff. In general, a gap analysis of generic training needs across departments should be made for the field of asylum. Equipment needs to be modernised, including computers with access to central databases. As yet there is no central database for checking against previous applications or other relevant actions. Croatia should begin to develop a national database for checking asylum seekers' personal data, including fingerprints, with a view to preparing for participation in EURODAC.

The number of asylum seekers is low: there were 152 applications in 2004 and 104 in the first half of 2005, and to date there have been no decisions recognising refugees, nor has subsidiary protection been accorded in any cases. In 2004, 21 appeals were lodged against negative decisions, but none were upheld. It is therefore in practice difficult to assess the implementation of the new legislative framework as regards family reunification, education and access to work of recognised refugees.

In the area of **police cooperation and the fight against organised crime**, a number of pilot schemes on community policing have been introduced, with good results. The concept should be introduced nationwide, including support to relevant training, as an element in prevention-oriented anti-crime policy. Intelligence-led law enforcement remains to be introduced. Special attention should be given to methods of intelligence gathering, analysis and dissemination. It may also be advisable to re-evaluate the role and tasks of the investigative judge in order to streamline the pre-trial investigation procedure in criminal cases, as there are some indications of duplication of work among prosecutors and investigating judges.

As regards administrative capacity, training at the Police Academy should be more closely tailored to policing needs, including both the number and type of actual vacancies, and there should be an increased focus on continuous in-service training for existing officers in the field. Specialised training should be delivered, in particular on criminal analysis and threat assessment in the field of organised crime. There should also be a greater emphasis on IT education and further investment to equip the Academy with sufficient and updated hardware. There is also a need to modernise the overall human resource policy to ensure, at all levels, a transparent, merit-based system which fosters accountability. Moreover, continuity of management in the police is a pre-requisite for its development and reform.

With regard to equipment and infrastructure, the police force urgently needs an internal network linking the headquarters of the General Police Directorate with the 20 police districts and 175 police stations throughout the country, in line with modern standards. There is also an urgent need to ensure that police stations are equipped with local networks and computers with the capacity to run multimedia and to exchange intelligence, including images, with the central intelligence database KROS. The Forensic Institute is well equipped and staffed, but still needs to introduce the Automated Fingerprint Identification System.

Croatia has signed international police co-operation agreements with 20 countries, including with Belgium and Egypt, as well as participating in several regional initiatives.

In September 2004, the government adopted a National Plan for the Fight against Organised Crime. Its objectives include preparations for the conduct of common investigations with other countries and increased coordination between the police, the Ministry of Finance and the State Attorney's Office. In November 2004, the Parliament ratified the Protocol to the UN Convention on Transnational Organised Crime concerning illicit manufacture and trafficking in firearms. Following the entry into force of the Act on Witness Protection in 2004, a Witness Protection Unit has been established within the general Police Directorate.

In February 2005, the Act on the Office for the Prevention of Corruption and Organised Crime (USKOK) was amended to broaden its competence, as well as that of the courts. USKOK's powers have been extended with regard to accessing banking data and requesting control of financial operations and temporary seizure of money, securities and other documentation. In addition, the legal framework for cooperation between USKOK, the police, the Ministry of Finance Taxation Department and the Anti-Money Laundering Office has been more clearly defined. Attention needs to be paid to the implementation of the amended Act on the Office for the Prevention of Corruption and Organised Crime, to ensure that a common definition of organised crime, and a common concept for how to deal with it, is shared in practice by all law enforcement bodies, as well as the courts. Further legislative streamlining, including on proceeds from crime and admissibility of evidence, may be necessary. A clear concept for collection of data on organised crime should be adopted and specialised training on this provided, as well as on operational and strategic analysis. The fight against all types of organised crime would benefit from the creation of an integrated criminal justice data system accessible to all relevant law enforcement agencies, while respecting the data protection legislation.

The Criminal Code was amended in October 2004 to define trafficking in human beings as a criminal act. In December 2004, the National Programme for Suppression of Human Trafficking 2005-2008 was adopted, as well as an operational plan for 2005. Since 2004, four temporary residence permits have been granted to victims of trafficking under the Law on Foreigners.

In general, there is a need for a more pro-active stance in the investigation and prosecution of organised crime, including money laundering (*see Chapter 4: Free movement of services*) and corruption. As regards credit card fraud and counterfeiting of currencies, an agreement or memorandum of understanding should be established between the police and the National Bank of Croatia in order to clarify their respective responsibilities, including clear guidelines on when and how to exchange information and intelligence. In addition, the designation of a service with competencies to protect the euro against counterfeiting should be envisaged. The operational agreement with Europol should be signed as soon as possible in order to have a legal basis for exchange of personal data with Europol, and consideration should be given to sending a liaison officer to Europol.

Croatia has ratified a number of international instruments on the **fight against terrorism**, including the International Convention for the Suppression of Terrorist Bombings, the Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation and the Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms on the Continental Shelf. 12 UN instruments on terrorism have thereby now been ratified. The International Convention for the Suppression of Acts of Nuclear Terrorism was signed in September 2005 and now needs to be ratified. The national legal framework was strengthened in July 2004 by the introduction of new criminal offences in the Criminal Code, including the financing of international terrorism. Urgent attention now needs to be paid to implementation, in particular to enhancing the capacity to detect, investigate and prosecute money laundering and other financial crimes linked to the financing of terrorism. Inter-agency cooperation needs to be strengthened, and adequate technical skills provided to the police and prosecutors when analysing and dealing with complex financial crimes. As regards international cooperation, continued and more systematic use should be made of bilateral agreements which include specific provision for cooperation in the fight against terrorism.

On the **fight against drugs**, Croatia does not yet have a national drugs strategy in line with the EU Drugs Strategy for 2005-2012 and the EU Action Plan on Drugs 2005-2008. This should be prepared in consultation with all relevant ministries and institutions and

should clearly set out objectives, expected results and indicators of performance. Attention needs to be paid to both prevention and demand reduction, including the provision of adequate financial means. Croatia has initiated the accession procedure for membership of the European Monitoring Centre for Drugs and Drug Addiction. The legislation governing the Government Office for Combating Narcotic Drug Abuse has been amended to allow its establishment as a National Focal Point. Inter-agency cooperation in this area is satisfactory, but efforts should be enhanced to develop links with relevant academic and research institutions. Cooperation with the Member States should also be intensified, making full use of the possibilities for cooperation with Europol foreseen in the Pre-Accession Pact on Organised Crime. Croatia is situated on the “Balkan Route” to Western Europe and drug smuggling, especially of heroin, remains a serious concern to be addressed, in particular through attention to border surveillance. Croatia’s 1 000 km coastline and over 1 000 islands present an attractive target to smugglers moving narcotics into the EU. Cocaine, intended for the illegal drugs market of Western Europe, is in most cases smuggled by sea.

On **customs cooperation**, the National Strategy for Integrated Border Management and its Action Plan, adopted in April 2005, applies to the customs service as well as other related agencies. Croatia should start timely preparations for accession to, and implementation of, the 1997 Convention on Mutual Assistance and Cooperation between the Customs Administrations (Naples II) upon accession, and to the 1995 Convention on the Use of Information Technology for Customs Purposes. With a view to fighting fraud and corruption within the customs administration, there is an urgent need to implement a Code of Conduct for custom officers, to ensure that cases of corruption are properly investigated and disciplinary actions are taken and to provide adequate training for customs officials to allow them to develop a sense of professional ethics.

As regards **judicial cooperation in criminal and civil matters**, a new Act on Mutual Legal Assistance in Criminal Matters entered into force in July 2005 and covers *inter alia* extradition, enforcement of foreign judgements and international legal aid.. The quality of the transposition and implementation of the *acquis* in the area of judicial cooperation both in civil and penal matters is closely dependent on the efficiency and reliability of the justice system. Recent developments in this area, towards court to court dealings, mean that the reform of the judiciary in Croatia will be a pre-condition for the correct implementation of this *acquis*. Croatia should enhance international co-operation in this area, including developing contacts with Eurojust, in order to strengthen the fight against severe, cross-border organised crime.

### *Conclusion*

Croatia has made further progress as regards legislative alignment and the adoption of international instruments, in particular in the fields of asylum and the fight against organised crime and terrorism. Moreover, important strategic documents were adopted in the field of border management. However, in these areas, and among law enforcement in general, urgent attention must now be paid to building on the progress made through proper implementation. This includes in particular strengthening administrative capacity through adequate staffing and training and transparent, efficient procedures, ensuring an appropriate level of technical and IT equipment, and developing databases and other means of effective information exchange, including enhanced inter-agency and international cooperation. It is advisable to adopt longer-term comprehensive national strategies in as many fields as possible under this chapter and to follow up on the swiftly developing *acquis* in the area of Justice, Freedom and Security.

## ***Chapter 25: Science and research***

The *acquis* in the field of science and research does not require transposition of EU rules into the national legal order. Implementation capacity relates to the existence of the necessary conditions for effective participation in the EU's Framework Programmes. In order to ensure the full and successful association with the Framework Programmes, Member States need to ensure the necessary implementing capacities in the field of research and technological development including adequate staffing.

Progress has been made.

Croatia has taken a number of measures aimed at ensuring successful participation in the **6th Framework Programme for Research and Technological Development (FP6)**, including training measures for the National Contact Points designated in July 2005, the creation of a network of coordinators at all higher education institutions and research institutes, and enhanced information activities. In June 2005, Croatia requested to be fully associated with the FP6 for the remaining year of 2006. The necessary procedure has been launched and the memorandum of understanding stipulating the terms and conditions of this association is expected to enter into force on 1 January 2006. In parallel, Croatia is improving its research capacity to stimulate participation in and take up of Community programmes. Croatian participation in the Framework Programme as a third country has been running satisfactorily.

In March 2005, an Agency for Science and Higher Education was established, though it is not yet operational. In the area of science, the Agency will be responsible for carrying out administrative tasks related to the evaluation of the science system and for providing logistic support for the activities of the National Science Council.

Government expenditure on research and development remains fairly low, totalling around HRK 2 billion (approx. EUR 270 million) or little more than one percent of GDP in 2004. This compares with an EU average R&D spend of around 2% of GDP.

Croatia has not requested to be associated with the **Euratom Research Framework Programme**.

### ***Conclusion***

Association with the Framework Programmes should be the first step towards full implementation of the *acquis* in the field of research. This will require further development of research policy, infrastructure and appropriate institutional arrangements. Successful participation in the Framework Programmes will require continued thorough preparations as well as the availability of the necessary financial resources. Greater efforts will be needed to make Croatian research and technological development efficient and competitive at the European level.

## ***Chapter 26: Education and culture***

The areas of education, training, youth and culture are primarily the competence of the Member States. A cooperation framework on education and training policies aims to converge national policies and the attainment of shared objectives through an open method of coordination, which led to the "Education and Training 2010" program, which integrates all actions in the fields of education and training at European level. As regards cultural diversity, Member States need to uphold the principles enshrined in Article 151 of the EC Treaty and ensure that their international commitments allow for preserving and promoting cultural diversity. Member States need to have the legal, administrative and financial framework and necessary implementing capacity in place to ensure sound financial management of the education, training and youth Community programmes (currently Leonardo da Vinci, Socrates, Youth).

Overall, there has been good progress in the area of education and culture.

Several measures were adopted for the reform of the **education and training** system. In the area of secondary education, a Law on the National Centre for the External Evaluation of Education entered into force in January 2005. With this measure, this new public body will be entrusted with the external evaluation of the education system and the implementation of national standards for exams, including the exams for access to university. The Law on Secondary Education was adapted and amended in July 2005 to take into account these changes. A new Croatian National Educational Standard was also adopted in June 2005 which defines the knowledge, skills and abilities to be acquired by pupils at various levels of their education. In the field of basic education, measures intended to support foreign language learning from the first year of primary school were approved.

In the context of higher education reform, a number of decisions and implementing rules have been issued in relation to the Law on Science and Higher Education of July 2003, including the appointment of members of the Governing Board of the Agency for Science and Higher Education, established in July 2004. However, this Agency – the key body for the execution of reforms – is not yet fully operational. Staff have been gradually allocated since April 2005 but their job profiles remain unclear; furthermore, the Agency does not seem to have a real operational budget and hence its functioning is rather dependant on the Ministry. However the ENIC/NARIC office, which has benefited from technical assistance under the 2002 CARDS programme, is already fully operational.

Since January 2005, in coordination with all Croatian universities and polytechnics, the Ministry of Education and Science has accelerated the introduction of the Bologna process in higher education study programmes. By the end of May 2005, around 900 study programmes had been assessed by independent experts. Higher education students to take their first year in September 2005 will already study under this new system in line with the principles of the Bologna process. The Tempus programme, through its various activities such as Structural Measures and Joint European Projects between universities in the EU and Croatia and other partner countries, supports the higher education reform in Croatia and contributes to preparing the country for future participation in the Community programmes.

In the area of vocational education, an Agency for Vocational Education was established in January 2005. However, the Croatian system of vocational education and training (VET) has not seen major systemic change since the early nineties. In order to meet either the demands of the national and international labour market or modern EU standards, Croatia needs to substantially improve its VET system. A process of reform has started, but efforts need to be stepped up to overcome the main challenges such as the lack of qualified teachers, low investment levels, the lack of a system of nationally agreed occupational and qualification standards, and insufficient links with the private sector.

There are currently few children of EU nationals enrolled in Croatian schools. By the time of accession, appropriate measures for the **education of children of migrant workers** will need to have been adopted to meet the specific requirements of the *acquis*.

There are no particular developments to report as regards youth policy. Croatia has developed a structured youth policy and is implementing it on the basis of a National Action Plan for Young People from 2003. However, available funds have reduced to the point where there is no allocation whatsoever for the implementation of the Plan in the State budget for 2005.

In the field of **culture**, in April 2005 Croatia submitted a letter of intent on its possible participation in the future Culture 2007 programme. A certain number of Croatian

cultural operators have taken part in the activities undertaken within the framework of the Culture 2000 Programme as associated partners, acting on a un-funded basis. Cultural Correspondents within the Ministry of Culture have been established, as have informal contacts with Cultural Contact Points of Member States and candidate countries.

### *Conclusion*

Croatia's educational priorities have been gradually refocused to cope with the needs of a free market economy and to improve the quality of the education and training system. Several measures were adopted for the reform of the education and training system, in particular in the area of higher education with the introduction of the Bologna process in higher education study programmes. However, the Croatian system of vocational education and training (VET) needs substantial improvement, given in particular the need for a VET system more responsive to labour market needs. A new VET law based on a coherent vision of national policy in this area is required. More attention should be paid to youth policy. Good prospects for future cooperation exist in the field of culture.

### *Chapter 27: Environment*

EU environment policy aims to promote sustainable development and protect the environment for present and future generations. It is based on preventive action, the polluter pays principle, fighting environmental damage at source, shared responsibility and the integration of environmental protection into other EU policies. The *acquis* comprises over 200 major legal acts covering horizontal legislation, water and air quality, waste management, nature protection, industrial pollution control and risk management, chemicals and genetically modified organisms (GMOs), noise and forestry. Compliance with the *acquis* requires significant investment. A strong and well-equipped administration at national and local level is imperative for the application and enforcement of the environment *acquis*.

Good progress has been made in the areas of air quality and waste management and some progress in the water quality sector. Limited progress has been made in other areas.

Regarding **horizontal legislation**, limited progress can be reported. There is no development concerning the ratification of the Kyoto Protocol. Further efforts are needed to limit the growth of greenhouse gas emissions in order to meet Croatia's Kyoto target for the period 2008-2012. The transposition and implementation of the Emissions Trading Directive and the Linking Directive are at the core of cost effective climate actions to be implemented in Croatia. To implement new actions and limit growth of greenhouse gas emissions within the stringent timeline, the coordinating role of the Ministry of Environmental Protection, Physical Planning and Construction will have to be strengthened and the technical capacity of the responsible policy unit within the ministry will have to be reinforced.

Elements of a number of horizontal directives in the area of environment, such as provisions related to public participation in environmental decision making, are transposed through existing Croatian legislation but none of the regulations are currently fully in line with the *acquis*. Revisions continue to be needed to bring Croatian legislation in line with the *acquis* on Environmental Impact Assessment. No particular progress can be reported on the implementation of the *acquis* on Strategic Environmental Assessment.

The National Protection and Rescue Directorate came into being on 1 January 2005 rationalising the various services responsible for civil protection under one organisation.

In relation to **air quality**, good progress can be reported. The Air Protection Act, adopted in November 2004, transposes a substantial part of the Ambient Air Quality Framework

Directive. This act has also given rise to partial transposition of a number of other directives in the sector. The development of the national network for monitoring air quality continued with the addition of two new stations in Zagreb to the four existing stations.

Good progress can also be reported concerning **waste management**. Transposition has advanced regarding the horizontal legal framework (Waste Framework Directive and Hazardous Waste Directive) through the adoption of the Waste Act in December 2004 and a regulation transposing the European waste catalogue and the list of hazardous wastes in April 2005. The national waste management strategy has been adopted. However, an action plan to implement the strategy needs to be urgently adopted. The newly established Environmental Protection and Efficiency Fund focussed on remediation of official municipal waste landfills to EU standards in its first year of operation.

As regards **water quality**, progress can be reported as the transposition of the Drinking Water Directive was completed in 2004 through the adoption of an ordinance on drinking water quality. Croatia continues to play an active role in the Danube-Black Sea (DABLAS) Initiative and hosted the annual meeting of the Danube-Black Sea Task Force.

Whilst transposition of the *acquis* in the field of **nature protection** is already relatively advanced, completion of the alignment process has encountered delays and limited progress can be reported on the 15 legislative measures foreseen in the 2004 national programme for the integration of the Republic of Croatia into the EU, only one of which was adopted within the timescales foreseen by the programme. The Wild Animals in Zoos Directive is fully transposed but will not be fully implemented until 2009. Whilst the Ministry of Culture is the competent authority for nature protection, responsibilities for different aspects are scattered amongst various ministries. In 2004 the budget of the Directorate for Nature Protection was reduced to one sixth of its 2003 level. Although this was doubled in 2005 it remains one third of its previous level. One visible result of these budgetary constraints is that there is hardly any ongoing monitoring of nature protection in Croatia.

Croatia needs to ensure that activities and developments in potential Natura 2000 sites do not damage the natural assets of those sites, in line with the principle that in candidate countries, new investment must be in line with the environmental *acquis*. There are indications that this is not currently the case and that the impacts of construction on the environmental assets of such sites are not being assessed.

Regarding **industrial pollution and risk management** no substantial developments can be reported on the transposition of the *acquis*. The level of transposition remains low and Croatia faces a major challenge in aligning with the *acquis* in this sector. Croatia has been operating a permitting system for a number of years and though it is not compliant with the requirements of the *acquis*, it nevertheless provides a good foundation upon which to build.

In the field of **chemicals and genetically modified organisms**, the revised 2004 Chemicals Act did not come into effect on 1 July 2005 as foreseen, since the government proposed to postpone the adoption of the amendments to the law in parliament. This revised act would partially transpose a number of directives. In its absence, no particular progress on transposing the *acquis* can be reported in this sector. A number of acts were adopted that partially transpose the directives on genetically modified organisms.

There has been limited progress in transposing the *acquis* in the **noise** sector. Certain national noise indicators were defined by an ordinance on maximum permitted noise

levels in human living and working environments that entered into force in September 2004.

As regards **forestry**, administrative capacity has been provided and work is ongoing on drafting legislation with a view to approximation to the *acquis*.

With regard to administrative capacity in the environmental sector, following the reorganisation of the Ministry of Environmental Protection, Physical Planning and Construction the number of staff has increased by 14. Reorganisation of the Directorate for Inspection has resulted in a small increase in staffing levels. The Agency for Environmental Protection (established in 2002) is now operational and currently has 15 staff members. Whilst many institutions have staff who are knowledgeable of the *acquis* there remain resource constraints that affect their ability to implement environmental law. Of particular concern are staffing levels in local authorities responsible for issues such as municipal waste collection and disposal. The distribution and fragmentation of responsibility within the administration is hampering efforts to align with the *acquis*. The relative weakness of the Ministry of Environmental Protection, Physical Planning and Construction in relation to other ministries weakens the influence of environmental protection in Croatia and jeopardises its ability to fully implement the requirements of the environmental *acquis*.

The basic requirements of an inspection and enforcement system are in place but its effectiveness varies from sector to sector. The water inspection system works well whilst the industrial inspectorate is too small and poorly resourced to perform its current tasks let alone those required in order to implement the Integrated Pollution Prevention and Control (IPPC) Directive. At local level the situation remains poor with many waste facilities rarely inspected. The level of fines for breaches of environmental law do not offer an adequate deterrent and collection rates remain low. There is little evidence that the judicial system is sufficiently supportive of enforcement of environmental law.

Regarding financial resources, 0.46% of the 2004 State budget was allocated for environmental protection (administrative and salary expenditure not included). The 2005 State budget provides for a similar level of expenditure. In addition, counties and local self-government units have their own revenues that are used, amongst other things, for environmental protection. An Environmental Protection Fund was established and became operational in 2004. The fund has allocated grants for co-financing remediation of 151 municipal waste landfills.

### *Conclusion*

Good progress has been made in the areas of air quality and waste management. Some progress has been made concerning water quality whilst limited progress has been made in the other sectors. Overall progress is slower than envisaged in the 2004 National Programme for the Integration of the Republic of Croatia into the EU. An overall timetable for transposing the environmental *acquis* has yet to be drafted. The implementation and enforcement of new laws lag some way behind.

Most of the problems highlighted in the Commission Opinion on Croatia's application for EU membership remain present and continue to pose a threat to successful implementation of the *acquis*. The Opinion's conclusion that Croatia needs to make considerable and sustained efforts in the environmental sector does not appear to have led to any significant change in the overall importance attached to environmental protection by the Croatian government.

The Ministry of Environmental Protection, Physical Planning and Construction has responsibility for many areas of environmental protection without being given the corresponding authority to ensure delivery on these responsibilities. The comparative

weakness of the Ministry of Environmental Protection, Physical Planning and Construction compared to other ministries, coupled with the division of responsibilities for operational aspects of environmental protection, continues to hamper progress in approximation, implementation and enforcement.

### ***Chapter 28: Consumer and health protection***

The consumer protection *acquis* covers the safety of consumer goods as well as the protection of the economic interests of consumers in a number of specific sectors. Member States need to transpose the *acquis* into national law and to put in place independent administrative structures and enforcement powers which allow for effective market surveillance and enforcement of the *acquis*. Appropriate judicial and out-of-court dispute resolution mechanisms as well as consumer information and education and a role for consumer organisations should be ensured as well. In addition, this chapter covers specific binding rules in the area of public health.

Limited progress has been recorded in this chapter.

No particular progress can be reported with regard to **safety related measures**. Alignment with the principles of the general product safety directive was sought by adopting the General Product Safety Act in September 2003, which had to be supplemented by further legislation. As regards liability for defective products, the legal framework based on the Obligations Act also needs to be amended.

No particular progress was made either in the area of **market surveillance**. This task is largely delegated to the State Inspectorate. The basic provisions are in force but no specific market surveillance activities are conducted except for a few categories of products. For the other categories, either the pre-market approval system is still in place, or there is insufficient capacity to undertake market surveillance.

No new legislation was adopted as regards **non-safety related measures**. A Consumer Protection Act, adopted in 2003, aims at transposing EU Directives on misleading and comparative advertising, on contracts negotiated away from business premises, on consumer credit, on unfair terms in consumer contracts, on timesharing, on distance contracts and on the indication of the prices of products. The Tourist Trade Act and Obligations Act are partially in line with the EU Directive on package travel, package holidays and package tours and will need to be amended. Croatia's legislation does not cover EU Directives on injunctions for the protection of consumers' interests, on certain aspects of the sale of consumer goods and associated guarantees and on the distance marketing of consumer financial services. Further alignment with the *acquis* is therefore needed on these issues.

Concerning **consumer organisations**, no particular developments have taken place. While Croatia counts three main consumer organisations, which are associated to policy-making via a platform, efforts are needed to develop a strong, independent, representative and effective consumer movement.

As regards information to consumers, in August 2004 rules on assessing the qualifications required for posts in the Consumer Protection Advisory Centre entered into force. Consumer organisations have continued their information, awareness-raising and advocacy actions. Resources remain limited for that purpose and programmes should continue to be developed in this area.

In the area of **public health**, the Parliament adopted an act on transplantation of human tissues and organs for medical purposes, which entered into force in December 2004. This is meant to provide a legal basis for the transposition of Directive on the quality and safety of tissues and cells.

Overall, Croatia is currently reforming its health system. The guidelines on health promotion, prevention of ill health, and access for all seem adequate but the corresponding resources have not been fully identified. A system for the control of communicable diseases has been established, as have plans for eradicating communicable diseases and an immunisation programme. The list of diseases covered by State control should be modified and the EU case definitions introduced into the reporting system to allow comparability of data. Additional efforts are required in order to prepare the system for cooperation with EU structures, such as developing an a nosocomial diseases control system, a system for anti-microbiological resistance surveillance and an action plan how to react on a nationwide outbreak.

The legislation on blood quality and human tissues and cells seems to be partly in line with the *acquis*; however, further amendments and implementing legislation will be needed. Adequate technical resources will be required to fulfil the *acquis* requirements in this area.

The Croatian Act on Restriction of Tobacco Product Use of 1999 is broadly in line with the provisions of the Tobacco Products Directive. However, it does not meet several important requirements of the *acquis* in particular with regard to warning labels, carbon monoxide yields and misleading descriptors. The maximum nicotine and tar yields are also higher than provided for by the Directive. The Act includes a ban on advertising that is stricter than that provided for in the Advertising Directive. The Act also includes provisions on smoke-free environments, sets an age limit for tobacco purchasers and provides for smoking prevention measures.

### *Conclusion*

Progress has been limited to public health legislation. Croatian legislation only partially covers the *acquis* in the various sectors of consumer and health protection and market surveillance remains far from meeting EU requirements.

Concerning safety related measures, efforts should focus on product liability and on completing the product safety framework. While the main structures for consumer protection are in place, a market surveillance system should be put in place and provided with adequate resources. Regarding non-safety-related measures, the legislation should be supplemented to cover several EU Directives, notably on injunctions, sales and guarantees, and distance marketing of financial services, and should be further aligned in all other areas. In the area of public health, the legislative alignment should be completed, especially on tobacco products.

### ***Chapter 29: Customs union***

The customs union *acquis* consists almost exclusively of legislation which is directly binding on the Member States. It includes the EU Customs Code and its implementing provisions, the combined nomenclature, common customs tariff and provisions on tariff classification, customs duty relief, duty suspensions and certain tariff quotas, and other provisions such as those on customs control of counterfeit and pirated goods, drugs precursors, export of cultural goods as well as on mutual administrative assistance in customs matters and transit. Member States must ensure that the necessary implementing and enforcement capacities, including links to the relevant EU computerised customs systems, are in place. The customs services must also ensure adequate capacities to implement and enforce special rules laid down in related areas of the *acquis* such as external trade.

Croatia has only made limited progress in the legislative field but it has made some efforts which can provide the basis for the required strengthening and modernisation of its Customs Administration.

Concerning further legislative alignment with **customs rules**, only limited developments can be reported. Certain amendments made to the EU customs code in 2000 and relating to customs procedures with economic impact, free zones and free warehouses, the use of electronic declarations and incurrence of a customs debt have been transposed into Croatian legislation. However, notably the rules on free zones are not yet fully aligned with the customs *acquis*. Also the Croatian transit procedure will require major adaptations and certain customs clearance fees currently applied will have to be removed.

With regard to the **administrative and operational capacity** of its customs services, Croatia undertook important changes in the areas of *organisation and infrastructure*. A large re-organisation of the central Croatian Customs Administration took place in March 2005 with the aim of streamlining its structure. Currently its staff comprises 137 employees. At regional level, a department for origin, value and tariff was set up in five customs houses with heavier traffic, with a view notably to strengthening the control of preferential rules of origin. The reorganisation also includes setting up a department for internal audit and control at headquarters. Overall, the Croatian customs administration will require further strengthening, e.g. with regard to the excise duty collection (*see also Chapter 16 – Taxation*). Steps have been taken to improve communication with end users; these should be developed further.

Customs controls based on selectivity and risk analysis have been introduced as a pilot project in four customs houses. One central customs laboratory has been established in headquarters; the two laboratories currently operating in Split and Rijeka will be gradually closed and replaced by the central one where human resources and equipment will be concentrated.

Croatia has continued to provide *mutual assistance*, in line with obligations under the SAA, notably by strengthening its system for proper subsequent verifications of proofs of origin.

Concerning *ethics and anti-corruption measures*, a Code of Ethics has been drafted but it remains to be adopted and implemented.

A Customs *Training Centre* was formally set up in April 2005, in order to cater for the training needs of the customs administration. However, it has not yet become fully operational.

With regard to *computerisation and interconnectivity*, a comprehensive Interoperability Implementation Strategy (IIS) was adopted in early 2005 which will have to be integrated into an overall IT strategy. While the core business teams for transit, TARIC and Excise Movement and Control System projects have been set up, the central core business teams in the area of tariff-related issues require further strengthening. More generally, the IT capacity of the Customs Administration needs to be significantly increased.

### *Conclusion*

There have only been limited developments concerning Croatian customs legislation, which is partially aligned with the EU *acquis* and will require further harmonisation in certain areas.

Croatia has taken steps such as reorganising the administration and setting up a training centre, to strengthen and modernise its customs administration. However, these efforts will have to be intensified to ensure it has sufficient capacity to implement and enforce the EU *acquis*. With regard to IT and interconnectivity, Croatia has now a clear strategy in place and has started to staff the relevant business teams. This initial effort will have to be sustained to ensure timely preparation for full interconnection.

### ***Chapter 30: External relations***

The *acquis* in this field consists mainly of directly binding EU legislation which does not require transposition into national law. This EU legislation results from the EU's multilateral and bilateral commercial commitments, as well as from a number of autonomous preferential trade measures. In the area of humanitarian aid and development policy, Member States need to comply with EU legislation and international commitments and ensure the capacity to participate in the EU's development and humanitarian policies. Applicant countries are required to progressively align its policies towards third countries and its positions within international organisations with the policies and positions adopted by the Union and its Member States.

Croatia has made some progress in alignment with the common commercial policy; no progress can be reported concerning development policy and humanitarian aid. Croatia continued coordination and cooperation with the Commission on WTO-related matters, notably with regard to activities under the Doha Development Agenda.

In the field of the **common commercial policy**, Croatia continued the process of gradual reduction of customs duties, in line with its WTO commitments and bilateral agreements such as the Stabilisation and Association Agreement with the EU. Under WTO commitments, 2005 and 2007 are the final years for reducing customs duties on industrial and agricultural products, respectively. Croatia's applied tariffs currently average 58% (Most Favoured Nation - MFN) on all products, 11.3% on agricultural products, 8.2% on fishery products and 3.9% on industrial products. By comparison, EC tariffs currently stand at 6.3% on almost all products, 16.2% on agricultural products, 12.4% on fishery products and 3.6% on industrial products.

In the area of services, Croatia's commitments under the GATS are not entirely in line with those of the Community. Croatia should continue to co-operate and co-ordinate closely with the Commission, mainly with regard to the Doha Development Agenda negotiations, so as to ensure that, upon accession to the EU, its commitments are as consistent as possible with those of the Community.

Concerning **bilateral agreements with third countries**, since March 2003 Croatia is member of CEFTA which – following the EU's enlargement in May 2004 – is a Free Trade Agreement (FTA) between Romania, Bulgaria and Croatia. Free Trade Agreements with Serbia and Montenegro (July 2004), with Moldova (October 2004) and with Bosnia and Herzegovina (January 2005) came into force (the latter had been provisionally applied since 2001). Within the framework of the Stability Pact, in June 2005 Croatia agreed to a ministerial declaration on trade liberalisation in southeast Europe launching the process of upgrading the network of existing bilateral FTAs into a single regional FTA (*see also the chapter on political criteria*). Furthermore, Croatia signed an agreement on trade and economic cooperation with Israel and bilateral investment treaties with Oman, Morocco and San Marino. The bilateral investment treaty with Slovenia entered into force.

Croatia further developed its implementing legislation regarding trade defence instruments. National legislation and measures in this field will have to be repealed upon accession. Croatia adopted a law on export control of dual-use items as well as the necessary implementing measures, which have been applied since January 2005 and are aimed at harmonisation with the relevant EU *acquis*.

Limited developments have taken place with regard to administrative capacity. The Foreign Economic Relations Directorate within the Ministry of Economy, Labour and Entrepreneurship was reorganised in July 2005 but requires further strengthening.

Croatia has not yet drafted a **development policy** and does not have a specific administrative service in this area; **humanitarian aid** remains limited to assistance from the state commodity reserve (EUR 15,000 in 2004).

### *Conclusion*

Croatia has continued to liberalise its trade policy by implementing the Stabilisation and Association Agreement, WTO commitments and bilateral FTAs. The further pursuit of this process will facilitate trade integration with the EU. The legal framework on dual-use goods was brought closer to the EC *acquis*.

Croatia should continue to keep the EU fully informed of any new free trade agreements or investment treaties with third countries and closely coordinate work with the Commission on WTO and on regional trade issues. Croatia will have to strengthen its institutional capacity to be able to fully participate in the EU's policies in this chapter of the *acquis*.

### *Chapter 31: Foreign, security and defence policy*

The common foreign and security policy (CFSP) and the European security and defence policy (ESDP) are based on legal acts, including legally binding international agreements, and on political documents. The *acquis* consists of political declarations, actions and agreements. Member States must be able to conduct political dialogue in the framework of CFSP, to align with EU statements, to take part in EU actions and to apply agreed sanctions and restrictive measures. Applicant countries are required to progressively align with EU statements, and to apply sanctions and restrictive measures when and where required.

Good progress has been made in the field of foreign and security policy as well as defence policy.

Following entry into force of the Stabilisation and Association Agreement in February 2005, the regular **political dialogue** between the European Community and its Member States and the Republic of Croatia has continued on the basis of the SAA. Croatia has also aligned itself with several **EU sanctions and restrictive measures, statements**, including on the freezing of assets and travel/visa bans in support of the effective implementation of the mandate of ICTY. Croatia has not signed a bilateral agreement with the USA concerning the non-surrender of certain persons to the International Criminal Court (ICC) and continues to support the Council's Common Positions on the, having ratified the Rome Statute in 2001. In this regard, the Croatian Parliament adopted an Act on International Restrictive Measures in December 2004.

Croatia is party to most of the existing international regimes for **non-proliferation** of weapons of mass destruction. In April 2005, a joint statement was agreed by the EU and Croatia on non-proliferation of weapons of mass destruction and on combating **terrorism**. Croatia has ratified three further UN conventions in the field of the fight against terrorism – on the suppression of unlawful acts against the safety of maritime navigation, on the suppression of unlawful acts against the safety of fixed platforms located on the continental shelf, and on the suppression of terrorist bombings – bringing the number of conventions ratified in this field to a total of twelve. In September 2005, Croatia signed the new International Convention on the Suppression of Acts of Nuclear Terrorism. Croatia should ensure these international instruments are fully implemented and further actively support the early finalisation of the UN Comprehensive Convention on Terrorism.

In June 2005, Croatia became a member of Nuclear Suppliers Group and joined the Wassenaar Arrangement. Croatia has applied to join the Australia Group and the Missile

Technology Control Regime. Croatia continues to take part in the preparatory work for the International Code of Conduct against Ballistic Missile Proliferation. A National Commission for Arms and Ammunition composed of representatives of competent ministries and Government agencies was established.

Concerning relations with **neighbouring countries**, some border issues remain unresolved (*see chapter on Political Criteria*).

Croatia has continued to take part in international peace-keeping efforts, participating in 12 UN peacekeeping missions. A Croatian military police platoon is participating under the ISAF in Afghanistan.

### *Conclusion*

Croatia has made good progress in aligning with the CFSP *acquis*. Croatia continues to align itself with EU sanctions and restrictive measures, statements, declarations and demarches and has ratified all twelve UN anti-terrorism conventions. Croatia has declared that, as an EU Member State, it will support the CFSP actively and unreservedly. Croatia has also declared its willingness to support, participate in, and contribute to European Security and Defence Policy civilian and military crisis management operations, for which the necessary resources will need to be allocated. Croatia should keep its foreign and security policy in line with that of the EU and ensure the necessary legal and administrative improvements are made. Attention should be paid to the full implementation of the Code of Conduct for Arms Exports and the fight against unauthorised weapons transfers as well as full implementation of the UN conventions on terrorism. Croatia needs to strengthen the relevant law enforcement agencies in charge of the internal controls necessary for the full implementation of international non-proliferation regimes and relevant EU standards, including those pertaining to the control of trade both in small and light weapons and dual use goods. In order to be able to work with EU CFSP structures, Croatia would need to establish the necessary functions and mechanisms within the Ministry for Foreign Affairs.

### *Chapter 32: Financial control*

The *acquis* under this chapter relates to the adoption of internationally agreed and EU compliant principles, standards and methods of public internal financial control (PIFC) that should apply to the internal control systems of the entire public sector, including the spending of EU funds. In particular, the *acquis* requires the existence of effective and transparent financial management and control systems (including adequate ex-ante, ongoing and ex-post financial control or inspection); functionally independent internal audit systems; the relevant organisational structures (including central co-ordination); an operationally and financially independent external audit organisation to assess, amongst others, the quality of the newly established PIFC systems. This chapter also includes the *acquis* on the protection of EU financial interests and the fight against fraud involving EU funds.

Some progress has been made in this chapter.

The Government adopted a revised Policy Paper on **Public Internal Financial Control** (PIFC) in June 2005. This document is meant to serve as the basis for an overall comprehensive legal PIFC framework to be devised for the implementation of a modern internal control and internal audit system in the public sector. This framework should be linked to the Organic Budget Law and the Civil Service Law, and include references to the status and salaries of internal auditors. Amendments to the decree on the Government Office for Internal Control came into force in June 2005. The former office is merged into a new Office for Internal Audit, which will exclusively carry out internal audits of

those Government entities which are considered too small to establish their own internal audit units.

The Government adopted a decree reorganising the Ministry of Finance in March 2005, which officially established the Central Harmonisation Unit (CHU) and the independent Internal Audit Unit in the Ministry of Finance. Independent internal audit units have also been formally established through internal organisation decrees in nine other ministries out of 13, plus the State Audit Office, the State Inspectorate (NN 66/05), and the City/County of Zagreb. Some of the staff have been recruited.

Overall, Croatia is at the early stages of developing its PIFC legislative framework. This requires a coherent legal PIFC framework including a PIFC Framework Law, implementing legislation and internal regulations (such as control and audit manuals, Audit Charter, Code of Ethics and Audit Trails), with clarified interactions with the Organic Budget Law and its implementing legislation. The internal management and control systems need further definition, notably on the status of the financial controller and accountant and the responsibilities of managers in establishing and developing such systems.

The newly established Central Harmonisation Unit should conduct pilot internal audits of budget users, and develop its networking and guidance role. Functionally independent audit units remain to be established in several spending bodies, and those in place should develop their capacity.

In the field of **external audit**, amendments to the Law on State Audit were adopted by Parliament in December 2004. The amendments ensure partial alignment with the acquis, as they extend the scope of the State Audit Office (SAO) audits to the spending of EU funds, increase autonomy in defining auditor profiles, and repeal the requirement for SAO to obtain a prior approval from the Parliament on its yearly audit programme.

Some changes have been introduced to the organisational and senior management structure of the SAO. The main changes were the abolition of the Department dealing with privatisation and the creation of two new departments: the Department responsible for methodology development and the Department responsible for the audit of all Funds including those of the EU. Both new departments are headed by an Assistant Auditor General. New recruitments since April 2004 brought the total staff number to 278, of which 229 are audit staff.

Overall, the Act on State Audit should be further amended to ensure the financial independence of the State Audit Office, while the SAO should be subject to independent external audit and could be allowed to be established as the certifying body for future EU funded programmes in Croatia. The SAO should start pilot projects in the field of system-based and performance audits. Both Parliament and the SAO should establish mechanisms to regularly review the SAO's audit reports and to continuously monitor the implementation of the SAO's recommendations.

Regarding the **protection of EU financial interests**, bodies involved in the implementation of PHARE and ISPA have included in their operating manuals a description of procedures to be applied in case of irregularities. Overall, Croatia still needs to designate an official contact point for OLAF, to develop effective procedures for the detection, treatment and follow-up of irregularities (notably safe and prompt recovery of illegal spending of EU funds), and to establish an adequate anti-fraud coordination structure. Significant steps towards accreditation for decentralised management have been made and a Memorandum of Understanding on establishing the National Fund has been signed. New structures also urgently need to be established and accredited to implement the 5 components of the Integrated Pre-Accession (IPA) instrument from 2007 (see *Chapter 22 – Regional policy and coordination of structural instruments*).

### *Conclusion*

Some progress has been made, mainly thanks to the adoption of a policy paper on Public Internal Financial Control, the establishment of internal audit units in several spending institutions, and the amendments to the State Audit Law. Croatia remains at an early stage of alignment as important efforts will be needed to have adequate systems in place.

Policy implementation should continue in the area of Public Internal Financial Control, which will necessitate a comprehensive regulatory and institutional framework, including strengthened control bodies. In the area of external audit, further efforts are necessary notably to strengthen the capacity of the State Audit Office and to ensure its independence.

Regarding the protection of EU financial interests, Croatia will need to design and establish the administrative capacity necessary to provide effective and equivalent protection of the EU financial interests and to establish management and control capacity for pre-accession funds.

### ***Chapter 33: Financial and budgetary provisions***

This chapter covers the rules concerning the financial resources necessary for the funding of the EU budget ('own resources'). These resources are made up mainly from contributions from Member States based on traditional own resources from customs and agricultural duties and sugar levies; a resource based on value-added tax; and a resource based on the level of gross national income. Member States must have appropriate administrative capacity to adequately co-ordinate and ensure the correct calculation, collection, payment and control of own resources. The *acquis* in this area is directly binding and does not require transposition into national law.

No particular progress is to be reported under this chapter.

### *Conclusion*

There are no significant divergences between the Croatian and the EU system concerning the basic principles and institutions in the underlying policy areas linked to the application of the own resources system. Croatia needs to continue its efforts to align with the relevant *acquis* chapters, in particular customs, taxation, statistics and financial control. In due course, although the *acquis* in this area does not require transposition, Croatia will need to establish coordination structures and implementing rules so as to ensure the correct calculation, collection, payment and control of own resources and reporting to the EU for implementation of the own resources rules.

## **3.2 General evaluation**

As regards Croatia's **ability to assume the obligations of membership**, Croatia has made some progress since the Opinion, mainly in terms of legislative alignment with the *acquis* in areas such as free movement of goods and public procurement and in the field of information society. Progress has also been good in the field of education and culture and in foreign, security and defence policy.

Croatia needs to continue legislative alignment across the board, however, while at the same time strengthening administrative and judicial structures that are necessary for the effective enforcement of the *acquis*. In many cases enforcement is weak and administrative capacity remains uneven.

In particular, increased efforts will be needed to align legislation with the *acquis* and to effectively implement and enforce in the following fields: Free Movement of Capital,

Company Law, Information Society and Media, Fisheries, Transport, Energy, Consumer and Health Protection, Customs Union and Financial Control.

Croatia will need to make considerable and sustained efforts to align legislation with the acquis and to effectively implement and enforce it in the following fields: Free Movement of Goods, Public Procurement, Freedom of Movement for Workers, Rights of Establishment and Free Movement of Services, Financial Services, Competition Policy, Agriculture and Rural Development, Food Safety, Taxation, Social Policy and Employment, Regional Policy, Judiciary and Fundamental Rights, and Justice, Freedom and Security.

Very significant efforts will be required in the area of Environment, including substantial investment and the strengthening of administrative capacity for the enforcement of the acquis.

### C. EUROPEAN PARTNERSHIP: OVERALL ASSESSMENT

Croatia's progress and overall state of preparations with respect to the Copenhagen criteria have been examined and conclusions drawn above. This section assesses briefly the overall extent to which priorities of the European Partnership have been met.

A first European Partnership for Croatia was adopted in September 2004<sup>9</sup>. Along with the present report, a revised Partnership is being proposed. The purpose of the Partnership is to assist the Croatian authorities in their efforts to meet the accession criteria. It covers in detail the priorities for accession preparations, in particular implementation of the *acquis*, and forms the basis for programming pre-accession assistance from EU funds.

The priorities of the Partnership have been selected on the basis that it is realistic to expect that the country can complete them or take them substantially forward over the next few years. A distinction is made between short-term priorities, which are expected to be accomplished within one to two years, and medium-term priorities, which are expected to be accomplished within three to four years.

Overall, Croatia has made some progress in addressing the priorities in the Partnership, but substantial further efforts will be necessary to complete the tasks foreseen. The revised priorities will reflect the progress achieved to date and address areas where more progress is needed.

With regard to priorities related to the **political criteria**, Croatia has made progress in a number of areas, most significantly in the area of *regional cooperation*. However, further efforts are still required to find definitive solutions to all pending bilateral issues, especially as regards border issues.

While some progress has been made in the field of *refugee return*, such as with regard to housing repossession and reconstruction, a number of deadlines have not been met. There is a need for further significant efforts from Croatia, particularly as regards implementing housing care programmes for former tenancy rights holders and creating the economic and social conditions necessary for sustainable refugee return. As regards *minority rights*, implementation of the Constitutional Law on National Minorities has been slow and the need to improve the position of minorities, in particular the Serb minority, remains an urgent priority. Implementation of a new Roma strategy has begun, but major challenges still lie ahead.

Despite some progress in the field of the *judiciary*, the scope of the challenges faced will require continued serious attention. The comprehensive strategy for judicial reform needs to be properly implemented. In the area of anti-corruption, there has been progress in establishing a legal framework for tackling *corruption*. However, these efforts need to be followed up with real implementation on the ground including improved coordination of the government bodies and agencies involved.

Concerning the priorities related to the **economic criteria**, Croatia has made some progress in meeting the priorities of the Partnership, most notably in the area of land reform. Croatia needs to continue to address the present macroeconomic imbalances – mainly government deficit, current account deficit and external debt, as well as structural problems that may impair its capacity to stay on a path of strong growth. Progress also needs to continue on structural reforms and on advancing privatisation and enterprise restructuring. A number of foreseen measures need to be implemented without delay.

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<sup>9</sup> Council Decision 2004/648/EC of 13 September 2004 on the principles, priorities and conditions contained in the European Partnership with Croatia (OJ L 297, 22.9.2004, p. 19)

As to the priorities related to the **ability to assume the obligations of membership**, Croatia has made some progress in terms of legislative alignment with the *acquis*, in particular in areas such as the free movement of goods, and public procurement, and in the field of telecommunications, including with respect to strengthening the capacity of the regulator.

Croatia needs to continue legislative alignment across the board, however, while at the same time strengthening administrative and judicial structures that are necessary for the effective implementation and enforcement of the *acquis*. In many cases enforcement is weak, for example in the areas of competition policy, taxation, environment and in the field of social policy and employment, and administrative capacity remains uneven.

Progress on the issues identified as priorities in the Partnership is discussed in more detail in other parts of this report, notably in section B.3.: *Ability to assume the obligations of membership*. The revised Partnership follows the same structure as the present report.

The revised Partnership continues to be the main tool for guiding Croatia's work on preparation for accession to the EU. Implementation of the Partnership needs to continue. It should be given the necessary political attention and should help Croatia to set its legislative and institution-building agenda.

## STATISTICAL ANNEX

### STATISTICAL DATA on Croatia as of 1 September 2005

Basic data	Scale	Unit	Foot-note	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Population: total	Thousand	Number	1)	4.669	4.494	4.572	4.501	4.554	4.427	4.440	4.444	4.442	4.439
Total area of the country	Unit (x1)	km <sup>2</sup>		56.610	56.610	56.610	56.542	56.542	56.542	56.542	56.542	56.594	56.594

National accounts	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Gross domestic product	Million	National currency		98.382	107.981	123.811	137.604	141.579	152.519	165.640	179.390	193.067	207 082f
Gross domestic product	Million	EUR		14.391	15.657	17.739	19.305	18.677	19.977	22.177	24.219	25.526	27 629f
Gross domestic product per capita	Unit (x1)	EUR	2)	3.100	3.500	3.900	4.300	4.100	4.600	5.000	5.400	5.700	6 200f
SI: Growth rate of Gross domestic product at constant prices (national currency), relative to the previous year	Unit (x1)	%		:	5,9	6,8	2,5	-0,9	2,9	4,4	5,2	4,3	3.7f
SI: Employment growth (national accounts), relative to the previous year	Unit (x1)	%		:	:	:	:	-1,5	-1,7	0,5	0,8	:	:
Labour productivity growth: growth in GDP (constant prices) per person employed, relative to the previous year	Unit (x1)	%		:	:	:	:	4,4	9,6	8,0	5,7	:	:
SI: Unit labour cost growth (national accounts), relative to the previous year	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:
GDP per capita at current prices	Unit (x1)	PPS	2)	5 700e	6 400e	7 000e	7 500e	7 400e	8 200e	8 600e	9 300e	9 700e	10 300f
SI: GDP per capita at current prices, PPS, EU-25=100	Unit (x1)	%	2)	37.1e	39.9e	41.4e	42.1e	40.0e	41.3e	41.9e	43.6e	45.2e	46.0f
SI: Labour productivity, PPS (GDP per person employed), EU-25=100	Unit (x1)	%	2)	:	:	:	:	:	:	:	:	:	:
Agriculture (NACE Sections A+B): share of total gross value added	Unit (x1)	%		:	:	:	:	9,8	9,0	9,1	8,2	8,4	8,2
Industry (excluding construction) (NACE Sections C to E): share of total gross value added	Unit (x1)	%		:	:	:	:	24,6	24,7	24,3	23,4	23,3	23,2
Construction (NACE Section F): share of total gross value added	Unit (x1)	%		:	:	:	:	5,3	4,6	4,9	5,3	6,8	6,9
Services (NACE Sections G to P): share of total gross value added	Unit (x1)	%		:	:	:	:	60,4	61,9	61,8	63,2	61,5	61,7
Final consumption expenditure, as a share of GDP	Unit (x1)	%		:	:	:	:	85,4	84,9	83,6	82,1	79,3	77,9

Final consumption expenditure: household and NPISH, as a share of GDP	Unit (x1)	%	:	:	:	:	58,9	60,1	60,0	60,1	58,7	58,1
Final consumption expenditure: General government, as a share of GDP	Unit (x1)	%	:	:	:	:	26,5	24,8	23,6	22,0	20,6	19,9
—Gross fixed capital formation, as a share of GDP	Unit (x1)	%	:	:	:	:	23,3	21,8	22,9	24,8	27,5	27,6
—Stock variation, as a share of GDP	Unit (x1)	%	:	:	:	:	-0,3	-1,6	1,6	2,1	2,9	2,5
Exports of goods and services, relative to GDP	Unit (x1)	%	:	:	:	:	40,9	47,1	49,1	45,9	47,1	47,5
Imports of goods and services, relative to GDP	Unit (x1)	%	:	:	:	:	49,3	52,3	54,7	54,9	56,8	55,7

Inflation rate	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SI: Consumer price index: total (CPI), growth relative to the previous year	Unit (x1)	%	:	:	:	:	:	4,0	4,6	3,8	1,7	1,8	2,1

Balance of payments	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Balance of payments: current account total	Million	EUR	:	:	:	:	:	-1.313	-490	-818	-2.097	-1.757	-1.250
Balance of payments current account: trade balance	Million	EUR	:	:	:	:	:	-3.106	-3.499	-4.604	-5.960	-6.974	-6.725
Balance of payments current account: exports of goods	Million	EUR	:	:	:	:	:	4.134	4.969	5.319	5.293	5.572	6.602
Balance of payments current account: imports of goods	Million	EUR	:	:	:	:	:	7.240	8.469	9.923	11.253	12.546	13.327
Balance of payments current account: net services	Million	EUR	:	:	:	:	:	1.545	2.470	3.303	3.285	5.047	4.904
Balance of payments current account: net income	Million	EUR	:	:	:	:	:	-346	-420	-616	-574	-1.074	-618
Balance of payments current account: net current transfers	Million	EUR	:	:	:	:	:	594	959	1.099	1.152	1.245	1.190
Balance of payments current account: net current transfers - of which government transfers	Million	EUR	:	:	:	:	:	-123	25	65	32	71	0
Direct investment (FDI) in the reporting economy	Million	EUR	:	:	:	:	:	1.369	1.142	1.503	1.195	1.788	921

Public finance	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
General government deficit/surplus, relative to GDP	Unit (x1)	%	3)	:	:	:	:	:	:	-6.5p	-4.2p	-4.6p	-5.2p
SI: General government debt, relative to GDP	Unit (x1)	%	4)	:	:	:	:	:	:	40.1p	39.9p	41.5p	44.2p

Financial indicators	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Gross foreign debt of the whole economy, relative to GDP	Unit (x1)	%	:	:	:	47,6	54,1	60,6	60,7	62,2	77,6	82,1	
Gross foreign debt of the whole economy, relative to total exports	Unit (x1)	%	:	:	:	:	132,2	128,7	124,6	135,3	149,5	157,2	

Money supply: M1	Million	EUR		1.209	1.656	1.977	1.846	1.805	2.373	3.216	4.148	4.432	4.505
Money supply: M2	Million	EUR		:	:	:	:	:	:	:	:	:	:
Money supply: M3	Million	EUR		:	:	:	:	:	:	:	:	:	:
Total credit: credit by monetary financial institutions (MFIs) to total residents (consolidated)	Million	EUR		7.043	7.061	8.089	9.131	8.587	9.483	11.891	15.119	16.526	18.417
Interest rates: day-to-day money rate, per annum	Unit (x1)	%		:	:	:	:	9,9	7,9	3,4	1,6	3,5	5,1
Lending interest rate (one year), per annum	Unit (x1)	%		:	:	:	:	:	:	:	11,6	11,2	11,0
Deposit interest rate (one year), per annum	Unit (x1)	%		:	:	:	:	:	:	:	1,4	1,2	1,4
EUR exchange rates: average of period - 1 euro= ... national currency	Unit (x1)	Number		6,758	6,805	6,960	7,137	7,580	7,635	7,469	7,407	7,563	7,495
EUR exchange rates: end of period - 1 euro= ... national currency	Unit (x1)	Number		6,812	6,864	6,947	7,329	7,679	7,598	7,370	7,442	7,647	7,671
Effective exchange rate index (1999=100)	Unit (x1)	Number		:	:	:	:	:	:	:	:	:	:
Value of reserve assets (including gold)	Million	EUR		1.479	1.868	2.304	2.400	3.013	3.783	5.334	5.651	6.554	6.436
Value of reserve assets (excluding gold)	Million	EUR		1.479	1.868	2.304	2.400	3.013	3.783	5.334	5.651	6.554	6.436

External trade	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Trade balance: (all goods, all partners)	Million	EUR		:	:	:	:	-3.302	-3.776	-5.031	-6.139	-7.071	-6.901
Value of exports: (all goods, all partners)	Million	EUR		:	:	:	:	4.049	4.822	5.214	5.188	5.439	6.312
Value of imports : (all goods, all partners)	Million	EUR		:	:	:	:	7.351	8.597	10.245	11.327	12.510	13.213
Terms of trade (export price index / import price index), relative to the previous year	Unit (x1)	Number	5)	:	:	:	:	:	98,3	94,4	97,8	98,2	109,3
Share of exports to EU-25 countries in value of total exports	Unit (x1)	%		:	:	:	:	66,8	69,3	67,6	:	:	:
Share of imports from EU-25 countries in value of total imports	Unit (x1)	%		:	:	:	:	71,7	70,1	71,7	:	:	:

Demography	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Natural growth rate : crude rate of natural increase (births minus deaths)	Unit (x1)	per 1000		-0,1	0,7	0,8	-1,2	-1,5	-1,5	-1,9	-2,4	-2,9	-2,1
Net migration rate: number of immigrants minus the number of emigrants	Unit (x1)	per 1000		:	:	:	:	:	:	:	:	:	:
Infant mortality rate: number of deaths of children under one year of age relative to 1000 live births	Unit (x1)	Number		8,9	8,0	8,2	8,2	7,7	7,4	7,7	7,0	6,3	6,1
Life expectancy at birth: male	Unit (x1)	Years		:	:	:	:	:	:	71,1	71,2	71,4	72,0
Life expectancy at birth: female	Unit (x1)	Years		:	:	:	:	:	:	78,1	78,3	78,4	79,0

Labour market	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Economic activity rate (15 - 64): proportion of the population aged 15-64 that is economically active	Unit (x1)	%	6)	:	65,5	63,6	62,8	62,6	62,2	62,2	62,9	62,4	63,2
SI: Employment rate (15-64): proportion of the population aged 15-64 that is in employment	Unit (x1)	%	6)	:	58,7	57,1	55,3	53,2	51,3	51,8	53,6	53,2	54,3
SI: Employment rate (15-64), male: proportion of the male population aged 15-64 that is in employment	Unit (x1)	%	6)	:	65,8	63,6	61,7	59,0	57,4	59,0	60,1	59,6	60,7
SI: Employment rate (15-64), female: proportion of the female population aged 15-64 that is in employment	Unit (x1)	%	6)	:	51,9	50,9	49,4	47,8	45,5	44,9	47,4	47,0	47,9
SI: Employment rate of older workers (55-64): proportion of the population aged 55-64 that is in employment	Unit (x1)	%	6)	:	31,1	29,1	25,6	25,9	24,2	23,7	26,8	29,0	30,4
Agriculture, forestry and fishing (NACE Sections A+B) as a share of total employment	Unit (x1)	%	6)	:	19,9	17,8	16,5	16,7	11,7	15,6	14,9	16,8	15,9
Industry (NACE Sections C to E) as a share of total employment	Unit (x1)	%	6)	:	22,9	23,9	23,5	23,9	22,7	23,1	22,9	21,0	22,0
Construction (NACE Sections F) as a share of total employment	Unit (x1)	%	6)	:	6,2	5,7	6,7	6,6	5,9	6,3	6,6	8,1	8,1
Services (NACE Sections G to P) as a share of total employment	Unit (x1)	%	6)	:	50,9	52,3	53,1	52,8	59,5	55,0	55,3	53,9	54,1
SI: Unemployment rate: proportion of the labour force that is unemployed	Unit (x1)	%	6)	:	10,0	10,0	11,7	14,5	17,0	16,3	14,4	14,4	13,8
SI: Unemployment rate, male: proportion of the male labour force that is unemployed	Unit (x1)	%	6)	:	9,6	9,6	10,6	13,5	15,9	14,4	13,3	13,3	11,9
SI: Unemployment rate, female: proportion of the female labour force that is unemployed	Unit (x1)	%	6)	:	10,5	10,4	12,9	15,7	18,2	18,7	15,8	15,7	16,1
Unemployment rate of persons < 25 years: proportion of the labour force aged <25 that is unemployed	Unit (x1)	%	6)	:	26,7	28,5	31,0	39,2	43,1	41,7	34,4	35,8	33,8
SI: Long-term unemployment rate: proportion of the labour force that is long-term unemployed	Unit (x1)	%	6)	:	4,1	4,4	5,4	7,3	9,1	9,0	7,6	7,7	6,9

Social cohesion	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SI: Inequality of income distribution: ratio of top quintile to lowest quintile	Unit (x1)	Number	7)	:	:	:	:	:	:	:	:	4,6	:
SI: Early school-leavers: proportion of the population aged 18-24 having not completed upper secondary education and who are currently not in any education or training	Unit (x1)	%	6)	:	:	:	:	:	:	:	:	7,3	4,5

SI: Children aged 0-17 living in jobless households: share of children aged 0-17	Unit (x1)	%		:	:	:	:	:	:	:	:	10,4	:
SI: Persons aged 18-59 living in jobless households: share of persons aged 18-59	Unit (x1)	%		:	:	:	:	:	:	:	:	13,2	:

Standard of living	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Number of passenger cars / population	Unit (x1)	per 1000		164,4	187,1	205,4	222,5	234,1	258,4	269,3	280,0	291,2	301,3
Number of main telephone lines (fixed) / population	Unit (x1)	per 1000	8)	268,6	309,1	325,5	346,1	360,3	382,2	386,5	379,2	379,1	377,6
Number of subscriptions to cellular mobile telephone services / population	Unit (x1)	per 1000	9)	6,6	13,4	26,2	39,3	79,3	251,2	389,9	526,6	571,1	640,2

Infrastructure	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Density of railway network (lines in operation)	Unit (x1)	per 1000 km <sup>2</sup>		47,7	47,7	47,7	47,8	47,8	47,8	47,8	47,8	47,7	47,7
Length of motorways	Unit (x1)	km		300	300	300	300	400	400	400	500	600	700

Industry and agriculture	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Industrial production volume index (2000=100)	Unit (x1)	Number	10)	87,3	90,0	96,2	99,7	98,3	100,0	106,0	111,7	116,3	120,6
Agricultural production volume indices of goods and services (at producer prices) (previous year = 100)	Unit (x1)	Number	11)	99,8	101,6	104,1	110,1	98,8	88,7	108,5	107,7	84,1	:

Innovation and research	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SI: Spending on human resources (public expenditure on education) as a share of GDP	Unit (x1)	%		:	:	:	:	4,20	4,50	4,20	4,30	4,20	:
SI: Gross domestic expenditure on research & development, relative to GDP	Unit (x1)	%		:	:	:	:	0,99	1,23	1,07	1,12	1,14	:
SI: Percentage of households who have Internet access at home. All forms of Internet use are included. The population considered is aged 16 to 74.	Unit (x1)	%		:	:	:	:	:	:	:	:	:	:

Environment	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
SI: Total greenhouse gases emissions, CO <sub>2</sub> equivalent (1990=100)	Unit (x1)	Number		70,4	73,9	78,8	79,5	82,7	82,6	85,1	88,5	:	:
SI: Energy intensity of the economy	Unit (x1)	kg of oil equivalent per EUR 1000 GDP		409	410	397	415	549	492	486	481	511	:

SI: Share of renewable energy in electricity consumption	Unit (x1)	%		42,6	56,1	38,2	37,7	44,4	39,4	42,3	36,7	32,7	:
SI: Road freight transport as a share of total inland freight transport (Modal split of freight transport)	Unit (x1)	%	12)	38,4	39,1	38,6	37,9	38,6	37,1	75,9	76,4	76,2	76,6

e = estimate

f = forecast

p = provisional

1) 1995-2001, as of 30 June.

2) Source: NewCronos.

3) Privatisation revenues are excluded and reclassified to the financing of the balance.

4) The data for 2002 includes central government, local government, the Croatian bank for reconstruction and development, and guarantees; the data for earlier years is not fully comparable with the data for 2002 because of methodological differences and is currently being harmonised/ revised.

5) Calculated on the basis of exports and import values expressed in US dollars; change in methodology as of 1 January 2004.

6) Second half of the year.

7) Data for 2003 were calculated according to Eurostat document "Methodology of calculation of common cross-sectional EU indicators", 2004.

8) 2000 to 2004: number of main telephone lines is presented with total sum of analogue lines, ISDN lines and FGSM lines.

9) 1999 onwards: the number of prepaid and postpaid users.

10) Gross series; includes NACE Sections C to E.

11) Volume indices of agricultural production have been calculated on the basis of production data for 65 agricultural products since 1977; the moving average of producer's prices (purchase prices) in the last three years has been taken as a weighting factor for the calculation of the index.

12) From 2001 onwards, break in series; until 2000 data cover all legal entities with 5 or more freight vehicles, while transport performed by private individual road carriers (natural persons) was excluded; beginning in 2001 data cover the operation of legal entities and natural persons engaged in the transport of goods, with a random sample method being used to carry out the survey (vehicles selected for the sample are monitored during one week, road freight vehicles are defined with a loading capacity of over 3500kg and must be registered with the Ministry of Interior).

Note: The full set of Key indicators is available in [http://europa.eu.int/estatref/info/sdds/en/coop\\_eur/coop\\_eur\\_base.htm](http://europa.eu.int/estatref/info/sdds/en/coop_eur/coop_eur_base.htm). The definitions of the indicators that countries have been requested to follow can be found (in English) in [http://europa.eu.int/estatref/info/sdds/en/coop\\_eur\\_definitions.pdf](http://europa.eu.int/estatref/info/sdds/en/coop_eur_definitions.pdf), which also includes the definitions of the few indicators extracted from Eurostat's database, and from Comext. When countries have indicated divergences from the definitions requested these are indicated in a list of the footnotes.