



**COUNCIL OF
THE EUROPEAN UNION**

Brussels, 9 November 2006

14971/06

**ELARG 167
COWEB 249**

COVER NOTE

from:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	9 November 2006
to:	Mr Javier SOLANA, Secretary-General/High Representative
Subject:	Croatia 2006 Progress Report

Delegations will find attached Commission document SEC(2006) 1385.

Encl.: SEC(2006) 1385



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 8.11.2006
SEC(2006) 1385

COMMISSION STAFF WORKING DOCUMENT

Croatia 2006 Progress Report

{COM(2006) 649 final}

TABLE OF CONTENTS

1.	Introduction	4
1.1.	Preface.....	4
1.2.	Relations between the EU and Croatia.....	4
2.	Political criteria	5
2.1.	Democracy and the rule of law	5
2.2.	Human rights and the protection of minorities	8
2.3.	Regional issues and international obligations.....	13
3.	Economic criteria	18
3.1.	Introduction	18
3.2.	Assessment in terms of the Copenhagen criteria	18
3.2.1.	The existence of a functioning market economy	18
3.2.2.	The capacity to cope with competitive pressure and market forces within the Union	22
4.	Ability to assume the obligations of membership.....	25
4.1.	Chapter 1: Free movement of goods	25
4.2.	Chapter 2: Freedom of movement for workers	27
4.3.	Chapter 3: Right of establishment and freedom to provide services	27
4.4.	Chapter 4: Free movement of capital	28
4.5.	Chapter 5: Public procurement.....	29
4.6.	Chapter 6: Company law.....	30
4.7.	Chapter 7: Intellectual property law.....	31
4.8.	Chapter 8: Competition Policy.....	31
4.9.	Chapter 9: Financial Services.....	33
4.10.	Chapter 10: Information society and media	35
4.11.	Chapter 11: Agriculture.....	36
4.12.	Chapter 12: Food safety, veterinary and phytosanitary policy	37
4.13.	Chapter 13: Fisheries.....	38
4.14.	Chapter 14: Transport policy	39
4.15.	Chapter 15: Energy	41

4.16.	Chapter 16: Taxation.....	42
4.17.	Chapter 17: Economic and Monetary Union	42
4.18.	Chapter 18: Statistics.....	43
4.19.	Chapter 19: Employment and Social Policy	44
4.20.	Chapter 20: Enterprise and Industrial Policy	45
4.21.	Chapter 21: Trans European Networks	46
4.22.	Chapter 22: Regional Policy and Coordination of Structural Instruments	48
4.23.	Chapter 23: Judiciary and fundamental rights	49
4.24.	Chapter 24: Justice, Freedom and Security	54
4.25.	Chapter 25: Science & Research.....	57
4.26.	Chapter 26: Education & Culture.....	58
4.27.	Chapter 27: Environment	59
4.28.	Chapter 28: Consumer and Health Protection.....	60
4.29.	Chapter 29: Customs Union	61
4.30.	Chapter 30: External Relations	62
4.31.	Chapter 31: Foreign, Security and Defence Policy	63
4.32.	Chapter 32: Financial control.....	64
4.33.	Chapter 33: Financial and Budgetary Provisions.....	65
	STATISTICAL ANNEX.....	66

COMMISSION STAFF WORKING DOCUMENT

Croatia 2006 Progress Report

1. INTRODUCTION

1.1. Preface

Since March 2002, the Commission has reported regularly to the Council and the Parliament on progress made by the countries of the Western Balkans region.

This report on progress made by Croatia in preparing for EU membership largely follows the same structure as in previous years. The report:

- briefly describes the relations between Croatia and the Union;
- analyses the situation in Croatia in terms of the political criteria for membership;
- analyses the situation in Croatia on the basis of the economic criteria for membership;
- reviews Croatia's capacity to assume the obligations of membership, that is, the *acquis* expressed in the Treaties, the secondary legislation, and the policies of the Union.

The period covered by this report is 1 October 2005 to 30 September 2006. Progress is measured on the basis of decisions taken, legislation adopted and measures implemented. As a rule, legislation or measures which are under preparation or await Parliamentary approval have not been taken into account. This approach ensures equal treatment across all reports and permits an objective assessment.

The report is based on information gathered and analysed by the Commission. In addition, many sources have been used, including contributions from the government of Croatia, the Member States, European Parliament reports¹, and information from various international and non-governmental organisations.

The Commission draws conclusions regarding Croatia in its separate communication on enlargement², based on the technical analysis contained in this report.

1.2. Relations between the EU and Croatia

Accession negotiations were opened with Croatia in October 2005. The first phase of the accession process, the analytical examination of the *acquis* (screening), was completed in October 2006. Negotiations on one chapter, science and research, were opened and provisionally closed in June.

¹ The *rapporteur* for Croatia is Mr Hannes Swoboda.

² Enlargement Strategy and Main Challenges 2006 – 2007.

In order to support the reform process, the Commission has continued its regular monitoring of the Copenhagen political criteria, with frequent meetings in Zagreb and Brussels.

Implementation of the **Stabilisation and Association Agreement (SAA)** has largely continued without major difficulty. Notable exceptions include delayed compliance with the state aid provisions and in particular the need to present restructuring plans in the shipbuilding and steel sectors. There are also difficulties with the provisions on access to real estate, where existing rules are not being applied in a full and expedient manner as required by the SAA.

The revised **Accession Partnership** was adopted in February 2006, which sets out priorities that Croatia should address in its preparations for accession in the short- and medium-term,

The EC pre-accession **financial assistance** amounts to € 140 million for 2006. The Commission decided to confer the management of aid on a decentralised basis to Croatia's Central Financing and Contracting Unit (CFCU) in February 2006, while maintaining the ex-ante approval requirements.

2. POLITICAL CRITERIA

This section examines progress made by Croatia towards meeting the Copenhagen political criteria which require stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. It also monitors, regional cooperation, good neighbourly relations, and the respect for international obligations, such as cooperation with the UN International Criminal Tribunal for the former Yugoslavia.

2.1. Democracy and the rule of law

Parliament

The Parliament has dealt with an increasing amount of EU-related legislation but significant challenges lie ahead in the context of *acquis* alignment. The Parliamentary Committee on Minorities has shown commendable maturity over the past year in terms of raising awareness of minority issues and promoting reconciliation. The Committee for the Establishment of Conflict of Interest adopted its operating procedures. In February 2006, Parliament adopted the conclusions of its Investigative Commissions into two Members of Parliament, concluding in one case that the person concerned was in conflict of interest during his ministerial mandate.

However, there has been no follow up to these conclusions. Investigative Commissions appear to be used partly as a political tool rather than a serious means to tackle conflicts of interest. The conduct of the debate in Parliament on the public broadcaster amid attempts at political interference in December 2005 was also less than laudable.

In relation to electoral legislation, Parliament adopted in March 2006, a law foreseeing the establishment of a permanent and independent State Election Commission (SEC) to be responsible for Parliamentary, Presidential and local elections. Other aspects of electoral reforms mentioned in previous reports remain to be definitively addressed, notably the regulation of the financing of political parties and electoral campaigns, out-of-country voting as well as the updating of the voters' lists.

Government

There have been some limited changes in the functioning of government. In March 2006 the then Justice Minister and leader of the Democratic Centre Party was replaced by HDZ's Ana Lovrin, leading to the withdrawal of DCP from the HDZ-led governing coalition. The government's majority in the Sabor was thus reduced to one seat.

Public administration

In January 2006, the Central State Office for Administration (CSOA) began work on a public administration reform strategy. However, no proposal has as yet been submitted to the Government for approval, meaning there is still no overall strategic framework for tackling this crucial issue.

A new independent Civil Service Council tasked with dealing with complaints against administrative decisions was set up in April 2006. In September 2006 the Government adopted a policy paper committing itself to drafting a revised General Administrative Procedures Act (GAPA) by July 2007.

However, besides the existing GAPA, there are numerous special administrative procedures regulated through special legislation. The existing legal administrative system in Croatia is cumbersome and needs simplification. The wide discretionary scope in legislation leads to inefficiency and legal uncertainty and facilitates corruption. The Administrative Court is unable to cope with the present workload of reviewing administrative decisions.

The new Civil Service Law reported on last year entered into force in January 2006. This law is an important first step in the reform process. It addresses – to a degree – the need to reduce the number of political appointees in the public administration.

In March 2006, a new law on direct election of municipal and city mayors as well as of county prefects was adopted.

As regards the police, reforms continue under the Croatian Police Action Plan 2004-07 according to which the police should be transformed from a “force” to a “service”. There has been progress in implementing the Community Policing Action Strategy, leading to important improvements in relations between the police and citizens. There has been some progress in the recruitment of minorities to the police. Authorities usually act quickly when serious shortcomings in police conduct occur.

In June 2006 the Parliament adopted a law on Croatia's security and intelligence system. All political actors agree on the need for reform of the intelligence services. The current Intelligence Agency and Counter-intelligence Agency is being replaced by the Security and Intelligence Agency, in charge of civilian intelligence. The existing Military Security and Intelligence Agency will remain. The work of security and intelligence agencies will be monitored by Parliament, the Office of the Council for National Security and the Council for the Civilian Supervision of Security and Intelligence Services.

In March 2006, the Government also adopted a Draft Law on Data Secrecy and a Draft Law on Information Security. The Law on Data Secrecy as well as the reform of the security services were included in the Action Plan drawn up in the context of the Gotovina case in 2005. This plan was a response to the constant leaking of classified information as well as

accompanying scandals involving the secret services and alleged inappropriate use of wiretapping and surveillance.

However, a number of issues require attention. The Civil Service Law left many critical issues to implementing legislation, the adoption and full and proper implementation of which is required if the law is to have any positive effect. So far only seven out of thirteen foreseen implementing regulations have been adopted. The de-politisation 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. This means that civil service in Croatia continues to be somewhat dependent on political affinities. Policy making effectively lies in the hands of political advisors. Even for new vacancies, provision has not been made for immediate de-politisation. More generally, the civil service in Croatia also suffers from high staff turnover and a lack of qualified personnel.

The administrative and management capacity of institutions in charge of public administration reform, particularly the Central State Office for Administration, is not yet sufficient. As regards training of civil servants, the Civil Service Training Centre is not yet operational.

There has been limited progress in the decentralisation process, which is important for the development of capacities and the clear definition of the responsibilities of local self-government. The Decentralisation Commission was set up in December 2004 but has not yet established itself as the main body leading the decentralisation process. There are still no clear strategic guidelines for the future direction of this process. There has been criticism of a lack of clarity on relations between directly elected officials and local assemblies. Two incidents in December 2005 at the Pozega-Slavonia-County Assembly and in Sisak respectively were illustrative of a general need to improve ethical standards in local politics. While repeat elections were held in certain localities following allegations of mandate "selling" connected with the local elections of spring 2005, follow-up has been limited. There has also been no definitive regulation of the issue of blank resignations. There is no planned and concerted effort from the relevant institutions to introduce clear and transparent rules and procedures with regard to elections and the forming of governments at the local level.

Further implications of possible links between organised crime and the police are not always followed-up. Overall, progress on police reform is slow and without clear direction. Weaknesses in recruitment and human resources management and development remain. The role of politics cannot be completely excluded, even in the recruitment of technical staff.

It needs to be ensured that the civil institutions overseeing the work of the intelligence agencies can adequately carry out their functions. In case of shortcomings, appropriate follow-up action has to be taken.

The draft Law on Data Secrecy has not yet been sent to Parliament, however, following heavy criticism by NGOs and the press for providing too wide and vague a definition of data secrecy and national security interest amid concerns that secrecy could become the rule rather than the exception. A balance between the interest of the public to be informed and the protection of national security needs to be carefully struck.

Overall, the issue of public administration reform continues to represent a major challenge for Croatia. It will require sustained serious attention from the authorities if Croatia is to eventually enjoy the professional, efficient, accountable, transparent and independent public

administration it needs at central and local level. Such efforts are also needed to provide an important basis for the successful implementation of the *acquis*.

Judicial system

Implementation of the judicial reform strategy has begun. Legislative and organisational changes have been made aimed at improving the functioning of the judiciary. Some progress has been made in reducing the case backlog.

However, reform is at an early stage and the judicial system continues to suffer from severe shortcomings. Successful implementation of the reform strategy requires serious sustained efforts. More needs to be done to reduce the still significant case backlog, to reduce the length of court proceedings, improve case management, rationalise the court network, including the closure of courts, to ensure proper enforcement of judgements and to reform legal aid. To ensure impartiality the procedures for the appointment, training and disciplining of judicial officials need to improve. Croatia is still some way from enjoying an independent, impartial, transparent and efficient judicial system, the establishment of which will be an important indicator of Croatia's readiness for eventual membership and a prerequisite for the successful implementation of the *acquis* (see Chapter 23: *Judiciary and fundamental rights*).

Anti-corruption policy

A new anti-corruption programme was adopted in March 2006. A number of sectoral actions plans were subsequently prepared and the Minister of Justice appointed as coordinator. The importance of tackling corruption is being increasingly highlighted by senior politicians. Measures have recently been taken in some hitherto uninvestigated corruption cases. The Office for the Prevention of Corruption and Organised Crime (USKOK) has been strengthened.

However, corruption remains a serious problem. Many allegations of corruption remain uninvestigated and corrupt practices usually go unpunished. Implementation of the anti-corruption programme is at an early stage. Full implementation of the programme and strong political will to step up efforts are needed, especially on high level corruption. There continues to be a need for greater efforts to proactively prevent, detect and effectively prosecute corruption. Awareness of corruption as a serious criminal offence needs to be raised and codes of conduct and action plans to prevent corruption developed in the relevant law enforcement agencies. USKOK and other bodies involved in the anti-corruption programme need further strengthening and coordination among them needs to be improved. The fight against organised crime needs further attention. Progress on tackling corruption will also be an important indicator of Croatia's readiness for eventual membership (see Chapter 23: *Judiciary and fundamental rights*).

2.2. Human rights and the protection of minorities

Observance of international human rights law

The European Court of Human Rights (ECtHR) delivered 25 judgements concerning Croatia in the reporting period. The majority of judgments issued against Croatia continue to concern violations of the right to a fair trial and the length of proceedings, under Article 6 of the European Convention for the Protection of Human Rights (ECHR).

In March 2006, the Court issued its judgement in the case *Blecic v. Croatia* regarding Occupancy/Tenancy Rights (OTR). The Court decided that it had no jurisdiction over the case as the *ratione temporis* requirement was not fulfilled. There is, therefore, as yet no international legal opinion on the question of OTR and their termination by the Croatian courts. However, while most of the judicial terminations occurred in the early nineties, there are still a number of pending cases at Croatian courts that might end up before the ECtHR.

Civil and political rights

In March 2006, the European Court of Human Rights ruled in the *Cenbauer v. Croatia* case that there had been a violation of Article 3, condemning Croatia for **degrading treatment** of a former prisoner of the Lepoglava State Prison. While Croatia has already addressed this case, further improvements in prison conditions are needed more generally (*see Chapter 23*).

As regards the **right to an effective remedy and to a fair trial**, there has been some progress. There has been progress in tackling ethnic bias in war crimes trials. However, difficulties as regards witness protection in the broadest sense remain (*see below*). An integrated legal aid system for both criminal and civil proceedings still needs to be put in place.

There are generally no difficulties reported as regards **arbitrary arrest**, which is forbidden by the Constitution.

There have been no particular difficulties reported as regards violation of the **freedom of religion**.

With respect to the **freedom of expression**, the media remains free, deregulated to a large extent and generally subject to free market rules. In June 2006 Parliament approved amendments to the Criminal Code abolishing the sanction of prison sentences for libel.

However, concerns expressed in the 2005 Progress Report concerning possibilities for political influence at the local level remain valid. Two cases in particular concerning the political TV shows “Otvoreno” and “Latinica” also highlighted political pressure being exerted on the public broadcaster HRT, threatening its independence and raising concerns about freedom of expression in Croatia. The procedure for the appointment of the steering committee of the state news service HINA suffered important shortcomings.

No progress has been made in following up the recommendations of the 2004 joint expert mission for changes to the Law on Electronic Media and to the Law on Croatian Radio and Television, which remains a short term partnership priority. The improved media legislation should reflect European standards and facilitates media freedom and independence, in particular through improved legal and regulatory framework including the creation of safeguards against political interference.

There have been no particular difficulties as regards **freedom of assembly/association**.

Civil society organisations continue to play an important role in the promotion and protection of human rights and democracy in Croatia. However, NGOs are still often viewed with suspicion from within the establishment.

In the field of **women's rights**, the National Policy for the Promotion of Gender Equality came into effect in 2006, covering the period up to 2010. This document includes a large number of measures for improvement of the general social position of women and for raising awareness of the need to respect women's rights. In the field of equal opportunities in the labour market, objectives include reduction of unemployment and elimination of discrimination, promotion of women's entrepreneurship and better enforcement of labour law, including encouragement to women to make use of existing mechanisms for filing discrimination claims. The document also strengthens and promotes measures that enable reconciliation of family and professional obligations.

The Office for Gender Equality has also initiated the creation and networking of county gender-equality committees. In November 2005, trained around-the-clock teams were established in police departments to deal with family violence. Enforcement of existing provisions on gender equality remains problematic, however, and is hampered by the absence of gender-segregated statistical indicators. Concern has been voiced over a growing number of cases of discrimination against women. Overall, the work of the Ombudsman for Gender Equality lacks visibility. Further efforts are needed to tackle human trafficking.

In the area of **children's rights**, a National Plan for the Benefit of the Rights and Interests of the Child 2006-2012 was adopted in March 2006. In the same month, the Parliament finally nominated a new Ombudsman for Children. There has been little follow-up to the Parliament's Committee for Human Rights finding in October 2005 that there was a lack of proper supervision of children's homes and inadequate coordination among the bodies involved. There has been limited follow up of cases of ill-treatment of children in such institutions, beyond the dismissal of the Deputy State Prosecutor (in the Brezovica case).

As for **socially vulnerable or disabled persons**, a pilot project to introduce a system of personal assistants to support disabled persons and their families is on-going and a few further advanced models of community services are also being piloted. However, budgetary constraints continue to limit the scope of their rights to health and special care and their social integration. More attention is needed for the implementation of the National Plan for the Disabled. Despite government policy in favour of deinstitutionalisation, the number of mentally disabled persons in institutions has increased by over 19% in the past year.

As regards **trade union's rights**, the situation in Croatia was more favourable than in previous years, with the authorities having taken steps to solve property-related problems of trade unions, for example. However, there are concerns about inefficient courts and certain restrictions on the right to strike. Weak administrative capacity of the relevant State authorities responsible for overseeing implementation of labour law further restricts workers' rights.

The process of **restitution of property** that was confiscated during the Yugoslav regime continues to proceed slowly. Provisions discriminating on grounds of nationality have not been removed from the Law on the Restitution of Nationalised Property.

Minority rights, cultural rights and the protection of minorities

Implementation of the Constitutional Law on National Minorities (CLNM) continues to be slow and problems persist particularly in terms of under-representation of minorities in state administration, the judiciary and the police. In November 2005, the Parliament adopted legal provisions to implement the CLNM's representation guarantee in State administration with the Law on Civil Service and the Law on Local and Regional Self-Government. This requires state bodies to develop employment strategies for ensuring appropriate levels of minority representation. Minority provisions in these laws, as well as in the Law on Courts and Law on State Judicial Council of December 2005, basically only mirror the provisions of CLNM without providing for more detailed regulation, however.

As regards political representation, implementation of the CLNM has been more successful. The Parliament already has eight minority MPs and in local and regional assemblies adequate minority representation has been achieved, although clarification is still needed on how minority quotas should be reached, notably though the necessary updating of voters' lists.

In 2006, the CNM received € 4 million from the State budget for national minority associations, up 22% from the € 3.27 million allocated in 2005.

As regards citizenship questions, there has been some progress. As an alternative to the extension of the deadline for applications to reconfirm the status of permanent residence based on Article 115 of the Law on Foreigners, a protocol has been signed between the Ministry of Interior and the Ministry of the Sea, Tourism, Transport and Development allowing the renewal of the status of permanent residence on humanitarian grounds based on the Article 47 the Law on Foreigners. Seven cases have been resolved on this new basis.

Some progress is being made as regards education of minorities. The Ministry of Science, Education and Sport recently established a separate department in charge of minority education. Special advisor posts were also created to function as a link between the Ministry, local school authorities and minority communities. Education in Eastern Slavonia is being provided for the Serb minority language and script in line with Croatia's obligations under the Erdut Agreement. Some progress was made in Vukovar to tackle the issue of timetabling sometimes limiting possibilities for children to spend breaks together.

However, a number of issues need to be addressed. The political will to develop a long-term strategy to implement the CLNM's minority employment provisions is lacking, although some statistics on which to build a strategy are becoming available³. Concrete action is now required to develop recruitment plans at all levels of state administration and, to set up civil servants registry to allow for systematic statistics collection. The Government needs to issue clear instructions on how to proceed. The establishment of an action plan covering all bodies concerned by the CLNM is recommended to ensure the CLNM can be fully implemented.

³ Croatian Government estimates suggest minorities make up 4% of the civil servants at central government level, and around 4.5% of those working in courts and prosecutors offices. They also point to an under representation of minorities among judicial advisors and trainees, from which judges are usually recruited. There are signs of improvement with regard to the police. Out of the 300 trainees for the position of a police officer with the Basic Police School in 2006, 22 trainees, i.e. 7.3% were members of national minorities. This almost corresponds to the share of minority population, according to the 2001 census (7.5%).

Following regional seminars of Local Councils of National Minorities in December 2005 run by the State Council for National Minorities (CNM), it emerged that the capacity of CNMs to advise local government in relation to minority issues- as outlined in the CLNM- continues to go unrecognised by the majority of local authorities. Progress was noted in Eastern Slavonia and some urban areas, especially Zagreb, but overall CNMs, of which 274 have been elected to date, lack a clear understanding of their role and struggle to obtain premises and basic funding. It was noted that the local authorities need to institutionalise their relations with CNMs. It was also suggested that Government efforts in this direction would be beneficial ahead of the next CNM election in early 2007.

National minorities are still generally perceived in the media as separate entities and not as an integral part of society. Negative stereotyping in the press has continued. 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 continue to be implemented at a slow pace.

Initiatives promoting greater integration, reconciliation and tolerance as well as joint activities within the current system should be further encouraged. Outside Eastern Slavonia minority education is usually on the basis of model C of the European Charter of Regional and Minority Languages. Some practical financial and logistical problems remain with its implementation. There is often a lack of resources for Serbian sections of schools and translation of Croatian books into Serbian is slow.

Bilingual rights are guaranteed by the Constitution in those municipalities and towns where the members of an ethnic minority constitute at least one third of the total population, or when it is prescribed by an international agreement or laid down in the statute of a municipality or town. In the majority of cases these bilingual rights are not exercised.

In relation to the **Serb minority**, there have been mixed developments. Generally, the mood in the country appears to continue to move forward, albeit slowly. Symbolic gestures and positive statements on reconciliation from senior State officials, mutual visits between leaders from both Croatia and Serbia, and events such as the celebration of the 150th anniversary of the birth of the Croatian Serb inventor Nikola Tesla, have contributed towards an improved atmosphere. At the political level, the coalition between HDZ and the Serb party SDSS seems to function well. Existing institutions of the Serb minority (political parties, schools, cultural organisations) generally continue to operate without obstacles. In April 2006, the Council for National Minorities approved the flag of the Serb national minority in Croatia. The flag should be displayed in accordance with the CLNM.

Positive leadership does not always filter down to the rest of society, however, and many problems remain. The number of apparently ethnically motivated attacks against the Serb minority and the Orthodox Church remains similar to last year. In some cases police are intervening more rapidly than before. However, there is still insufficient police investigation and prosecution in relation to such incidents. While top officials have quickly condemned some incidents, notably the Biljane Donje incident in July, there is often an absence of clear statements condemning ethnically motivated incidents when they occur, especially from local politicians and media. Zero tolerance of such incidents is needed so as to help create a climate more accepting of minorities.

There are also still real obstacles to the sustainable return of Serb refugees, such as enduring hostility in certain localities, and remaining housing concerns, mainly 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. Discrimination continues in access to employment, particularly in the public sector. A comprehensive anti-discrimination strategy has yet to be developed and implemented. Despite the progress made, more needs to be done in terms of tackling ethnic bias in the area of war crimes.

The position of the **Roma minority** in Croatia is slowly improving. The Government is taking this issue much more seriously and a more positive attitude within the administration is slowly appearing. The Government has appointed a special advisor for Roma in the national Employment office, as well as in the Ministry of Science, Education and Sports. Progress is being made on the pre-school education of Roma under the government's action plan for the "Decade of Roma Inclusion 2005-2015". Funding is also increasing substantially, mainly in the context of co-financing EC projects.

Overall implementation of the action plan needs to be speeded up. Funding is still not adequate for addressing the challenges of the action plan if real improvements in the Roma's position are to be achieved. Most Roma remain excluded from mainstream Croatian society. Unemployment remains endemic. Recent research indicates that of those Roma aged 15 and over, only 18% are employed and 32% have no schooling. Many are illiterate. Discrimination of Roma in Croatia continues, whether in terms of access to employment, in schooling, or in general attitudes in society. Many obstacles still exist, especially at grass roots level with various efforts aimed at desegregation often met by opposition from the parents of non-Roma children. There is also a continued unwillingness or inability of some local authorities to finance Roma programs. Coordination among Roma groups is weak and they do not have the expertise needed for effective implementation of programmes.

2.3. Regional issues and international obligations

Overall, compliance with the **Dayton/Paris** and **Erdut Peace Agreements** has been ensured.

It was established on 3 October 2005 that Croatia was fully cooperating with the **International Criminal Tribunal for the former Yugoslavia (ICTY)**. There continue to be no particular 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. Following the arrest of Ante Gotovina on 7 December 2005 in Spain, the last remaining fugitive indictee from Croatia was transferred to The Hague. In June 2006, ICTY granted a motion by the Prosecution to join the Gotovina case with the cases against Generals Cermak and Markac, also charged with war crimes against Serb civilians during and after the Croatian military operation 'Storm'. The Croatian Government has requested to act as *amicus curiae* in this case, as well as in the trial against six Bosnian Croats. Both requests have been rejected.

The ICTY Prosecution has also asked for a revision of the appeal verdict in the Tihomir Blaskic case following the discovery of an unabridged version of a Croatian Ministry of Interior report on the crimes in Ahmici which sheds further light on this case. Charges of contempt of the Tribunal were levied against four Croatian journalists, three of which have been convicted. All four were indicted for violation of orders of the Tribunal protecting the identity and testimony of protected witnesses.

The case against Rahim Ademi and Mirko Norac, transferred from ICTY to Croatian jurisdiction in September 2005, has still not got underway. After more than one year, no domestic charges have been levied, highlighting difficulties in transposing ICTY charges into domestic law. No other indictments have been transferred. Some witnesses in the Ademi/Norac case refuse to participate in Croatian proceedings given security concerns, citing the incident in late 2005 when the HSP mayor of Osijek publicly read out a list of potential witnesses in an important war crimes case. In this context, security guarantees for witnesses and informants as well as investigative materials are of paramount importance. Some limited training measures for the four County Courts designated for the purpose of trying transferred cases have continued.

In July, senior government ministers and local politicians attended the opening of a night club in Zadar owned by a company under investigation in the framework of the Government's action plan of April 2005 to locate Ante Gotovina. In August, Hrvoje Petrac, convicted in absentia for kidnap and implicated in the Gotovina support network, was extradited to Croatia. His retrial started in September. Croatia needs to take advantage of its work under the action plan to better tackle organised crime.

Since the arrest of Ante Gotovina, the Croatian Government has indicated its willingness to support his defence, and various local authorities have also contributed financially to a fund established for the same purpose. It is perhaps indicative of the general mood that little is said in public discourse about the need to establish the truth about who is responsible for the crimes for which Ante Gotovina and other Croatian generals are indicted. As elsewhere in the region, the general public does not have easy access to objective information about the work of the ICTY.

As regards domestic prosecutions, Croatia has also been active in trying **war crimes** cases on its own initiative. There has been progress in tackling the hitherto persistent ethnic bias against Serbs in domestic war crimes prosecutions in Croatia'. The Chief Prosecutor has further reduced the list of outstanding indictments against Serbs by removing many unfounded cases; and a willingness to prosecute Croats for war crimes is slowly increasing, the most notable case recently being the war crimes charges brought against independent MP and Chairman of the Osijek City Council Branimir Glavas⁴. However, the trial is facing certain difficulties. In view of concerns about witness intimidation and the publication of witness testimony by the accused, the Prosecution requested the detention of this person on three occasions. The third request was granted and following the lifting of his parliamentary immunity, he was taken into custody.

The retrial at Split County Court of the Lora case is generally considered to have been well run and led in March 2006 to the conviction of all eight former Croatian military policemen for war crimes against Serb prisoners of war. The court continued however with the practice of taking into consideration as mitigating circumstances the defendants' active involvement in the war. Three of those convicted are still at large. There has been some progress on international cooperation between State Prosecutors on war crimes. Important agreements have been reached between the Croatian State Prosecutor and his Serbian and Montenegrin

⁴ The events in Osijek in 1991 were allegedly one of the most severe cases of organised killing of civilians in Croatia committed by the Croatian side. So far, these crimes have largely never been prosecuted. In this case the State Prosecutor has requested for the first time that the trial be conducted at another court (Zagreb), outside the place where the crimes happened.

counterparts respectively to allow war crimes suspects to be tried in their countries of residence. Such cooperation needs to be intensified and widened geographically. In July 2006, the Criminal Procedure Code (CPC) was amended to allow the possibility of using video-link testimony in Croatia from witnesses in third countries.

Many cases of war crimes in Croatia remain unprosecuted, however. A systematic mechanism for resolving and ending ethnic bias by ensuring application of a uniform standard of criminal responsibility has not been developed. Some problems persist as regards quality of the defence provided by court-appointed counsel. 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, nor for intimidating witnesses or revealing the identity of a protected witness.

A number of other 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 and obstacles to the transfer of individual cases between jurisdictions where the more serious crimes are concerned.

While the issue of witness protection is being tackled seriously by the State Prosecutor, this issue is not being addressed sufficiently in the wider judicial system. Witnesses, particularly those called to testify against members of the Croatian army, still face intimidation, and there is a reluctance to turn to the police among potential witnesses, especially minorities. To ensure integrity of the judicial process, protection for witnesses should be extended beyond the trial period, to informants, or other sources of information in the pre-trial or investigative phase.

Croatia has not signed a bilateral agreement with the USA concerning the non-surrender of certain persons to the **International Criminal Court** and continues to support the EU position on this matter.

Regarding **refugees**, the total number of Croatian Serbs registered as returnees to Croatia is 126 573 or about one third of the 370,000 who left the country during the war. Around 5 000 have returned over the past year. Estimates point to a sustainability rate of return of around 60-70%. Following a re-registration exercise in 2005, there are now 78 415 refugees from Croatia in Serbia, 2 239 in Montenegro and in 7 566 in Bosnia and Herzegovina. The issue of displaced persons has largely been resolved; with 4 192 in Croatia by August 2006.

Although there have been some positive developments, there has been little change in terms of the difficulties returning refugees face, with access to housing and employment as well as convalidation remaining the main concerns. As regards public infrastructure in certain return villages there has been significant progress; budgets have been increased and a Task Force Group (TFG) on re-electrification of minority settlements has been created, including the international community and Serb representatives. Mine clearance operations, while still under funded, have continued and are planned to be completed by 2010. In terms of economic reintegration, measures for the economic development of the areas of return are in place but there are no specific measures targeted at returnees.

The main housing problem for refugees remains the extremely slow implementation of *housing care programmes* within and outside the Areas of Special State Concern (ASSC) for those *former tenancy right holders* who wish to return.

Inside the ASSC 7 496 requests were received in total, of which 2 859 (38%) had been allocated an apartment by July 2006. 4 615 requests have not been processed yet, only about 824 cases less than 1 year ago. Of the pending requests, 1,422 families are already living in the apartment waiting for confirmation. For 3 193 applicants (42%), apartments or other models of housing care have to be provided. Outside the ASSC 4 468 requests were received, of which 2 220 for rent and 2 248 for purchase. To date, 50 apartments (1%) have been purchased of which 40 have been physically handed over and 222 administrative decision have been taken (4%). It is disappointing that almost three years after its adoption, the only major remaining housing scheme remains at a very early stage of implementation: very few apartments have been allocated and the vast majority of requests have not been processed administratively. It is a matter of concern that even the relatively limited funding currently available from 2005 and 2006 is not yet being spent.

In September 2006 the Croatian Government adopted a new five year plan estimated at € 450 million for the construction of 3 600 and the purchase of 400 apartments to cater for the outstanding applications outside the ASSC. The Government has announced that special measures will be adopted aiming at preventing the ghettoisation of the housing care applicants. While it is positive that a clear financial envelope has been identified, the plan is based on an untested public/private partnership model. The plan raises a number of other concerns. The government's completion deadline of 2011 is unambitious, especially taking into account the delays which have already occurred and the target deadline of 2008/09 under the existing programme. It is also unclear how the transition from the existing Housing Care programme to the new plan will function. There have been conflicting signals sent publicly as regards the option to purchase apartments at favourable rates and on the rules of inheritability of the protected lease. The changes made and the continued resistance of some local authorities have reinforced the impression that the authorities are not serious about implementing the commitments made. Confidence of potential returnees in the process has needs to be raised.

Political will is clearly needed for urgent action both at national and local level if the housing care programmes are not to remain largely an empty promise. Consideration should be given to accelerating plans for completing implementation.

The situation concerning *reconstruction* of housing has continued to improve. To date, the Government has reconstructed over 140,000 out of the 200 000 destroyed houses and apartments, up around 10,000 units. By the end of July 2006, 2,630 houses remained to be finalised from the 2006 programme and another 2,000 from the 2007 programme. 2 129 requests were not yet processed and there were 13 882 pending appeals. Those who receive a negative decision due to "no residence 1991" are now entitled to receive building material to enable self repair. It is expected that all pending requests will be processed by the end of this year. The reconstruction programme is scheduled to be finalised by mid 2007. Outstanding cases should be treated expediently and particular care taken that negative eligibility decisions are properly grounded.

Only a relatively small number of the 20 000 or so houses that had been occupied remain to be *repossessed* and handed over to their rightful owners. There has been little progress with these remaining cases, however. 18 houses were still occupied at the end of August 2006 and 80 cases were waiting for a court decision, implying little movement since last year. A number of problems linked to repossession also remain. As regards damage/looting by the temporary occupant or third persons, a repair programme for 396 households has been put in place, the implementation of which has now started. A number of cases are before the courts

where the returnee before repossessing his property is faced with substantial claims for unsolicited investments made in his absence. The Government has still not issued a foreseen decree on this issue based on extra-judicial settlements. There remains a backlog in payment of compensation to owners for delays in repossessing their property.

The recognition or "convalidation" of working years during the "Republika Srpska Krajina" (RSK) is still an outstanding issue. This convalidation is necessary to assure pension rights. While accepting the principle that working years should be convalidated, the Government has not reopened the original deadline of 1999, as called for in the accession partnership, 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.

There has been continued, but slower than expected, progress on regional cooperation and implementation of the Sarajevo Declaration aimed at closing the refugee file by the end of 2006. Three Task Force meetings were held and one Ministerial meeting, serving to reduce the number of open issues to two: convalidation and how to deal with lost OTR for those who do not wish to return. Croatia has presented a new roadmap with benchmarks and budgetary allocations. Not all road maps have been finalised, however, and no joint implementation matrix has been drawn up. Implementation of existing commitments needs to continue and a way forward on the convalidation issue found. The Governments concerned should identify a mechanism for addressing the OTR question so that a solution can be found sooner rather than later.

As regards **regional cooperation**, a number of important bilateral visits, agreements and further engagement by Croatia in regional initiatives have contributed towards the aim of further improvement of relations between Croatia and its neighbours. Regional cooperation and good neighbourly relations forms an essential part of the process of moving towards the European Union.

Croatia is an active participant in regional initiatives such as the Stability Pact, the South East Europe Cooperation Process (SEECP), Central European Free Trade Agreement (CEFTA), the Central European Initiative, and the Adriatic Ionian Initiative. Croatia is presently chairing the SEECP. It is committed to the establishment of the Regional Cooperation Council. It is a party to the Energy Community Treaty that entered into force in July 2006 and a signatory of the June 2006 agreement on the European Common Aviation Area.

Croatia is participating in the negotiations for establishing a single regional Free Trade Agreement, based on an enlarged and amended CEFTA. It has concluded bilateral free trade agreements with all South East European countries. In September 2006 it signed a free trade agreement with Kosovo.

Progress towards finding definitive solutions on outstanding border issues has been limited, as has implementation of the Succession Agreement on SFRY and efforts aimed at reconciliation among citizens in the region

Bilateral relations with *Serbia* have continued to improve, building on the cautious normalisation of relations over the past couple of years. Further important high level visits have taken place and trade and investment is increasing. In July 2006, the two countries' Prime Ministers opened a renovated border crossing. A provisional visa free regime is in place, with a recent proposal by Croatia to make this arrangement permanent. A number of important open issues remain however to be resolved. There has been no progress with border

demarcation at the Danube river. Other open matters include property related issues, refugee return, missing persons and Croatia's claim for compensation for war damage.

The stance of Croatia towards the *Kosovo* issue continued to be fully aligned with the position of the international community throughout the initial phase of the status negotiations.

The Croatian government recognised *Montenegro* as a sovereign and independent state in June 2006 and established diplomatic relations in July. Outstanding issues concern property, refugees and missing persons. Border demarcation at Prevlaka is still outstanding, although the temporary border regime seems to be running smoothly.

Relations with *Bosnia and Herzegovina* remain relatively stable. Bilateral contacts continue to increase. Main issues concern unresolved border, refugee and property questions as well as trade. Ratification of the 2005 agreement on demarcation of the land and river borders is on hold due to Croatian concerns about the status of islets near Neum. There is also a continued lack of progress on the Port of Ploce issue, on which Croatia has not submitted a new proposal for an Agreement. Discussion on the Peljesac bridge project and possible technical solutions which might allow sufficient access for BiH to the open sea are on-going.

Relations with *Slovenia*, while generally well developed, continue to be affected periodically by difficulties linked to outstanding border issues. On issues such as the maritime and land borders, on Ljubljanska Banka, and on implementing rules for the fisheries aspects of the Border Traffic and Cooperation Agreement, there is no momentum towards reaching permanent solutions.

Relations with *Italy* are good. Relations were affected over the last year by the difficulties faced by Italian citizens in purchasing real estate in Croatia. However, this issue has now been solved though mutual confirmation that reciprocity applies. Croatia continues to have good relations with the *former Yugoslav Republic of Macedonia* and with *Hungary*.

3. ECONOMIC CRITERIA

3.1. Introduction

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, and the capacity to cope with competitive pressure and market forces within the Union.

3.2. Assessment in terms of the Copenhagen criteria

3.2.1. The existence of a functioning market economy

Economic policy essentials

The second Pre-accession Economic Programme (PEP) was submitted by the authorities in December 2005. It sets out a generally sound medium-term macroeconomic framework and an ambitious structural reform agenda. A National Development Strategy with a strong economic reform orientation was launched for public consultation in May and adopted by the government in August 2006. Cooperation with the International Monetary Fund (IMF) and the World Bank has continued to be an important anchor for economic policies. However, the

authorities have decided not to request an IMF successor programme when the current arrangement expires in November 2006. At times, poor communication and coordination between various line ministries and agencies have undermined the quality of economic policy making. Strong vested interests have also led to delays in the implementation of important economic reforms. Overall, consensus on the direction of economic policy has generally been maintained, but intergovernmental communication and coordination needs to be strengthened.

Macroeconomic stability

In 2005, real GDP growth was 4.3%, up from 3.8% in 2004, mainly driven by domestic demand. Net exports added only 0.1 percentage point to real growth. In the first half of 2006, real GDP accelerated further to 4.8% year-on-year, largely due to stronger private investment. Economic activity in the third quarter of 2006 remained strong. In the eight months to August 2006, industrial production rose by 4.1% year on year, as compared to an annual average growth of 3.2% in the first half of the year. Average per-capita income further increased to an estimated 47% of the EU-25 average (in purchasing power standards) in 2005. Overall, economic growth continued on the back of stronger private investment.

The current account deficit widened from 5% of GDP in 2004 to 6.4% in 2005 and further to 7.7%⁵ in the second quarter of 2006. This was mainly a result of higher oil prices, continued strong imports as well as higher net factor payments to non-residents in early 2006. A large deficit in merchandise trade in the twelve months to end-June 2006 (24.8% of GDP) was not fully compensated for by the surplus in services (16.8%). In the same period, net foreign direct investment (FDI) grew to 4.6% of GDP and covered 60% of the current account deficit. FDI were largely driven by capital increases and takeovers rather than by privatisation or greenfield investments. Due to strong capital inflows, official foreign exchange reserves increased 27.1% year on year at end-July 2006. External debt continued to grow, although at a slower pace than, from € 24.1 billion at end-September 2005 26.8 billion by end-August 2006. At the end of 2005, external debt amounted to 82.6% of GDP, up from 80.2% at end-2004, and continued growing to 86.7% of 2005 GDP by August 2006. Overall, external deficits have widened further.

The officially registered unemployment rate has continued to decline to 15.7% in July 2006 compared to 16.9% in the same month a year earlier. The downward trend is confirmed by the most recent labour force survey. It recorded a decline in the unemployment rate from 13.8% in the second half of 2004 to 12.3% in the second half of 2005. According to official data, total employment grew by a small 0.6% year-on-year in April. Data of the Pension Insurance Fund suggest a stronger growth of above 3% in the same period. Still, a relatively high unemployment rate and limited job turnover and job creation remain some of the most pressing economic problems.

The general monetary policy framework of a “managed float” with the primary objective of maintaining price stability has not changed. The Central Bank took a number of measures to contain strong capital inflows through foreign borrowing by commercial banks. It raised the rate of reserve requirements on the net increase in banks' foreign liabilities in three times to 55% in January 2006. It also expanded the basis for calculation. In March 2006, it introduced a special reserve requirement on banks' liabilities arising from the issuance of securities abroad. Despite these measures, credit and money aggregates continued to accelerate. Annual

⁵ On a four-quarter moving average.

growth of broad money accelerated from 9.3% in September 2005 to 12% in July 2006. Annual domestic credit growth accelerated from 16.7% to 22.2% in the same period. Overall, monetary policy continued to aim at price stability and relied on additional administrative measures to curb capital inflows.

The Central Bank continued to tightly manage the exchange rate vis-à-vis the euro. In 2005 and early 2006, the Kuna remained under appreciation pressure due to strong demand. This resulted from government bond issues, continued capital inflows as well as appreciation expectations generated by the EU accession process. The central bank intervened 10 times in the foreign exchange market between October 2005 and August 2006 to purchase a total of € 860 million from commercial banks. In the twelve months to August 2006, the Kuna appreciated by 1.4% vis-à-vis the euro, the same pace as in the year 2005. Exchange rate stability remained an important policy objective in the context of a highly euroised financial system.

Average annual consumer price inflation increased significantly from 2.1% in 2004 to 3.3% in 2005 and to 3.6% in July 2006, resulting from higher prices for energy (oil), transport and food. Annual average core inflation has remained at around 3%. Overall, price stability has been maintained.

Fiscal performance in 2005 has been broadly in line with policy targets set in the PEP 2005 and agreed under the current IMF programme⁶. The general government deficit (ESA 95) fell to 3.9% of GDP in 2005 (2004: 5%). Total revenues grew by 6.9%. VAT has continued to be the main source of revenues. Growth of current spending fell to 6.6% in 2005 (2004: 8%) supported by a moderate growth of wages and social contributions. Capital spending decreased with 13.7% in 2005, adjusting towards a more sustainable level. Strong economic performance has led to favourable fiscal developments in the first half of 2006. The growth of revenues accelerated markedly to 11.4% year-on-year while current spending grew by a moderate 4%. A revised budget with a lower deficit was adopted by Parliament in July 2006. By the end of May 2006, general government debt had grown by 3.6% year-on-year, reaching 41.2% of GDP. Public sector arrears reportedly continued to grow mainly due to financial problems in the health sector. Overall, fiscal consolidation continued on the back of strong revenue growth.

Some important public finance reform measures have been implemented in early 2006 to strengthen tax administration, such as the establishment of a Financial Police and an e-VAT service. Expenditure management has also improved. A reform in health care financing was adopted in July 2006 to address financial difficulties and stop further arrears accumulation. The scope of this reform was less ambitious than initially envisaged and is expected to reap lower fiscal savings than originally planned. The government has started preparatory work on the reform of the social welfare system. This encompasses proposals for consolidating numerous welfare benefits and for simplifying procedures. The reform aims to better target social benefit spending.

However, the timing and scope of this reform remain uncertain as vested interests have lobbied for the exclusion from the reforms of categorical benefits. These benefits count for a

⁶ Deficit figures for the general government reported in the context of the IMF stand-by arrangement and in the PEP 2005 differ due to different methodologies. The IMF uses GFS 1986 (modified accrual basis) and the PEP 2005 applies GFS 2001.

large part of social spending. Significant state support to loss-making enterprises continued to put considerable strain on the budget. In June 2006, the government released the first instalment of debt repayments to pensioners, equivalent to around 0.5% of GDP. This required a significant bridge financing as earmarked revenues from privatisation did not materialise as foreseen. The transparency of public debt management remains weak. The inclusion of local governments in fiscal reporting is still partial. Overall, public finance reforms have continued but significant fiscal risks remain.

The stabilisation of the high and still rising external debt has been a key target of macroeconomic policies. Given the limited scope for monetary policy discretion under the circumstances of currency substitution, fiscal policy has continued to play an important role for macroeconomic adjustment and stabilisation. Fiscal consolidation has reduced financing needs in the public sector and has helped reducing savings-investment balances in the economy. A shift in government borrowing from external to domestic markets was intended to support this process. However, it may have led to crowding out effects and higher financing costs. Fiscal risks, high spending ratios as well as continuously increasing arrears in the public sector remain a concern. In general, the macroeconomic policy mix was largely adequate, but fiscal consolidation needs to be strengthened.

Free interplay of market forces

There is some evidence from available business data that the private sector's share in output has risen above earlier estimates of a 60% share. The share of the private sector in total employment increased slightly from 66.2% in 2004 to around 68% in 2005. Overall, state intervention and ownership has remained significant in important industrial sectors, such as in shipbuilding and the steel industry.

Until June 2006, the State Privatisation Fund had offered 55 companies of its portfolio, comprising 48 companies with minority and seven companies with majority state ownership. However, the number was drastically short of the authorities' policy objective reaffirmed in August 2005. The intention was to sell 50% of companies with minority and a third of companies with majority state ownership by June 2006, totalling almost 500 companies. A number of factors have delayed this, such as a generally low commitment from the government as well as legal problems, low investors' interest, and sometimes unrealistic sale conditions. The authorities' intention to draft and adopt a new Privatisation Law, which allows for partial employee ownership, may have also slowed down the process. To conclude, privatisation continued at a significantly slower than envisaged pace.

Free market entry and exit

A network of "one-stop-shops" has been established and company registration procedures have been simplified. The average time needed to set up a business has been reduced. The number of newly established companies in the Register of business entities has increased by 15.3% in 2005. At the same time, the number of companies that were eliminated from the Register has declined significantly. As a result, the stock of registered businesses rose by 5% in 2005. Starting and running a business remains hampered by bureaucratic procedures and inefficiencies in administrations and courts. Recently approved amendments to the Bankruptcy Law aim to simplify and accelerate bankruptcy procedures and to enhance the transparency of the process. Overall, company registration procedures have started to improve, but administrative inefficiencies continue to hamper market entry and exit.

Adequate legal system

The judicial system has continued to suffer from slow and inefficient court proceedings, poor case management and low administrative and professional capacity. These circumstances may discourage economic actors from taking cases to court and undermine an effective enforcement of creditor and property rights.

Sufficiently developed financial sector

The banking sector represented 78.7% of total financial sector assets in 2005 (2004: 81.4%). Banks are mostly privately-owned (95%) and the share of foreign ownership remained high at 91.3%. In 2005, the number of banks decreased from 37 to 34, which is still relatively high. The degree of market concentration remained moderate, as the five largest banks represented a market share of 75% at the end of 2005 (2004: 74%). The further reduction of the spread between average lending and deposit rates indexed to foreign exchange (from 4.1% in mid-2005 to 3.7% in April 2006) indicates that the current level of concentration has not been an impediment to market competition. The largely privately-owned banking sector remains the key player in the financial sector.

Domestic private credit increased to 65.2% of GDP in 2005, up from 59.8% in 2004. Annual bank credit growth accelerated from 17.9% in October 2005 to 23.5% in July 2006. In 2005, commercial bank lending to households has been growing stronger (20.3%) than lending to enterprises (14.3%), but the growth of lending to both sectors accelerated to around 24% year-on-year in July 2006. The share of non-performing loans has been reduced from 4.4% in 2004 to 4.0% in 2005. However, the banking system continues to be confronted with foreign-exchange induced credit risks arising from un-hedged non-financial sector balances. Overall, financial intermediation through banks continued to expand rapidly.

The share of non-banking financial sector assets in total financial sector assets increased from 18.6% at the end-2004 to 21.3% at end-2005. This was primarily the result of a strong asset growth of pension and investment funds. The shares of other market segments (insurance, leasing, saving cooperatives) have not changed significantly. Bond market capitalisation grew to 15% of GDP by end-2005, supported by a switch of government borrowing from foreign to domestic financial markets. Overall, capital markets continued to play a minor role in financing the economy.

A single supervisory agency for the non-banking sector was established in November 2005. It started its operations in January 2006, but has not yet reached the required staffing level. A recently adopted insurance law still needs to be fully implemented. Overall, there remains scope for the strengthening of non-banking supervision, in particular regarding leasing companies which have become more important in financial intermediation.

3.2.2. The capacity to cope with competitive pressure and market forces within the Union

Existence of a functioning market economy

Croatia has generally maintained macroeconomic stability. Relatively low inflation and exchange rate stability have continued to support market mechanisms. However, fiscal and external deficits still pose potential risks to macroeconomic stability.

Sufficient human and physical capital

Several measures have been taken concerning the Education Sector Development Plan 2005-2010. These aimed at improving the quality of primary and secondary education as well as of vocational education and training. Ongoing reforms were meant to tackle serious shortcomings, such as outdated curricula, low quality teaching and poor equipments, which apparently takes time. Emphasis has also been put on enhancing the scope and quality of adult education. Life long learning remained at a very low level at 2.3% in 2005 (2004: 2%). Overall, reforms of the education system have continued, but further efforts are needed to increase its efficiency and quality.

The participation rate remained unchanged at around 63% in the second half of 2005. With a view to increasing participation and employment rates, the authorities introduced a new set of active labour market measures in early 2006 related to the National Employment Action Plan. These include more focussed support, training and employment subsidies for young persons without work experience, the long-term unemployed, older persons and other vulnerable groups. The unemployment rate declined by 1.5 percentage points to 12.3% in the second half of 2005. Yet, it remained high at above 30% for the young population. The long-term unemployment rate increased slightly to 7.4% in 2005 (2004: 7.3%). Overall, the economy continued to be affected by a relatively high share of inactive persons.

Gross fixed capital formation (GFCF) continued to grow strongly in 2005 and early 2006. This led to a further increase in the investment ratio to 29% of GDP (2004: 28.6%). Private investment picked up markedly, whereas the share of general government GFCF in GDP declined to 3.9% (2004: 4.5%). Government investment continued to focus on highway construction. The motorway network was extended by 100 kilometres to 800 kilometres in 2005. Net inflows of foreign direct investment (FDI) increased from 2.6% in 2004 to 3.9% in 2005. The financial sector represents the largest share of cumulative FDI inflows (27.9%), followed by manufacturing (23.4%), then telecommunication (16.3%). Banking and other services attracted most of the FDI inflows, thus reflecting a relatively slow pace of privatisation and restructuring in industry. Total spending on research and development has remained relatively high at around 1.1% of GDP. To conclude, the economy has generally benefited from stronger private investment growth.

Adequate sector and enterprise structure

Preparations were made for a restructuring strategy of the shipbuilding industry. The government therefore adopted general guidelines and chose an external consultant to assist in elaborating a restructuring programme. However, shipyard restructuring has been on the government's agenda for a long time and little progress has been achieved so far. Privatisation of the first shipyard was planned for 2005, but then postponed. Following an unsuccessful offer in March 2006, the Privatisation Fund reissued a tender for government stakes in the aluminium factory TLM. The government also established a working group to prepare a strategy for the privatisation of some remaining state owned tourist companies in March 2006. In May 2006, the government submitted – with some delay – a programme for the restructuring and privatisation of the steel sector to the Commission. In September, tenders for the sale of two state-owned steel companies were launched. Overall, the restructuring of large state-owned companies has made little progress (*see also Chapter 8: Competition*).

The liberalisation of the telecommunication industry is well advanced and market competition has particularly increased in the mobile phone sector. Fixed line operators entered the market, but regulation of network access needs to be improved. The sale of remaining government shares in the telecom company has been delayed. This was initially foreseen for June 2006. Restructuring of the railway company has continued and led to moderate staff reductions, resulting in initial improvements in the working ratio. The legal basis for the structural separation of the railway company was established at end-2005. The privatisation of the first three subsidiaries has not advanced, due to unresolved ownership issues and uncertainties about the privatisation model to be applied. The restructuring and liberalisation of the energy sector is still in progress. The sale of some state shares in the oil company INA, announced for June 2006, has been further delayed. Restructuring and privatisation of an electricity company has not started yet. Overall, the reform of network industries has continued.

Sectoral change is slowly progressing, against the background of an already strong service sector. The shares of the agricultural sector in output declined slightly to 7% in 2005 (7.2% in 2004). This was 62.2% for the services sector (62.5% in 2004). Industry's share (including construction) rose to 30.8% (2004: 30.3%). The share of employment in agriculture rose to 17% (2004: 16.2%), declined slightly for industry to 28% (2004: 28.4%), and rose further for the services to 53.7% (2004: 53.5%).

A growing sector of small- and medium-sized enterprise (SME) still has to cope with a difficult business environment. The relative importance of the SME sector has recently grown. It represents 99% of the total number of firms and 65.5% of total employment. SMEs generate 55% of GDP and 25% of exports. They represent 38% of total enterprise assets. Despite various government initiatives, SMEs have continued to be confronted with inefficiencies in the administrative and judicial system. Access to longer-term financing has remained problematic, particularly for small businesses. The support of SMEs has remained an important priority of the government's medium-term economic policy strategy.

State influence on competitiveness

Progress has been made in enhancing transparency on state aid issues through the establishment of a state aid inventory. A new state aid law came into force in late 2005, bringing legislation more in line with EU requirements. State aid granted remained high at around 2.8% of GDP in 2005. A large part represents support to specific sectors, such as shipbuilding, steel, aluminium and railways. Horizontal aid accounts for only a minor share of state aid, although its relative importance has risen recently. The government announced its intention to reduce the share of subsidies to 2.1% of GDP by 2007 in the context of the PEP 2005. This will require bolder steps in cutting state aid to non-viable, loss-making companies, either through restructuring and privatisation or liquidation. Overall, state intervention in the productive sector remains significant.

Trade integration with the EU

Croatia is an open economy with total trade representing more than 100% of GDP. In 2005, the shares of imports and exports of goods and services in GDP slightly went down to 55.8% (2004: 56.7%) and 47.1% (2004: 47.4%), respectively. Tourism remains the most important export revenue, representing 18% of GDP in 2005 (2004: 17.8%). The EU has continued to be the most important trading partner with a share of 64.6% in Croatian exports and 65.6% in imports. Both shares were slightly lower than in 2004. At the same time, Croatia has

expanded its trade with developing countries and its neighbours in the Western Balkans. In summary, Trade integration is fairly high and trade with neighbouring countries has grown.

Price competitiveness has been maintained. The real effective exchange rate of the Kuna measured on the basis of consumer price developments has remained stable through 2005. Wage and labour cost developments also indicate that price competitiveness has been maintained in 2005. Real unit labour costs declined by 2.3% as real wage growth (1.2%) was lower than the growth of average labour productivity (3.6%).

4. 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 also analyses Croatia's administrative capacity to implement the *acquis*. The analysis is structured in accordance with the list of the 33 *acquis* chapters.

4.1. Chapter 1: Free movement of goods

Little progress has been made regarding alignment on **general principles**. Croatia needs to make sure that its legislation, including distinctly as well as indistinctly applicable measures, be compatible with Articles 28–30 of the EC Treaty and related jurisprudence.

As regards **horizontal measures**, governmental decrees dating from October 2004 provide a legislative basis for the 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 establishment in February 2005 of the State Office for Metrology (DZM) as a new governmental body and two new public institutions, the Croatian Standards Institute (HZN) and the Croatian Accreditation Agency (HAA), which started operations in July 2005. The separation of their functions was finalised in 2006.

As regards *standardisation*, HZN had transposed 8 173 harmonised European standards (ENs) by September 2006, or about 66.6% of the CEN and CENELEC standards. By the end of May 2006, the number of HZN staff was 46 and recruitment of additional staff is underway. HZN is an affiliate member of the European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CENELEC), but does not yet have a target date for full membership in either body.

In the area of *accreditation*, since July 2005, HAA has recruited new staff, trained assessors and promoted accreditation among governmental institutions responsible for harmonisation of New and Old Approach directives.

HAA has been a full member of the European Co-operation for Accreditation (EA) since November 2005. HAA employed 17 persons at the end of May 2006 in comparison with a number of staff of eight when it started working as an independent institution in July 2005. By September 2006, HAA had accredited a total number of 68 bodies.

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 State Office for Metrology (DZM) employs 114 staff. A new General Director was appointed in March 2006. Pursuant to the new Regulation on the Organisation of the DZM adopted in 2006, an independent Department for Basic Metrology functions as the National Metrology Institute and is responsible, together with national calibration laboratories, for the realisation, management and maintenance of national measurement standards.

Regarding *market surveillance*, no particular progress can be reported regarding administrative capacity and enforcement measures of the State Inspectorate.

In terms of administrative capacity, the Department for Internal Market Coordination within the Directorate for Trade and Internal Market of the Ministry of Economy, Labour and Entrepreneurship (MELE) has become operational and employs three persons. This level of staffing is insufficient as the Department is responsible for overall policy coordination with other ministries and agencies and for the application of Articles 28–30 of the EC Treaty and introduction of the mutual recognition principle.

Overall, in the area of horizontal measures, basic structures for harmonisation with EU legislation are in place. However, legal efforts should be matched by adequate capacity building measures to enable Croatian institutions to become full members of relevant European organisations. The adoption and implementation of revised horizontal framework legislation is a priority as well as the segregation of tasks between the various functions (regulatory, standardisation, accreditation, metrology, conformity assessment and market surveillance). Both are key elements for accession negotiations in this chapter.

As regards sectors covered by the **old approach product legislation**, Croatia adopted between September 2005 and April 2006, ten new ordinances aimed at transposing type-approval directives as regards motor vehicles, two- or three-wheel motor vehicles and agriculture or forestry tractors.

As regards *pharmaceuticals*, Croatia has adopted an ordinance aiming at transposing Community *acquis* on good laboratory practice, an ordinance regarding drugs for veterinary medicine. In August 2006, new legislation and a regulation on the criteria for determining wholesale prices of medicinal products were adopted. However, reimbursement decisions and pricing procedures are still not transparent and impartial enough.

A draft Law on General Use Items has been prepared which would provide the legal basis for the adoption of secondary legislation transposing the *acquis* in the field of detergents and cosmetics. Implementing legislation regarding textile and footwear labelling, textile fibre mixtures as well as crystal glass were adopted in November 2005. Further progress in the transposition of Old Approach *acquis* is needed. Substantive efforts are required in the areas of chemicals, pharmaceuticals, cosmetics, legal metrology and with the remaining motor vehicles directives.

As regards **new and global approach product legislation**, progress can be reported regarding legislative alignment with the New and Global Approach directives.

Legislation aiming at transposing the *acquis* on lifts, machinery, gas appliances, low voltage equipment, pressure equipment and simple pressure vessels was adopted in November 2005. Legislation aiming at alignment in the field of non-automatic weighing instruments, radio and telecommunications terminal equipment, electromagnetic compatibility, recreational crafts ,

explosives for civil use as well as parts of the Community *acquis* in the fields of safety of toys, construction products and medical devices were adopted in 2005. Further amendments are needed in these sectors to achieve full alignment with the *acquis*.

Overall, further alignment with the New Approach *acquis* both on the horizontal and vertical levels (framework legislation and sectoral transpositions) continues to 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 implementing legislation.

Concerning **procedural measures**, a new Weapons Law has been drafted. However, most of procedures embodied in the Directive on control of the acquisition and possession of weapons remain to be implemented.

Conclusion

Croatia has made some progress to harmonise its national legislation with the *acquis* of the free movement of goods, but it has been uneven progress as many elements of the *acquis* are not yet in place. Adjusting the conformity assessment infrastructure and the market surveillance activities to the requirements deriving from the New and Global Approach is a major challenge. Alignment with the *acquis* in this chapter is underway, but considerable and sustained efforts are still needed to align legislation with the *acquis* and to effectively implement and enforce it.

4.2. Chapter 2: Freedom of movement for workers

There have been no developments on **access to the labour market**. A number of important adjustments still need to be made to Croatian legislation to align it with EU rules on the free movement of workers and the rights of accompanying family members, mainly as regards non-discrimination. No progress can be reported on preparations for participation in EURES.

There has been little progress on **coordination of social security systems**. Sufficient administrative capacity must be developed to apply Community provisions in this field, and pre-accession assistance should be used to this effect.

Conclusion

Overall, limited progress has been achieved in this chapter. Considerable and sustained efforts will be needed by Croatia under this chapter, particularly in terms of developing administrative capacity for the coordination of the social security systems.

4.3. Chapter 3: Right of establishment and freedom to provide services

Limited progress can be reported regarding the **right of establishment**. In early 2006, the Government changed the decree on the registration fee for ships, yachts and boats eliminating the discriminatory treatment of vessels flying the flag of an EU Member State. However, numerous restrictions on the right of establishment remain, the main obstacles being citizenship and residence requirements, language requirements, restrictions on purchasing property (*see also Chapter 4, Free Movement of Capital*) and the one-office rule.

Certain institutions in the sense of the Institutions Act cannot be set up by foreigners, including EU citizens. The provision of some services, such as tourist guide services, is reserved to Croatian nationals.

There has been no progress regarding the **freedom to provide cross-border services**. At present, Croatian legislation does not provide sufficient legal certainty that cross-border provision of services is possible without establishing a commercial presence in Croatia.

No further progress has been made in the field of **postal services** where the level of legislative alignment is already relatively high. Some outstanding issues have not been addressed, such as a better structuring of the "inspectional supervision" of the providers of postal services, the public financing of the Universal Service Provider (Croatian Post), the inadequate administrative capacity and insufficient funding of the Council for Postal Services as National Regulatory Authority.

No progress could be observed regarding the **mutual recognition of professional qualifications**. Croatian legislation does not distinguish between the recognition of academic and professional qualifications. It also contains nationality requirements which restrict access to certain profession to Croatian citizens and sets out a priori conditions for linguistic skills.

Conclusion

Limited progress has been achieved in this chapter. Substantial obstacles to the right of establishment remain and further work is required in the field of mutual recognition of professional qualifications. Overall alignment with the *acquis* is at a reasonable level although considerable and sustained efforts are still required in some areas.

4.4. Chapter 4: Free movement of capital

Some progress can be reported in the area of **capital movements and payments**. Decisions were adopted by the Croatian National Bank (HNB) which lifted some of the restrictions on cash transactions between residents and non-residents, on non-resident cash transactions to and from domestic bank accounts, and on investments by residents in foreign investment funds. Some statements by the head of the HNB on the potential take-over of a Croatian bank by EU-based bank raised questions about the application of objective criteria.

As regards the acquisition of real estate by foreign nationals, amendments to the Property Act were adopted to simplify the authorisation procedure for the acquisition of real estate by foreigners, which will now be managed solely by the Ministry of Justice.

However, the practical effect of the new procedure remains to be seen, particularly given most of the bottlenecks in the system rest with the Ministry of Justice. Improved case management and strengthened staff numbers will be required, not least in view of the growing backlog of pending applications. Preparations for alignment with the *acquis* in this area are underway.

On the whole, the short-term partnership priority calling for a streamlining of procedures for authorising the purchase of real estate by EU nationals on a non-discriminatory basis and substantially reducing the large backlog of applications has been fulfilled only partially.

There has been some progress in the area of **payment systems**. In June 2006, a Decision of the Croatian National Bank entered into force which partially aligned with the Directive on Cross-Border Credit Transfers. Preparations are already well underway in this field.

Some progress can be reported as regards the **fight against money laundering**. Amendments to the Foreign Exchange Act entered into force in December 2005 introducing 'fit and proper' criteria for owners of foreign exchange offices in line with one of the key recommendations of the second MONEYVAL evaluation of Croatia. As of January 2006, the amended Civil Obligations Act no longer allows the opening of bearer pass books, although existing bearer passbooks have not yet been abolished. Memoranda of understanding on exchange of information were signed with the Serbian and Ukrainian Financial Intelligence Units (FIUs).

There is a need for further legislative alignment with the directives as well as the standards of the Financial Action Task Force in this area. Institutional capacity needs to be strengthened. Monitoring and supervision of reporting entities remains inadequate, especially outside the banking sector, and the enforcement record (including convictions, confiscations, seizures and asset freezing) is still weak. Improving anti-money laundering legislation, ensuring effective implementation, strengthening the FIU and improving inter-agency cooperation are all short-term partnership priorities which remain to be fulfilled.

Conclusion

There has been some progress in this chapter. Croatia has further liberalised transactions on the capital account. Despite amendments to the Property Act that appear to be a step in the right direction, Croatia is not complying with the SAA obligation to make "full and expedient use" of its procedures to authorise the acquisition of real estate by EU nationals. Legislation in the area of fight against money laundering needs further alignment and administrative and enforcement capacity should be strengthened. Increased efforts will be needed to meet the requirements of this chapter.

4.5. Chapter 5: Public procurement

No progress can be reported in the fields of general principles and remedies.

As regards the **award of public contracts**, amendments to the Public Procurement Act entered into force in October 2005. Since then, no significant legislative developments have taken place in this sector.

In February 2006, a Decision on the working group for drafting the proposal on implementation of the Public Procurement Act was adopted. In March 2006, the working group for drafting the Concessions Act was established within the Ministry of Finance.

Some implementing measures were issued during the reporting period. A list of public procurement contracting entities, which have to apply the Public Procurement Act, was published in February 2006. The Decree on Amendments to the Public Procurement Announcements and Records Decree was adopted in October 2005. In September 2006, Guidelines for Public-Private Partnership (PPP) were published in the Official Gazette. The Department for PPP was established by Government Decree, within the Export and Promotion Agency (EIPA), to cover the register of PPP contracts, provide instructions and information, risk assessment and to control tendering as well as work on PPP legal framework. The coherence of these provisions concerning PPPs with the legal and administrative framework on public procurement, including concessions, needs to be ensured.

Regarding *administrative capacity*, the Public Procurement Office (PPO), has been reorganised into three departments, based on the Decree on Amendments to the Internal

Organisation of the Public Procurement Office adopted in October 2005. The PPO published the first issue of the electronic public procurement bulletin on its website, which is a positive step to increase transparency and to provide information to potential bidders.

However, weaknesses in co-ordination of policy making and implementation continue to undermine the coherence of the public procurement system. There is currently no institutional capacity in the field of concessions, with the exception of a registry on concessions held at the Ministry of Finance. Moreover, the PPO staffing levels remain low (19 staff employed by May 2006 out of 24 foreseen in the establishment plan) and further improvements are needed in terms of logistical resources and staff qualifications in order to be able to efficiently design and implement procurement policy.

The State Commission for the review of public procurement procedures has increased its staff numbers to 18 by May 2006. The State Commission registered 746 appeals during 2005. The State Commission has established a record of dealing with appeals promptly, with no significant backlog and publishes its case-law on its website.

Conclusion

Limited progress has been achieved as specific gaps remain to be addressed in relation to concessions, review procedures, implementing capacity, but also on a number of legislative aspects of public contracts. Alignment with the *acquis* in this chapter is underway, but considerable and sustained efforts are needed on the design of a strategy and strengthening of the institutional set-up.

4.6. Chapter 6: Company law

In the area of **company law**, existing legislation is largely aligned with the *acquis*. Some amendments will nevertheless be required, for example in relation to disclosure requirements by limited liability companies and the determination of the offer price in the context of takeover bids.

In the area of financial reporting, good progress in the area of **corporate accounting** took place during the reporting period. A new Accounting Act entered into force in January 2006. Most of the provisions of the Accounting Directives will be transposed through the standards to be adopted by the Croatian Financial Reporting Council (FRC).

The Accounting Act contains a number of provisions referring to the powers of the FRC to issue requirements supplementing International Financial Reporting Standards (IFRS). The Accounting Act already requires a broader application of the IFRS than foreseen in Article 4 of the IAS Regulation, as it applies to all large entities, as well as financial institutions and entities whose securities are listed. There is no special reference to consolidated accounts and a definition of the scope of entities subject to consolidation would ensure clarity of the legal framework. Moreover, enforcement of accounting requirements needs to be monitored.

As regards **auditing**, progress can be reported with the entry into force of the Audit Act in January 2006. However, gaps remain in respect of, for instance, external quality assurance and public oversight. The Audit Act contains citizenship requirements, restricting EU audit firms from establishment in Croatia, which are not in line with the Stabilisation and Association Agreement (SAA) provisions on establishment. Moreover, the practical

application/enforcement of statutory auditing requirements as well as developments in the auditing profession will require monitoring.

Conclusion

Overall progress under this chapter has been good. Significant legislative changes took place towards alignment in the areas of corporate accounting and auditing. Alignment with the *acquis* in this chapter is well on track, although monitoring and enforcement of corporate compliance requires continued efforts.

4.7. Chapter 7: Intellectual property law

No particular progress can be reported in the field of **copyright and related rights**. The administrative capacity of enforcement bodies needs to be reinforced, and the legal procedures implementing the rules in this area need to be reviewed. Improvements need to be made as regards the implementation of the directive concerning satellite broadcasting and cable retransmission, in particular as regards compulsory collective management for satellite broadcasting. Overall, alignment with the *acquis* is already well advanced in this area.

No particular progress can be reported in the field of **industrial property rights**. Alignment with the *acquis* is already well advanced in this area.

Some progress can be reported as regards **enforcement**. In September 2005, Croatia adopted a National Strategy for the Development of the Intellectual Property System (2005-2010). It aims at achieving the level of protection granted by the Enforcement Directive through improvements in the legislative and institutional framework, reform of the judicial system and encouraging rights holders to set up further collective rights management associations (CRMA). In November 2005, amendments to the State Inspectorate Act entered into force which expanded its competence in the field of copyright to supervision of circulation and duplication of books. The State Intellectual Property Office (SIPO) recruited and trained 7 junior clerks in January 2006. In 2005, actions to enforce IPR were performed, which gave rise to misdemeanour proceedings concerning computer programmes sound recording media, cinematographic works and video games. Also in 2005, more than 4 000 inspections to enforce the Trademark Act were carried out (mainly concerning textile products, shoes and leather goods), which resulted in 102 misdemeanour proceedings. The strengthening of implementing capacity, including through specialised training and improved cooperation among enforcement bodies, remains a challenge.

Conclusion

Some progress has been made in this chapter, particularly on enforcement. Continued efforts by Croatia should allow for meeting the requirements of this chapter.

4.8. Chapter 8: Competition Policy

Croatia has made some progress under this chapter. In the **area of anti-trust**, including **merger control**, the Competition Act of 2003 contains the basic rules on restrictive agreements, dominant position and merger control, but further alignment is still necessary. In addition to a need for a general fine-tuning of the provisions, a single competition regime still needs to be created to ensure that the Competition Act applies to all sectors, particularly banking and telecommunications. The Croatian authorities should exclude the possibility for

the Government to overturn anti-trust decisions on the basis of Article 266 of the General Administrative Procedure Act.

As regards the *administrative capacity*, the Croatian Competition Agency (CCA) has made some progress regarding training activities and case-management. The Agency is well managed and provides strategic statements of its activities. However, in order to cope with the heavy and steadily increasing workload of the CCA and training needs, further resources are needed. In this context, it causes concern that the CCA's budget has not been increased in 2006. Furthermore, the CCA should be empowered to impose fines. The current judicial system is not functioning satisfactorily, and 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 93 substantive decisions in 2005, including on restrictive agreements (5), abuse of dominant position, (3) merger control (26) and advocacy decisions (59). The enforcement record needs considerable strengthening, including economic and legal assessment. Enforcement should focus better on preventing the most serious distortions of competition, in particular in the field of prohibiting restrictive horizontal agreements and exclusionary abuses of dominant position. It is also essential that a whole new system for fining is introduced that allows for sufficiently deterrent sanctioning.

In the area of **state aid**, considerable progress has been made with the adoption of the new State Aid Act and the new Regulation on State Aid, particularly as regards the possibility for the Competition Agency to issue binding decisions on draft State aid provisions. Progress has also been made in the new State Aid Act as regards the non application to the State aid area of Article 266 of the General Administrative Procedure Act on the Government's power to overturn decisions.

The Competition Agency is still in the process of 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 reduced from nine in 2005 to eight. There is an urgent need to further strengthen the administrative capacity for State aid control as regards staff, budget resources and training.

There has been some progress as regards the *state aid enforcement* record. In 2005, the Agency handled 91 State aid cases (decisions and opinions). The majority of cases was either not considered state aid in the meaning of the Law or was approved as eligible aid. Only four cases were found to be incompatible with the Law. Enforcement continues to be in its infancy, and needs to be strengthened considerably in relation both to the scope and to the economic and legal assessment. In particular, aid grantors continue to ignore the notification obligations or to not provide sufficient cooperation with the Competition Agency. The Croatian authorities have compiled a list of existing aid schemes and other legal instruments on the basis of which state aid has been granted before the entering into force of the State Aid Act of 2003. As regards fiscal aid, a key element for the accession negotiations, some progress has been made. Alignment with the *acquis* as regards the Profit Tax Act and the Investment Promotion Act is well on track, while the alignment of the Free Zones Act with the *acquis* is still lagging behind. Croatia has yet to submit a proposal for a regional aid map.

As regards the shipbuilding sector, which is a key element of the accession negotiations, the adoption of the strategic guidelines for the future development of the Croatian shipbuilding sector is only a starting point for reflection. Croatia urgently needs to adopt viable

restructuring plans for the companies in difficulties in order to comply with the state aid rules of the Stabilisation and Association Agreement and in view of the importance of the industry in Croatia.

In the steel sector, which is also a key element of the accession negotiations, Croatia has made limited progress. The adoption of a draft restructuring programme for the steel industry in Croatia is a positive step forward but not enough for Croatia to fulfil its obligations under the SAA. Essential elements of the plan, namely the industrial strategy, detailed information on the privatisation process and the state aid measures involved as well as the associated compensatory measures are still to be completed.

Given the continued state aid provided to both sectors, viable restructuring plans for shipbuilding companies in difficulties need to be urgently adopted, as well as a restructuring programme that meets the requirements of the SAA for the steel sector.

Croatia adopted the annual State Aid Report for 2005 in July 2006. The report is based largely on the EU methodology.

Conclusion

Croatia has continued to make some progress, both as regards anti-trust and state aid. However, it needs to intensify its efforts. There is a need for important further legislative alignment, strengthening of administrative capacity, particularly regarding staffing levels, and a more efficient enforcement record. Special attention is needed in order not to violate SAA obligations, in particular as regards state aid to steel and shipbuilding, as well as fiscal aid.

4.9. Chapter 9: Financial Services

Some progress can be reported in the area of **banking and financial conglomerates**. In June 2006, the Croatian National Bank (CNB) adopted a plan aiming at the full implementation of the EU's new capital requirements framework in January 2009. The CNB also adopted amendments to the implementing decisions under the Banking Act, with a view to integrating recently amendments to IAS/IFRS in prudential reporting requirements.

Some progress can be reported in the area of **insurance and occupational pensions**. New insurance laws entered into force in January 2006. The new laws provide for rules on liquidity management and define in more detail types of technical reserves. Life and non-life insurance and non-life-insurance business has to be separated with an exemption for health and accident insurances. Both the Insurance Act and the Act on Compulsory Insurance within the Transport Sector largely comply with EU insurance legislation. However, gaps remain with regard to certain prudential requirements, in particular concerning solvency calculation and supplementary supervision of insurance groups. Croatian legislation is not aligned to the minimum level of compensation, as required by the motor insurance *acquis*. Some progress can be reported as regards the **securities market and investment services**. A new institutional framework has been established in November 2005 on supervision of the non banking financial institutions. The Law on the Agency for Supervision of Financial Services merges three institutions dealing with securities, supervision of pension funds and insurance into a single supervisory authority which started operations in January 2006. The agency is independent; however, its administrative capacity needs further reinforcement.

The new Law on Investment Funds was adopted in Parliament in December 2005. The Law further aligns Croatia's legislation to the Directive on Undertakings for Collective Investment in Transferable Securities.

The area of securities market and investment services is partially aligned.

Conclusion

Some progress has been made in this chapter, significantly so with regard to insurance legislation. The institutional framework overseeing the non-banking financial sector has been clarified. Alignment to the *acquis* in this chapter is moderately advanced. However, increased efforts are required to meet overall requirements of the EU financial services *acquis*.

4.10. Chapter 10: Information society and media

Progress has continued as regards the **electronic communications and information technologies**. A Telecommunications Users Council was established within the Croatian Agency for Telecommunications as a mediation body in the out-of-court disputes between providers and users of public telecommunications services, and also on the protection of users' rights. The Agency itself has taken important regulatory decisions such as the adoption of a new interconnection offer and the reference offer for unbundled access to the local loop. Also, a decision was taken identifying SMP operators in four relevant products and geographic markets. The Agency is now well staffed and its independence, autonomy, and powers are assured by the law. However, it needs to reinforce its organisation, improve its capacities and demonstrate more transparency and focus in its work, with a solid work programme and regular public consultation procedure.

The current Telecommunication Act from June 2003 has been amended four times up to May 2005. A completely new primary law will need to be drafted, however, in order to align with the *acquis*. *Liberalisation* is slowly emerging as regards the fixed network but the incumbent operator is still dominates. In the mobile market, continued growth and the entry of a third player have translated into significant tariff decreases, but some limitations in regulatory conditions and difficulties in network roll-out may slow down this progress. The broadband market has grown significantly but is highly dependent upon the incumbent operator's offering. Not all access options are offered and infrastructure competition has not been introduced. The concession agreement and other agreements between the State and the incumbent need to be disclosed and harmonised with the Telecommunications Act, in particular with regard to any limitations to the further liberalisation of the sector.

Some competitive safeguards are still incomplete or are proving difficult to implement, such as carrier selection, number portability, accounting separation and cost accounting systems, reference unbundling offer, leased lines wholesale offer and pricing, rights of way and facility sharing.

Regarding **information society services**, Croatia's Law on Electronic Signature, Law on Electronic Commerce and the Law on Electronic Media implement the general principles of the *acquis* on e-signatures, electronic commerce, conditional access and e-government.

As regards **audiovisual policy**, Croatia's Law on Electronic Media and the Law on Media have transposed a number of provisions of the Television without Frontiers Directive. However, some issues still need to be addressed in Croatian legislation regarding advertising, the majority rule of European Works and independent works, freedom of reception and judicial appeal. Changes to the Criminal Code removing the sanction of prison sentences in libel cases constitute important progress towards European standards (*see political criteria*). However, a review of audiovisual media legislation in line with the recommendations formulated in February 2004 by the joint expertise mission of the Council of Europe, the Commission and the OSCE is still outstanding. In particular, there is a need to review the Law

on Electronic Media in order to establish a transparent, predictable and effective regulatory framework and ensure political independence of the Council for Electronic Media. Similarly, the Law on Croatian Radio and Television should be reviewed to ensure its Programme Council can work independently and free from political interference. A broad role for civil society should be found for the nomination procedures for both Councils.

Conclusion

There has been some progress under this chapter. In most fields concrete steps have been taken to transpose the *acquis* and a detailed analysis of remaining gaps have been made. However, increased efforts are needed to achieve effective liberalisation of the electronic communications market, both in term of legislation and strengthening of the Agency for Telecommunications. A good level of alignment has been reached as regards audiovisual *acquis* but further efforts are needed.

4.11. Chapter 11: Agriculture

As regards **horizontal issues**, some steps have been taken to prepare for the establishment of the Integrated Administration and Control System and the Land Parcel Identification System as well as for a farm register but these preparations are still at an early stage. A National Committee and an Implementing Agency were established with a view to setting up a Farm Accountancy Data Network. Substantial staff and financial resources will be needed to ensure the administrative capacity that Croatia will need to administrate the Common Agriculture Policy.

No particular progress can be reported on **common market organisations**. The large majority of Croatia's agricultural markets are not in line with the EU requirements, which is understandable at this stage of the enlargement process. Increased efforts will be required to ensure that key elements will be in place at accession, like market intervention, quotas, price reporting and monitoring, and in particular the EU's system of decoupled direct payments. This represents a substantial task and the efforts in this regard need to be intensified.

With regard to **rural development**, Croatia has made substantial progress related to the implementation of the Special pre-Accession Programme for Agriculture and Rural Development (SAPARD). The Croatian programme for SAPARD was approved by the Commission in February 2006 and the Multi-annual Financing Agreement between Croatia and the EU entered into force on 6 April 2006. The management of the SAPARD programme was conferred on a provisional basis to the Ministry for Agriculture, Forestry and Water Management and to the National Fund within the Ministry of Finance, by Commission Decision of 29 September 2006. This decision marks the date for the SAPARD Agency to start selecting and contracting projects and so far covers the measures "Investments in agriculture holdings" and "Improving the processing and marketing of agricultural and fisheries products". The measure "Improvement of rural infrastructure" is currently being prepared for national accreditation.

Good progress has been made as regards **quality policy** where Croatian legislation has been amended so that a high level of compliance with EU required has been achieved. Agricultural products not intended for human consumption are however not covered. Further efforts are needed as regards the inspection system.

Good progress has also been made as regards **organic farming** where Croatia has achieved a high level of compliance with EU requirements. Croatia has the necessary register of organic operators, authorised testing laboratories and technical inspections.

Conclusion

Reasonable progress has been made in the field of agriculture in particular with regard to rural development, quality policy and organic farming. Preparations need to be intensified as regards horizontal issues and the common market organisations. In particular, due attention should be given to the establishment of the Integrated Administration and Control System and the Land Parcel Identification System.

4.12. Chapter 12: Food safety, veterinary and phytosanitary policy

Concerning **general** foodstuffs policy, progress remained limited in transposition and implementation. Croatia needs to implement the fundamental principals of the Food law, namely the responsibility of food and feed operators and traceability. The administrative capacities to fulfil the obligation of registration of establishments and implement the new approach of food and feed controls need to be strengthened.

Some progress has been made as regards **veterinary** issues. The veterinary system in Croatia is in general well functioning but substantial adaptation is still required to achieve full compliance with EU requirements. Croatia has continued to make progress as regards animal registration. An electronic database was set up in May 2003 and was implemented for bovine animals by the end of 2005, although there is still a need for further improvement of certain procedures for instance as regards the marking of calves, issue of animal passports and the deduction of slaughtered animals. Further development is needed for other animals, such as sheep, goats, pigs and equidae.

As regards veterinary checks on third country borders some progress has been made. A plan for rationalisation of border inspection posts has been developed but needs further refinement. Eight external border inspection posts are foreseen after accession at the present stage. There is a substantial need for infrastructure investments and upgrading of staff qualifications.

As regards animal disease control measures, Croatian authorities reacted swiftly to control the Avian Influenza outbreak end of 2005. Croatia continues its non-vaccination approach for Classical Swine Fever (CSF) that was introduced in 2005. This represents a positive development with a view to EU requirements, but in view of recent sporadic outbreaks, there is a need for further monitoring and assessment. A programme of active surveillance of CSF among wild boars is taking place. Disease notification is taking place in accordance with the procedures determined by the World Organisation for Animal Health which gives a good basis for meeting EU requirements.

With regard to the **placing on the market of food and feed**, progress has been relatively limited. Establishments for food processing, such as slaughterhouses, meat processing plants and dairies, do in general not comply with the requirements of the EU as regards hygiene standards. Substantial efforts will be required to elaborate the detailed plans needed to bring Croatia's food processing establishments in compliance with EU requirements at accession. There is also a need for further improvement of laboratory capacity in the food safety field. The progress in this field is closely linked to the implementation of the Food Safety Strategy.

In the field of animal welfare, only limited progress has been made. An Animal Protection Law is being drafted that will serve as a framework for implementing legislation in the field.

No development can be reported in the areas of **specific rules for food** and **specific rules for feed**.

Good progress has been made in the area of **phytosanitary** issues although substantial further efforts are required in particular as regards implementing legislation and enhancement of administrative capacity. Pursuant to a Decree of May 2006 the phytosanitary activities of the Ministry of Agriculture, Forestry and Water Management were reorganised with a view to better supporting the preparations for EU accession. There is, however, still a need to enhance staff numbers and qualifications as well as the general administrative capacity.

Good progress was made in the area of plant health. Implementation of the new Plant Health Act started in January 2006. The Act aims at harmonisation with the provisions of the *acquis* regarding harmful organisms. On the basis of this Act, a substantial number of implementing ordinances are under preparation. Activities related to the control of harmful organisms were enhanced, in particular as regards systematic surveys for certain harmful organisms. The number of examination sites was increased. Phytosanitary border inspection posts do not meet the minimum EU requirements and further improvement is needed in infrastructure and staff qualifications, aiming in particular at those inspection posts that will remain after accession.

Good progress was also made in the field of plant protection. The Plant Protection Products Act that will enter into force in 2007 aims at harmonisation with the EU *acquis* on the marketing of plant protection products. A number of implementing ordinances were issued in the second quarter of 2006 on evaluation of active substances and on the evaluation and authorisation of plant protection products.

Progress has also been made as regards the area of seed production and plant reproduction material. The new Act on Seeds, Planting Material and Registration of Varieties of Agricultural Plants was adopted by Parliament at the end of 2005 aiming at a high degree of compliance with EU requirements. Implementation will only take place in 2008. A substantial amount of implementing legislation will be required to ensure full compliance in this field.

Conclusion

Some progress has been made in the field of food safety, veterinary and phytosanitary policy. Substantial efforts are however required in order to accelerate the preparations. The Food Safety Strategy needs to be officially approved as a matter of priority and the on-going preparations for remaining framework legislation must be finalised.

4.13. 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 developments can be reported in the areas of **resource and fleet management** and **inspection and control**. Based on the amended Marine Fisheries Act, Croatia adopted several implementing regulations introducing notably new temporal and spatial restrictions on fishing, restrictions on engine power and on the issuing of new licences for commercial fishing as well as a framework for better data collection. Their scientific basis and alignment with the *acquis* remain to be assessed. Croatia also adopted implementing regulations providing the legal base for establishing an aligned fleet register and the installation of a satellite based vessel monitoring system (VMS). Five additional inspectors were recruited for control at sea. A number of technical differences to the *acquis* remain in the area of resource management and Croatia does not yet have a compatible fleet register, fleet management measures, VMS or landing declarations. Preparations in these areas are being launched.

No particular progress can be reported with regard to **market policy**. Currently Croatia does not yet have producers' organisations and uses different marketing standards. Preparations in this area are at an early stage.

There has been no particular progress in the areas of **structural actions** and **state aid**. Croatia still needs to create the necessary administrative structures for the implementation of the EU's structural policy. It will also have to remove state aid incompatible with the *acquis* such as the current fleet construction programme. Preparations in both areas are at an early stage.

No particular developments can be reported in the area of **international agreements** where Croatia has already reached a considerable level of alignment.

Conclusion

Croatia has made some progress in the field of fisheries. Overall, Croatia has reached a satisfactory level of alignment in its preparations for accession. Important gaps remain in the areas of fleet management, inspection and control, structural actions and state aid. Croatia will need to make increased efforts to close these gaps.

4.14. Chapter 14: Transport policy

Progress can be reported in the field of **road transport**. Progress was made in alignment to the *acquis* through the adoption of ordinances on the transport of hazardous substances by road, on safety advisors, and speed limitation devices. Concerning social rules, further progress needs to be made on working time, on the new rules on driving time and resting periods and on the introduction of the digital tachograph. Efforts are also needed in the area of access to the occupation (professional competences). The legislation covering taxes, tolls and road user charges still needs to be aligned with the *acquis*. A national programme for road safety was adopted in February 2006. However, the adoption of implementing legislation on weights and dimensions, tunnels safety and driving licenses is still outstanding.

Administrative capacity for the implementation and enforcement of legislation remains limited. No new staff was recruited in the relevant departments. A working group with members from the Ministry of Sea, Tourism, Transport and Development and the Ministry of the Interior was established in November 2005 to improve the coordination and prioritisation of topics concerning alignment to the *acquis*. Preparations in this area are underway.

There has been some progress in the area of **rail transport**. The Railway Act entered into force in 2006. In December 2005, the Act on the Division of the Croatian Railway Company

was adopted, and a small holding with four different operational daughter companies, i.e. traction, passenger, freight and infrastructure is under establishment. A network statement has not yet been published by Croatia. Implementing legislation was adopted concerning safety certification, on licensing of railway undertakings and on railway infrastructure; the alignment with the *acquis* remains to be confirmed. However, transposition of safety legislation and the establishment of the different rail authorities remain outstanding. The railway directorate in the Ministry of the Sea, Tourism, Transport and Development was reorganised to establish a separate entity dealing with safety. The Croatian authorities have established contact with the European Railway Agency. Preparations in this area are at an early stage.

Concerning **combined transport**, the Law on ratifying the Memorandum of Understanding on the participation of Croatia to the Marco Polo Programme was adopted in September.

No particular progress can be reported in the area of **inland waterways transport**. The legislation on access to the market and to the profession remains to be aligned. The alignment with the *acquis* of legislation of technical requirements remains to be confirmed. A strategy for the alignment of the Croatian inland waterways sector is under preparation. Administrative capacity in the sector remains generally adequate. The International Commission for the Sava basin, with its seat in Zagreb, started its work in January 2006. This Commission aims to facilitate the revitalisation of the Sava navigation route and addresses issues concerning river basin management, navigation, accident prevention and control, and flood prevention. Preparations in this area are still at an early stage.

There has been good progress in the area of **air transport**. Croatia has adopted an ordinance on the investigation of accidents. An ordinance on ground handling services and slot allocation was adopted, aimed at full alignment with the *acquis*. Croatia has signed the Agreement on the establishment of a European Common Aviation Area (ECAA). by signing the European Common Aviation Area Agreement (ECAA), Croatia has undertaken to integrate into the EU internal aviation market and to apply EU aviation standards. This will require the application of the ECAA agreement in practice and the fast implementation of the first transitional phase of the relevant aviation *acquis*, including market access conditions, safety, security, airport policy, environmental and social issues and air traffic control, in line with the Accession Partnership short term priority. The compliance of Croatia's legislation on aviation security with the *acquis* remains to be verified. Reinforcing the administrative capacity in the aviation sector should be an immediate priority for Croatia and the establishment of an independent accident investigation body remains outstanding. Overall preparations in this area are underway.

Good progress can be reported in the area of **maritime transport**. Ordinances have been adopted aimed at alignment with the *acquis* on port reception facilities and pollution prevention, on the minimum level of training of seafarers and working time of seafarers, on marine equipment, and on port state control. The detention rate of Croatia-flagged ships has improved from 7.8% in 2004 to 4.9% in 2005. Croatia has adapted its rules on vessel registration fees in order to comply with the requirements of the SAA concerning market access. However, further alignment concerning classification societies, port state control, vessel traffic monitoring, marine equipment, fishing ships, the safety of roll on–roll off ferries, the minimum level of training of seafarers and the registration of persons sailing on passenger ships is still outstanding. Croatia also remains on the grey list of the Paris Memorandum of Understanding. Further alignment is also still required to align to the *acquis* on maritime cabotage and the freedom to provide international maritime transport services. As

regards maritime security, Croatian legislation is partially aligned with the *acquis* concerning port security. Preparations in this area are underway.

Conclusion

Overall, there has been good progress in this chapter. Croatia needs to make increased efforts to align with the *acquis*, notably by further adoption of implementing legislation. Reinforcement of administrative capacity (both in staff numbers and in level of training) also remains a matter of priority for most transport sectors.

4.15. Chapter 15: Energy

In the area of **security of supply** good progress was made with the establishment of an oil stock agency. Croatia currently holds stocks equivalent to 71.9 days of annual consumption, which needs to be raised to 90. Alignment in this area is underway.

There has been good progress in the area of the **internal electricity and gas markets**. A regulatory body established in 2005 currently employs 34 persons. Its administrative strengthening is a matter of priority. The state-owned electricity company HEP has been restructured into a holding company. However, all unbundled assets remain in the ownership of the holding company. In addition to the transmission system operator, there is also a market operator. The state gas company INA holds a monopoly as the only supplier and importer. Croatia ratified the Energy Community Treaty in June. Alignment in this area is on track.

As for **state aids** to the coal industry, Croatia no longer produces coal domestically.

Limited progress can be reported in the field of **energy efficiency and renewable energy sources**. Ordinances on hot-water boilers and household appliances were adopted. Croatia is partially aligned with the directive on the energy performance of buildings. There is no guarantee of origin for renewable energy and for combined heat and power yet. No target for renewable electricity for 2010 has been set. To align with the *acquis*, Croatia's target for the share of renewable electricity must include all hydropower. A target for biofuels has been set in line with the *acquis*. Administrative capacity requires significant strengthening. Alignment has well begun, but needs continued efforts.

Limited progress has been made on **nuclear safety and radiation protection**. Of two storage facilities, only one is licensed. Legislative alignment continued, but is still outstanding concerning foodstuffs, radioactive waste management, radiological emergencies and for the control of high activity radioactive sealed sources. An inventory of sources was established only for medial sources. Spent sources are stored in pools existing in the hospitals until activity decreases below the exemption levels. The State Office for Nuclear Safety (SONS) became operational in June 2005 but only 12 of its 18 staff positions are filled. A clear division of responsibilities between SONS and the similarly understaffed State Office for Radiation Protection needs to be ensured. The ECURIE agreement with the Community has been signed.

Conclusion

Overall, there has been some progress. including on security of energy supply and on the internal energy and gas market. However, increased efforts are needed, particularly on energy

efficiency, nuclear safety and regulatory strengthening. The Accession Partnership's short-term priorities have been mostly met.

4.16. Chapter 16: Taxation

No progress can be reported in the area of **indirect taxation**. Croatian tax legislation concerning *VAT* and *excise* duties remains only partially aligned to the *acquis*. Discrepancies to the *acquis* in the field of VAT include amongst others certain reduced and zero-rates applied in Croatia, the scope of tax exemptions, the inclusion of free zones in the tax-territory, the special schemes and the introduction of VAT refunds to non-established traders. Also, the system of excise duties will require substantial changes regarding for example product coverage, rates and duty suspensions. Alignment in the area of indirect taxation is at an early stage.

Limited progress was made in the area of **direct taxation**. Amendments to the Law on Profit Tax were adopted in May 2006 and will enter into force in January 2007 with the objective of aligning certain special fiscal regimes to the state aid *acquis* (see Chapter 8, *Competition*) and the code of conduct for business taxation. Divergences to the *acquis* remain with regard to the merger, 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. Alignment in the area of direct taxation is at an early stage.

Some progress can be reported with regard to **administrative cooperation** and operational capacity. The new division for international cooperation and European integration set up within the Tax Administration became operational in late 2005. It is foreseen to become the future Central Liaison Office and has 11 staff members. A 'Financial Police' created in 2004 to curb fraud became operational in January 2006 and focuses mainly on excise duties. Some steps have been taken to strengthen the IT-divisions of the Tax Administration. However, these divisions remain strongly dependent on external companies, with very limited internal capacity to guarantee the continuity of the IT services. IT-interconnectivity with the Community systems needs to remain a priority for the authorities. Despite ongoing efforts to improve performance, the overall administrative capacity of the Croatian Tax and Customs Administrations (the latter being responsible for excise duties) remains limited and preparations are only starting.

Conclusion

In the area of taxation Croatia has made limited progress. While the overall structure of tax legislation is similar, Croatian tax legislation is at an early stage of alignment with the *acquis*. Significant efforts are needed to accelerate alignment and to strengthen the Tax Administration, including with regard to IT-interconnectivity, in order to make sure that Croatia is in a position to implement and enforce the *acquis*.

4.17. Chapter 17: Economic and Monetary Union

In the field of **monetary policy**, no progress can be reported. Croatia will need to continue to implement the necessary changes to its institutional and legal framework. In particular, the HNB (Hrvatska Narodna Banka) has to adopt a secondary objective that allows for general economic objectives of the European Community taking precedence over domestic objectives. In addition, it has to adopt the relevant rules and structures related to the integration of the HNB into the European System of Central Banks by the time of EU-accession.

The provisions in the Croatian legislation only provide for a partially independent central bank. Several provisions, in particular concerning institutional and personal independence are not compliant with the *acquis*. A draft proposal for a new Croatian National Bank Act was formulated in April 2006. There are still some provisions in the Croatian legislation that do not preclude monetary financing of the public sector and give rise to privileged access of public authorities to financial institutions. Overall, preparations in the area of monetary policy are well on track.

In the area of **economic policy**, the country has made some progress in its alignment with the *acquis*. In particular, the Pre-accession Economic Programme (PEP), which was submitted to the Commission in November 2005, provided a sound basis for economic policy coordination in the medium term (2006-2008) since quality significantly increased compared with the previous PEP. The medium-term fiscal framework adopted by the Government as well as the Budget Act set objectives in line with *acquis* reference values. Pursuant to the Government's Economic and Fiscal Policy Guidelines 2006-2008, Croatia has started in 2006 the implementation of the ESA 95 methodology for the purpose of statistical reporting to the EU within the framework of fiscal surveillance.

However, several ministries and government agencies have varying degrees of responsibility in key and interrelated economic policy areas. The strong fragmentation of responsibilities hampers the effectiveness of policy formulation and implementation. As result, key decisions on economic policy are often delayed. Nonetheless, in the area of economic policy, Croatia is fairly advanced.

Conclusion

There has been some progress in the area of economic and monetary union. However, further efforts have to be made, in particular with respect to full Central Bank independence. Preparations to align with the *acquis* are well under way in this chapter.

4.18. Chapter 18: Statistics

Concerning **statistical infrastructure**, the strategy for the development of official statistics for the period 2004–2012 and the Programme of Statistical Activities for 2004–2007 have been adopted. These documents, together with the Annual Implementation Plan, define long-term objectives, general principles and criteria regarding the functioning and development of the statistical system. Important managerial decisions in the Croatian Bureau of Statistics (CBS) and other strategic decisions are hindered by a long-term senior management vacancy (since June 2005).

With regard to administrative capacity and enforcement, the budget allocated to the CBS for 2006 has been reduced considerably and constitutes a threat to basic statistical activities of the CBS. The CBS lacks staff in the vital IT department as well as in the Project Implementation Unit, responsible for all donor activities.

As regards the implementation of **classifications**, continued progress is needed. The basic classifications and statistical registers are already implemented. However, further work has to concentrate on the improvement of the coverage and quality of the business registers and the preparation of implementation of the future changes of the NACE nomenclature.

In the area of **sector statistics**, Croatia needs to step up efforts in agricultural statistics especially with a view to obtaining comparable agricultural structure, agromonetary and dairy data. Progress can be reported from the economic and monetary statistics where the ESA 95 was widely introduced. Further work should concentrate on methodological fine-tuning and the introduction of financial accounts. As far as public finance statistics are concerned, a twinning project has started which will allow the CBS, the Ministry of Finance and the Central Bank to develop public finance statistics according to the *acquis*.

Conclusion

Good progress has been made in this chapter. Improvements can be reported in the main statistical areas. However, continued efforts, and sustained national funding are necessary if Croatia is to meet the requirements of this chapter.

4.19. Chapter 19: Employment and Social Policy

In the area of **labour law**, the Ministry of Economy, Labour and Entrepreneurship launched in June 2006 a wide consultation process with economic and social partners in order to agree an action plan for the adoption and/or amendment of regulations necessary for transposing the *acquis*.

Concerning **health and safety at work**, no new legislation transposing the *acquis* has been adopted. The Labour Inspectorate needs substantial strengthening, and it needs to become more mobile.

As regards **social dialogue**, a number of activities have been undertaken relating to the provision of support to social partners in capacity building, and in particular through bipartite social dialogue. There is still scope, however, for improvement in this area. In general, tripartite dialogue seems to be well developed in Croatia. However, clarification on the criteria for including employers' associations other than the Croatian Employers' Association in the work of the Economic and Social Council is needed.

In the area of **employment policy**, in March 2006 the Government adopted an annual programme for the promotion of employment in line with the provisions of the National Employment Action Plan 2005-2008. The funds allocated for the implementation of this programme amounted to HRK 335 million for 2006. Launched in September 2005, work under the Joint Assessment of Employment Policy Priorities (JAP) process has been relatively modest. A roadmap has been agreed for its completion. Despite some reduction in recent years, the unemployment rate remains high in Croatia. Regional inequalities are also considerable and qualification and skills levels of the Croatian labour force are lower than in the EU. Attention should be paid to undertaking active labour market measures, as well as to adult education and training. Efforts should also be pursued to tackle illegal work.

Preparations for the **European Social Fund** work have started in particular in the framework of the IPA pre-accession instrument and its component VI on human resources development. In this context, work has started on the relevant programming documents including the single Operational Programme.

As regards **social inclusion** and **social protection**, work on the Joint Inclusion Memorandum process (JIM) between the EU and Croatia is well advanced. In terms of social exclusion and poverty in Croatian society, much remains to be done. A more strategic approach to social

benefit reforms is necessary in order to provide more effective support for the most vulnerable groups of the population. Concerning people with disabilities, sufficient financial resources should be allocated in order to ensure implementation of the National Strategy for the Disabled.

There has been limited progress in the **anti-discrimination** field. A comprehensive national strategy for the elimination of discrimination still remains to be adopted. There has been no new legislation transposing the *acquis* in this field; nor has there been progress in the establishment of the Equality Body. Serious attention should be paid to availability of sufficiently comprehensive statistical data to allow monitoring of discrimination.

There have been some developments in the field of **equal opportunities**. Shortcomings with respect to parental leave are being addressed and the review of the Croatian legislation on occupational pension schemes is underway. In September 2006, the Government adopted the National Policy for the Promotion of Gender Equality 2006-2010 (*see also political criteria*).

In terms of *administrative capacity*, a new Regulation on Internal Organisation of the State Inspectorate was adopted, which increased the number of inspectors by 50, and the Act on Amendments to the State Inspectorate Act widened the powers of inspectors and introduced more stringent criminal sanctions. An initiative has also been launched to set up special departments and chambers within the courts to deal with procedures in civil suits deriving from labour related disputes. An internal reorganisation was undertaken at the Ministry of the Economy, Labour and Entrepreneurship resulting in the establishment of a new Department for Project Preparation and Monitoring within its Directorate for Labour and Labour Market. Of the total six staff required, four have already been hired. A new department with four full-time employees has been established in the Croatian Employment Service.

Conclusion

There has been limited progress in this chapter. Specific gaps remain to be addressed particularly in relation to administrative capacity, which remains weak and which is a key element for the accession negotiations in this chapter. Overall considerable and sustained efforts are needed to meet the requirements of the social policy and employment *acquis*.

4.20. Chapter 20: Enterprise and Industrial Policy

Notable but uneven progress has been made in the area of **enterprise and industrial policy principles**. Croatia has initiated preparations for a comprehensive industrial strategy aimed at improving its industrial competitiveness in line with EU policy principles. With regard to privatisation, no particular developments can be reported concerning large state-owned companies and utilities outside the portfolio of the State Privatisation Fund. The portfolio of the State Privatisation Fund still comprises of 965 companies of which 68 are majority state-owned. The remaining 897 represent minority participation, with the State owning less than 50%. In 848 companies, the State holds less than 25%.

Good progress can be reported in the field of the business environment and SME policy. Croatia has further extended the services provided by the one-stop system for companies. Time for company registration has been limited to five days and online registration is now possible in the crafts sector. Croatia has introduced initial regulatory impact assessments but there remains scope for improving the quality and regularity of consultation between government and the business community on relevant draft legislation. Croatia has also

launched a project aimed at reducing regulation redundancies and consequently lowering regulatory burdens on the business sector. Croatia has continued to successfully implement the European Charter for Small Enterprises. Croatia's SME definition is largely in line with that of the EU. Preparations in the area of business environment and SME policy are well advanced while the development of an industrial strategy and privatisation require further attention.

Some progress has been made in the area of **enterprise and industrial policy instruments**. In July 2006, Croatia initiated the procedure for participating in the EU's Competitiveness and Innovation Programme. Croatia has to a large extent transposed Directive 200/35/EC combating late payments in commercial transactions. Preparations in this area are well underway.

Limited progress was made with regard to **sectoral policies**. Some sectoral industrial strategies, such as for textiles, are being prepared. In March 2006, Croatia adopted a targeted support programme for the tourism sector. With regard to restructuring of industrial sectors, Croatia has not yet adopted restructuring plans for its shipbuilding companies. This sector is of high importance to the country and requires urgent and significant restructuring, given its deficit in global competitiveness compensated by large scale government subsidies. Concerning steel, Croatia has made some progress towards a National Restructuring Programme for the steel sector. A draft programme has been sent to the Commission in June 2006 and is currently being revised. 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*). Preparations in this area are at an early stage.

Conclusion

Croatia has made notable but uneven progress in this chapter. Good progress in the area of business environment and SME policy contrasts with limited progress in the fields of industrial strategy as well as privatisation and restructuring, in particular in the steel and shipbuilding sector, where increased efforts are required. Overall, Croatia has achieved a reasonable alignment with the *acquis* in this chapter.

4.21. Chapter 21: Trans European Networks

Good progress can be reported in the area of **transport networks**. Croatia is actively participating in the development of the Core Regional Transport Network and in the South East Europe Transport Observatory (SEETO) but has not yet signed the SEETO Agreement. Croatia needs to ensure transmission to SEETO of complete traffic and transport data on the core regional transport network. Croatia also signed a memorandum on the establishment of a high performance railway network in South East Europe in May 2006.

Continued cooperation is required in the context of the annual revisions of the plans in order to make further progress on the definition of regional priorities and the coordination of investments.

There has been some progress in the area of **energy networks**. Croatia ratified the Energy Community Treaty in June 2006. The Treaty establishes a regionally integrated market for electricity and gas, based on the relevant *acquis* on the internal energy market, renewable energy sources, environment and competition. Interconnection is of vital importance for the proper functioning of the Energy Community. Croatia's priorities include the development of

an LNG terminal on the Adriatic coast and development of access to gas from the Caspian region through Turkey. Croatia also prioritises the gas and electricity interconnections with its neighbouring countries. Croatia is encouraged to increase its interconnection, which is vital for creating an effectively functioning regional energy market.

Conclusion

Some progress can be reported in this chapter. However, the development of a long term transport and energy infrastructure programme with clear timetables and financing strategies is still outstanding. Overall, implementation of the *acquis* in this chapter requires continuous efforts by Croatia.

4.22. Chapter 22: Regional Policy and Coordination of Structural Instruments

Some progress can be reported regarding the **territorial organisation**. Croatia has made proposals regarding the establishment of statistical and planning regions at Nomenclature for Territorial Statistical Units (NUTS) II level, which are being discussed with the Commission. However, there continues to be a lack of adequate regional statistics. Preparations in the area are still at an early stage.

Progress has been limited regarding the **legislative framework**. A draft law on regional development has been prepared but remains to be adopted. The coherence between the national legislation and the Structural funds regulations as well as other Community legislation, namely competition and state aids still needs to be ensured. Preparations are still at an early stage in this area.

There has been some progress regarding the **institutional framework**. A Central State Office for Development Strategy was created in May 2006. This State Office is the IPA coordinator and it will be in charge of programming national and regional development policies. Identification of future operational structures for the implementation of the IPA instrument and structural interventions is progressing well. Inter-ministerial coordination and the consultation with partners need further strengthening. Preparations in this area are under way.

Progress has been limited regarding **administrative capacity**. Management capacities as well as the capacities of Programme Implementing Units (PIU) vary between different ministries. Strengthening administrative capacity remains a priority for Croatia to be able to benefit effectively from the cross-border cooperation, regional and human resources development components of the IPA instrument from 2007. Preparations in this area are still at an early stage and accreditation of the relevant implementing structures should be started as soon as possible to avoid delays in the dispersal of funds.

Good progress can be reported regarding **programming**. The Central State Office for Development Strategy coordinated the elaboration of a Strategic Development Framework for 2006–2013 through the inter-ministerial coordination working group. The competent line ministries are in the process of preparing programming documents with relevance for IPA in Croatia, which bridges towards Structural Funds. Preparations in this area are being initiated with the preparation of the Multi Annual Indicative Planning Document (MIPD), the Strategic Coherence Framework and Operational Programmes. In addition, several counties are preparing programming documents with relevance for the structural funds.

There has been some progress regarding **monitoring and evaluation** and **financial management and control** (*see also Chapter 32 – Financial Control*). However, standard methodologies and common cross-sectoral procedures still need to be developed and financial control systems need to be continuously reinforced. Preparations are still at an early stage in this area.

Conclusion

Some progress can be reported in this chapter. However, Croatia still needs to make considerable and sustained efforts to establish the necessary framework and structures for the implementation of the Structural and Cohesion Funds. Overall, Croatia's alignment with the *acquis* in this chapter remains modest.

4.23. Chapter 23: Judiciary and fundamental rights

As regards the **independence of the judiciary**, there have been some developments.

Amendments to the Law on the State Judicial Council adopted in December 2005 establish a Disciplinary Council, consisting of three members, and extend the time limit for initiating disciplinary proceedings from two to three years. A new Law on Courts, also adopted in December 2005, includes more elaborate and verifiable evaluation criteria for the work of judges, obligatory training for judges, and the introduction of a judicial inspection. These new provisions now need to be implemented.

In 2005 disciplinary proceedings were brought against judges in eight new cases, and measures were taken in three cases, including two fines and one dismissal. However, as private parties do not have standing to initiate or request disciplinary proceedings against judges, a large number of complaints are instead lodged with the ombudsman, who has no competence to examine complaints concerning the judiciary. Private parties need to be given an appropriate forum for complaints and disciplinary proceedings need to be processed in a more transparent way.

There is still no system in place which would ensure a uniform, objective and transparent assessment of judges and judicial trainees wishing to enter into the profession (such as a competitive examination and/or interviews). The State Judicial Council continues to make judicial appointments based on the opinion of local Judicial Councils, which are in turn based on written applications. Procedures for the appointment of both judicial trainees and of court presidents by the Ministry of Justice need to be reviewed to ensure transparency and the use of objective criteria. Some of the current problems in the judicial system are attributable to the number of judges lacking the appropriate competence and experience, and to judicial appointments based on political suitability rather than professionalism.

Judges are initially appointed for a period of five years. They assume office permanently only thereafter, following a positive assessment. Measures are to be taken to make judges irremovable unless in the context of sanctions, incapability or voluntary resignation.

A judge may generally not be detained or have criminal proceedings instituted against him/her without the approval of the State Judicial Council. The provision on penal *immunity* needs to be re-assessed in line with the need for transparency and accountability within the judiciary.

As regards the **impartiality of the judiciary**, there have been limited developments.

The main shortcomings with respect to the need for impartiality of the judicial system continues to be risks of corruption and the undue influence of particular economic and other interests, as well as the prevalence of ethnic bias against Serbs. A new Code of Judicial Ethics laying down ethical principles and rules of conduct for judges has not yet been adopted.

As regards **professionalism and competence** in the judiciary, there has been limited progress.

In the area of training, the Judicial Academy increased its staff by one to 14. Funding has been doubled to € 0.4 million. However, three of the five planned regional centres are still not fully operational, and funding and staffing need further improvement. A clear vision is required in order to move away from the current ad hoc curriculum to more strategically planned training based on the medium to long-term needs of the Croatian judiciary. The Academy needs to step up its activities in order to broaden its “clientele”, ensuring that it trains all judges, judicial trainees, judicial advisors, prosecutors and court staff on a systematic and regular basis.

In relation to the **efficiency of the judiciary**, there has been some progress.

The total *budget* for the Croatian judiciary was approximately € 291 million in 2006, up 8% from 2005.

As regards *infrastructure and equipment* of courts, there has been good progress particularly in digitalising land registries. Significant further investments are still needed, however, especially to improve IT in Courts and State Prosecutors offices. While still not operational, there has been some progress towards an integrated case management system. It will be important to make progress also on the use of random case allocation measures.

The Law on Courts adopted in December 2006 introduced changes to the possibility of merging some of Croatia’s 248 courts in an effort to rationalise the court network. Mergers of misdemeanour and municipal courts have now begun on a pilot basis following adoption of implementing legislation in April 2006. However, while criteria for rationalisation appear in the judicial reform strategy, there is a clear reluctance to implement the necessary measures. In general Croatia has too many courts, and further mergers and closures are inevitable. Also, at 1 935, the total *number of judges* in Croatia remains high relative to total population. There are also 322 judicial trainees, 521 judicial advisers and over 6,000 court clerks.

Some headway has been made in reducing the *backlog of pending cases*. The total number of pending cases was 1.23 million at the end of June 2006, compared to 1.64 million last year. In this context various short-term steps were taken such as continued redistribution of cases from over-burdened to less burdened courts, extra overtime for judges and the use of notaries for the execution of non-disputed decisions. However, the backlog remains significant. The impact of some of these measures has been mitigated by resistance from the parties to the cases. Also, the State continues to contribute to the backlog by continuing to engage in litigation where there is little chance of success.

Particular progress was made in reducing the backlog of *enforcement* cases, including through the use of notaries for the execution of non-disputed decisions. However, enforcement cases still make up around one quarter of all pending court cases and procedures for the enforcement of court decisions need to be further reformed. Execution and enforcement cases are the main problem in 93% of the courts. Croatia needs to consider taking the enforcement process out of the hands of the courts, for instance through the use of special enforcement officers vested with public powers. Courts and parts of the state administration themselves do not always respect or execute in a timely manner the decisions of higher courts. This practice is contributing to cases against Croatia before the ECtHR.

As regards the *length of proceedings*, the new Law on Courts includes provisions aimed at ensuring the right to be heard within a reasonable time. Some steps have been taken to promote alternative dispute resolution. Amendments were made to the Civil Procedure Code prohibiting the introduction of new facts or evidence at the appeal level. However, the Court of Appeal still has to send cases back to lower courts even if the evidence contained in the file would have been sufficient to decide on the case at the appeal level.

The excessive length of court proceedings in Croatia remains a serious problem. Global statistics indicating the average duration of proceedings before the Croatian courts, at different levels, are not yet available. This makes the calculation of the judges' workload and efficiency difficult. In November 2005, the Supreme Court began collecting statistics on cases pending for more than 3 years for criminal cases and more than five years for civil cases. Since January 2006, a new computerised statistical system has been setup for the registration of new cases in all courts. Not all cases are covered therefore. Those covered are not necessarily in the same statistical system. A system of comparable data and a detailed analysis of the duration of proceedings before the different courts has to be developed, identifying the types of cases which have been pending for excessive periods, and the reasons for the delay.

Several significant reforms which have been planned for several years are still outstanding, including placing limits on the number of times appealed cases can be remitted back to first instance, clearer rules governing the postponement of court proceedings, an overhaul of the system of attorneys' fees, streamlining of the court document delivery system and tackling divergences in case law across the country.

Implementation has begun of the comprehensive new **judicial reform** strategy adopted by the Government in September 2005 and approved by Parliament in February 2006. However, question marks remain over financing and precise deadlines. An action plan has been drafted but lacks sufficient detail to allow for proper implementation of the reform and its monitoring.

A 2-person unit within the Cabinet of the Minister of Justice has been set up to monitor progress made in the reform of judiciary. However, in view of the scope of the reform challenges, reinforcement is necessary not only in terms of monitoring and follow-up but also within the Ministry of Justice more generally, accompanied by the strong political support necessary. There has only been tepid support for the reform process from the Bar association, which also lacks strong self-regulation of the profession. Increase support from judges themselves, which is fundamental for the success of the reform process, is also of crucial importance.

As regards prosecution services, reform of pre-trial proceedings is still pending. Equipment of municipal prosecutors remains insufficient.

There has been some progress in the area of **anti-corruption** policy and measures.

The Croatian Parliament approved in March 2006 a new anti-corruption programme 2006-2008 with special attention devoted to areas where perceived corruption is widespread, including the judiciary, health services, local government and public administration, political parties and the economy and science. A number of ambitious sectoral actions plans were subsequently prepared by each Ministry. The Minister of Justice was appointed as coordinator.

The legal framework to combat corruption is largely in place. Changes to the Criminal Code which entered into force in October 2006 raised the maximum sentences for certain corruption related crimes. Legislation on the financing of political parties has been presented to Parliament.

Efforts have been made to bolster the capacity of the Office for the Prevention of Corruption and Organised Crime (USKOK). The head of USKOK was replaced in November 2005, staff numbers have since been doubled to 36 and joint task forces established with the Ministry of Finance and the Police. A cooperation agreement was signed between the Ministry of Finance, USKOK and the Tax Administration. In this context, the recent meeting of the President, the Prime Minister and Speaker of Parliament, where they announced an intensification of the fight against corruption is a positive first step.

However, information on material and financial means for the programme's implementation as well as its monitoring is lacking. The success of the national strategy for preventing and combating corruption will rely to a large extent on strong and efficient coordination by the relevant authorities and the provision of sufficient financial and human resources.

The question of financing of election campaigns is not included in the legislation. Clarifications on the Right of Access to Information Law are also needed. The scope of the Law for the Prevention of Conflict of Interest should be widened to ensure proper sanctions can be applied. Also, authorities need to develop public written interpretative guidance of the current prohibitions for public officials in this respect.

Problems with the uniform implementation of the law and its enforcement persist. Efforts need to be turned into concrete action, such as the recent awareness-raising activities with participation of USKOK. Some high-profile cases have recently come under investigation, although the absolute number remains for the time being low. Investigations are often not sufficiently broad or thorough. Greater efforts to proactively prevent, detect and effectively prosecute corruption are clearly needed. 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. Too often high profile and other cases that appear in the media – whether well founded or not – disappear from view unresolved. The general attitude of the authorities to corruption is reactive rather than proactive. On-going allegations of corruption in connection with coalition-building following the 2005 local elections (which led to repeat elections in some cases) for example need to be seriously investigated and appropriate action taken. There has also been no comprehensive follow-up to allegations of financial corruption connected with a construction materials company brought to light by the incident at Pozega-Slavonia County Assembly in December 2005.

Overall, corruption continues to be a serious problem in Croatia that affects various aspects of society. Public perception of corruption has actually deteriorated over the past year. There has been no successful prosecution of any high-profile case to date. General tolerance of petty corruption appears to be widespread. Corruption in Croatia is aided by a lack of good governance, transparency and accountability in public administration and by a lack of ethic codes and codes of conduct in the public and private sectors.

As regards **fundamental rights**, there have been some new developments.

In May 2006, the *Ombudsman* submitted his 2005 annual report to Parliament. According to the report, 1 653 new complaints had been received, a decrease compared to 2004 (2 011). Most of the complaints, as in previous years, related to the length of administrative proceedings, particularly in the areas of pension insurance, reconstruction, construction and urban planning, as well as obstacles faced by returning refugees. It has also become common practice that state administrative bodies do not respond within the legal timeframe. The other main group of citizens' complaints concerned the length of judicial proceedings, although the Ombudsman has no competence over judicial issues. The Ombudsman warned that the current practice of filling administrative posts with politically suitable staff has a negative effect on the professionalism and continuity of the State administration. Despite a further increase in funding for 2006, the work of the Ombudsman is limited by a lack of funding and personnel.

As regards *prohibition of torture, inhuman and degrading treatment and punishment* in March 2006 the European Court of Human Rights ruled in the *Cenbauer v. Croatia* case that there had been a violation of Article 3, condemning Croatia for degrading treatment of a former prisoner of the Lepoglava State Prison. While Croatia has already addressed this case, challenges remain as regards prison conditions more generally. In March 2006 the Office of the Ombudsman issued the first comprehensive report on the Croatian prison system, concluding that prisons were suffering from overcrowding and poor hygienic and medical conditions. Overcrowding of prisons is to a large extent due to slow judicial procedures as up to 50 percent of prisoners are on remand awaiting verdict. There is also a need to increase the number of employees in the network of prisons, including guards, and to provide adequate training.

As regards *the right to protection of personal data*, alignment with the data protection Directive and the Council of Europe recommendation regulating the use of personal data in the police sector remains to be completed. The Croatian Personal Data Protection Agency has been fully operational only since April 2005. Effective application of its supervisory and control powers is still lacking, in particular as regards the public administration, especially the police, and the telecommunication sector.

As regards *the freedom of expression and information*, the sanction of prison for journalists in cases of libel was removed from the Criminal code in July 2006. However, there have been instances of political interference in the media (*see political criteria – Civil and political rights*).

Right to property is ensured. However, the process of restitution of property that was confiscated during the Yugoslav regime continues to proceed slowly.

In terms of non-discrimination policy, there has been limited progress. The Penal Code was amended in June 2006 to include a wider definition of "hate crime". However, a comprehensive national strategy and action plan on the suppression of all forms of discrimination – an important partnership priority - has still not been adopted. This process should be accelerated. Public awareness regarding these issues needs to be raised. The level of protection against discrimination and its judicial prosecution is still not in line with EU standards.

In the field of **women's rights**, the National Policy for the Promotion of Gender Equality came into effect in 2006, covering the period up to 2010. The Office for Gender Equality has also initiated the creation and networking of county gender-equality committees. In November 2005, trained around-the-clock teams were established in police departments to

deal with family violence. Enforcement of existing provisions on gender equality remains problematic, however, and is hampered by the absence of gender-segregated statistical indicators. Concern has been voiced over a growing number of cases of discrimination against women. Overall, the work of the Ombudsman for Gender Equality lacks visibility.

As far as *the right to an effective remedy and to a fair trial*, there has been limited progress. There has been some progress in tackling ethnic bias in war crimes trials. However, difficulties as regards witness protection in the broadest sense remain (*see political criteria*). An integrated legal aid system for both criminal and civil proceedings still needs to be put in place. Croatia needs to adopt the foreseen legislation as soon as possible and provide the necessary training and funds for its implementation.

In the area of *children's rights*, a National Plan for the Benefit of the Rights and Interests of the Child 2006-2012 was adopted in March 2006. In the same month, the Parliament finally nominated a new Ombudsman for Children, after the post had been vacant for several months.

There has been little follow-up to the Parliament's Committee for Human Rights finding in October 2005 that there was a lack of proper supervision of children's homes and inadequate coordination among the bodies involved. There is a lack of experienced professionals working in social welfare centres, schools and children's homes. There has been little follow up of cases of ill-treatment of children in such institutions.

There has been some progress in the area of *minority rights*. However, a number of important challenges still remain (*see political criteria*).

As regards **EU citizens' rights**, there have been no particular developments.

Conclusion

Croatia has made some progress. However, given the scope of this chapter, substantial efforts will still be required overall. Progress is being made in the judicial reform process but reform is at an early stage and improving the functioning of the judiciary remains a major challenge for Croatia. There has been some progress in the fight against corruption, but this issue remains a serious problem. The situation as regards fundamental rights in Croatia leaves scope for further improvements in various fields, notably as regards non-discrimination.

4.24. Chapter 24: Justice, Freedom and Security

In the field of **Schengen and external borders**, progress can be noted in the area of border management, in particular regarding land borders. The situation on the blue border requires special attention but is in the process of improving. A working group for integrated border management (IBM) has been established and met on five occasions. Inter-agency cooperation works well in practice at the border posts and has benefited from the separation of the Border Police from the general police structures. Shortage in staffing remains an issue and stands now at 4 643 border guards. The IBM strategy was adopted in April 2005. Overall, staffing targets and training need to be clarified, based on an updated IBM Action Plan, which is a key element for accession negotiations in this chapter.

Progress was noted in the area of **visa policy**, mainly on visa issuing procedures and technical equipment. Croatia has further aligned to the EU visa negative list by introducing visa requirements for Ecuador as of December 2005. The exemption of the visa regime for citizens

of Serbia and of Montenegro was extended for the whole of 2006. Croatia's visa policy is broadly in line with the EU's, but alignment with the Visa Regulation (EC) No 539/2001 will need to be gradually completed before accession. Croatia needs to prepare for the introduction of biometric identifiers into passports and travel documents.

Thirty two 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. An Action Plan for linking up all diplomatic missions and consular offices into an information network was adopted in January 2006, under the coordination of the Ministry of Foreign Affairs.

In the field of **migration**, the legal framework for dealing with both legal and illegal migration is in place, although a coherent migration strategy is still missing (the current one was sent back by Parliament in May 2006). During 2005, around 3 814 work permits and 3 356 business permits were issued, mainly to nationals of Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia. In 2005, 5 406 illegal border crossings were registered, although there are signs that only a fraction of actual cases are detected. Croatia has 24 readmission agreements in force and further readmission agreements are under preparation with Moldova and Ukraine.

The illegal migration deportation centre at Jezevo has a capacity of 116 beds, and overcrowding remains an issue. Forced expulsions from Croatia in 2005 were 1 760 and about 750 expulsions took place in the first half of 2006.

The **Asylum Act**, which entered into force in July 2004, brings the legislative framework closer into line with the *acquis* and the Geneva Convention, by guaranteeing the basic rights of asylum seekers. However, the new Act does not cover accelerated procedure, temporary protection as well as special procedures at airport and harbours. Currently, asylum decisions of the Ministry of Interior 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. Croatia should step up preparations for participation in Dublin and EURODAC systems. The number of asylum seekers is low: there were 210 applications in 2005. Although all the relevant by-laws adopted so far allow for the integration of recognised refugees (family reunification, education, and access to work), it is impossible to assess their functioning as there has, to date, been no recognised refugee in Croatia.

Progress can be reported on the opening of a temporary asylum reception centre, in June 2006, at Kutina where about 20 asylum seekers have stayed so far. The centre has a capacity of 100 beds.

As there are no detention facilities at the border, asylum seekers are transferred from the border immediately to Jezevo for registration and then on to Kutina, if seeking asylum. Often asylum seekers just disappear during this transfer process. In order to enhance transparency, the current asylum appeal process handled by the Government Commission needs reviewing and the role of the Administrative court clarified.

Police cooperation and the fight against organised crime continue to work well, with further progress expected as reorganisation plans get underway. Four pilot schemes on community policing have been introduced in major urban areas. The operational agreement with Europol has been ratified by Parliament in June 2006. Neither Europol coordination unit

nor a unit on counterfeiting the Euro has been set up yet. Croatia should consider the posting of a liaison officer at Europol.

In the field of organised crime, the strategy on the confiscation of assets from organised crime should be further developed, with issues linked to arms trafficking remaining a priority. The recent operation "Trigger" led by the Office for Combating Corruption and Organised Crime (USKOK), in which a large number of firearms were seized, demonstrated good cooperation with neighbouring countries. This regional cooperation should be further promoted in order to tackle various illicit trafficking offences such as trafficking in human beings, firearms, drugs and goods in a joint approach by Governments and all relevant law enforcement agencies, state prosecutors and judicial authorities.

As regards administrative capacity, training at the Police Academy should be more closely tailored to policing needs, and there should be an increased focus on continuous in-service training for existing officers in the field. Closer cooperation between the public, the private sector and law enforcement agencies is needed to establish the public private partnership to prevent and combat organised and financial crime, as well as terrorism, based on EU best practices. 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. The Forensic Institute is well equipped and staffed, but still needs to introduce the Automated Fingerprint Identification System.

As of June 2006, Croatia has signed international police co-operation agreements with 23 countries, the latest with Moldova, and participates in several regional initiatives.

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. For the time being, USKOK is not properly staffed and equipped to address all of the tasks in its mandate. USKOK does not have the administrative capacity to fulfil its central coordinating role between all agencies and courts involved in cooperation with international bodies in joint investigations, as well as local, regional and national level.

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 capital*) and corruption. The capacities within law enforcement to apply EU best practices on investigation techniques, intelligence models and use of organised crime threat assessments should be enhanced in order to be able to contribute actively to the European organised crime threat assessment (OCTA). In addition, the designation of a service with competencies to protect the euro against counterfeiting is needed.

Croatia has ratified a number of international instruments on the **fight against terrorism**. Twelve UN instruments on terrorism have been ratified. The International Convention for the Suppression of Acts of Nuclear Terrorism was signed in September 2005 and still needs to be ratified.

Croatia is at an advanced stage in taking into its legislation the definitions of crimes related to terrorism as required in the *acquis*, but there is a need for further alignment regarding the definition of terrorism. A national co-ordination arrangement for the day-to-day exchange of information, involving all law enforcement bodies and security services involved in

countering terrorism, has not yet been established. Direct cooperation and information exchange with EU instances needs to increase.

On the **fight against drugs**, a National Strategy for Combating Drug Abuse was adopted by parliament in December 2005, emphasizing the need for an integrated and, multidisciplinary strategy in the field of drugs. On the basis of this strategy, an Action Plan on Combating Drug Abuse (2006-2009) was adopted in February 2006. Croatia has applied to participate in the work of the European Monitoring Centre for Drugs and Drug Addiction (EMCDDA) in 2005. Strengthening the national Focal Point and starting to submit data on key indicators, remain a priority. On **customs cooperation**, legislation in the field of customs co-operation in criminal matters needs adaptation to be ready to join, by the date of accession, to the Convention on Mutual Assistance and Co-operation between the Member States (Naples II) and the Convention on the use of Information Technology for customs purposes (CIS). The required number of customs officers and of IT equipment, will need to be assessed, in particular for the prevention and the fight against crime.

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. Participation in the European Arrest Warrant system will require an amendment of the general prohibition to extradite own nationals, which is laid down in Article 9 of the Croatian constitution.

Conclusion

Progress can be reported in this chapter, particularly in border management, visa policy and asylum. However, the integrated border management action plan should be updated and equipment needs upgrading. Alignment with the *acquis* in this chapter is well underway but continued and sustained efforts are needed to ensure administrative and enforcement capacity particularly regarding multidisciplinary inter-agency cooperation, including law enforcement authorities, customs service, prosecutors and the judiciary system as well as the prevention of corruption and fight against organised crime.

4.25. Chapter 25: Science & Research

There has been good progress in the area of **research policy**. In May 2006, Croatia adopted the 'National Scientific and Technological Policy 2006-2010' which sets out both short-term and long-term strategic aims, establishes a new financial instrument, and defines new rules and procedures for individual research grants and existing research programmes. The National Science Council, assisted by the Agency for Science and Higher Education, has also adopted a series of implementing regulations in the area of science. However, research grants remain low, and a proper peer review system is lacking. There is room for improvement in terms of participation of industry in research projects.

Croatia continues to take actions to facilitate increased participation in the 6th **Framework Programme** for Research and Technological Development (FP6), following full association to the EC Framework Programme on 1 January 2006. Croatia was not associated with the EURATOM Research Framework Programme under FP6, but is considering its association to the 7th Framework Programme. Regarding the activities of the Joint Research Centre (direct

actions), Croatia has been able to fully participate in specific actions organised for acceding and candidate countries.

There have been some initiatives for further integration into the **European Research Area**. Croatia became an observer in the CREST group.

Conclusion

Overall, there has been good progress in this chapter. Croatia has already reached a good level of alignment with the *acquis* in this field. However, continued efforts are required in certain areas, such as budgetary provisions, improved research facilities and human resources capacity building for participation in EU projects and Framework Programmes, and ensuring improvements in the granting of national funds by introducing international peer reviews.

4.26. Chapter 26: Education & Culture

There has been reasonable progress in the area of **education, training and youth**. Croatia is continuing the education reform process under the Education System Development Plan 2005-2010, which establishes a framework of national indicators and benchmarks. Croatia started actively participating in the Education and Training 2010 Work Programme Coordination Group (ETCG). An Agency for Adult Education has been established and an Adult Education Act is in preparation. However, increased efforts are required to develop a coherent and comprehensive national strategy for lifelong learning and to raise participation. Croatia has started preparing a National Qualification Framework. Progress is continuing in relation to the introduction of the Bologna process in higher education study programmes. Further efforts are needed to improve the system of vocational education and training. Croatia has presented an alignment plan regarding the non-discrimination principle in access to education as well as for education of children of migrant workers.

In the area of youth policy, the Operational Plan of the National Youth Action Plan for the period of 2006-2007 was adopted by the Government in December 2005, but some challenges remain, such as the need to improve coordination and communication between youth organisations.

To participate in the Integrated Lifelong Learning Programme and the Youth in Action Programme, Croatia will need to establish the appropriate legal, institutional and administrative framework for the management and monitoring of these programmes.

In the field of **culture**, Croatia ratified the UNESCO Convention on the Protection and Promotion of Diversity of Cultural Expression in May 2006. Croatia has confirmed its intention to fully participate in the Culture 2007 programme.

Conclusion

There has been reasonable progress in this chapter. Croatia has achieved a good level of preparation for implementing the *acquis*. However, further attention will need to be paid to the establishment of the management structures and implementation of the future Integrated Lifelong Learning Programme and Youth in Action Programme, as well as measures to guarantee non-discrimination between EU and Croatian nationals.

4.27. Chapter 27: Environment

Limited progress has been made in the areas of **horizontal legislation**. Croatia made the commitment to ratify the Kyoto Protocol by first quarter of 2007. Efforts are still 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 related decisions as well as the reinforcement of administrative capacity is still outstanding and remain a high priority in this respect. There has been little progress as concerns further transposition and implementation of a number of horizontal directives in the area of environment, such as provisions related to public access to environment information and public participation in environmental decision-making. Revisions are still necessary to bring Croatian legislation in line with the *acquis* on Environmental Impact Assessment. Though some elements are already present in existing Croatian legislation, no progress can be reported on the transposition and the implementation of the *acquis* with regard to the Strategic Environmental Assessment as well as the environment liability and reporting directives. Preparations are underway in this area with the preparation of a new Environment Protection Act to be adopted by end 2006.

There has been significant progress in the area of **air quality**. The Ambient Air Quality Framework Directive has been transposed with the transposition of the daughter directives nearly completed. In addition, some implementing legislation has been adopted. The development of the national network for monitoring air quality continued with the addition of two new stations to the six existing stations in urban and industrial areas. The Directives on quality of petrol and diesel fuels and on the sulphur content of certain liquid fuels have also been transposed and a new Regulation on substances that deplete the ozone layer was adopted, transposing the relevant EU Regulations in this area. However, the transposition of the directives on National Emission Ceilings Directive, Volatile Organic Compound (VOC) from petrol stations and consumer information on fuel consumption as well as on CO₂ on emissions from new passengers' cars is still outstanding. Preparations in this area are well underway.

Some progress can be reported in the area of **waste management**. Transposition regarding the horizontal legal framework is high but limited progress has been recorded as regards further alignment. An ordinance on waste tyres has been adopted. The directive on packaging and packaging waste has been fully transposed and progress in implementation has been significant through the establishment of a new collection system. Progress has also been made regarding transposition of the landfill directive. No significant progress can be reported on the transposition of other Directives concerning different waste streams. In addition, an action plan to implement the waste management strategy is still outstanding. Further efforts are required with regards to deploying the financial resources required for the implementation of the waste *acquis*. Preparations in this area require substantial efforts.

There has been good progress in the area of **water quality**. Due to the adoption of amendments to the Croatian Water Act and of the Act on Financing Water Management in December 2005, transposition of the Water Framework Directive is well advanced. The new legislation has also resulted in some progress on transposition of the Dangerous Substances Directive. However, transposition of all other Directives in this area is still outstanding. Limited progress has been made as regards the development of a financing strategy for the implementation of the water *acquis*. Preparations in this area are underway.

Good progress can be reported in the area of **nature protection**. Through the adoption of the Nature Protection Act and subordinate ordinances as well as the Hunting Act, a good level of transposition has been reached as regards the Wild Birds and Habitats directive. The directives on Wild Animals in Zoos, Leghold Traps and Seal Pups have also been transposed. However, administrative capacity is still insufficient to ensure proper monitoring of nature protection in Croatia. Preparations in this area are on track.

Limited progress can be reported in the area of **industrial pollution and risk management**. No further alignment has taken place as regards the Large Combustion Plants and the Incineration of Waste Directives. Some elements of the Solvents directive have been transposed through the adoption of the Air Protection Act. No progress can be reported on the transposition and the implementation of the *acquis* concerning the industrial pollution and prevention control (IPPC) directive. Preparations in this area are still at an early stage.

No progress can be reported in the **noise** sector. Transposition of the Croatian legislation with the noise *acquis* is limited. Croatian legislation is not yet aligned with the *acquis*. Preparations in this area are only being launched.

Progress has been good in the area of **chemicals** and **genetically modified organisms (GMOs)**. With the adoption of the 2005 Chemicals Act, the division of competences and responsibilities in this area were clarified. The Act also provides the basis for the adoption of implementing legislation. A new Genetically Modified Organisms Act has been adopted in 2005, resulting in almost complete transposition of the Contained Use of GMMs Directive. However, transposition with regard to the Directive on the Deliberate Release of GMOs is still outstanding. Competences for GMOs are spread across many departments. Preparations in this area are underway.

As regards **forestry**, work is ongoing concerning incorporating in the sector provisions existing in the *acquis*.

In terms of *administrative capacity*, following the reorganisation of the Ministry of Environmental Protection, Physical Planning and Construction, the Inspection Directorate has been strengthened both at national and regional level. The Directorate for Environmental Protection and Directorate for Strategic and Integration Processes in Environmental Protection have also increased their number of employees. However, Staffing is still insufficient, especially at local level and the enforcement and inspection system remains weak.

Conclusion

Overall there has been good progress in this chapter, especially on air and water, nature protection, chemicals and GMOs. However, in view of the scope and complexity of this chapter, very significant efforts are still needed. Administrative capacity is weak and strategies for financing the significant investments necessary are lacking. The division of responsibilities for operational aspects of environmental protection and lack of coordination between ministries continues to hamper progress.

4.28. Chapter 28: Consumer and Health Protection

Few developments can be reported as regards **safety related measures**. A Consumer Protection Department with seven staff has been set up within the directorate for trade and

internal market of the Ministry of Economy, Labour and Entrepreneurship. Staffing needs to be further reinforced and legislative harmonisation remains to be completed as regards the directives on general product safety and dangerous imitations. Preparations in this field are underway.

No particular progress can be reported in the area of **market surveillance**. Legislative alignment with the regulation on administrative cooperation is outstanding and the capacity and working procedures of the State Inspectorate need to be enhanced, as does the co-operation between different enforcement agencies. Preparations are starting in this area.

No particular progress can be reported as regards **non-safety related measures**. Legislative alignment has been completed or partly completed in most areas but is still outstanding as regards the directives on unfair commercial practices, distance marketing of consumer financial services, injunctions and misleading and comparative advertising. Preparations are underway.

In the area of **consumer organisations**, there has been some progress. During 2005, three counselling centres for consumer protection were established across the country. Funding from the state budget has been allocated to consumer protection organisations during 2006 in connection with a number of projects aimed at informing the consumer. Other awareness raising activities for consumers have included publication of information materials, seminars and workshops.

Good progress has been made in the area of **public health**. In December 2005, a National Strategy for Combating Drug Abuse was adopted for the period 2006-2012 and in February an Action Plan for Combating Drug Abuse was adopted for the period 2006-2009. The new Act on Blood and Blood Components was adopted in June 2006, however, further legal alignment is required. In the reporting period a number of ordinances were adopted which implement the Act on Explantation and Transplantation of parts of the human body for therapeutic purposes, in line with the directive setting standards of quality and safety in connection with human tissues and cells. Preparations in this area are well advanced.

Conclusion

There has been only limited progress. Much legislative alignment remains and market surveillance is far from EU standards. Increased efforts will be needed if Croatia is to meet the requirements of the *acquis* in this chapter.

4.29. Chapter 29: Customs Union

There has been good progress in the area of **customs rules**. Amendments to the Croatian Customs Act entered into force in January 2006. Their objective is to align legislation on national transit to Common Transit requirements and to provisions on customs procedures with economic impact, guarantees and occurrence of customs debt. The amendments also introduce the concepts of 'risk management' and 'authorised economic operator'.

Amendments to the implementing regulation to the Customs Act entered into force in July 2006. They introduce payment of customs duties on equipment used in free zones, as required by the *acquis*, and align time limits for binding opinions. A new regulation on intellectual property rights entered into force in May 2006 aimed at aligning with the relevant *acquis*. Discrepancies to the *acquis* remain in areas such as counterfeit, drug precursors, rules of

origin, customs debt, guarantees, summary declarations, customs declaration, cultural goods, cash controls, customs valuation and tariff, management of tariff quotas, duty relief and mutual assistance and cooperation. In the area of customs rules, alignment to the *acquis* is well on track.

Little progress can be reported in the area of **administrative and operational capacity**. The Customs Training Centre started its activities in 2006. A Code of Ethics has been prepared but remains to be formally adopted and implemented. Work has continued in the field of computerisation and interconnectivity and the Croatian Customs Administration has set up project teams for the main IT-interconnectivity projects. The administrative capacity in the IT-field of the Customs Administration remains weak and heavily dependent on external companies, with very limited internal capacity to guarantee the continuity of the IT services. This situation is a reason for concern. More generally the Croatian Customs Administration will require further strengthening to ensure it will be able to manage and implement the *acquis*. In the area of administrative and operational capacity, Croatia only partially meets its targets and priorities.

Conclusion

In the area of customs, Croatia has made some progress, notably by further aligning customs procedures and customers protection of intellectual property rights. Croatian Customs legislation is already well aligned to the *acquis*. However, increased efforts will be needed to significantly strengthen administrative capacity, including with regard to timely preparation for IT-interconnectivity and operating with the centralised and decentralised Community IT systems.

4.30. Chapter 30: External Relations

There has been some progress 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, 2007 is the final year for the transitional period to reduce customs duties on agricultural products. In line with a key accession partnership recommendation, Croatia completed negotiations with the Commission in March 2006 on a protocol introducing tariff quotas for sugar replacing the present bilateral regime which permits Croatia to export unlimited duty-free quantity of sugar to the EU. Croatia should continue to co-operate and co-ordinate closely with the Commission in international fora, mainly with regard to the Doha Development Agenda negotiations, in particular so as to ensure that, upon accession to the EU, its commitments under the GATS are as consistent as possible with those of the Community. The administrative capacity to participate in the common commercial policy requires strengthening.

With regard to dual use goods, Croatia has reached a good level of alignment. It will have to continue to align with the revised list of dual-use items and technology. Croatia will also have to transpose the *acquis* concerning export credits. Overall, in the field of the common commercial policy preparations for accession are well underway.

In the area of **bilateral agreements with third countries**, Croatia has been very active in promoting the simultaneous enlargement and modernisation of the Central European Free Trade Agreement (CEFTA) as a means to upgrading the network of existing bilateral FTAs into a single regional FTA, in line with the relevant European Partnership recommendation.

Croatia actively participates in the negotiations to this effect which started in June 2006. A free trade agreement with Kosovo under UNSCR 1244 was initialled in September 2006 and an agreement on trade and economic cooperation with Libya entered into force in March 2006. Also a bilateral investment treaty with Belarus came into force. Croatia will have to analyse all of its existing agreements and, as part of its future EU accession commitments, bring them into conformity with the *acquis*. Preparations in this area are just starting.

Limited progress can be reported with regard to **development policy** and **humanitarian aid**. Croatia has started the process of drafting a development policy as well as reforming the Ministry for Foreign Affairs and European Integration in view of establishing a new department responsible for development policy. Preparations in this area are at an early stage.

Conclusion

Croatia has made some progress in this chapter. Provided Croatia continues preparations as scheduled and improves its administrative capacity, it should be able to apply the *acquis* and participate in the common commercial policy upon accession. Enhanced efforts are needed in the areas of development policy and humanitarian aid.

4.31. Chapter 31: Foreign, Security and Defence Policy

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 remained committed to the development of the **European Security and Defence Policy (ESDP)** including through training and administrative capacity building. In May 2006 Croatia responded positively to the EU's invitation for contributions to building EU military capacity. Croatia has continued to take part in international peacekeeping efforts and is currently participating in eight UN peacekeeping missions.

Concerning the **Common Foreign and Security Policy (CFSP)**, Croatia has continued to align itself with a number of EU sanctions and restrictive measures and statements. Croatia has not signed a bilateral agreement with the USA concerning the non-surrender of certain persons to the International Criminal Court and continues to support the EU position on this matter. Croatia is party to most of the existing international regimes for non-proliferation of weapons of mass destruction.

As regards the fight against **terrorism**, Croatia is party to the UN conventions in this field. Croatia aligns itself with EU positions and follows the principles of EU counter-terrorism policy.

In 2002, Croatia aligned itself to the EU Code of Conduct on Arms Exports, and in 2005 it joined the Wassenaar Arrangement and the Nuclear Suppliers Group. Croatia has ratified the UN Protocol on Fire Arms. The legislative framework for arms control is now robust. A National Small Arms and Light Weapons Commission and ministerial focus points have been established. Despite improvement in inter-ministerial cooperation and in transparency of arms related information, there remains a need to strengthen implementation and enforcement. There also remains an unwillingness to disclose certain information that is publicly shared in most Member States, such as the number and type of weapons ear-marked for destruction by the armed forces, as well as the majority of issues relating to arms production, import and export.

Concerning relations with **neighbouring countries**, see chapter on Political Criteria.

With regard to **administrative capacity**, the Directorate for the European Union and European Cooperation within the Ministry of Foreign Affairs and European Integration was reorganised and a Section for Common Foreign and Security Policy and EU External Relations was established within the Department for EU Political Issues, in order to work with EU CFSP structures. The post of political director has not been formally established. The post of European correspondent already exists.

Conclusion

Continued progress has been made. Overall, preparations in the area of Foreign, Security and Defence Policy are well underway. Croatia continues to systematically align with EU declarations and other CFSP instruments. However, some gaps remain to be addressed in terms of enforcement in the area of arms control and continued efforts are needed.

4.32. Chapter 32: Financial control

Progress can be reported in the area of **Public Internal Financial Control (PIFC)**. Croatia is developing a PIFC framework law defining requirements for the expected PIFC system. This includes training of persons involved in financial management and control as well as in functionally independent internal audit, reporting requirements on PIFC to the Government and actions to be taken in cases of irregularities and fraud. In addition, the Ministry of Finance has passed regulations such as a code of ethics, a charter, a rulebook and a manual for internal audit. Furthermore, a programme for professional training and examination for the qualification of a certified public sector internal auditor has been adopted. Training and certification of internal auditors is on going within the functional responsibility of the Central Harmonisation Units. Independent internal audit units have been established in 12 out of 13 Ministries. However, the existing internal audit regulations still need to be revised for consistency with the new PIFC framework law and implementing regulations for financial management and control need to be developed. Training of management, financial officers and auditors needs to be prioritised and continue. Preparations in this area are moving forward.

There has been some progress in the area of **external audit**. The financial independence of the State Audit Office has been strengthened by a new Act affecting certified state auditors' salaries. However, the financial independence of the State Audit Office remains to be addressed, since its budget is included in the State budget prepared by the Ministry of Finance. Croatia is committed to provide the State Audit Office with a legal basis in its Constitution. The State Audit Office has developed audit manuals for both financial audit and performance audits and has started extensive training programmes as well as pilot financial audits and performance audits. Preparations in this area are underway.

Progress has been limited in the area of **protection of EU financial interests**. Within the system of decentralised implementation of EU pre-accession funds, Croatia is subject to provisions requiring the National Authorising Officer to communicate regularly on suspected irregularities and fraud. A whistle-blowing system is in place that protects officials reporting suspected wrongdoings in the administration. Croatian penal law provides for the principle offences of fraud, corruption and money laundering. The Budget Supervision division of the State Treasury has been appointed as Croatia's anti-fraud office (AFCOS). This service will be responsible for ensuring efficient coordination and the fight against fraud and cooperation

with the European Anti-fraud Office. No rules are yet in place regarding cooperation during on-the-spot checks by EU investigators or for safeguarding evidence. Croatia still has to fully align its legislation with the PIF-Convention and its protocols. Preparations in this area are underway.

Some progress can be reported in the area of **protection against the Euro against counterfeiting**. An adequate level of police capacity is in place. However, Croatia needs to designate national analysis centres for coins and notes and specific sanctions for credit institutions failing to withdraw counterfeits from circulation need to be established. Moreover, there should be a provision for sanctions against medal and tokens similar to Euro coins. Preparations in this area are on track.

Conclusion

Overall there has been some progress in this chapter, notably as regards Public Internal Financial Control, external audit and protection of the Euro against counterfeiting. More capacity for internal audit and financial management is needed, however. Structures to protect the EU's financial interests need to become operational.

4.33. Chapter 33: Financial and Budgetary Provisions

There has been no particular progress under this chapter. There continue to remain 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. Although the *acquis* in this area does not require transposition, Croatia will need to establish in due course 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.

Conclusion

While there has been no particular progress in this chapter, Croatia should be able to meet the requirements of the financial and budgetary provisions *acquis* as long as alignment in the relevant linked chapters continues and the necessary coordination structures and implementing rules are established.

STATISTICAL ANNEX

STATISTICAL DATA (as of the 12th of September 2006)

Croatia

	Scale	Unit	Foot-note	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Basic data														
Population: total	Thousand	Number	1)	4669,0	4494,0	4572,0	4501,0	4554,0	4427,0	4440,0	4444,0	4442,0	4439,0	4443,9
Total area of the country	Unit (x1)	km²		56610,0	56610,0	56610,0	56542,0	56542,0	56542,0	56542,0	56542,0	56594,0	56594,0	56594,0

	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
National accounts														
Gross domestic product	Million	National currency		98382,0	107980,6	123810,7	137603,7	141579,1	152518,8	165639,5	181231,0	198422,0	212826,0	229031,0
Gross domestic product	Million	EUR		14390,9	15657,0	17738,7	19304,9	18676,8	19976,5	22177,0	24468,0	26234,0	28395,0	30949,0
Gross domestic product per capita	Unit (x1)	EUR		3100,0	3500,0	3900,0	4300,0	4100,0	4600,0	5000,0	5507,1	5906,0	6397,0	6972,0
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	5,6	5,3	3,8	4,3
SI: Employment growth (national accounts), relative to the previous year	Unit (x1)	%		:	:	:	0,0	-2,2	-2,2	-0,8	1,5	-0,2	0,4	-0,2
Labour productivity growth: growth in GDP (constant prices) per person employed, relative to the previous year	Unit (x1)	%		:	:	:	5,8	44,6	2,1	4,2	5,2	2,7	2,4	3,3
SI: Unit labour cost growth (national accounts), relative to the previous year	Unit (x1)	%		:	13,8	15,3	14,0	7,0	5,5	2,4	:	:	:	:
GDP per capita at current prices	Unit (x1)	PPS	2)	5600e	6400e	7000e	7400e	7500e	8200e	8600e	9400e	10000e	10600f	11400f
SI: GDP per capita at current prices, PPS, EU-25=100	Unit (x1)	%	2)	:	39,2e	40,7e	41,5e	39,7e	40,9e	41,4e	43,6e	45,9e	46,7f	48,8f
SI: Labour productivity, PPS (GDP per person employed), EU-25=100	Unit (x1)	%	2)	:	47,0e	48,5e	50,9e	51,5e	49,8e	54,5e	55,2e	57,7e	57,7	60,1f
Agriculture (NACE Sections A+B): share of total gross value added	Unit (x1)	%		10,4	10,0	9,3	9,4	9,7	8,8	9,0	8,7	7,0	6,9	6,7
Industry (excluding construction) (NACE Sections C to E): share of total gross value added	Unit (x1)	%		27,7	25,7	25,9	25,0	24,6	24,7	24,4	23,0	22,8	22,7	23,2
Construction (NACE Section F): share of total gross value added	Unit (x1)	%		5,7	6,6	7,1	6,7	5,3	4,6	4,9	5,3	6,3	6,5	6,4
Services (NACE Sections G to P): share of total gross value added	Unit (x1)	%		56,3	57,8	57,8	59,0	60,4	61,9	61,8	63,1	63,9	63,9	63,8
Final consumption expenditure, as a share of GDP	Unit (x1)	%		91,4	85,5	88,2	86,2	86,0	85,6	83,0	84,0	82,7	81,9	80,7
Final consumption expenditure: household and NPISH, as a share of GDP	Unit (x1)	%		61,5	58,6	62,2	60,3	59,1	59,8	59,8	61,1	60,6	60,7	60,2
Final consumption expenditure: General government, as a share of GDP	Unit (x1)	%		31,0	28,4	26,0	25,9	26,9	25,8	23,1	23,0	22,1	21,2	20,5
—Gross fixed capital formation, as a share of GDP	Unit (x1)	%		15,7	20,5	24,2	23,3	23,3	21,8	22,3	24,3	28,6	28,6	28,6
—Stock variation, as a share of GDP	Unit (x1)	%		1,9	1,5	3,3	0,7	-0,3	-1,6	1,6	4,8	2,5	2,3	2,7

Exports of goods and services, relative to GDP	Unit (x1)	%		41,3	41,7	41,1	39,6	40,9	47,1	48,4	45,4	47,1	47,4	47,1
Imports of goods and services, relative to GDP	Unit (x1)	%		51,3	51,3	56,8	49,2	49,3	52,3	54,5	56,4	57,9	56,7	55,8

Inflation rate	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
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	3,3

Balance of payments	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Balance of payments: current account total	Million	EUR		:	:	:	:	-1312,9	-489,9	-817,7	-2097,2	-1866,0	-1458,0	-1963,6
Balance of payments current account: trade balance	Million	EUR		:	:	:	:	-3105,9	-3499,4	-4603,8	-5960,3	-6974,2	-6727,8	-7482,9
Balance of payments current account: exports of goods	Million	EUR		:	:	:	:	4134,1	4969,3	5318,8	5293,1	5571,7	6603,1	7244,3
Balance of payments current account: imports of goods	Million	EUR		:	:	:	:	7240,0	8468,6	9922,6	11253,5	12545,9	13330,9	14727,1
Balance of payments current account: net services	Million	EUR		:	:	:	:	1544,5	2470,5	3302,8	3284,8	4933,0	4715,0	5317,1
Balance of payments current account: net income	Million	EUR		:	:	:	:	-345,5	-419,8	-616,2	-573,8	1069,5	-637,0	-974,2
Balance of payments current account: net current transfers	Million	EUR		:	:	:	:	594,0	958,9	1099,5	1152,2	1244,5	1191,8	1176,3
Balance of payments current account: net current transfers - of which government transfers	Million	EUR		:	:	:	:	-122,9	24,6	65,3	32,2	70,6	2,6	2,2
Direct investment (FDI) in the reporting economy	Million	EUR		:	:	:	:	1369,1	1142,1	1502,5	1195,1	1788,4	989,3	1327,8

Public finance	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
General government deficit/surplus, relative to GDP	Unit (x1)	%	3)	:	:	:	:	-7,1	-7,5	-6,8	-4,3	-4,8	-5,0	-3,7
SI: General government debt, relative to GDP	Unit (x1)	%	4)	:	:	:	:	33,4	39,7	40,6	40,0	40,9	43,7	44,3

Financial indicators	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Gross foreign debt of the whole economy, relative to GDP	Unit (x1)	%		:	:	:	47,6	54,1	60,6	60,7	61,5	75,5	80,2	82,5
Gross foreign debt of the whole economy, relative to total exports	Unit (x1)	%		:	:	:	:	132,2	128,7	124,6	135,3	150,8	160,0	167,0
Money supply: M1	Million	EUR		1208,9	1656,4	1976,5	1846,3	1804,8	2372,9	3216,2	4147,9	4431,7	4505,4	5262,9
Money supply: M2	Million	EUR		:	:	:	:	:	:	:	:	:	:	:
Money supply: M3	Million	EUR		:	:	:	:	:	:	:	:	:	:	:
Total credit: credit by monetary financial institutions (MFIs) to total residents (consolidated)	Million	EUR		7042,7	7061,2	8088,9	9131,1	8586,9	9482,5	11891,1	15118,9	16525,9	18416,6	22835,7
Interest rates: day-to-day money rate, per annum	Unit (x1)	%		:	:	9,1	10,3	9,3	6,9	3,0	1,3	4,1	5,6	3,3
Lending interest rate (one year), per annum	Unit (x1)	%		:	22,4	19,3	20,1	20,9	20,6	19,5	16,4	15,0	14,4	12,9
Deposit interest rate (one year), per annum	Unit (x1)	%		:	:	9,3	9,6	9,5	8,2	6,6	5,3	3,8	3,8	4,0
EUR exchange rates: average of period - 1 euro= ... national currency	Unit (x1)	Number		6,760	6,800	6,960	7,140	7,580	7,630	7,470	7,410	7,560	7,500	7,400
EUR exchange rates: end of period - 1 euro= ... national currency	Unit (x1)	Number		6,810	6,860	6,950	7,330	7,680	7,600	7,370	7,440	7,650	7,670	7,380

Effective exchange rate index (2000=100)	Unit (x1)	Number		:	:	:	:	95,4	100,0	98,7	96,5	93,7	90,4	89,2
Value of reserve assets (including gold)	Million	EUR		1479,0	1867,7	2303,7	2400,2	3012,7	3783,2	5333,6	5651,3	6554,1	6436,2	7438,4
Value of reserve assets (excluding gold)	Million	EUR		1479,0	1867,7	2303,7	2400,2	3012,7	3783,2	5333,6	5651,3	6554,1	6436,2	7438,4

External trade	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Trade balance: (all goods, all partners)	Million	EUR		:	:	:	:	:	:	:	-6138,9	-7071,0	-6900,5	-7880,1
Value of exports: (all goods, all partners)	Million	EUR		:	:	:	:	:	:	:	5188,2	5438,9	6453,8	7069,4
Value of imports : (all goods, all partners)	Million	EUR		:	:	:	:	:	:	:	11327,0	12509,9	13354,4	14949,5
Terms of trade (export price index / import price index), relative to the previous year	Unit (x1)	Number	5)	:	:	:	:	:	108,8	98,8	99,7	100,4	109,3	92,6
Share of exports to EU-25 countries in value of total exports	Unit (x1)	%		:	:	:	:	:	:	:	65,7	67,5	64,6	61,9
Share of imports from EU-25 countries in value of total imports	Unit (x1)	%		:	:	:	:	:	:	:	71,4	72,1	69,5	65,6

Demography	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
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	-2,1
Net migration rate: number of immigrants minus the number of emigrants	Unit (x1)	per 1000	6)	5,7	7,7	7,4	9,8	4,1	5,3	3,8	1,9	2,7	2,6	:
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	5,7
Life expectancy at birth: male	Unit (x1)	Years		:	:	:	:	:	:	71,1	71,2	71,4	72,0	71,8
Life expectancy at birth: female	Unit (x1)	Years		:	:	:	:	:	:	78,1	78,3	78,4	79,0	78,8

Labour market	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Economic activity rate (15 - 64): proportion of the population aged 15-64 that is economically active	Unit (x1)	%	7)	:	65,5	63,6	62,8	62,6	62,2	62,2	62,9	62,4	63,2	63,1
SI: Employment rate (15-64): proportion of the population aged 15-64 that is in employment	Unit (x1)	%	7)	:	58,7	57,1	55,3	53,2	51,3	51,8	53,6	53,2	54,3	55,0
SI: Employment rate (15-64), male: proportion of the male population aged 15-64 that is in employment	Unit (x1)	%	7)	:	65,8	63,6	61,7	59,0	57,4	59,0	60,1	59,6	60,7	62,0
SI: Employment rate (15-64), female: proportion of the female population aged 15-64 that is in employment	Unit (x1)	%	7)	:	51,9	50,9	49,4	47,8	45,5	44,9	47,4	47,0	47,9	48,2
SI: Employment rate of older workers (55-64): proportion of the population aged 55-64 that is in employment	Unit (x1)	%	7)	:	31,1	29,1	25,6	25,9	24,2	23,7	26,8	29,0	30,4	33,6
Agriculture, forestry and fishing (NACE Sections A+B) as a share of total employment	Unit (x1)	%	7)	:	19,9	17,8	16,5	16,7	11,7	15,6	14,9	16,8	15,9	17,3

Industry (NACE Sections C to E) as a share of total employment	Unit (x1)	%	7)	:	22,9	23,9	23,5	23,9	22,7	23,1	23,0	21,0	22,0	20,8
Construction (NACE Sections F) as a share of total employment	Unit (x1)	%	7)	:	6,2	5,7	6,7	6,6	5,9	6,3	6,6	8,1	8,1	8,0
Services (NACE Sections G to P) as a share of total employment	Unit (x1)	%	7)	:	50,9	52,3	53,1	52,8	59,5	55,0	55,4	53,9	54,1	53,9
SI: Unemployment rate: proportion of the labour force that is unemployed	Unit (x1)	%	7)	:	10,0	10,0	11,7	14,5	17,0	16,3	14,4	14,4	13,8	12,4
SI: Unemployment rate, male: proportion of the male labour force that is unemployed	Unit (x1)	%	7)	:	9,6	9,6	10,6	13,5	15,9	14,4	13,3	13,3	11,9	11,0
SI: Unemployment rate, female: proportion of the female labour force that is unemployed	Unit (x1)	%	7)	:	10,5	10,4	12,9	15,7	18,2	18,7	15,8	15,7	16,1	14,1
Unemployment rate of persons < 25 years: proportion of the labour force aged <25 that is unemployed	Unit (x1)	%	7)	:	26,7	28,5	31,0	39,2	43,1	41,7	34,4	35,8	33,8	32,0
SI: Long-term unemployment rate: proportion of the labour force that is long-term unemployed	Unit (x1)	%	8)	:	4,1	4,4	5,4	7,3	9,1	10,1	8,6	8,6	7,4	7,2

Social cohesion	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
SI: Inequality of income distribution: ratio of top quintile to lowest quintile	Unit (x1)	Number	9)	:	:	:	:	:	:	:	:	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)	%	7)	:	:	:	:	:	:	:	:	7,3	4,6	5,4
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	2005
Number of passenger cars / population	Unit (x1)	per 1000		164,5	187,1	205,4	222,5	234,1	258,4	269,3	280,0	291,2	301,3	311,6
Number of main telephone lines (fixed) / population	Unit (x1)	per 1000		268,6	309,1	325,5	346,2	360,3	382,2	386,5	379,2	379,1	377,6	376,9
Number of subscriptions to cellular mobile telephone services / population	Unit (x1)	per 1000		6,6	13,4	26,3	39,3	79,3	251,2	389,9	526,6	574,3	640,2	821,4

Infrastructure	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Density of railway network (lines in operation)	Unit (x1)	per 1000 km ²		47,7	47,7	47,7	47,8	47,8	47,8	47,8	47,8	47,7	47,7	47,7
Length of motorways	Thousand	km		0,30	0,30	0,30	0,30	0,40	0,40	0,40	0,50	0,60	0,70	0,80

Industry and agriculture	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
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	126,7

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	105,7	:
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Innovation and research	Scale	Unit		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
SI: Spending on human resources (public expenditure on education) as a share of GDP	Unit (x1)	%		:	:	:	:	4,2	4,5	4,2	4,3	4,2	:	:
SI: Gross domestic expenditure on research & development, relative to GDP	Unit (x1)	%		:	:	:	:	1,0	1,2	1,1	1,1	1,1	:	:
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	2005
SI: Total greenhouse gases emissions, CO ₂ equivalent (1990=100)	Unit (x1)	Tonnes		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		409,2	409,8	397,1	414,8	548,6	491,6	485,5	481,3	510,6	478,9	:
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	45,8	:
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	76,0

e: estimate

f: forecast

p: provisional

(1) 1995-2001, as of 30 June; 2002-2005, as of 1 January.

(2) Source: Eurostat.

(3) GFS 1986 basis. Privatisation revenues are excluded and reclassified to the financing of the balance.

(4) The Croatian National Bank is using revised GDP data in comparison to the National accounts division of the Statistical Bureau.

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

(6) Total number of migrants include Croatian citizens and permanently resident foreigners who reported/unreported their place of permanent residence in the Republic of Croatia at the Ministry of Interior.

(7) Second half of the year.

(8) Second half of the year. Before 2001 long-term unemployment refers to thirteen months or more; from 2001 onwards long-term unemployment refers to twelve months or more.

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

(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 3500 kg and must be registered with the Ministry of Interior).