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COUNTRY STRATEGY PAPER**

FOR

CROATIA

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CARDS

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1. EXECUTIVE SUMMARY

As provided for in the CARDS regulation¹, the Country Strategy Paper (CSP) provides a strategic framework in which EC assistance will be provided in the period 2000-2006. It sets out EU co-operation objectives, policy response and priority fields of co-operation based on a thorough assessment of the partner country's policy agenda and political and socio-economic situation. The multi-annual indicative programme (MIP) attached to the strategy, and forming an integral part thereof, sets out the EU response in more detail, highlighting programme objectives, expected results and conditionality in the priority fields of co-operation for the period 2002-2004. The indicative financial allocation for CARDS assistance for Croatia for the period 2002-2004 is €168 million under the national programme and €23 million under the regional programme.

Croatia is a full participant in the Stabilisation and Association Process. Following the dissolution of the former Socialist Yugoslav Federation in 1991 it established itself as an independent republic. During its first decade of independence Croatia was involved in two military conflicts. It suffered increasing international isolation as a result of the nationalist regime of President Tudjman. The elections in January 2000 which led to the formation of a coalition government marked a turning point in the development of the Croatian state towards one based on the principles of democracy, the rule of law and respect for human rights, as well as in its relations with the international community. Croatia experienced a period of strong growth of the economy from the mid 1990's, though it suffered a recession in 1998-1999 before reviving from the beginning of 2000. The main challenges facing the country over the medium-term are the reform of the state administration and judiciary, the return of refugees and displaced persons, the restructuring of the economy, the full integration of ethnic minorities into society, the adoption of obligations arising from the Stabilisation and Association Agreement.

Within that context, and taking into account the objectives of the Stabilisation and Association Process, the EC CARDS programme can most effectively assist the partner country in meeting those challenges by focusing on the priorities of (i) democratic stabilisation, (ii) economic and social development, (iii) justice and home affairs, (iv) administrative capacity building and (v) environment and natural resources.

2. THE EU/EC CO-OPERATION OBJECTIVES

2.1. CARDS

The EU's co-operation objectives with Croatia are anchored in the Stabilisation and Association Process (SAP), a proximity policy which reflects the political and strategic importance of the Balkans to the EU. The

¹ Council Regulation (EC) 2666/2000, OJ L 306/1 07/12/2000

Stabilisation and Association Process is a framework in which a new contractual relationship (Stabilisation and Association Agreements) and an assistance programme (CARDS) help each country to progress, at its own pace, towards EU membership.

The European Commission set out this ambitious vision for the region's development in a communication of May 1999. The approach is based on:

- (1) a recognition that one of the main motivators for reforms relating to respect for the rule of law, democratic and stable institutions, and the development of a market economy is a relationship with the EU that is based on a credible prospect of membership once the relevant conditions have been met;
- (2) the need for the countries of the region to develop bilateral relationships between themselves as a basis for greater economic and political stability in the region;
- (3) the need for assistance programmes and contractual relations, although anchored to a common set of political and economic conditions, to be flexible enough to allow each country to move ahead at its own pace to accommodate a range of situations, from post-conflict reconstruction and stabilisation to technical help with matters such as the approximation of legislation to the core elements of the *acquis*.

Following the Feira Council of June 2000, which confirmed that the EU's goal is the fullest possible integration of these countries into the economic and political mainstream of Europe, the Zagreb Summit of 24th November 2000 set the seal on the SAP by gaining the region's agreement to a clear set of objectives and conditions. In return for the EU's offer of a prospect of accession on the basis of the Treaty on European Union (TEU) and the 1993 Copenhagen criteria, and an assistance programme to support that ambition, the countries of the region undertook to abide by the EU's conditionality and participate fully in the Stabilisation and Association Process.

They also accepted that the Stabilisation and Association Agreements (SAAs), when signed, would be the principal means to begin to prepare themselves for the demands that the perspective of accession to the EU naturally entail. The SAAs focus on respect for democratic principles and integration of the countries of the region into the EU single market. They foresee the establishment of a free trade area with the EU and set out rights and obligations in areas such as competition and state aid rules, intellectual property and establishment, which will allow the economies of the region to begin to integrate with the EU's. The conclusion of such Agreements represents the signatories' commitment to complete over a transition period a formal association with the EU, tailored to the circumstances of each country but based on the implementation of the same core obligations.

The EU's political strategy towards the region relies on a realistic expectation that the contract it enters into with individual countries will be fulfilled satisfactorily. Careful preparation with each country before the EU

offers such a contract has been and remains a vital component of the Stabilisation and Association Process. The agreements contribute to the EU's objectives in the following way:

- (1) They are a tool which provides, much as the Europe Agreements did for the candidate countries in Central Europe, the formal mechanisms and agreed benchmarks which allow the EU to work with each country to bring them closer to the standards which apply in the EU.
- (2) They are a means to focus attention on respect for key democratic principles – human and minority rights, stable democratic institutions, standards of political behaviour and the independence of the media.
- (3) They include the core elements which are at the heart of the single market. Through free trade with the EU and the associated disciplines (competition and state aid rules, intellectual property etc) and rights (e.g. establishment), this process will allow the economies of the region to begin to integrate with the EU's.

Effective implementation of the Stabilisation and Association Agreements is a prerequisite for any further assessment by the EU of a country's prospects of accession. Each country will need time, help and encouragement to implement such obligations properly.

The SAP is not simply a bilateral process with each country: the Zagreb summit placed considerable emphasis on the need for regional co-operation. Similarly, the SAAs include a clear commitment to regional co-operation, which is reflected both by the funding of a regional CARDS programme and by the shared objectives of national CARDS programmes.

The CARDS programme underpins the objectives and mechanisms of the Stabilisation and Association Process, and as each country moves deeper into that process assistance will focus increasingly on support for the reforms and institution building necessary to implement the obligations in the Stabilisation and Association Agreements. A precondition for receiving assistance under CARDS is compliance with Article 5 of the CARDS Regulation (Council Regulation 2666/2000 of 5 December 2000) covering conditionality issues.

The indicative financial allocation for CARDS assistance for Croatia for the period 2002-2004 is €168 million under the national programme, and €23 million under the regional programme for measures which will be implemented in Croatia. Croatia will, in addition, benefit from other measures under the regional programme.

2.2. Croatia in the Stabilisation and Association Process

Between the dissolution of the Socialist Federal Republic of Yugoslavia and the negotiation of the SAA, Croatia did not enjoy global contractual relations with the European Community. Croatia was granted autonomous trade measures on a unilateral basis. In accordance with the conditionality

established by the EU Regional Approach, and continued by the SAP, financial co-operation was limited to humanitarian assistance, support to democratisation and, from 1996, reconstruction assistance.

Following the change of government in Croatia in early 2000 and the resultant change in approach towards the European Union and European integration, Croatia has become fully engaged in the SAP. Negotiations for an SAA began in the autumn of 2000 and an agreement was initialled on 14th May 2001 and signed on 29th October 2001. In parallel, an Interim Agreement covering trade and trade-related areas was concluded to allow the early entry into force of these provisions of the SAA, since it is likely to take a certain time until all parties have ratified the SAA. Croatia has indicated that it intends to submit a formal application for EU membership at an early stage.

3. CROATIA'S POLICY AGENDA

The Government is committed to a challenging reform programme, announced immediately after it came to power. The programme covers political, economic, social, and justice and home affairs aspects. The overall objective is for Croatia to complete the process of transition, through full democratisation, international and European integration, regional stability and a sustainable economic performance. Within this general framework, the Government has given a firm commitment to a rapid start to the implementation of the obligations foreseen under the SAA.

Key elements of the reform programme are:

3.1. Political

Major reforms relating to democracy and the rule of law target respect of human rights, with particular reference to minority rights, full democratisation of the media and swift implementation of the return process. To this end, Parliament has already adopted some important pieces of legislation and will continue the process through a focus on proper enforcement of the new legal framework. The Government has renewed its commitment to the non-discriminatory and rapid enforcement of the return process.

The decentralisation of government functions to strengthen local government is seen as a key element in the reorganisation of the overall political system. A new legislative framework defines the respective responsibilities of, and the relations between, central and local government, based on the principle of subsidiarity. The streamlining of public administration through an horizontal decentralisation, with transferral of some administrative tasks to autonomous organisations outside the State administration (e.g. trade unions, employer's associations, universities, civil society), is also planned as an important measure to create the necessary administrative capacity.

Reform of the judiciary is a key concern for the Government, with the main elements of the reform being to strengthen the professional quality of judges and prosecutors, to improve the efficiency of the judiciary, to reduce the

backlog of cases, and to develop proper and efficient law enforcement mechanisms in all sectors. The fight against corruption and organised crime is also a crucial priority.

In the medium to long term, priority foreign policy goals include accession to the European Union and NATO, as well as the promotion of good neighbourly relations. To achieve the former, the establishment and implementation of a comprehensive plan for the implementation of the Stabilisation and Association Agreement is a key priority. Following the accession to the World Trade Organisation (WTO), Croatia is now working to enhance its relations with all the Central and Eastern European Countries (CEECs) with the aim of joining the Central Europe Free Trade Area (CEFTA). In addition Croatia will gradually conclude free-trade agreements with all the countries involved in the Stabilisation and Association Process.

In terms of regional co-operation, Croatia's policy is to foster close partnerships with its neighbours, recognising that this will be an important element of EU political conditionality, and that Croatia's attitude will have an important impact on the stability of the whole region. The Government is also committed to improving the implementation of the Dayton Peace Agreement.

3.2. Economic

The overall aims of Croatian economic policy, reiterated in the context of the Stand-by Arrangement (SBA) with the IMF, are to promote employment and raise living standards while strengthening macroeconomic stability and furthering structural and other necessary reforms.

The main fiscal policy target of the Government is to significantly reduce the consolidated central government deficit from 6.5% of GDP in 2000 to some 1.5% of GDP by the end of 2003. This will involve reducing public sector wages as well as downsizing the public sector. The main monetary policy objective is price stability, with a major emphasis on the stability of the exchange rate.

The main elements of the structural reform programme are the single treasury system, a uniform budget classification system, the liberalisation of reserve requirements in exchange deposits for private companies, further privatisation of financial sector institutions, the pension and health care systems, and the divesting of public enterprises and privatisation.

Regional development is a high priority, summarised in two principal goals: (i) to reduce the development imbalances, in particular promoting the prospects for sustainable development of the war-affected areas, rural areas and islands, and (ii) decentralisation, territorial reorganisation and strengthening of local authorities.

The Government has put an emphasis on promoting the growth of small and medium enterprises to help meet its goal of fostering sustainable development within the framework of a market-oriented, stable and predictable business environment. Given the short- as well as long-term

potential of the tourism industry, the particular priority is SME support to this sector.

Structural reform of agriculture is high on the Government agenda, to create the necessary conditions for Croatian agriculture to face European competitiveness and develop adequate working and living conditions in rural areas.

Government policy is for environmental protection and the sustainable use of natural resources to underpin all economic activities. A National Environmental Action Plan (NEAP) has been developed.

3.3. Social

Within the limits of its tight financial resources, the Government plans to develop an active employment policy to alleviate the acute unemployment problem. Particular emphasis is placed on the bundling of re-training and re-employment measures for workers affected by the restructuring/privatisation of state-owned enterprises and the redundancies in the public sector, as well as on various support measures for the unemployed, including the promotion of entrepreneurship and specific support measures for young people, women, war veterans and long-term unemployed.

The Government is committed to rationalising social welfare policies and to establishing a new legislative framework to protect labour rights. A priority is the reform of the pension and social security systems, with a view to providing better social protection, especially for the most vulnerable groups.

The planned reform of the health sector will aim to restructure health care institutions, reform the financing of and payment for services, modernise the delivery of health care services, and increase investment in medical equipment and the training of professionals.

The education system will be further developed with the aim of promoting democratisation, decentralisation, pluralism, and a better match between the education and training system and labour market needs.

4. POLITICAL, ECONOMIC AND SOCIAL SITUATION IN CROATIA

4.1. Political situation

The Parliamentary and Presidential elections in January 2000 marked a turning point in the Croatian democratisation process. The convincing victory of a centre-left, pro-European, six party coalition, committed to democratic principles, created a new momentum both as regards the internal political environment and in Croatia's relations with the International Community², in particular with the EU.

2 Accession to the NATO Partnership for Peace in May 2000, membership of WTO which was formalised in November 2000, and the Council of Europe decision to consider the Parliamentary

One of the major planks of the political programme of the coalition that took power in 2000 is the deepening of relations with the EU, with a view to a gradual integration of Croatia into the European structures. The Government is committed at the political level to fulfilling all the underlying political conditions and to strengthening the overall democratic environment in order to achieve this aim. It has also accepted wide-ranging obligations in the framework of the Stabilisation and Association Agreement, the implementation of which will require substantial efforts, notably in terms of the structural reforms that will be needed. In demonstration of its determination, the Government has established a challenging reform programme that, if achieved, would allow it to fully implement the SAA obligations by 2006. The successful implementation of the necessary reforms depends, however, on the Government maintaining a high level of internal cohesion and continued commitment from the coalition partners to take what may be difficult political decisions.

For such a demanding process to be sustainable will require not only serious commitment and active participation by the Government and all parts of the public administration but also public consensus in the face of potentially painful reforms for businesses and individuals. This necessary public consensus could both result from, and lead to: improved cohesion within the ruling coalition; the establishment of a more constructive dialogue between the Government and a mature opposition, and; increased co-operation between the different institutional players.

The results of the nation-wide local elections on 20th May 2001 showed, however, that the population seems to be rather disappointed, if not even disillusioned, with the Government's performance. There has been a general loss of interest in "political affairs", evidenced by a low turnout in the election (45%) which cannot be explained simply by the number of elections which had taken place over the previous year. Growing and more focused public discontent and criticism, aggravated in particular by the difficult economic situation and the impact of high unemployment, would put pressure on the Government, and make the reform process increasingly difficult. For reform to be accepted, the level of public debate and the participation of civil society in policy development must increase. For the moment, however, the different parts of civil society are not sufficiently well organised or pro-active, and so are not able to voice public interests in an effective manner.

In addition to the normal problems and challenges of a country in transition, Croatia struggles with the effects from the wars of the 1990s, notably in terms of the return of refugees and reconstruction. Although the change of government in 2000 led to an improvement in the treatment of minorities wishing to return, significant numbers of those who left their homes during the 1990's have still not returned. The incomplete return and integration of refugees and displaced persons thus remains a problem, which is an issue

Assembly's human rights monitoring procedure as closed, were all important steps which marked the end of the international isolation of the country.

particularly in terms of obligations under the peace accords. Return is still not genuinely encouraged in practice, and the legal framework is not fully and fairly applied. Further factors inhibiting return are incomplete reconstruction, bleak economic prospects, animosity by local populations to Serb communities and a negative perception of the security situation in the war-affected areas. Repossession of property and restitution of occupancy/tenancy rights also remain problems that the Government needs to address more decisively. The Government has developed a national action plan for the return of refugees and displaced persons within the framework of the Stability Pact Agenda for Regional Action (AREA).

Croatia's human rights record has improved under the new Government, demonstrated in a number of ways. Elections have shown a positive evolution towards the respect of international election standards. The independence of the judiciary has been strengthened, although it is underfunded, suffering from an inherited backlog of cases, and still subject to some political influences at a local level. The freedom of speech has improved, with the adoption of laws on State Radio and TV and on telecommunications, and with the dropping of libel lawsuits against journalists. The possibility of governmental interference in NGO operations has been reduced. Co-operation with ICTY has improved, and the commitment to co-operation confirmed by a vote of confidence in the Government. With regard to treatment of minorities, the overall atmosphere has changed positively and the legal framework has been improved. However, de facto discrimination still exists, particularly at the local level, and notably towards the Serb community. As elsewhere in the region, discrimination also affects the Roma population. Finally there is the problem of trafficking in persons, for which Croatia is mainly a transit country but also, although to a lesser extent, a source and destination country. Croatia is a signatory to nine of the twelve principal international human rights treaties of the United Nations

Looking at the place of Croatia within the region, the country has a key role to play in the reconciliation and the stabilisation process of the whole region, and has expressed a commitment to both improving its bilateral relations and continuing to play an active role within the region. Croatia understands that these are major conditions in the furthering of its bilateral relations with the EU. However there is still resistance to concrete co-operation with neighbouring countries. In particular, Croatia tends to reject regional initiatives, which it fears might strengthen the regional identity at the expense of closer integration with central European countries and EU Member States, which is its primary aim. At the bilateral level, the new Government does have a significantly different attitude towards Bosnia and Herzegovina in comparison with the old, and has worked to build more transparent relations with the Bosnian Croats and enhance direct contacts with the Central Bosnian institutions. However further progress is still needed in controlling financial assistance to the Bosnian Croats, to ensure that it is devoted exclusively to open and transparent co-operation and to prevent any misuse. Relations with the Federal Republic of Yugoslavia (FRY) have also started to improve as economic ties hum back to life, but the pace is slow. In addition disputes over the Prevlaka peninsula remain

unresolved. Of the outstanding issues with Slovenia, agreements on land and sea borders and on the Krško nuclear plant have been reached between the respective governments but difficulties in ratification mean that the questions might be re-opened.

4.2. Economic and social situation

4.2.1. Economic situation, structure and performance

After a thriving stabilisation effort starting in late 1993, the economic situation started to deteriorate in 1997 (from a combination of factors: a tightening of monetary policy, mounting structural problems, increases in taxes and administered prices, the Kosovo crisis), and the country found itself in a recession which started in the last quarter of 1998 and continued through the first three quarters of 1999.

From the end of 1999 the macro-economic situation started to improve. A rebound in household consumption, improved exports, and the very good performance of the tourism sector in 2000 meant that GDP started to grow again in the last quarter of 1999, albeit at modest levels, with a rate of 3.7% in 2000. Industrial output recovered only moderately in 2000 with an output growth of 1.7% over the previous year, but strengthened in the first months of 2001.

Annual inflation accelerated in 2000, at 6.4% compared to 4.3% in 1999, though it stabilised from July 2000 onwards. Despite Central Bank interventions, the nominal exchange rate against the Euro appreciated slightly, reflecting strong capital inflows from privatisation and tourism, until beginning to depreciate in August 2001.

Unemployment has grown steadily since Croatia's independence (caused by the recession, slow progress in restructuring and modernising the economy, and wage increases above productivity gains) reaching an average rate of 21.4% in 2000 according to official figures, although this official rate is likely to overstate the actual situation. Youth unemployment represents 34% of the total, and the levels of female unemployment and unemployment of the middle-aged unskilled are also causes for concern. Real after tax wages of those who are employed have reached pre-transition levels.

An important step towards economic reform was taken on 19th March 2001, with the approval of a stand-by arrangement with the IMF. Although Croatia has indicated that it does not need the associated IMF resources, the arrangement provides an important framework of economic policy-making and monitoring. In the context of the stand-by arrangement, the Croatian authorities have committed themselves to carrying out stability-oriented economic and financial policies as well as the necessary economic reforms. The medium-term (2000-2003) economic strategy of the Government aims to achieve "sustainable high rates of economic growth with price stability and external viability". This will be pursued by a "judicious combination of fiscal adjustment, wage discipline, and structural reforms in the context of continued exchange rate stability", according to Government statements.

4.2.2. Social developments

In terms of social indicators - literacy, infant mortality and life expectancy - Croatia is comparable to its European neighbours. As would be expected from the more stable state of its economy, there is a lower incidence of poverty in Croatia than in other countries in the SAP.

Looking first at education, reform has been on the Government agenda since the country gained independence in 1991. However, a coherent national strategy has not yet been developed, with education remaining rather politicised as the country seeks to define itself as an independent state with its own culture and language, and as part of Europe. The development of a new vocational education and training policy is a key consideration in a situation of high and increasing unemployment, when the unemployed comprise notably the young and the unskilled. However, such policy development, including crucially the concept of life-long learning, is not yet taking place. The Croatian system of higher education is extremely decentralised and rather outmoded by comparison with systems existing in Member States. In May 2001 Croatia formally joined the Bologna Declaration, which sets out the process of harmonisation of European institutions of higher education and of the establishment of recognisable and comparable academic degrees. The structure of curricula, degrees and institutions in Croatia currently differs significantly from the principles of the Bologna Declaration

Turning to health, access to health care is nearly universal. It is however highly centralised and badly conceived and managed, suffering as a result from low standards and services, long waiting lists for specialised medicine and surgical interventions. The private health insurance market is under-developed.

The social welfare system does not give comprehensive coverage to those in need, meaning that some of the most vulnerable in society currently slip through the net. This is because of a lack of co-ordination between different agencies responsible for managing different aspects of the social protection system, and because of a lack of awareness of their rights by the most vulnerable.

The provision of education, health and certain social welfare services has since 1st July 2001 been decentralised from central to local government. This is a decision with significant implications for the delivery of these services, but also for the policy framework. Decentralisation should mean more responsiveness to local conditions and needs. In the case of social welfare provision, decentralisation offers the possibility to develop new ways of service delivery, notably by partnerships between local authorities and non-governmental organisations (NGOs). However, there is a lack of resources at the local level to pay for social services.

In terms of social transfers, the Government has since the beginning of the transition process relied overmuch on early retirement to ease pressures in the labour market. This policy has created a gap between the falling number of contributors to the pension system and to the State transfer system in

general, and the growing number of beneficiaries. As a result transfer recipients have had to rely on smaller benefits. The poverty profile, which is dominated by the elderly and non-employed, can be traced back to these developments. Another key though disturbing observation is that ethnicity clearly affects the socio-economic situation, with the Roma population and returnees, especially those of Serb origin, enjoying living standards well below the average of Croatian society.

4.2.3. Assessing the process of reform

The size and the role of the state in Croatia are still very large and there is therefore a need not only to reduce Government expenditure, but also to increase the efficiency of the public administration. This may be partly achieved by the moves towards decentralisation, which will strengthen local administration and self-government units. The effects of an inefficient administration have clear economic impacts. For example, a survey carried out by the Foreign Investment Advisory Service (FIAS) of the World Bank in early 2001 argues that both foreign and indigenous entrepreneurs face a variety of administrative barriers to investment. The streamlining of administrative procedures is therefore important in the larger reform context, as Croatia's economy becomes more integrated with that of the EU and faces intensified competition.

Reforms to the pension system in 1998 and 1999, which attempted to rationalise and stabilise the pay-as-you-go system by introducing a three-pillar system, now appear to have been insufficient and too late. There will therefore be a need to revisit the reforms to ensure their medium and long-term financing and to improve equity, targeting and economic efficiency.

Education reform needs to be tackled urgently, given the identified links between individuals' lack of education and the proportionate chance of unemployment, and between the level of vocational training and potential to adapt to market restructuring. An under-investment in education, both in financial terms and in terms of a commitment to reform, runs the long-term risk of limiting productivity and growth. The Government has not so far been very successful in engaging in a sector dialogue with the major in-country stakeholders and international partners, nor in seeking consensus for a new reform programme and its implementation.

Croatia's health system is at a critical and unstable point, with its finances in major deficit and its care delivery system under strain. As well as the social considerations, the sector therefore also represents a major fiscal problem. Although changes in the mix of revenue sources and the efficiency of revenue collection are needed, the high level of expenditure relative to GDP implies that medium-term solutions lie mainly in more effective health spending rather than higher health revenues.

Social services are currently delivered almost entirely by the governmental sector, with local NGOs having been involved to a significant extent only in the delivery of humanitarian aid (procurement, supply and distribution). This is likely to change with the decentralisation of social welfare services from the national to the local level, as there will be an increased opportunity

for civil society to work in partnership with the public administration to deliver services. This could not only improve the human quality of services but also be more cost-effective and eliminate some holes in the welfare safety net.

4.2.4. Structure of public sector finance and main sectoral policies

Although consolidated general government expenditure has risen steadily both in absolute and relative terms over the past few years, parallel growth of revenue has contained the widening of the budget deficit. One reason for the growth of revenue has been the increasing importance since 1998 of capital revenues, mainly from privatisation (equalling some 13% of revenues in 1999 compared to 1.4% in 1997). The introduction of VAT in 1998 represented a sea change in revenue collections. On the expenditure side, the general government wage bill increased by 80%, and that of central government by 65% between 1994-1998.

The size of the budget deficit remains relatively high by international standards, having increased from 1-2% through most of the 1990s to 7.4% in 1999. This should fall over coming years as structural adjustments, along with a number of changes in the composition of government revenue and expenditure, take effect. These adjustments and changes reflect the more restrictive fiscal policy of the new Government, which aims to consolidate public finances and carry out structural reforms. The reduction in government expenditure as a proportion of GDP, which began in 1999, is expected to continue, reaching a target level of 37.5% in 2003, following revenue reduction measures adopted late in 2000. The main component of the budget reduction plan is to cut and freeze the public wage bill. A single treasury account system has been in place since January 2001, which will facilitate expenditure control. However there are still problems linked to extra budgetary funds, the deficit of which, on a consolidated basis, more than tripled over the four years to 1999 to 9.9% of GDP, which need to be addressed.

Corporate governance in Croatia is weak, since privatisation has often favoured insiders over strategic investors, and changes in ownership have not therefore been accompanied by a change in corporate governance. The privatisation of public enterprises is of major importance for the break-up of state monopolies (e.g. electricity, oil refineries, transport). The future privatisation strategy will also have to tackle the problem of (partially) state-owned enterprises which are dependent on direct or indirect (e.g. state guarantees, deferment, taking over of social security contributions) state aid, such as the shipbuilding industry, the ferry lines and the national railway company.

The financial sector remains underdeveloped, effectively comprising only the banking sector, and having a limited number of listed companies. Following privatisation, foreign-owned banks account for some 84% of total banking assets, but in terms of numbers the Croatian banking system is still characterised by small and micro institutions of only local scope. The creation of a sound financial system is therefore likely to require further

consolidation, merger or closure of financial institutions, to build on the increasing confidence of banks and depositors. .

Direct subsidies in Croatia, mainly concentrated in transport and agriculture, are relatively low compared to other transition countries, at some 2% of GDP. However, the actual magnitude of subsidies is likely to be well above this level since indirect subsidies – for instance in the form of government waivers to selected enterprises to contribute to social security funds - are common. The Government also often assumes the debt of enterprises, for example through debt to equity swaps.

4.2.5. External environment

The election of the new Government ended not just the political but also the economic isolation of Croatia. In July 2000, the WTO general council approved the entry of Croatia, which has by its membership committed itself to a phased reduction of barriers to agricultural and industrial trade over the period to 2005. Croatia was formally admitted to the organisation on 30 November as its 140th member. The authorities seem to have achieved their aim to cover more than 80% of trade under preferential trade agreements by the end of 2001. Free Trade Agreements (FTA) already exist with Slovenia, the Former Yugoslav Republic of Macedonia, Bosnia and Herzegovina and with Hungary. Negotiations with EFTA have been concluded, with the Agreement to come into force at the beginning of 2002. Bilateral trade negotiations are ongoing with Poland, Czech Republic, Slovak Republic, Bulgaria, Romania, FRY and Turkey. On 27th June 2001, in the framework of the Stability Pact, a memorandum of understanding was signed to liberalise trade and lower tariff barriers. It provides for the establishment of a network of bilateral FTA for South East Europe by the end of 2002, and the liberalising of at least 90% of trade among the parties within a transitional period of six years.

Croatia benefits from very advantageous trade preferences unilaterally granted by the EC in December 2000. It currently has duty-free access without any quantitative restrictions for its exports to the Community of all industrial products, all processed agricultural products and agricultural products with the exception of baby beef and wine, which are subject to quota, and bovine meat, which is excluded from preferential treatment. Fisheries products are also granted important preferences.

The Interim Agreement, putting into force the trade provisions of the SAA, will give this trade regime contractual status and will improve it by improved concessions for fisheries products. The final objective of the trade provisions is the creation of a free trade area over a six-year transitional period. To achieve this Croatia has agreed to gradually dismantle its tariff barriers to EC exports, with the elimination of duty for textile and steel exports by 1st January 2006 and of all other industrial products by 1st January 2007.

In terms of Croatia's external trade performance, the loss of international competitiveness in 1997 led to a significant reduction of exports (by 7.4%). Imports continued to grow at an annual rate of 14.5%, leading to a quickly

widening current account deficit of 11.6% of GDP in 1997 compared to 5.8% in 1996. However by 2000 the deficit had fallen to 2.1% it is expected to be 3.5-3.7% in 2001.

The deterioration in the current account deficit between 1996 and 1997 was paralleled by a sharp increase of the external debt from 23% of GDP to 32%. This trend continued until by the end of 2000 foreign debt had reached a record level of more than 50% of GDP. At these levels, debt service will exert an increasing strain on foreign currency reserves and on the budget as well as on the economy.

4.3. Capacity for European Integration

The Croatian Government has demonstrated a clear capacity to engage at a political level with the European Union and its member states. During negotiations on the SAA the Government showed that it was capable of undertaking political commitments in a wide range of areas, and it has undertaken to produce a plan for implementation of the SAA. However, full implementation and enforcement of the obligations undertaken, and of other necessary political and economic reforms that are part of the Government's programme, might be problematic. There are broadly two reasons for this risk.

Firstly, there is insufficient co-ordination and supervision at a central level to ensure that relevant ministries develop and carry through their work programmes in line with the Government's reform agenda. In addition a lack of political leadership where ministries have a number of different major responsibilities can make it difficult for them to identify key objectives. A linked concern is the degree to which the Government is able to prioritise, and then distribute human and financial resources accordingly, between its different objectives. For example, there was no agreement on preliminary work on a so-called strategy for Croatia in the 21st century. It is worth noting that this lack of co-ordination might also make it difficult for the Government to collect information on the extent to which progress in the reforms has been made.

Secondly, the level of technical and administrative capacity is not sufficient. There are a number of elements to this: (i) The public sector is not an attractive employer for those who could also find work in the private sector; (ii) Staffing levels in different ministries do not always reflect priority reform areas; (iii) Technical skill levels are in some cases inadequate because recruitment to the civil service in the past has sometimes been on political rather than professional grounds; (iv) The nature of the job of a civil servant has changed substantially in recent years, overtaking the skills of longer-serving employees.

Another indicator of Croatia's capacity for European integration is the situation in the field of justice and home affairs, in particular the judiciary, where there are causes for concern relating to its organisation and functioning. Concretely, the situation has not changed substantially since the new Government took power in 2000. The main issues identified for the judiciary are the large backlog of cases, currently 1.2 million (although the

growth of the backlog has been stopped), particularly in the larger courts and for certain types of cases, and the poor quality of decisions. The weaknesses in the system are: (i) the inexperience and lack of proper training of existing judges and prosecutors; (ii) the inefficiency of the court structures in carrying out judicial work; (iii) flaws in the procedural codes; (iv) that the judiciary in Croatia has a number of responsibilities which are normally administrative rather than judicial decisions.

The poor performance by the judiciary leads to a widespread lack of confidence in the legal system. This undermines the democratisation process, since people hesitate to bring cases to court. In addition, the difficulty of accessing justice, for example for victims of discrimination or domestic violence, remains an issue. The lack of certainty of legal procedures and the delays also impact negatively on the business environment and thereby inhibit private sector development and in particular foreign investment. A comprehensive reform of the judiciary, together with transitional solutions for the short-term management of the situation, is therefore a pre-requisite for European integration.

The progressive normalisation of the situation in the region has led to an increase in irregular migratory movements and Croatia has, mainly due to its geographical location, become a transit country for migration directed toward the EU. Croatian figures indicate a steady increase since 1996, with some 24,000 apprehensions of illegal entries recorded in 2000. Around 66% of this migration comes via BiH and 28% via FRY. Croatia is taking action and is involved in regional co-operation inter alia. within the framework of the Stability Pact. However, relevant national legislation is not in line with European standards and implementation capacity relating to asylum processing and migration management is low. In order for Croatia to play its part in what is becoming an increasingly important strand of European integration, the country will need make considerable efforts over the coming years.

4.4. Sustainability of current policies

The current Government is made up of a five-party coalition, meaning that decision-making is complex and in certain cases difficult because of the need to gain a broad consensus of support to make strategic choices and pursue a proper reform process. This has made strategic planning and related action more difficult. There is also a risk that while all coalition partners accept and endorse the eventual goals of reform and European integration, their different interests might threaten the adoption of the more painful reforms that are necessary to achieve these goals.

The focus so far of the post-nationalist Government has been on its foreign policy agenda, building relations and reversing Croatia's political isolation. There is a perceived lack of delivery on domestic policies, both social and economic. Apart from decision-making, the major reason for this is the lack of capacity of the public administration. It has not fully adjusted to the post-socialist, post-nationalist situation and is inefficiently resourced and insufficiently professional. Corruption is also an issue, partly stemming from the over-politicisation of the public service in the past, which has not

yet been fully addressed. This weakness in capacity to deliver could be a serious threat to delivering on the policy agenda adopted.

The social situation can be described as reasonably stable. The incidence of poverty is not high, compared with other countries in the region, though it is concentrated in the elderly and the ethnic minorities and is apparently on the increase. The problem of unemployment is serious both because of its effect on income and social transfers, and because of the brake it puts on economic development. In addition, a feeling of dissatisfaction or disappointment with the unemployment and social situation may lead to political disaffection.

4.5. Medium term challenges

The first building block of social, economic and democratic development in Croatia is the resolution of the effects of the conflicts in the 1990s, which continue to significantly affect Croatian society. There are still internally displaced people and refugees, and policies on return and integration, and on the normalisation of inter-ethnic relations, will remain at the forefront of the Government's agenda for a number of years. Ethnic divisions are still strong, and discriminatory practices an issue, particularly at the local level, meaning that the potential for social conflict still exists. One of the main problems in return areas is the lack of economic opportunity, an issue that must be addressed if return is to be sustainable.

The performance of the economy, although improving, is still weak in certain sectors and excessively reliant on domestic firms. The de-industrialisation of the economy is still having a significant impact on economic development. Progress in a number of structural reforms is necessary, including the successful completion of the privatisation process, and the improvement of both corporate governance and the management of the state portfolio. Private sector development, in particular the encouragement of foreign direct investment, must be a priority to broaden the economic base of the country. The growth of new businesses is also important in the fight against unemployment, which is a major medium-term challenge for the Government. In terms of economic development, but also more generally, the question of sustainable development and environmental protection needs to be addressed.

Consolidation of democracy requires reform of the judiciary. The current legal framework cannot be effectively implemented or enforced because the judiciary does not operate efficiently. These shortcomings affect not only law and order but also the effective functioning of a competitive market economy. Organised crime is growing, as is the illegal movement of goods and people transiting to the EU through Croatia. The modernisation of the police service to address this, as well as domestic and more general law and order issues, will be a key objective.

Long-term stabilisation requires improvements in all parts of the public sector. For the public administration this means a more efficient as well as smaller state administration. A reduction in the size of the public sector would encourage private sector development and reduce public expenditures.

The system of public finance must be addressed, in particular the pension system.

Finally, and crucially, an over-arching challenge for the Government in the medium-term will be the implementation of the Stability and Association Agreement, and the Interim Agreement. Under the terms of these agreements, Croatia has accepted a number of obligations that require legislative changes and effective implementation of these changes. These are most notably related to trade and investment and the internal market. The development of a clear strategy, and the creation of appropriate mechanisms for co-ordination of the numerous measures that will need to be adopted, will in itself be a significant challenge, as will their implementation, requiring strengthened administrative and institutional capacity.

5. OVERVIEW OF PAST AND ONGOING CO-OPERATION

5.1. EC co-operation past and present

The financial support from the European Commission to Croatia has been appropriate to each of the three different periods of the country's history over the last decade: i.e. first, a military conflict with all the characteristics of an emergency situation; secondly, a post-conflict environment where the priorities were reconstruction and the consolidation of democracy; and, thirdly, a stabilisation phase where the objectives have become integration and association into the international institutions of Western Europe, building up a modern state according to European democratic standards and reinforcing the rule of law, economic development and social justice.

Concretely, therefore, from 1991 to 2000 the EC provided a total of €369 million in assistance to Croatia. In the difficult period of war and transition, from 1991-1995, the EC mobilised €244 million for humanitarian and relief assistance. Subsequently, in the period 1996-2000, assistance was focused on reconstruction and the return and integration of refugees and internally displaced persons. Support was also given for democratisation, the independent media and de-mining. The mechanism for support to human rights and democracy has been the European Initiative for Democracy and Human Rights, from which Croatia received €358.000 through grants given mainly to local NGOs. A summary table of all the assistance given is in annex 2.

The national programme for 2001 (outline in annex 3) dedicated the largest single component (€23.2 million) to refugee return, including some economic revitalisation activities. Other key foci for support reflect the obligations of the SAA and the reforms that Croatia must undertake in its move towards European integration. €20.4 million is therefore allocated to justice and home affairs, customs and public administration reform. The other priority is economic development.

The EIB began operating in Croatia early 2001. By the end of the year it will have approved projects for a total of €186 million in the financial, electricity, roads and railways sectors. The electricity project is a loan for the

rehabilitation of the Ernestinovo transformer station, together with EBRD, and is being complemented by technical assistance under the CARDS 2001 programme. In 2002 and 2003 the EIB plans to pursue, in conjunction with the World Bank and EBRD, the financing of infrastructure projects of airports, seaports and waste water treatment.

5.2. Assessment of past EC assistance

The major assistance to Croatia from the beginning of the 1990's until early 2000 was humanitarian. The humanitarian operation was largely carried out by ECHO, in partnership with international organisations and NGOs. A phased exit strategy was set up from 1996, combining the progressive reduction of beneficiaries with a better targeting of the actions in terms of geographical areas and categories of vulnerable people. It was performed smoothly, and the goal of a non-abrupt phase-out was accomplished.

From 1996 assistance has been focused on the return of refugees, mainly through reconstruction of houses and related infrastructure, with an economic development component being added in the 1998 programme. The refugee return programmes have been implemented on a regional basis by an EU non-governmental organisation (NGO), with UNDP for the economic development elements. The close co-operation with central government and local authorities has contributed to the effective delivery of the reconstruction assistance in a focused way in identified municipalities and regions. The reconstruction programme, including the 2000 budget, will have paid for approximately 3000 dwellings to be reconstructed. This allows the same number of families to return to their homes, with other "indirect" returns becoming possible as housing units occupied by those families are freed. There have been no major delays in delivery, with resources from the 2000 programme being disbursed in 2001. Lessons learned during earlier phases of implementation have been taken into account in the evolution of the refugee return programme. Key ones have been: that resources should not be thinly dispersed geographically but should attain a critical mass; that the goal of economic development in return areas needs to be met by specific support; that strengthening of local planning capacity should be supported.

During 2001, the Commission financed two schemes of micro-projects implemented mainly by local NGOs: a strand of the European Initiative for Democracy and Human Rights (EIDHR) and the Small Scale Operations scheme (SSO). The objectives of the projects supported (some 30 in total) were in general terms to strengthen the capacity of civil society to deal with issues related to the sustainable return of refugees, conflict resolution, peace building, protection of human and minority rights, participation of citizens in the decision making process, gender issues and sustainable economic development and market oriented initiatives. Problems have been encountered with weak professional standards in reporting by the NGOs, which has made monitoring of project implementation difficult. However, certain NGOs and semi-public institutions have performed extremely well and some of the initiatives funded, because of their impact and relevance, would be worthy of follow-up finance.

The outputs of the technical assistance package of €3 million for selected ministries and public institutions programmed under OBNOVA 2000 have contributed to the programming within this strategy. In terms of implementation, lessons have been learned concerning the scheduling and length of visits of consultants to the country, their interaction with the Commission as well as the beneficiary, the importance of experts working as a cohesive team and the importance of understanding the background political and social situation.

5.3. EU Member States

Eleven Member States are engaged in co-operation activities in Croatia. The current situation is very heterogeneous as far as the fields and size of Member States interventions are concerned. Despite the dispersion of funds in various sectors, general objectives are largely shared by all Member States, with the two basic pillars of their co-operation in Croatia being the strengthening of democratisation and the rule of law, and the development of a market economy that is socially and environmentally sustainable. The major member state donors in Croatia are Germany, the Netherlands, the United Kingdom, Italy, Sweden and Austria. (See table in annex 4).

There is currently a shift towards allocating more funds to modernising the state and increasing its capacity, rather than traditional areas of support such as democracy and the rule of law. The issue of European integration is more and more relevant to Member States, each of whom makes a contribution according to their experience in Croatia or other transition countries.

5.4. Other donors' programmes

World Bank

As of September 2001, the World Bank Group had committed a total of US\$930 million for 26 projects. Its focus for assistance had shifted from post-war reconstruction to capital market development, reforms of enterprise and financial sector, health, agriculture and forestry. The World Bank plays an important advisory role to the Government, by providing policy advice and technical assistance. The Bank has committed 56% of its portfolio to infrastructure development, 31% to the finance and enterprise sector, 6% to agriculture and forestry and the remaining 7% to health. A Structural Adjustment Loan for \$200 million will be signed with the Government early in 2002, along with an \$80 million Enterprise and Financial Adjustment Loan. The International Finance Corporation (IFC) concentrated its activities in the banking and manufacturing sectors.

IMF

Croatia, a member of the IMF since December 1992, has benefited from the IMF's technical assistance in key monetary, fiscal and public administration areas. In 1999 negotiations on a stand-by arrangement failed because of conflicting views on the government's wage policy and enterprise privatisation. Under the new Government, negotiations on a stand-by credit resumed in March 2000 and resulted in the agreement of a 14-month stand

by credit for SDR 200 million. According to IMF sources in Croatia the programme seemed to be on track for the first quarter of 2001 as regards the relevant economic indicators in the Croatian economy and the quantitative performance criteria laid down in the SBA. This should facilitate the enhancement of Croatia's credit rating. The programme will be subject to review, with the first completed on 5th November 2001.

EBRD

By September 2001 the EBRD had made a cumulative commitment of €745 million in Croatia, of which the majority are classified as private sector operations. Approximately one third of the bank's commitments (in financial terms) have been in the financial sector, concentrating on equity investments and long-term credit lines to local banks for on-lending purposes. Nearly half of the commitments in value terms concern the infrastructure sector, with the remainder going to investments in the corporate sector.

The EBRD country strategy for Croatia approved by the Board in October 2000, gives priority to: first, infrastructure, municipal and environmental projects with a regional dimension; second, corporate sector investments, and; third, financing activities in non-banking institutions and SME delivery channels.

CEB

The Council of Europe Development Bank is involved in financing two projects in the health sector (€49 million), two in the education sector (€23 million), one on reconstruction for refugee return (€30 million), one project for SME development (€8 million) and one project on cultural heritage for €1.4 million.

USAID

USAID's focus in Croatia began with humanitarian assistance, and moved onto return and reintegration of war-affected populations and strengthening of political processes and civil society. From 1997 until 2000 assistance was almost exclusively to local governments, political parties, labour unions, media and NGOs. The four strategic objectives of assistance for the current five-year strategy are economic growth, reintegration of war-affected populations, civil society and governance, and social reform programmes.

6. THE EC RESPONSE STRATEGY

6.1. Principles and objectives for co-operation

This response strategy is based on an analysis of the political, economic and social situation in Croatia, and on an assessment of how the Community can best contribute to the long-term goal of Croatia's integration in the European mainstream, given the EC's comparative advantages as a donor and the resource available.

The main objectives of the assistance are:

- to embed political and democratic stability, enhance good governance and consolidate the rule of law;
- to contribute to a sustainable growth in economic activity and a reduction in unemployment, particularly in war-affected areas;
- to assist Croatia in fulfilling the obligations, and taking advantage of the opportunities, of the SAA.

The EC Response Strategy serves not only the direct policy goals of the SAP as required by the CARDS regulation but also two critical objectives underpinning EC support, namely conflict prevention and poverty reduction. The Stabilisation and Association Process is a regional conflict prevention strategy and the EC Response Strategy will address fundamental weaknesses and tensions which may contribute to, or trigger, conflict within the country and the region. In addition, the SAP is designed to contribute to the stabilisation of the countries of the region and their economies. Sustainable economic development is central to the SAP. All of the measures supported will contribute directly or indirectly to this goal. It is only through sustainable development that poverty reduction can be effectively addressed. This is an approach which is shared with the World Bank.

For a number of the programmes identified in the strategy, the reforms undertaken will impact on other areas. These links are brought out for each of the programmes concerned, in the multi-annual indicative programme, to demonstrate the “multiplier” effect of the actions that will be supported. One specific issue which will impact on the entire programme is the environment. It has been identified as a separate priority in order to dedicate resources to it, but as it has cross-cutting importance it will be considered in the implementation of each of the programmes selected.

6.2. Priorities for co-operation

6.2.1. Democratic stabilisation

Return of refugees and internally displaced persons

Given the importance of refugee return for Croatia and the region, and EU policy on this issue in the context of the peace accords, one of the major priorities for CARDS support will be the sustainable return and reintegration of refugees and internally displaced persons. In the light of experience elsewhere in the region, and consistent with the Stability Pact regional return initiative’s Agenda for Regional Action (AREA), the priority for support will move from the reconstruction of houses which has been financed in the past towards encouraging and supporting the return of refugees in other ways. The main thrust of this will be to contribute to sustainable economic development in return areas, since without economic opportunities in these areas people are not willing or able to return. The objective of the assistance will be to support locally led economic development. Locally articulated development plans will provide the basis for support to small-scale infrastructure at the local municipal level that is directly related to economic development, and for support to entrepreneurs and potential entrepreneurs.

This specific support to economic development in return areas will be complemented by the support to be given to removing obstacles to investment in these areas under the programme to improve the investment climate.

Complementary support to economic development in return areas will address the democratic stabilisation aspect of return. The first objective of this will be to increase the confidence of those who are considering returning, or who have returned, and to support the local integration of minority ethnic populations. The other key objective will be to improve the functioning of existing governmental structures and procedures, principally at the local but also at the national level, to ensure that legislation governing and affecting return is fully and appropriately applied, so that all those who wish to return can do so.

Civil Society

A well-developed and vocal civil society is a key requirement if Croatia is to become a modern democratic society. Civil society holds such a key position for a number of reasons. Firstly it plays a role in monitoring government activities and possible abuses of power. Secondly it provides a source of grassroots initiatives which can lead to new social practices and legislation. The situation in Croatia is not yet as mature as in longer-established democracies. CARDS assistance over the period covered by this strategy will therefore have as an objective to support the two aspects of civil society activity identified. That is, first, to increase the capacity of civil society to contribute to the process of democratisation, to the establishment of the rule of law, and to the respect of human rights and the protection of minorities. Second, to enhance the ability of non-governmental organisations to provide services in areas where such a provision represents an added value and where the state fails or is unable to deliver. This second aspect, initiated by the Government Office for NGOs, and in which they will be fully involved, is particularly relevant in Croatia since the decentralisation of responsibilities from central to local government has started with the delivery of education, health and social services. Municipalities are for the first time required to deliver such services, yet may not have the capacity to do so. The opportunity to strengthen NGOs, as well as encouraging partnerships with local municipalities, will be taken.

6.2.2. Economic and Social Development

High levels of unemployment and low levels of investment are serious impediments to Croatia's development. The lack of economic opportunities in return areas makes a policy of sustainable return extremely difficult to implement, and specific support to address this is to be given in the programme for the return of refugees and displaced persons. However, the programmes identified in this economic and social development priority will also be oriented in particular to return areas, to maximise the economic development potential of those areas. The specific support given to return areas under the democratic stabilisation priority may be extended to other areas of special state concern over the period covered by this Country Strategy Paper.

Trade

Croatia became a member of WTO on 30 November 2000. In this context its trade policy and relevant legislation has been undergoing extensive revision which needs to be continued and successfully completed in the coming years. However, there are still a number of areas in which Croatia will need to make further progress to enable it to benefit from the opening of increased trade possibilities resulting from the Interim Agreement and the SAA and meeting all its WTO commitments. The EC's response will therefore be to support Croatia in this, concentrating on helping it benefit to the maximum from the trade liberalisation, and on assisting in the adoption of the obligations resulting from the SAA and Interim Agreement. The focus will be on agricultural (including processed agricultural products), as well as industrial, standards. Another key area where Community assistance will be directed is the field of consumer protection, in terms of Croatia's undertakings under the SAA.

Investment Climate

The major issue constraining private sector development is the enabling environment, that is the legal, organisational and information framework for business. This enabling environment affects both Foreign Direct Investment (FDI), which has been identified by the Government as a key part of their development policy, and domestic investment. The Community response will be to target a limited number of major identified impediments. Perhaps the most significant example, both in terms of its impact on the business environment and in terms of the size of the task is reform of land cadastre and property registers. Other barriers to private sector development of an administrative nature will also be addressed. An important part of establishing the right investment climate, where the Community has an advantage as a donor and should therefore concentrate its efforts, is in assisting Croatia align its legislation with the *acquis* in trade-related and key internal market areas. The particular needs and problems of war-affected areas will be taken into account, and those areas given priority, under this programme.

Social Cohesion

A coherent approach to social cohesion requires government to develop and implement social policies to reduce income poverty and social inequality. Vulnerable populations, minorities and people with disabilities need to be assured of access to health care, social services, and employment and education opportunities. Since social cohesion concerns all members of society, government must aim to promote society's active participation in decision-making, to restore and encourage civic and social ties, and to develop sound relationships between the state, the market, and civil society.

Within this wider policy framework, the analysis has highlighted that unemployment is a serious problem in Croatia and that the risk of unemployment is closely linked to a lack of education and training, as well as to the restructuring of the economy. The three elements of the Community strategy to respond to these problems and to contribute to social

cohesion in Croatia are vocational education and training, labour market restructuring and higher education. The vocational education and training system is not sufficiently focused on the needs of the labour market, and there appears to be a close correlation between a lack of education and unemployment. A review of the education and vocational education training systems, and upgrading of the skills of the labour force, should therefore be part of a response strategy which aims to address the problem of unemployment. The objective will be to assist in developing a skilled and flexible workforce in Croatia. The second element of the response strategy on social cohesion will be related to the development of an employment policy which seeks to address structural changes resulting from the opening up of the economy and to promote the socio-economic reintegration of the unemployed. The third and final element of the social cohesion programme of the response strategy will be higher education. The objectives will be to contribute to improving the standards in higher education, and to increasing the mobility of students and workers through more standardisation of higher education qualifications with those elsewhere in Europe.

6.2.3. Justice and Home Affairs

Modernisation of Justice

The major challenge in the area of justice is how to improve the functioning of the judiciary system. There are two elements to this, which will form the two strands of the EC response strategy in the justice sector. The first element is the professional capacity of the judiciary. This needs to be enhanced, taking account of the fact that the role of the judiciary in a modern democracy is evolving and that therefore continuous training will be particularly important. The second element is the functioning of courts, where the objective is to improve the way in which they are run, in particular in terms of case management. This will address civil, administrative and penal procedures. In both of these strands, priority will be given to commercial law, in recognition of the crosscutting importance that this has for trade and private sector development. Reduction of the potential for fraud and corruption will be a horizontal priority in this area, as it is for public administration reform.

Policing and Organised Crime

The role of the police is changing in Croatia as a result of the new democratic status of the country, as well as because of the evolving nature of society and crime. To ensure that police officers work effectively and with due regard to the rule of law and other fundamental rights – an essential step in the democratisation process of the country - the organisation of police service, as well as its human resource development, needs to be addressed.

Organised crime may not yet be at the levels of other countries of the region, but the overall trend seems to be upward. In addition, in South Eastern Europe as elsewhere in the world, crime is increasingly organising itself across national borders, taking advantage of an emerging trans-border movement of goods, capital, services and persons. Because of the effects of this on the stability of the country, and because of the regional impact of

organised crime, preventing and combating organised crime will be another priority area for EC assistance. Attention will be given to creating an appropriate legal framework and strengthening the investigative and prosecution capacities of the dedicated services in combating both organised crime - including preventing and combating drugs abuse, trafficking of human beings and money laundering - and corruption. A response to the problem of organised crime must involve co-operation between law enforcement agencies in countries across Europe, a principle which will underlie particularly actions related to organised crime but also all of the institution-building in policing.

Integrated Border Management

Border management problems in Croatia are inter-linked and only a comprehensive solution addressing the various problems can increase their efficiency and effectiveness. For this reason, an overall integrated border management approach is proposed that strengthens controls at the border and facilitates trade across the border. The focus will be on horizontal measures such as developing integrated information and communication systems, and institutional capacity building at the central level. In recognition of the increased irregular migratory flows, and to enhance the movement of people, a comprehensive approach will include also the development of asylum systems and migration management according to European standards. There is also a need to upgrade the capacity and facilities at individual main border crossing points. Such border crossing points will be identified in co-operation with Slovenia, Hungary, FRY and Bosnia and Herzegovina, and following the findings of the JHA assessment missions undertaken through the Regional CARDS programmes.

- The measures taken will focus on facilitating the movement of people and goods as well as reducing illegal movements, the latter in view of Croatia's position at the end of the northern Balkan route. Support will be given to horizontal issues as well as to the identified border-crossing points. Enhanced border control will involve not only strengthening capacities and infrastructure of border police agencies and promoting inter-agency co-operation with migration and asylum services and customs, but also actions on border demarcation and regional crime fighting.
- Facilitating trade will involve strengthening the policy-implementation and operational capacity of institutions such as the Customs administration and veterinary and phytosanitary services, including enhanced procedures and co-operation mechanisms. These institution building measures will be supported by investments in modernising the infrastructure for management along the borders and improving the border management capacity within the country (e.g. multi-agency information systems). This represents a multidimensional approach to border management rather than a linear one.

6.2.4. Administrative Capacity Building

Public Administration Reform

The operation and functioning of the public administration is problematic, while the policy-making capacity of the central public administration also remains weak. Public administration reform is an integral part of the Stabilisation and Association Process, since administrative capacity must be sufficient to develop and implement new legislation and policies. The EC priority will be to assist the Government in its planning and implementation of the reform of the public administration, both at the central and the local level, to develop a modern and professional public service. The major focus of this programme will be the enhancement of the institutional and administrative capacity of those parts of the public administration involved in implementing the obligations outlined in the SAA, with a particular emphasis on legislative, regulatory, organisational, and human resource issues. This will include strengthening the policy planning capacity of the Government in priority sectors identified by the SAA, including inter-institutional co-operation mechanisms. The policy areas selected are public finance, the environment, justice and home affairs, agriculture and competition, complemented by assistance to inter-ministerial co-operation structures. Anti-corruption and anti-fraud measures will be an element of each CARDS project under this public administration programme.

National, Regional and Local Development

Administrative capacity building at the regional and local level is crucial for two main reasons: (i) the ongoing process of decentralisation from the national to the local level; (ii) the development and implementation of a regional policy. The Community interest is to enhance the capacity of all levels of public administration. In terms of decentralisation, local and regional structures must be capable of delivering the services for which they are responsible, and a key component of this Community response strategy will be to assist them in this process. Turning to regional policy development, the development and implementation of a national strategy for regional and local development will also demand increased capacity at regional and local levels. The Community will therefore intervene to help the Government in its policy and legislative development, including the territorial definitions of regions in line with the SAA, and to define and establish or reinforce the institutional structures necessary to support a comprehensive regional and local policy. This will focus specifically on the development of regional and local capacity to plan and manage (economic) development at those levels.

Public Finance

In the field of public finance a key priority is the alignment of internal and external audit, and financial control, with EC standards. This is particularly important in terms of the Government policy of decentralisation, since this cannot be effective without the control systems being introduced or amended. The second part of the programme will help the Government to improve its debt management capacity, to ensure that the risk profile of the portfolio remains within the cost and risk guideline set out in the national budget. The final element of the public finance programme will be support to the customs administration, to help it to develop into a modern and efficient service that improves compliance with the law. This will

complement the specific assistance to customs in the framework of integrated border management.

6.2.5. Environment and Natural Resources

The environment and sustainable development are cross-cutting themes that affect almost all areas of Government policy, and therefore the reforms that it is undertaking. CARDS support will be focused on improving the effectiveness of existing legislation and ensuring the full implementation of future legislation, by building capacity in the administration and in non-governmental organisations, and by publicity and education, including of the consumers and the private sector. Environmental legislation is one of the major parts of the acquis and significant investments will be required to bring Croatia into line with environmental requirements. Particular attention will be paid to the monitoring of the environment. In addition, support, in terms of technical assistance to prepare and undertake investments, to necessary investments consistent with priorities under the acquis and the National Environmental Action Plan (NEAP) will be considered.

6.3. Coherence

The CARDS regulation is the main instrument in support of the Stabilisation and Association Process, and its main purpose is to support participation in the SAP. The SAA that Croatia has agreed with the European Community sets out a large number of specific objectives. This strategy paper seeks to assist Croatia in meeting a number of those commitments within the deadlines that have been agreed. In these cases, the assistance will not only be coherent with EU policies, but will seek to implement them in Croatia.

In the case of exceptional financing need, there is the possibility for the Community to provide macro-financial assistance based on an ad-hoc Council decision. This is also stipulated in the SAA (article 108).

The bulk of CARDS support to the countries of the region is being provided through national programmes. Experience from PHARE and other Community programmes has shown that this approach ensures greater levels of national commitment and ownership, better targeting and impact of projects, and greater efficiency in implementation.

The national programme will be complemented by a small regional CARDS programme, amounting to some 10% of the funds available for the region. This regional programme will intervene in areas where either: (i) the problem addressed is truly cross-border and requires active regional co-operation between the SAP governments if it is to be corrected; or, (ii) there are significant gains to be obtained in terms of efficiency or enhanced impact by implementing through one regional programme instead of five national ones. Concretely, the regional programme will be focused on three priorities: (a) supporting democratic stabilisation, including minority rights, media and good governance; (b) building the capacities of state institutions; and, (c) reinforcing regional infrastructure and environmental development. These priorities are outlined in greater detail in the CARDS Regional Strategy Paper.

The CARDS national programme will ensure as far as possible complementarity with the INTERREG IIIA programme when priorities of the CARDS programme have a cross border co-operation nature, i.e. Integrated Border Management. To this end, close cooperation will be developed between the country concerned, the CARDS and Interreg programmes and the concerned EU member states and candidate countries, including as appropriate the identification of relevant projects in the priority areas of the Multi-annual Indicative Programme and regular reporting of progress.

6.4. Complementarity with EU Member States and other donors

An established mechanism for co-ordination and exchange of information on assistance programmes exists between the Commission delegation in Zagreb and the Member State missions to Croatia. This mechanism enables EU donors to make decisions avoiding duplication of activity or effort, and fostering positive complementarity from an early stage of planning. In terms of specific action, the Commission has a comparative advantage as a donor in support for harmonisation with Community law or practice, given its comprehensive overview of the *acquis* and EU policies. The planned assistance concentrates on those areas, as well as on capacity strengthening and policy advice in order to support the Croatian authorities in their ambitious reform efforts. Member States' actions are complementary to the CARDS assistance strategy in helping the Government achieve its objectives by providing assistance in fields where they have a specific expertise or interest. There are also areas, such as private sector and regional development, where CARDS support will mainly address the institutional framework and Member States might complement this with operational support, for example by fostering co-operation between their business communities, local administrations and civil society.

In terms of other donors, the response strategy is complementary to the World Bank's country strategy, particularly given the Bank's increasing awareness of the European integration objectives of the Croatian Government when conceiving sector reform programmes, including the structural adjustment loan. There are therefore many possibilities for co-operation in policy advice and capacity strengthening. USAID is involved in the fields of financial sector reform, private sector promotion and judiciary support. Effective co-operation on the ground will be needed to co-ordinate interventions in these sectors.

Given that the strategy does not give support to major infrastructure investments, but recognises at the same time that such investments can be important for economic and social development and for regional co-operation, there will be scope for co-operating with IFIs, notably the EIB and EBRD. CARDS assistance would be given for preparation, monitoring and support of projects identified by those donors which are also consistent with the response strategy.

6.5. Risks and assumptions

The social and political situation in Croatia is generally stable. The main objective of the current government is European integration, to which goal it links its reformist agenda. The level of risk associated with the implementation of the strategy could therefore be judged overall as low.

However, there are a number of potential risks to the stability of the current situation which could affect the assistance programming.

The Government plans a number of economic reforms, the most notable being the restructuring of the economy, restructuring of the public sector, privatisation, and the reduction in the size of the welfare state. Such reforms will be painful and could lead to social strain, in particular given the high unemployment rate and the vested interests of the various social groups, ranging from war veterans to pensioners. Such strain would make it difficult to maintain the pace of reform, and could be destructive to social cohesion.

The decision to co-operate fully with ICTY is supported by the majority of the population. It has however been manipulated by certain social groups, backed by some political parties, and presented as anti-patriotic. If such manipulation gains ground and public anxiety grows, there is a risk of additional pressure on the Government which may destabilise the ruling coalition and risk re-orienting policy in this field.

Slippages in the reform timetable, whatever the reason for them, would have wider repercussions. An important one would be the effect on co-operation with donors and IFIs, who would have to re-evaluate their programmes with Croatia. With less external assistance, the pace of reform would falter further.

The Government's financing plan depends on continued borrowing from international capital markets. Either because of the markets' judgements about the internal political situation in Croatia, notably expressed in a worsened credit rating (the scenarios outlined above), or because of a wider economic downturn, the availability of finance may be called into question. This would have an impact on Croatia's budget planning and again on the pace of reform. In addition, rising external debt and debt service combined with limited foreign exchange reserves would put pressure on the balance of payments and curtail economic growth.

Finally, the volatility of the region, remembering recent conflicts and refugee flows, must be taken into account. Although there are no immediate ethnic pressures in Croatia, developments in the region, and in particular in neighbouring FRY and BiH, cannot be ignored.

List of annexes

- Annex 1:** Multi-annual indicative programme
- Annex 2:** Summary of past EC assistance to Croatia
- Annex 3:** Outline of CARDS annual programme 2001
- Annex 4:** Matrix of member state co-operation
- Annex 5:** Matrix of other donor co-operation
- Annex 6:** Main economic trends
- Annex 7:** List of abbreviations

ANNEX 1

MULTI-ANNUAL INDICATIVE PROGRAMME

2002-2004

This multi-annual indicative programme sets out the support which will be given between 2002 and 2004 to the five priorities, and the twelve programmes which make up these priorities, identified in the response strategy of the Country Strategy Paper. These priorities and the programmes within them are:

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1. DEMOCRATIC STABILISATION

1.1. Return of refugees and internally displaced persons

Objectives

- To encourage the return of refugees and internally displaced persons, including especially those from minority groups;
- To increase the sustainability of returns to war-affected areas.

Expected results

- An increase in economic activity in return areas;
- Increased return of minority groups and their full integration into local populations;
- An increased transparency and fairness in application of the provisions of the legal framework at national and local level;
- A less discriminatory access to property by refugees and displaced persons.

Programmes to be implemented

Two aspects of sustainable return can be identified: (i) the existence of economic opportunity in the areas of return, (ii) the efficient and equitable operation of the return process, and good inter-ethnic relations in local communities.

To promote economic development in identified return areas, selected according to objective criteria, CARDS will finance small-scale infrastructure that is necessary for increased economic activity. This will cover rehabilitation and reconstruction of small-scale transport and public utilities infrastructure, as well as the construction of premises suitable for entrepreneurs and start-up businesses. Any de-mining specifically necessary for these infrastructure works will be carried out. These infrastructure investments will only be made where they are integral to and consistent with a local economic development plan that has been developed by the relevant local authority. Such plans are already being developed on a pilot basis in certain municipalities. The extension of this approach will be financed under the national, regional and local development programme set out below. Also consistent with such plans, training will be given to existing and potential entrepreneurs in subjects such as preparation of business plans, financial management, market analysis and export development. This will include training of trainer programmes in the selected return areas, to ensure sustainability.

The support to the proper functioning of the return process will focus on the legal, procedural and integration issues underpinning sustainability of return, the second aspect of sustainability identified above. Concretely, measures will: (a) Support continued legal reform where necessary, and the application of the law effectively and impartially throughout the administration. (b) Build capacity in local municipalities and counties as well as in the central administration as part of ensuring this. (c) Support the Government in resolving return-related property issues, such as the repossession of occupied property, the resolution of lost occupancy/tenancy rights and the non-discriminatory access to reconstruction assistance for damaged property. (d) Finally, and centrally, encourage the integration of minority ethnic groups into local communities. Confidence-building measures between different ethnic groups will be a key part of this.

Indicators of achievement

- The number of potential entrepreneurs assisted to develop, and existing entrepreneurs assisted to improve, their business skills;
- Number of new investors locating in return areas;
- The number of sustainable jobs created;
- An increased number of refugees, including minority groups, in FRY and BiH indicating an intention to return to Croatia;
- An increased number of internally displaced persons, including minority groups, indicating an intention to return to their homes;
- A decreased number of returnees choosing to leave;
- The number of occupied properties returned to property-holders.

Cross-cutting issues

The existence of economic opportunity is key in encouraging return and ensuring its sustainability through successful reintegration of those that return. Other support will be given to private sector development in return areas under the economic and social development priority, in particular the investment climate and social cohesion programmes. Return areas will also benefit from the administrative capacity building priority, in particular the programme related to national, regional and local development. Actions supported in those programmes will prioritise return and war-affected areas. The civil society programme, in particular support to democratisation, will also contribute to the better integration of minorities.

Conditionality

The Government must maintain implementation of its programme for return, including planned budgetary allocations for the Areas of Special

State Concern. Housing Commissions at municipal level need to function effectively, and legal decisions by the competent authorities must be enforced.

Other EC instruments

Assistance under the regional CARDS programme will be given to measures for refugee return that involve more than one country in the region, for example in facilitating the Agenda for Regional Action (AREA) between Croatia, BiH and FRY. De-mining in Croatia is also undertaken with other funds from the general budget of the EU, specifically allocated for actions against anti-personnel landmines.

Several member states have ongoing programmes on democratic stabilisation. USAID has a major programme of reconstruction of municipal infrastructure. One of its strategic objectives in its five-year strategy is the reintegration of war-affected populations. The Council of Europe Development Bank also finances reconstruction for refugee return.¹

1.2. Civil Society

Objectives

- To strengthen the capacity of civil society to contribute to the process of democratisation;
- To strengthen the service delivery capacity of NGOs in areas where the state system fails, or is unable to deliver, certain services to the most vulnerable groups;
- To facilitate co-operation between civil servants and NGOs at national and local level.

Expected results

- A strengthened, more professional, civil society;
- Increased democratisation, consolidation of the rule of law, fuller respect for human rights and protection of minorities;
- Formulation of a law on service delivery by the non-profit sector;
- Increased delivery of services in social assistance, health and education.

¹ Annexes 4 and 5 set out in detail Member State and other donor assistance to Croatia.

Programmes to be implemented

Democratisation: Further to previous funding experience in this field, interventions will firstly strengthen the institutional capacity of civil society organisations operating in the field of democratisation, the consolidation of the rule of law, the fuller respect of human rights and the protection of minorities. The public presence and social impact of civil society groups will be sustained and enhanced through publications, training courses, seminars, workshops, the promotion of networks and alliances, and implementation of specific projects by NGOs.

Service Delivery: Support to service delivery by NGOs will be phased over the three years to reflect the fact that it is an almost entirely new concept in Croatia. In the first instance, support will be given to facilitate the adoption of a law on service delivery by the non-profit sector. This support will include encouraging and enabling the participation of NGOs in the policy making on social welfare. In parallel with policy and legislative development, work should begin to increase the capacity: of local government to administer social, health and education policies; of national and local civil servants to co-operate with NGOs; and of the relevant NGOs to manage the projects. This will be the major emphasis of this part of the civil society component of the programme. The increased capacity of the two partners will enable partnerships to be established between the public administration and civil society, a process, which should also be supported through CARDS. It is intended that there should be some pump-priming, or pilot, financing of the actual delivery of services.

Indicators of achievement

Democratisation:

- Civil society groups are included in any formal consultation process related to adoption of policies in Croatia;
- Establishment of consultative bodies;
- Number of legal service users, number of cases, number of complaints filed at the courts by the legal services;
- The Law on Association includes human rights protection as one of the purposes of forming an NGO;
- Racist propaganda is prohibited.

Service delivery:

- Law on service delivery by the non-profit sector is drafted and enacted;
- Consultative bodies between the different governmental levels and civil society for the delivery of services are created;

- Number of partnerships formally signed;
- Number of beneficiaries of the NGO service delivery;
- Number of new jobs created in the non-profit sector linked to service delivery.

Conditionality

The latter elements of the phased support to service delivery by the non-profit sector will be conditional on the law for service delivery being adopted. Central, regional and local authorities should show willingness and capacity to enter into partnerships with civil society and allocate funds for the delivery of services.

Other EC instruments

The European Initiative for Democracy and Human Rights will complement the small-scale support that is envisaged under this civil society programme. The CARDS regional programme will support regional actions for democratic stabilisation.

Several member states have ongoing programmes of democratic stabilisation. USAID's strategic objectives for its five-year strategy include civil society and governance.¹

2. ECONOMIC AND SOCIAL DEVELOPMENT

2.1. Trade

Objectives

- The exploitation by Croatia of the increased trade possibilities opened up by the SAA and interim agreement.

Expected results

- Adoption of key EU harmonised standards for agricultural, processed agricultural and industrial products;
- An increased capacity to verify and certify that agricultural, processed agricultural and industrial products are meeting adopted standards.

Programmes to be implemented

¹ Annexes 4 and 5 set out in detail Member State and other donor assistance to Croatia.

Under the CARDS programme for 2001, support has been allocated to the harmonisation of legislation on standardisation, metrology and units of measurement, to training and to provision of laboratory equipment. Further residual support, through technical assistance and equipment, to the introduction of EU consistent industrial standards will be given between 2002 and 2004. The focus of this programme, however, will be standards for processed agricultural goods. Agricultural (veterinary and phytosanitary) standards will also be addressed. Support will comprise in all three cases a package of advice, training and equipment to the relevant state institutions. Information and training will also be provided for SMEs operating in sectors covered by the standards adopted.

In line with the SAA provisions relating to consumer protection, the Commission will co-operate with Croatia in order to align the standards of consumer protection to those of the Community. CARDS funding will be oriented to develop the necessary structures in order to ensure market surveillance and law enforcement in this field. Hence projects aiming at (i) the harmonisation of legislation and the alignment of consumer protection with that in force in the Community, and (ii) the development of a policy of active consumer protection through increased information, the development of independent organisations (e.g. NGOs) and effective legal protection for consumers, will be supported.

Indicators of achievement

- Exports from Croatia to the EU of agricultural, processed agricultural and industrial products;
- Number of EU-compatible standards, technical regulations and conformity assessment procedures for agricultural, processed agricultural and industrial products;
- Number of NGOs active in the field of consumer protection.

Cross-cutting issues

A necessary condition for trade development is an efficient and certain commercial legal system. This is being addressed through assistance to modernisation of justice. Another issue inextricably linked to standards, in particular, but to the harmonisation of all legislation in line with the internal market provisions of the interim agreement, is the proper functioning of the customs service. This is being addressed through a dedicated customs programme.

Conditionality

EC support will be conditional on the Government putting prepared legislation on standards, according to the obligations of the SAA and Interim Agreement, into the legislative process. The Law on Consumer Protection must be enacted.

2.2. Investment Climate

Objectives

- To make a substantial and focused beginning to the reform of the land and property system;
- To improve the legal and institutional framework affecting private sector development;
- To improve the trade environment through adoption and implementation of legislation in line with standards and best practice in EU Member States.

Expected results

- A removal of barriers and impediments to investment;
- An increase in domestic and foreign direct investment, in particular in return areas;
- Increased capacity of entrepreneurs to develop their businesses.

Programmes to be implemented

Under the programme for return of refugees and internally displaced persons, specific assistance will be given to return areas, to encourage economic development. However, all the actions financed under this programme to improve the investment climate will also apply to return areas. Indeed, those areas will be given priority and their needs taken into particular consideration (for example in the removal of administrative barriers).

Enabling environment: Substantial assistance will be given to the implementation of the action plan of the State Geodetic Agency and the Ministry of Justice, developed with the World Bank, to reform the land cadastre and land and property registry. This action plan is to be implemented by four specific sub-programmes, in priority locations (return areas, towns, the coast, and islands). CARDS will contribute to the sub-programme to establish a multi-purpose spatial information system. CARDS will also support technical assistance and training activities required to strengthen the two main institutions involved. For the Ministry of Justice this means in particular the land registration offices at the courts, and for the State Geodetic Administration the cadastre offices.

Support will be given to the implementation of the Government's action plan to address the legal and administrative barriers to investment. This will be through technical assistance to assess the best ways of revising legislation and procedures, in line with law and practice in EU Member

States. Assistance will also be given to publicising change to the business community. In addition, set-up support will be given to the “one-stop-shop” to be established by the Ministry of Economy to give advice to investors at a national level.

State aid, public procurement, competition and intellectual property are key legislative areas in restructuring the economy and facilitating trade. For state aid and public procurement, technical assistance support will be given for the drafting of acquis compatible legislation. This will be followed by advice to establish the most suitable administrative and institutional structures to ensure effective and efficient implementation of the legislation. It will also include information and training for business to take on board the requirements of the new legislation. The same implementation support will be given in the cases of competition and intellectual property rights, building on assistance given under the CARDS programme for 2001.

Indicators of achievement

- Number of municipalities with accurate and computerised land and property records;
- Average time taken for new businesses to register;
- Reduced number of administrative requirements for businesses, in particular new domestic and foreign investors;
- Number of clients served by one-stop-shop for investors;
- Degree of compatibility of trade-related legislation to standards in EU Member States.

Cross-cutting issues

The reform and updating of the land cadastre and property registry is important for a number of sectors in addition to private sector development. One of the most important is the return of refugees, to give certainty over ownership of property, and to facilitate de-mining. Reforms to the land and property registry are linked with, and will depend on, wider reforms to the judicial system.

Conditionality

EC support to reform of the land cadastre and land and property registry is dependent on the Government making the financial contribution to the project to which it has committed itself. Support to the “one-stop-shop” will be conditional on the Government committing itself to long-term financial support to guarantee its viability. The Government must review remaining barriers to investment and take steps to remove or lessen them. An independent policy-making/supervising public procurement agency must be established. The Agency for Market Competition must be given

the necessary legal instruments and responsibilities to initiate legal proceedings against unfair market practices.

World Bank, EBRD and Member State programmes for economic development provide direct support to the private sector and complement the assistance from CARDS to the investment climate. The World Bank Structural Adjustment Loan will address some of the issues relating to enhancement of the investment climate.¹ Support foreseen under this programme to the reform of land cadastre and land and property registry will be delivered through CARDS co-financing of the World Bank's project with the Government of Croatia.

2.3. Social Cohesion

The social cohesion component of the programme will comprise three parts, the first relating to vocational education and training (VET), the second to labour market restructuring and the third to higher education. In all parts of the programme priority will be given, where possible, to actions that support the development of return areas.

Objectives

- To implement, on a nation-wide basis, curriculum and teacher training reforms in VET in Croatia;
- To achieve a greater match between the labour market needs and supply;
- To promote the reform of higher education in line with practices in EU Member States.

Expected results

VET:

- Strengthened local and regional management capacity of VET system;
- Improved responsiveness of VET provision to labour market needs.

Labour market:

- Strengthened local, regional and national management capacity of the Employment Service to respond to structural change;
- National employment strategy prepared and agreed;

¹ Annexes 4 and 5 set out in detail Member State and other donor assistance to Croatia.

- Data on employment in line with EU standards produced and disseminated.

Higher education:

- Improved university administration and curriculum development and increased co-operation between Croatian and EU higher education institutes.

Programmes to be implemented

VET: Under the CARDS programme for 2001, support has been programmed for pilot projects in school management and teacher training, and for the development of vocational standards and curricula. This intends to prepare for wider reforms in the vocational education and training system, in particular because of the imperatives of decentralisation of education, including vocational education, to local government. To assist that process of reform, the intervention over the period 2002-2004 will focus mainly on further institutional development. Support will cover: further staff development at the Ministry of Education and Sports; the establishment of a VET research institute and regional VET councils; the development and installation of an education management information system; the establishment of a national system of vocational qualifications, standards and examinations, including curriculum development. The private sector will be involved in the reform process wherever possible. In addition to institutional development, CARDS assistance will also be given to vocational training programmes, in particular in return areas, normally through “train the trainer” programmes.

Labour market: Building upon the experience of the 2001 CARDS project on labour market restructuring, the model to be established by the Croatian Employment Service for addressing staff deployment/redundancies resulting from restructuring, privatisation and military demobilisation (so-called “mobility centres”) will be developed and strengthened. This approach includes education, training and financial support for, for example, self-employment and informal sector activities. The package of measures to address failures in the labour market will be reinforced and the results of its application evaluated. Development of the national employment strategy will also be supported, using experience of Member States, but reflecting the particular situation of the labour market in Croatia. To support and enable development of the strategy, limited technical assistance and training will be given to improve specific employment statistics and in particular a revision of the Labour Force Survey.

Higher education: Continued financial support will be given to the TEMPUS programme of higher educational reform covering Joint European Projects, individual mobility grants and institution building. Assistance will also be given, to the extent that it is not covered by TEMPUS, to develop Croatia’s degree system in line with common EU

practice, to introduce the European Credit Transfer System (ECTS), to promote the Diploma Supplement, to strengthen the European dimension in accreditation and quality assurance and remove obstacles for the mobility of students and staff.

Indicators of Achievement

VET:

- Number of staff of Ministry of Education and Science trained;
- A new VET curriculum is designed, approved and comes into force;
- A regulation on the new competences assumed by local and regional administrations relating to VET is approved and comes into effect;
- A VET research institute, and regional VET councils, are established and financial resources for their functioning are ensured.

Labour market:

- Training for Employment Services staff is carried out at all different levels of the administration;
- Number of mobility centres for pre-layoff assistance set up;
- Number of people benefiting from a labour redeployment fund;
- Publication of employment statistics according to EU standards.

Higher Education:

- Number of exchanges between Croatian and EU higher education institutes.
- Number of qualifications aligned with standards in EU Member States.

Conditionality

The Government must continue with the decentralisation process for vocational education and training. Support to the mobility centres is conditional on the Government making the necessary financial commitment to their long-term functioning. The Law on Higher Education should be enacted, through a consensus between the higher education authorities and the academic community.

Other EC instruments

The European Training Foundation (ETF) is available to advise Croatia in reforming and modernising its vocational education and training and employment systems. An ETF observatory exists in Zagreb.

Several Member States are involved in the education sector. The World Bank has supported a pilot project for mobility centres.¹

3. JUSTICE AND HOME AFFAIRS

3.1. Modernisation of Justice

Objectives

Judiciary:

- To improve the level of competence of Ministry of Justice staff, judges, prosecutors and other court personnel;
- To support the process of adoption and enforcement of EU standards and legislation in line with the requirements of the SAA, and with EU Member States' standards and best practice in judiciary.

Court reform:

- To improve court and case management;
- To improve the information available to courts (and individual judges) and prosecutors' offices (and individual prosecutors).

Expected results

Judiciary:

- Judicial staff (Ministry of Justice, judges, prosecutors and other court personnel) more competent in fulfilling their tasks;
- Improved quality of legislation.

Court reform:

- Improved organisation of both judicial and non-judicial activities in courts;
- More effective supervision of judicial work at court level;
- National information system for statistics, case and document management in place.

Programmes to be implemented

¹ Annexes 4 and 5 set out in detail Member State and other donor assistance to Croatia.

Judiciary: Support to the judiciary and prosecution will be for the education and training of staff of the Ministry of Justice, judges, state prosecutors and other auxiliary court personnel. The intervention will assist in curricula review and design, and in train-the-trainers programmes. Support will also be given to the direct delivery of training in specific areas on a pilot basis. The areas to be covered by these training actions will include: court and case management; familiarisation with EU Member States' standards and best practice in justice and home affairs; new legal areas, such as money laundering, company law, bankruptcy, IT-crime etc.

A second area of support will be technical assistance to improve the drafting of laws and regulations in line with EU standards and best practice. This technical assistance should cover the drafting of laws, their monitoring and verification, as well as the co-ordination with Parliament, Government etc. The assistance will be given to line ministries in line with their concrete needs.

Court reform: There is a lack of communication and mutual understanding between participants in the judicial process, which is clearly detrimental to the Croatian court system. Projects to be implemented should therefore involve all segments of the judicial process, including administrative court staff or judges, as far as is feasible.

Assistance to court reform will cover a number of specific issues, which need to be addressed in order to improve the operation of the court system. These issues can be grouped as: (i) the distribution of tasks within the courts; (ii) the distribution of tasks between courts; (iii) the procedures to be followed throughout the system to ensure optimum treatment of cases; (iv) the necessary technical support to the system.

Indicators of achievement

Judiciary:

- Availability of adequate training facilities and course materials and numbers trained;
- Positive evaluations from judges, prosecutors and auxiliary court personnel on training courses.

Court reform:

- Reduction in the backlog of cases;
- Lengths of time before cases come to trial.

Cross-cutting issues

The reform of the land and property system, and in particular the property registry, is a key part of legal reform in Croatia. Substantial support to

this reform is programmed under private sector development, but should be co-ordinated with this modernisation of justice programme. The other major area of complementarity and coherence is commercial law, since it has a major impact on trade development and private sector development. This will therefore be prioritised in support to the judiciary and to court reform. Finally, an effective reform of the public administration system cannot be achieved without an independent and modern judicial system. Support to the modernisation of justice is therefore key in achieving the objectives of the administrative capacity building priority. Anti-corruption and anti-fraud measures will be an obligatory element of each CARDS project involving public institutions.

Conditionality

The Ministry of Justice must develop a strategy for reform of the judiciary, including in the shorter term a strategy for the reduction of the case backlog.

Other EC instruments

Actions financed under the CARDS regional strategy under Institution Building will complement this programme on justice.

Member States have been involved bilaterally in legal training. USAID has implemented projects in the field of justice reform.¹

3.2. Policing and organised crime

This programme will have two parts: the first addressing policing and the second addressing organised crime, in particular combating trafficking of human being and drugs, and money laundering.

Objectives

- To strengthen the capacity of both the Ministry of Interior and the National Police to efficiently and effectively deal with policing and the fight against organised crime;
- To support Croatia in its steps to adopt the EU Member State standards and best practices in the field of police co-operation and training.

Expected results

Policing:

¹ Annexes 4 and 5 set out in detail Member State and other donor assistance to Croatia.

- Ministry of Interior reformed in line with the principles of the rule of law, with concepts of law enforcement appropriate to modern democracies introduced;
- Croatian home affairs policy meets the requirements of the SAP;
- Policing system has moved towards a decentralised, democratic and publicly accountable one based on the concept of "policing for the community".

Organised crime:

- Specialised law enforcement structures for preventing and combating organised crime and corruption established or reinforced.

Programmes to be implemented

As the basis for other interventions, an analysis of home affairs, policing and organised crime issues will be carried out. This will cover four aspects: a) the legislative and regulatory framework, b) administrative structures and capacity, c) education and training and d) investment in key policing information systems, infrastructure and facilities. An inventory of bilateral, non-operational, police co-operation and training projects between the EU Member States and Croatia will be done to avoid duplication and to identify any omissions.

Policing: The major intervention of the programme will be to assist in redesigning police training system (or process). This will be delivered through assistance to curricula development, training of trainers and pilot training courses, and will have two foci. The first focus will be professional policing capacity. In addition to more traditional police skills CARDS assistance will be given to training for tasks, skills and issues related to: (a) new approaches to policing (community policing, problem oriented policing etc.); (b) police management, accountability and policing ethics; (c) intelligence-led policing, including information technology; (d) inter-agency co-operation (procedures for co-operation, different modes of operation and related sensitivity); (e) problem-solving, conflict resolution and negotiation; (f) prevention of criminality and methods of technical criminal investigation.

The second focus will be to make police officers familiar with EU Member States standards and best practices in relevant fields, in particular related to SAA obligations. This will mean in particular the free movement of goods but also police co-operation.

Assistance will also be given to the Ministry of Interior and the national police service to introduce new regulations, standards, techniques and practices. This will focus in particular on the following areas: (i) A system of accountability to ensure that the rule of law is maintained and that democracy is "practised daily". (ii) The inspection and audit process, to ensure that state bodies maintain human rights and discourage

corruption by vigorous enforcement. (iii) A system of intelligence analysis in operational investigations and intelligence operational training. Underlying all interventions will be the need for police co-operation between law enforcement officers from Croatia and the EU Member States, and candidate and SAP countries.

Organised crime: There will be a number of co-ordinated interventions to assist the combating of organised crime (in particular trafficking in human beings, drugs trafficking and money laundering). (a) Surveillance training; (b) Support to develop intelligence analysis and intelligence operations; (c) Programmes on witness protection, and on informants and undercover operations. (d) New practices in criminal procedures and criminal codes.

Illegal migration via the Balkan route is an increasing problem for Croatia and the European Union. CARDS support will therefore focus on the development of adequate, well co-ordinated and efficient administrative structures to develop and implement policies for managing illegal migratory flows. Croatia will also be assisted in strengthening the institutions and administrative and operational arrangements which ensure the implementation of measures to prevent and combat trafficking in human beings, in particular trafficking of women and children.

In specific relation to drugs abuse and illicit drugs trafficking, support will be given to the production of a national strategy to combat drug abuse and illicit traffic of drugs and pre-cursors, which will be complemented by subsequent sector strategies and action plans in line with standards and best practices in EU Member States. These strategies and plans should be balanced and integrated so that drug demand and drug supply reduction are seen as equally important and mutually reinforcing parts of the strategy. The strategies and action plans will focus on reviewing the current legal and regulatory framework, on reducing the supply of drugs, and on law enforcement. Once the action plans are in place, support will be given to the implementation of the key planks. This may include the establishment of a drug information system, and networking with EU Member States, the candidate and SAP countries to reinforce the co-operation.

Interventions on money-laundering will commence with an analysis of the existing Croatian actual legal framework against European legislation and, if necessary, the drawing up of proposals to amend the law to increase its effectiveness. Support will be given to ensuring international co-operation with financial intelligence units in EU Member States and EU partner countries. In addition, a money-laundering information system should be designed and put into place, and networking with EU Member States, the candidate and SAP countries supported.

Indicators of achievement

Policing:

- Number of police officers completing redesigned training modules;
- Degree of compatibility with other EU Member States law enforcement agencies.

Organised crime:

- Number of networking activities between police services that take place;
- Extent to which national legislation is harmonised with standards and best practice in EU Member States in relation to the combating of organised crime;
- Number of successfully concluded national and international operations to counter organised crime.

Cross-cutting issues

Anti-corruption and anti-fraud measures will be an obligatory element of each CARDS project involving public institutions.

Conditionality

The Ministry of Interior should undertake to reorganise its human and other resources in accordance with the best practices of EU Member States. The Ministry must ensure a consistent implementation of the Civil Service Act so as to professionalise recruitment and career advancement practices. The Law on money-laundering must be revised, intensifying the co-operation between the Croatian Central Bank and the law enforcement services of the Ministry of Interior. The Government must fulfil policy and financial commitments to the Office for the Prevention of Corruption and the Fight against Organised Crime to ensure that it is operational. Croatia must co-operate with neighbouring countries in combating organised crime.

Other EC instruments

Actions financed under the CARDS regional strategy under Institution Building (regional police and judicial co-operation) will complement this programme on policing and organised crime.

3.3. Integrated Border Management

An overall integrated border management approach is required in Croatia to strengthen controls at the border and to facilitate trade across the border. To manage the phenomenon of increased irregular migration, Croatia also needs support to augment its asylum systems and migration management capacities.

This is an ambitious but necessary approach that has clear national policy implications. It is therefore imperative that Croatia has the time to discuss and develop coherent strategies on these issues in close co-operation with its international partners. To this end, in 2002-2003 there will be a focus on strategy and programme preparation, with substantive implementation measures taking place in 2003-2004. However, emergency programmes may be addressed earlier where clearly identified.

The integrated border management approach adopted by CARDS is further detailed in the CARDS Regional Strategy Paper. CARDS regional funds will be used to ensure regional co-operation and networking between the national agencies involved in the area of integrated border management

3.3.1.1. Strategy Development

Objectives

- To develop and implement national strategies for integrated border management, for augmented asylum systems and for migration management capacities for Croatia, defining the overall goals and supported by sectoral and inter-agency work plans.

Expected results

- An Integrated Border Management Strategy that has been agreed by all Government agencies with competence at the border, as well as agreed for issues of common interest with neighbouring countries (e.g. deciding priority crossings or common customs approaches);
- Croatian asylum and immigration legislation aligned with international conventions; penal legislation on trafficking and smuggling in human beings in conformity with the 2000 Palermo convention; visa regime consistent with EU introduced;
- Increased regional co-operation on asylum and immigration.

Programmes to be implemented

Support will be given in 2002/2003 to the Government for the development of strategies for integrated border management, asylum systems and migration management and for the technical preparation of the specific programmes. In general, the strategy process will: (i) detail Croatia's strategic goals in this area, based on a clear analysis of problems and work already completed; (ii) institution and capacity building of individual agencies with competence at the border, (iii) involve detailed discussions and agreement within an inter-service working group of the involved agencies; (iv) identify strategic priorities, programmes and indicators of achievement; and, (v) prepare clear and feasible work plans (including specifying studies, technical specifications

and terms of reference to be produced) that will be needed to ensure implementation of the strategy.

CARDS regional funding will be available to ensure regional networking of involved national agencies between the SAP countries

Indicators of achievement

- Production and implementation of strategy, work plans and agreement with neighbouring countries on key issues of common interest.

3.3.1.2. Trade facilitation

Challenge addressed

Low levels of regional and international trade.

Objectives

- To facilitate the flow of trade with Croatia's SEE neighbours and with the EU and candidate countries.

Expected results

- Increased levels of regional trade;
- Completion of border crossings as specified and scoped in the national strategy;
- Fully integrated facilities (i.e. border police, customs and phytosanitary/veterinary) by 2006 at the major border crossings on Pan-European Networks (PEN);
- Facilities on second priority crossings where agreed by the two neighbouring countries involved and included in Croatia's border management strategy, although these will be less extensive than those on PENs;
- Enhanced institutional capacities of key agencies involved, including co-operation with counterpart agencies in neighbouring countries.

Programmes to be implemented

Work has been done on customs and border crossings and Croatia has recently signed a World Bank Transport and Trade Facilitation Southeast Europe project (TTFSE) loan. The integrated border management strategy will incorporate this on-going work. CARDS funding will be used to help implement the agreed strategy, alongside national and other donor and IFI activities, specifically financing institutional strengthening programmes, border crossing improvements, and necessary technical work, including studies and training.

The first priority, and pre-requisite of work on individual border crossings and in-land facilities, will be support to strengthen the national institutions (primarily customs and veterinary and phyto-sanitary agencies) involved in processing and handling trade. A specific support to customs is also part of this multi-annual programme. Improvements to infrastructure linked to strengthening of institutions, for example centralised information technology system, will also be financed where necessary.

Focusing on developments at individual borders, studies to measure crossing times and identify trade flow problems, will be assisted. These will focus on procedural and technical rather than infrastructural improvements, for example co-ordination of closure times at border posts or simultaneous processing by involved agencies.

Co-ordination with World Bank

Co-ordination with the World Bank Transport and Trade Facilitation Programme for South East Europe will be particularly important in the area of trade facilitation and shall be conducted through regular review mechanisms and direct co-operation. Clear demarcation of activities between the two programmes will be addressed within the national integrated border management strategies.

3.3.1.3. Border security

Challenge addressed

High levels of organised crime and corruption.

Objectives

- To establish greater security at international borders that will diminish cross border crime and illegal migration, and at the same time facilitate cross border movement of people by developing and implementing asylum and migration policies.

Expected results

- Effective border security management (i.e. control and security) systems integrated with national police systems.
- Asylum and migration policies developed and implemented in line with EU acquis and European standards and best practice.

Programmes to be implemented

Support to border security, asylum and migration policies will include equipment and infrastructure but, as a conditionality, this will be preceded and complemented by assistance on institution and capacity building to ensure coherence, sustainability and the overall enhanced effectiveness of the institutions involved.

3.3.1.4. Complementarity and Co-ordination

The funds for integrated border management have been transferred from the regional CARDS envelope, reflecting the key role played by border management in promoting regional co-operation as required under the SAP (see Regional CARDS Strategy).

In addition to these funds allocated from the CARDS regional budget, allocations to other programmes within this national multi-annual programme have also been made to areas linked to integrated border management, reflecting the substantial costs involved and the numerous sectors touched upon both directly and indirectly by border control and trade facilitation. This refers to norms and standards (trade facilitation), the customs assistance programme, policing and modernisation of justice.

Actions in the field of asylum and immigration will take into account the co-operation between Croatia and Germany, Austria and Slovenia in the context of the Stability Pact working Migration and Asylum Initiative.

Given the need to develop integrated border management strategies, and to undertake pre-required institution-building work, in 2002/2003 it has been decided to back-load the financing of the integrated border management programmes to 2004. Funds have already been allocated in 2001 to start this integrated border management in Croatia. Croatia will also have access to a €15 million allocation for general project preparation allocated under the regional CARDS programme for work in this area.

Anti-corruption and anti-fraud measures will be an obligatory element of each CARDS project involving public institutions.

Conditionality

Croatia must co-operate with its neighbouring countries in policing borders and in facilitating the movement of goods.

4. ADMINISTRATIVE CAPACITY BUILDING

4.1. Public Administration Reform

Objectives

Civil service reform:

- To assist in the development and implementation of the civil service reform programme underway in Croatia, including changes to the civil service law, professionalisation of the service, and development of administrative procedures in conformity with EU standards;

- To develop the capacity of public institutions to implement efficiently and effectively their core public administration duties;
- To reinforce the accountability and transparency of Croatia's national and local public administration.

Administrative capacity:

- To assist in the creation, development and strengthening of the legal framework and the administrative capacity in selected priority policy areas which are crucial for implementation of the SAA.

Anti-corruption:

- To strengthen the capacity of the Croatian State institutions in the fight against public fraud and corruption, and against related organised crime involving national officials.

Expected results

Civil service reform:

- New civil service law adopted;
- Increased professionalism of the service;
- Administrative systems in conformity with EU Member State standards and best practices.

Administrative capacity:

- Improved efficiency and effectiveness of public administrations in the selected priority policy areas;
- Clear work plans relating to the implementation of the regional co-operation components of the SAA established.

Anti-corruption:

- Improved legal and institutional framework for the prevention and fight against public fraud and corruption and related organised crime in line with the standards of EU Member States;
- Respective competencies of different services in investigating and prosecuting corruption cases well defined;
- Investigating and prosecutorial staff more competent in dealing with cases of public corruption.

Programmes to be implemented

Public administration reform forms an integral part of the Stabilisation and Association process, since it addresses the administrative capacity to

develop and implement new EU-related legislation and policies. While legislation may be in place, the institutional capacity to implement that legislation is rather low in the Croatian national administration. This process of legislative change, in particular related to the SAA, will therefore set the framework for CARDS support to public administration reform.

The starting point for this CARDS programme will be support to the ongoing civil service reform programmes of the Government. The further specific interventions on public administration will reflect a vertical approach, that is to say that specific policy areas will be identified and direct support given to enhancing the administrative capacity of line-ministries and relevant state agencies, and to developing inter-institutional co-operation on that specific policy. These areas are public finance, the environment, justice and home affairs, agriculture, and competition, complemented by assistance to inter-ministerial co-operation structures. This greater focus on a limited number of priority areas is critical if advances are to be made in the medium term. The type of assistance provided also needs to be appropriate, meaning it should employ a range of instruments and extend beyond short-term technical assistance advice.

Civil service reform: Assistance will be given to introducing new approaches to civil service and public management based on the traditions and situation of Croatia, as well as principles common to the EU Member States (subsidiarity; neutrality and impartiality; responsiveness to the Government and accountability to the public; transparency; modern human resources management and development systems; recruitment and promotion systems based on merit). Assistance will also be given to raise awareness and build confidence in the structures of the State and in the public administration and services by its citizens.

Administrative capacity: Assistance will be given to establishing and further developing the governmental structures (organisational arrangements, decision-making processes, management framework and practices, etc.) dealing with public administration reform and European integration. Support will be given to the provision of legal and policy advice, training and other exchange of information/experience mechanisms for public officials in the selected sectors in order to familiarise them with the *acquis* and standards and best practice in EU Member States. This will focus in particular on the following areas: (i) General institution building and public administration reform matters; (ii) Feasibility and impact studies relating to the implementation of the obligations of the SAA; (iii) Development and delivery of specialised training, information and screening seminars on the selected priority areas, as required under the SAA.

Anti-corruption: Technical assistance will be provided to help the Government review and improve the legal and institutional framework for the prevention and fight against public fraud and corruption and

related organised crime. The aim of this will be to strengthen the capacity of the authorised investigation and prosecution institutions. The review will cover a gap and a needs analysis of administrative procedures in areas such as taxes, certification and licensing, customs etc. (identified as main areas causing public fraud and corruption). Support will also be given to drafting, and the implementation of, a training strategy based on a training need analysis, including an action plan for a training delivery system and delivery of professional training for specialised staff.

Indicators of achievement

Civil service reform:

- Number of regulatory texts drafted and eventually adopted and implemented;
- Number of specific institutional statutes harmonised with the mainstream civil service law;
- Number of pilot sectoral training policies designed and adopted;
- Number of civil service recruitments organised in accordance with new recruitment system;
- Length of time which young graduates stay in the civil service after entry.

Administrative capacity:

- The number of permanent contacts established with similar institutions in Europe.

Anti-corruption:

- Number of significant cases of public corruption investigated and brought to court.

Cross-cutting issues

An efficient public administration is important to many parts of this multi-annual indicative programme. Each CARDS programme targeting public institutions will therefore include an administrative capacity building component. Although this programme contains a dedicated sub-programme to address corruption, anti-corruption and anti-fraud measures will also be an obligatory element of each CARDS project involving public institutions.

Conditionality

A public report must be submitted to the Parliament presenting the aims and results of the governmental anti-corruption policy and containing all information on the number of investigations, prosecutions, court cases

and convictions, as well as a summary of judicial decisions related to bribery of public officials in business transactions. The Government must maintain its commitment to implement reforms.

Other EC instruments

Actions financed under the CARDS regional strategy under Institution Building (regional police and judicial co-operation) will complement this programme on public administration reform.

Several Member States are involved in public administration reform, good governance, and anti-corruption projects.¹

4.2. National, Regional and Local Development

Objectives

Decentralisation:

- To increase the capacity of local government to manage decentralised services.

Regional policy:

- To help the Government define a national strategy for regional and local development;
- To establish appropriate institutional structure, capacities and mechanisms for strategic planning at national, regional and local level.

Expected results

Decentralisation:

- An effective delivery by local government of services in health, education and social welfare, in line with their decentralised responsibilities.

Regional Policy:

- An agreed national strategy for regional policy;
- Regions defined consistently with EU standards;
- Accurate regional statistics for the main social and economic indicators available at NUTS II level.

¹ Annexes 4 and 5 set out in detail Member State and other donor assistance to Croatia.

- The completion of local economic development plans by targeted municipalities.

Programmes to be implemented

Decentralisation: Support to decentralisation will be given in a phased and integrated way in a number of areas. Technical assistance will be given to ensure that the basic legal framework required for implementing the decentralisation programme is appropriate and is in place. Support will also be given to the definition of the distribution of public resources (revenues and expenditure) to match the decentralised model of public administration. The Government will also be assisted in the formulation of a programme for “vertical” decentralisation of administrative functions and responsibilities to sub-national levels of government and public administration. Finally, support will be given to the implementation of the territorial decentralisation process, mainly by strengthening the capacity of sub-national levels of government and administration.

Regional Policy: Support would first be directed to the development by the Government of a strategy for regional policy. This will build on development work supported by OBNOVA, which has mobilised key players. On-going support should promote an inclusive approach, in order to obtain widely based support. A substantial programme of assistance will be given to the process of elaborating this strategy in practical terms, i.e. in terms of defining and setting up a suitable institutional framework supported by laws setting out the respective responsibilities for regional policy planning. This will also include assistance for a definition (geographically) of the NUTS regions, in accordance with the requirements of the SAA, which would be appropriate for both statistical and administrative purposes. Specific support will be given to the development of statistical systems to improve the collection and analysis of regional statistics.

Throughout the period, comprehensive technical assistance support will be given to increase the planning and programming capacities of both local authorities and social and economic partners at regional and local level. This will focus in particular on the development of local economic development plans, which will be a basis for investments in infrastructure supported under the component for private sector development.

Indicators of achievement

- Number of regional structures to support decentralised administration and a regional development policy established;
- Number of local economic development plans developed and agreed;
- The number of social and economic statistics available at NUTS II level.

Cross-cutting issues

The process of decentralisation of service delivery to local government is being supported also through the programme for civil society, where the interventions will encourage partnerships between local government and NGOs for effective delivery. In terms of regional policy, the local economic development plans that will be elaborated in individual municipalities are a pre-condition for accessing funds under the private sector development programme. The development of regional policy will be important in promoting growth in return areas. These areas will therefore be priority for the development of local economic development plans. Anti-corruption and anti-fraud measures will be an obligatory element of each CARDS project involving public institutions.

Conditionality

The Government must make the necessary financial arrangements to accompany decentralisation of responsibilities from central to local level. Support to the development of a regional policy is dependent on the Government demonstrating commitment to adopting and implementing such a policy.

USAID and the Open Society are involved in local self-government and decentralisation projects.¹

4.3. Public Finance

Objectives

- To improve the performance of internal and external audit in the public administration;
- Development of the Government's debt management capacity;
- The modernisation of the customs service so that modern customs practices are applied uniformly and consistently;
- To improve the quality of public finance statistics to enable improved management of public finances.

Expected results

- Improved budgetary and accounting rules within the public administration, in line with standards and best practice in EU Member States;
- The risk profile of the public debt portfolio remains within the limits set by the budget;

¹ Annexes 4 and 5 set out in detail Member State and other donor assistance to Croatia.

- Customs control operations at ports, airports, land borders and inland are capable of facilitating the flow of legitimate passengers and trade;
- Public finance statistics produced according to the latest international standards (IMF).

Programmes to be implemented

Audit: The objective of the assistance will be to introduce and enhance audit procedures in the public administration, particularly to facilitate the process of decentralisation from the national to local administrations. Improved internal and external audit procedures will increase the transparency and accountability of the budget. Support will be to develop new principles and procedures, and to increase the capacity of staff at all levels of the public administration to implement these.

Public Debt: To ensure that the public debt is effectively managed, i.e. that the desired risk profile can be achieved, support will be given to the Ministry of Finance to train staff in management of the multi-currency portfolio. This will specifically cover the appropriate procedures, according to best practice in EU Member States, as well as the information technology needs to support these procedures. Limited technical assistance and training will be given to the Central Bureau of Statistics in order to introduce new methods for producing specific, key, public finance statistics.

Customs: Support will be provided through technical assistance and training, principally provided by EU member state customs officials. The focus will be on providing the legal base for customs reform, strengthening headquarters structures (including strategic planning and reporting, communication, human resource management, internal audit etc.) streamlining customs procedures, improving customs compliance and enforcement of customs regulations and procedures, and developing training structures and associated training. Assistance will also be provided to improve customs IT, where gaps/weaknesses have been identified as necessary to improve procedures and performance. Assistance will be closely co-ordinated with other reform activities in this field (e.g. World Bank TTFSE programme and US customs).

Indicators of achievement

Audit:

- The number of incorrect or illegal transactions carried out;
- The time taken to conclude audit procedures.

Debt management:

- The degree of perceived vulnerability of Croatia's external and domestic debt towards interest and exchange rate movements.

Customs:

- The time taken for passengers and goods to cross borders and the efficiency with which they are handled;
- Increased number of detections and seizures of smuggled goods.

Cross-cutting issues

The development of effective internal and external audit is essential in the process of decentralisation. The support given to this under this public finance programme will therefore complement the support being given to decentralisation under the national, regional and local development programme. The support to customs in this programme will be fully complementary to and integrated with the integrated border management programme. Anti-corruption and anti-fraud measures will also be an obligatory element of each CARDS project involving public institutions.

Conditionality

The Ministry of Finance must strengthen the Budget Law and supporting legislation and the central organisations (especially their reinforcement mechanisms) overseeing budgeting, treasury functions and internal control. The Budget Law should be amended to establish formally the Budget Supervision Office within the Ministry, increasing the penalties for overspending budgeted resources and violating of the Budget Law. The Budget Supervision Office should be strengthened with additional staff and resources to carry out its duties properly.

The financial and functional independence of the Croatian State Audit Office should be guaranteed constitutionally.

The World Bank SAL will address some of the fiscal problems identified in its report on Public Expenditure and Institutional Review.

5. ENVIRONMENT AND NATURAL RESOURCES

Objectives

- To contribute to the process of alignment of environmental legislation with the acquis;
- To integrate sustainable development into all sectors through the use of environmental impact assessments;
- To promote renewable energy sources and energy efficiency;

- To increase the impact of existing environmental legislation.

Expected results

- An agreed strategy for EU approximation in the field of the environment;
- The systematic use of environmental impact assessments for investment proposals;
- An improved system of environmental monitoring.

Programmes to be implemented

Initial work has already been done on a legislation gap analysis between Croatia's environmental legislation and the acquis. On the completion of this work, CARDS support, in the form of technical assistance and training, will be given to the development of a methodology for a cost estimate study. This will be followed by support to the process of drafting and agreeing, by all the relevant stakeholders, of an EU approximation strategy that would include specific deadlines. The involvement of a large number of stakeholders is necessary to ensure a well-rooted commitment to implementation.

A law on environmental impact assessments (EIA) already exists. However, it is crucial for the improvement of the environmental situation and for consistency with the environmental acquis that such assessments are routinely and properly carried out to a standard in line with that performed within the EU. Assistance, to build capacity, will be given to the Ministry of Environmental Protection and Physical Planning to help them manage this process. Support will also be given, in this context, to environmental NGOs to ensure the necessary public participation in the EIA process. Financing of environmental NGO pilot actions in the field of lobbying and advocacy will also be part of this programme to create a wider public awareness of environmental issues, laying the groundwork for long-term environmental protection.

The environmental situation cannot be improved unless the authorities have an accurate picture of the actual situation. Monitoring of environmental data is also required as part of the co-operation with the European Environment Agency. Support will be given to Croatia, through the establishment of topic centres, to upgrade substantially its capability to monitor the environmental situation in the country. In parallel with the support to improve the accuracy and detail of the data that can be collected, assistance will be given to ensure that the data are presented in the right format to allow comparability with other countries.

Finally, technical assistance support to prepare and carry out projects will be given to investments in the priority areas of air quality, solid waste management and water quality, consistent with the national environmental action plan. In the case of small-scale investments having

a demonstration value (for example a pilot taking place on an island where experience can be spread), the investments themselves may be funded. In the case of larger investments, they are likely to be funded mainly from national sources with the support of IFIs.

The promotion of renewable energy sources and of energy efficiency will underpin this programme.

Indicators of achievement

The number of stakeholders actively involved in drafting the approximation strategy; the number of stages of the action plan of the strategy that are achieved; the number of properly implemented environmental impact assessments carried out; quality of environmental data produced; number of demonstration investment project supported; number of environmental improvement projects on which there is co-operation with IFIs

Conditionality

The Government must adopt the EU approximation strategy. The environmental impact assessment legislation must be applied where relevant. Support to the topic centres is conditional on the Government committing to ongoing financial support.

Other EC instruments

Croatia can benefit from the LIFE-third country programme, as well as participating in the Regional Environmental Reconstruction Programme for South and Eastern Europe.

A number of IFIs are active in the field of environmental infrastructure, including in particular the EBRD, EIB and the World Bank.

Financial breakdown by priority (€ million)

Priority	Measures	Annual allocations (€ million)			Total 2002-2004
		2002	2003	2004	
1. Democratic Stabilisation	1.1. Return of refugees and internally displaced persons	14.0	15.0	13.0	42.0
	1.2. Civil society	2.0	2.0	2.0	6.0
2. Economic and Social Development	2.1. Trade	3.0	2.5	2.0	7.5
	2.2. Investment climate	9.0	9.0	8.5	26.5
	2.3. Social cohesion (including Tempus)	6.0	6.0	6.0	18.0
3. Justice and Home Affairs	3.1. Modernisation of justice	4.0	4.0	4.0	12.0
	3.2. Policing and organised crime	2.0	3.0	3.0	8.0
	3.3. Integrated border management (Regional funding)	4.0	5.0	14.0	23.0
4. Administrative Capacity building	4.1. Public administration reform	6.0	6.0	6.5	19.0
	4.2. National, regional and local development	2.0	3.0	3.0	8.0
	4.3. Public finance	4.0	3.5	3.0	10.5
5. Environment and natural resources		3.0	3.0	3.0	9.0
TOTAL		59.0	62.0	68.0	189.0

The indicative allocation available to Croatia between 2002 and 2004 is €166 million, plus €23 million from the regional programme which is being implemented nationally.

ANNEX 2

EC Co-operation assistance to Croatia 1991 – 2000 (in € million)

	1991 – 1995	1996	1997	1998	1999	2000	Total
Obnova (reconstruct)		€ 7.02 m	€ 8.59 m	€15.00 m	€15.00 m	€12.34 m	€ 57.95 m
Obnova (technical assistance)						€ 4.5 m	€ 4.5 m
Democracy and Human Rights, Media	€ 0.39m	€ 1.44m	€ 3.87 m	€ 5.06 m		€ 0.9 m	€ 7.78 m
De-mining				€ 1.0 m	€ 0.5 m		€ 1.5 m
Customs (DG XXI)					€ 1.0 m		€ 1.0 m
ECHO	€243.2m	€21.15 m	€14.5 m	€ 6.95 m	€ 8.0 m		€293.8 m
Tempus						€ 1.5 m	€ 1.5 m
Energy (Stability Pact)						€ 0.5 m	€ 0.5 m
LIFE	€ 0.7m			€ 0.76 m			€ 1.46 m
TOTAL	€244.29m	€29.59m	€26.96 m	€24.9 m	€24.5 m	€18.84 m	€369.09m

ANNEX 3

ANNUAL PROGRAMME 2001

I. Political Priorities	€23.2m
Refugee return – reconstruction and related issues	€19.0m
Refugee return –economic sustainability	€ 4.2m
II. Economic Development	€14.4m
Human capital	€ 7.6m
EU industrial standards	€ 3.0m
Energy infrastructure rehabilitation	€ 3.8m
III. SAA Obligations	€20.4m
Justice and home affairs	€ 3.6 m
Integrated border management	€ 8.5 m
Customs	€ 2.0 m
Public administration reform	€ 4.8 m
Statistics	€ 1.5m
IV. Complementary Measures	€ 2.0m
Small Scale Operations	€ 1m
Strategy development capacity building	€ 1m
TOTAL	€60.0m

ANNEX 4

EUROPEAN UNION ONGOING CO-OPERATION WITH CROATIA

Updated on: 01 October 2001

<i>Member States</i>	<i>Areas of intervention (all amounts are given in €):</i>						<i>Total</i>
	<i>Democratic stabilisation²</i>	<i>Economic and social development</i>	<i>Justice and home affairs</i>	<i>Administrative capacity building</i>	<i>Environment and natural resources</i>	<i>Other fields</i>	
<i>Austria</i>	1.802.769	675.564		100.000			2.578.333
<i>Belgium</i>	247.900					111.060	358.960
<i>Denmark</i>	180.944			235.000	420.000		835.944
<i>Finland⁴</i>	156.000	7.500	11.500				175.000
<i>France</i>	157.940		153.412	211.775	120.890	1.017.681	1.661.698
<i>Germany</i>	3.767.308	5.955.336	1.025.000	2.345.421	9.047.608	25.000	22.165.673
<i>Greece</i>							0
<i>Ireland³</i>							
<i>Italy⁵</i>		5.112.929	57.969	288.322			5.459.220
<i>Luxembourg³</i>							
<i>The Netherlands</i>	3.548.723	2.869.052	603.073	406.640	1.782.825	36.302	9.246.615
<i>Portugal</i>							0
<i>Spain</i>	1.500.000		40.000			100.000	1.640.000
<i>Sweden</i>	3.721.137			166.000	9.000		3.896.137
<i>United Kingdom</i>	2.158.701	639.284	171.485	4.545.306		159.821	7.674.597
Total	17.241.422	15.259.665	2.062.439	8.298.464	11.380.323	1.449.864	55.692.177

Explanations:

¹ The phrase "ongoing co-operation" means that only the projects under implementation are included in this table, since this table is aimed for co-ordination purposes only.

² The column "Democratic stabilisation" includes funds allocated for return of refugees and reconstruction.

³ Ireland and Luxembourg do not have embassies in Zagreb and data were not available.

⁴ Under the framework of the Stability Pact, Finland is participating in the following programmes in Croatia: ERNO, PISA, SPAI and Investment Compact.

⁵ Italy operates projects in the fields of combating organised crime, organic agriculture and post-graduate education, but those data are not available and not included in the matrix.

Source: member states.

ANNEX 5

MATRIX OF OTHER DONOR FUTURE CO-OPERATION WITH CROATIA

Updated on: 30 August 2001

AREAS OF INTERVENTION	DONORS					
	UNDP	EBRD	EIB	IMF	USAID	WB
1. GOVERNMENT OF THE REPUBLIC OF CROATIA/PUBLIC SECTOR						
INSTITUTIONAL SUPPORT TO GOVERNMENT MINISTRIES						
<i>Ministry of Finance</i>				✓	✓	✓
<i>Ministry of Foreign Affairs</i>						
<i>Ministry of Public Works, Reconstruction and Construction</i>						✓
<i>Ministry of War Veterans</i>						
<i>Ministry of Agriculture and Forestry</i>						✓
<i>Ministry of Crafts, Small and Medium Enterprises</i>						
<i>Ministry of Justice and Administration</i>						✓
<i>Ministry of Education and Sports</i>						
<i>Ministry of Tourism</i>						
<i>Ministry of Science and Technology</i>						
<i>Ministry of Defence</i>						
<i>Ministry of Interior</i>						
<i>Ministry of Economy</i>					✓	
<i>Ministry of Culture</i>						
<i>Ministry of Maritime Affairs, Transport and Communications</i>						
<i>Ministry of Environment and Urban Planning</i>	✓					✓
<i>Ministry of Labour and Social Welfare</i>						✓
<i>Ministry of Health</i>						✓
<i>Ministry for European Integration</i>						
<i>Croatian National Parliament</i>						
<i>Croatian National Bank</i>				✓	✓	
<i>Croatian Privatisation Fund</i>					✓	✓
TECHNICAL ASSISTANCE AND CAPACITY BUILDING						
<i>Public administration reform</i>						✓
<i>Local government reform</i>					✓	
<i>Labour market reform</i>						✓

<i>AREAS OF INTERVENTION</i>	<i>DONORS</i>					
	<i>UNDP</i>	<i>EBRD</i>	<i>EIB</i>	<i>IMF</i>	<i>USAID</i>	<i>WB</i>
<i>Education reform</i>					✓	
<i>Economic reform</i>				✓	✓	✓
<i>Commercial law reform</i>					✓	
<i>Pension system reform</i>					✓	✓
<i>Prison reform</i>						
<i>Judicial reform</i>					✓	✓
<i>Police reform</i>						
<i>Health sector reform</i>					✓	✓
<i>Social welfare reform</i>						✓
<i>Land registry/cadastral</i>	✓				✓	✓
<i>Economic policies</i>				✓	✓	✓
<i>Monetary policy</i>				✓		
<i>Employment policies</i>						✓
<i>Regional and local development policies</i>	✓					✓
<i>Agricultural policies</i>						✓
<i>Industrial policies</i>						
<i>Taxation</i>				✓	✓	
<i>Customs</i>				✓	✓	✓
<i>Transport</i>						✓
<i>Energy</i>	✓				✓	✓
<i>Nuclear safety</i>						
<i>Disaster management</i>						
<i>Cross-border arrangements</i>						✓
<i>Law enforcement</i>						✓
<i>Anti-corruption, good governance and competition rules</i>					✓	✓
<i>International/organised crime and other illegal activities</i>						
<i>Illegal migration</i>						
<i>Illegal narcotics</i>						
<i>Intellectual, industrial and commercial property</i>						
<i>Consumer protection</i>						✓
<i>Information society</i>					✓	✓
<i>Electronic communication infrastructure and associated services</i>						✓
<i>Social co-operation (industrial and labour market restructuring, social security system, legislation on working conditions and equal opportunities, health protection and safety of workers)</i>	✓				✓	✓
<i>Competition in the audio-visual field</i>						✓
<i>Cultural co-operation</i>						

AREAS OF INTERVENTION	DONORS					
	UNDP	EBRD	EIB	IMF	USAID	WB
<i>Co-operation in research and technological development</i>						
<i>Co-operation with the Central Bureau of Statistics</i>				✓		✓
<i>Others</i>						
INFRASTRUCTURE						
<i>Public utilities</i>		✓				✓
<i>Energy</i>	✓	✓	✓			✓
<i>Transport</i>		✓	✓			✓
<i>Telecom</i>		✓				
<i>Regional and local development</i>	✓	✓				
<i>Others</i>						
EU INTEGRATION ISSUES						
<i>Law approximation (Acquis)</i>						
<i>Others</i>						
2. CIVIL SOCIETY/NON-PROFIT SECTOR						
NGOS/COMMUNITY ORGANISATIONS						
<i>Trade unions</i>					✓	
<i>NGO training/capacity building</i>					✓	✓
<i>NGO project funding</i>					✓	✓
<i>NGO technical assistance</i>					✓	
<i>Others</i>						
MEDIA						
<i>Croatian Radio and Television (HRT)</i>						
<i>Independent TV channels</i>					✓	
<i>Independent radio stations</i>					✓	
<i>Print media</i>						
<i>Journalism training</i>					✓	
<i>Journalists' or press associations</i>					✓	
<i>Others</i>						
REFUGEE ISSUES						
<i>Reconstruction</i>					✓	
<i>De-mining</i>	✓				✓	✓
<i>Property and other legal rights</i>					✓	✓
<i>Economic revitalisation projects</i>	✓				✓	✓
<i>Community services and humanitarian aid</i>					✓	✓
<i>Support to the UNHCR and other UN agencies</i>					✓	
<i>Others</i>						✓
DEMOCRATISATION AND HUMAN RIGHTS						

<i>AREAS OF INTERVENTION</i>	<i>DONORS</i>					
	<i>UNDP</i>	<i>EBRD</i>	<i>EIB</i>	<i>IMF</i>	<i>USAID</i>	<i>WB</i>
<i>Minority rights</i>						
<i>Women's rights</i>					✓	
<i>Croatian Ombudsman's office</i>						
<i>Legal/Rights advisory centres</i>						
<i>Peace and reconciliation process</i>					✓	✓
<i>Human trafficking</i>					✓	
<i>Others</i>						
ECONOMIC SECTOR						
<i>Banking, insurance and other financial services</i>	✓	✓				✓
<i>SME development</i>	✓	✓			✓	✓
<i>Investment promotion</i>		✓			✓	✓
<i>Market competition</i>					✓	✓
<i>Agriculture, livestock and fisheries</i>						✓
<i>Infrastructure</i>		✓				✓
<i>Tourism</i>		✓				
<i>Chamber of crafts, traders and professionals</i>						
<i>Others</i>						
ENVIRONMENTAL ISSUES						
<i>Natural parks</i>	✓				✓	✓
<i>Waste management</i>		✓				✓
<i>Water management</i>	✓	✓	✓			✓
<i>Fight against deforestation</i>						✓
<i>Others</i>					✓	

Source: donors and financial institutions.

ANNEX 6

Main Economic Trends

		1997	1998	1999	2000
Real GDP Growth	Percent	6.6	2.5	-0.4	3.7
Inflation (retail prices)	Percent (end of period)	3.8	5.4	4.4	7.4
Unemployment rate	Percentage of labour force (ILO definition)	9.9	11.4	13.6	16.1
Consolidated Central government budget balance	Percent of GDP (accrual basis)	-2.0	-3.0	-7.4	-5.7
Current account balance	Percent of GDP	-11.6	-7.1	-6.9	-2.1
Foreign debt	Percent of GDP	31.9	40.3	44.5	53.1
Debt–export ratio	Percent	178.7	211.1	229.0	247.8
Gross foreign debt	Million €	6,573	8,560	9,251	11,801
Foreign direct investment	Percent of GDP	1.7	3.7	6.9	4.4
	Million €	303.4	715.3	1,290.2	898.3
<i>Source: IMF</i>					

ANNEX 7

Abbreviations Used

AREA:	Agenda for Regional Action
BiH:	Bosnia Herzegovina
CARDS:	Community Assistance for Reconstruction, Development and Stabilisation
CEB:	Council of Europe Development Bank
CEECs:	Central and Eastern European Countries
CEFTA:	Central Europe Free Trade Area
CSP:	Country Strategy Paper
EBRD:	European Bank for Reconstruction and Development
EC:	European Community
ECTS:	European Credit Transfer System
EFTA:	European Free Trade Association
EIA:	Environmental Impact Assessment
EIB:	European Investment Bank
EIDHR:	European Initiative for Democracy and Human Rights
ETF:	European Training Foundation
EU:	European Union
FDI:	Foreign Direct Investment
FIAS:	Foreign Investment Advisory Service
FRY:	Federal Republic of Yugoslavia
FTA:	Free Trade Agreement
GDP:	Gross Domestic Product
ICTY:	International Criminal Tribunal for the former Yugoslavia
IFC:	International Finance Corporation

IFI:	International Financing Institution
IMF:	International Monetary Fund
IT:	Information Technology
JHA:	Justice and Home Affairs
MIP:	Multi-annual Indicative Programme
NATO:	North Atlantic Treaty Organisation
NEAP:	National Environmental Action Plan
NGO:	Non-Governmental Organisation
NUTS	Nomenclature des Unites Territoriales Statistiques
PEN:	Pan European Networks
SAA:	Stabilisation and Association Agreement
SAL:	Structural Adjustment Loan
SAP:	Stabilisation and Association Process
SBA:	Stand-by Arrangement
SEE:	South East Europe
SME:	Small and Medium-sized Enterprise
SSO:	Small Scale Operations
TTFSE:	Transport and Trade Facilitation Southeast Europe project
US:	United States
VAT:	Value Added Tax
VET:	Vocational Education and Training
WTO:	World Trade Organisation