The Economic and Political Situation in Croatia

NOTE
EN 2010
The Economic and Political Situation in Croatia
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1. **INTRODUCTION**

This note aims to present the current economic and political situation in Croatia; it is divided into three main parts:

1. the political situation;
2. the economic situation; and
3. the European Union's relations with the country itself.

The political section explains Croatia's political structure including its separation of powers and its political context, the latest news section and sensitive political topics related to neighbouring countries, plus any additional problems.

The economic section includes the following: an economic review, a section concerning Chapter 32 of the Stabilisation and Association Agreement, an assessment of the degree of alignment and implementing capacity, statistical data, some ideas on the world economic crisis and the economic problems of the country.

The European Union's internal/external relations section is made up of an overview of the state of Croatia's accession process, the European Parliament's position, the Commission 2009 Progress Report and European Assistance to Croatia.

Annexes included:
- Annex A- Basic Information on Political Structure and Country Data
- Annex B- Timeline of the Events
- Annex C- Chapters closed so far

2. **THE POLITICAL SITUATION**

2.1. **THE POLITICAL STRUCTURE**

Since the adoption of the 1990 constitution (22 December 1990) and since the declaration of its independence from Yugoslavia on June 25, 1991, Croatia has been a democracy. Between 1990 and 2000 it had a semi-presidential system, and since 2000 it has had a parliamentary system.

2.1.1. The President of the Republic

The executive, legislative and judiciary powers in the Croatian republic are represented as follows:
- The executive power - the President of the State and the government,
- The legislative power - the Croatian Parliament,
- The judiciary power - the Supreme Court, County Courts, and Municipal Courts

The President of the Republic is the representative for the country's executive power. The current President of the Croatian Republic is Ivo Josipovic. He is the head of state, directly elected by secret ballot, on the basis of universal and equal suffrage to a five-year term and is limited by the constitution to a maximum of two terms. The president is elected by a
majority vote. After the election and taking office, the President of the Republic resigns from membership of a political party.

In addition to being the supreme commander of the armed forces, one of the president’s duties includes appointing the Prime Minister with parliament's consent; according to the constitution, the President also has a certain degree of power over foreign policy.

According to the country's constitution, the President:

- represents and stands for the Republic of Croatia at home and abroad;
- takes care of regular and harmonized functioning and the stability of the state government;
- is responsible for the defense of the independence and territorial integrity of the Republic of Croatia;
- calls elections for the Croatian Parliament and convenes their first session;
- calls for a referendum in accordance with the constitution;
- on a proposal from the government and the Chairman of the Government, the President announces a referendum on proposed changes to the Constitution or any other matters which are deemed to be important for the independence, the uniqueness and existence of the Republic of Croatia;
- confides the mandate to form the government to the person who, upon the distribution of the seats in the Croatian Parliament and consultations held, enjoys the confidence of the majority of its members;
- promulgates laws;

The President of the Republic and the Government of the Republic of Croatia cooperate in the formulation and execution of the foreign policy (the establishment of diplomatic missions, appointments or recalls of diplomatic representatives to Croatia, letters of credence and letters of recall from foreign diplomatic missions).

The President of the Republic commands the Armed Forces of the Republic of Croatia. He appoints and relieves military commanders of their duties. On the basis of the decision of the Croatian Parliament, the President of the Republic may declare war and conclude peace.

The President of the Republic benefits from diplomatic immunity. He may not be detained, nor may criminal proceedings be instituted against him without prior consent of the Constitutional Court. Furthermore the President of the Republic is impeachable for any violation of the constitution he has committed in the performance of his duties. Proceedings for the impeachment of the President of the Republic may be instituted by the Croatian Parliament by a two-thirds majority vote of all representatives. The impeachment of the President of the Republic is decided by the Constitutional Court of the Republic of Croatia (two thirds of the votes).

2.1.2. The Croatian Government

The Croatian Government is headed by the Prime Minister who has two Deputy Prime Ministers and fourteen ministers in charge of particular sectors of activity. The executive branch is responsible for proposing legislation and a budget, executing the laws, and guiding the foreign and internal policies of the republic.
The Prime Minister is nominated by the President of the Republic among those who enjoy the support of the majority of the Croatian Parliament.

The Government of the Republic of Croatia is a body which exercises its executive powers in conformity with the constitution and the law; its internal organisation, its operational procedures and decision-making process are defined by the laws from the Government of the Republic of Croatia and the Rules of Procedure of the government.

The government passes decrees, introduces legislation, proposes the state budget and enforces laws and other regulations enacted by the Croatian Parliament. Within the scope of its powers, the government also passes decrees, administrative acts and orders on appointments and on the replacement of appointed officials and civil servants. The government decides in cases of conflict of jurisdiction between government institutions, replies to representatives' questions, prepares proposals for laws and other regulations, gives opinion on laws and other regulations and adopts strategies of economic and social development.

The government is responsible to the Croatian Parliament. The Prime Minister and the members of the government are jointly responsible for decisions passed by the government and individually responsible for their respective portfolios. The current Prime Minister is Jadranka Kosor (since July 6, 2009). The Deputy Prime Ministers are Durda Adlesic (appointed in 2008) and Slobodan Uzelac (appointed in 2008). Government ministers are from the Croatian Democratic Union (HDZ) and the Croatian Peasant Party (HSS).

2.1.2.1. The Ministry of Finance

The Ministry of Finance, in particular, is accountable for the preparation and implementation of the government's fiscal policy. Its goals are to contribute to stable economic growth and to the increase in prosperity, in the quality of life and in employment for all Croatian citizens.

One of the most important tasks of the Ministry of Finance is the preparation of the state budget, as well as the management of budget revenues and expenditures, as this is taxpayers' money.

Other important tasks of the ministry are macro-economic analysis and economic forecasts, public debt portfolio management, co-operation with international financial institutions, responsibility for tax and customs policy, monitoring the trends and improving the financial system, development, the co-ordination of concessionary1 policy systems, undertaking measures for the prevention of money laundering, terrorism financing supervision, inspection tasks in the area of taxes, customs and other public revenues, foreign exchange, foreign trade operations, construction and the maintenance of border-crossings, the establishment and development of Public Internal Financial Control (PIFC) systems at the state and local level and financial management within the framework of the Decentralised Implementation System (DIS) of the EU aid programmes for Croatia.

The Ministry of Finance is a state administrative body with its scope of work defined by the Act on the Organisation and Scope of Work of the Ministries and Other State Administrative Organisations.

1 The term concerns contracts with private companies for example in public services.
Pursuant to the Decree on the Internal Organisation of the Ministry of Finance, the following administrative organisations and other organisational units have been established:

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<th>MINISTER OF FINANCE (AT PRESENT IVAN SUKER)</th>
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<tr>
<td>STATE SECRETARIES</td>
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<td>Minister's Cabinet</td>
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<tr>
<td>Independent Department for Public Relations and Communications</td>
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<tr>
<td>Independent Internal Audit Service</td>
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<tr>
<td>Independent Department of Financial Management, Internal Monitoring and Control</td>
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<td>Ministry Secretariat</td>
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<tr>
<td>Bureau for Macro-economics Analysis and Planning</td>
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<td>State Treasury</td>
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<td>Independent Service for IPA Programme Audit and Verification of SAPARD Implementation</td>
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<td>Financial Inspectorate</td>
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The Independent Internal Audit Service provides an independent professional opinion on the quality of management, on risk management as well as on the management of internal control systems, and it also provides recommendations to create additional value to the Ministry of Finance's mission. The Internal Audit Service's main activities include: internal audit for the whole ministry, providing professional opinion and advice on management improvement, risk management and internal control systems management as well as of recognizing the Ministry of Finance's mission, producing internal audit strategy and annual plans, performing single internal audits, analysing, testing and evaluating internal control systems, presenting recommendations to the audited departments as well as to the minister with the overall aim of achieving more efficiency within internal control systems, producing reports on the internal audit and submitting these reports to the minister, the monitoring of the implementation of recommendations outlined in reports from previously performed audits and informing the minister, completing an audit at the minister's request, producing required reports on the performance of the division and delivering these reports to authorized institutions, the estimation and monitoring of the implementation of recommendations obtained from the State Audit Office and external auditors.
The division includes three departments: The Department for Internal Auditing of the State Treasury and European Union Funds Systems, The Department for Internal Auditing of the Customs System and the Department for Internal Auditing of the Tax System.

The Department for Internal Auditing of the State Treasury and European Union Funds Systems conducts an internal audit of business systems and processes concerning the analysis and forecasts of macro-economic trends, producing the draft of the state budget and non-budget users and is responsible for the execution of the following: the state budget, public debt management, business performance evaluations of state-owned companies, for keeping the Concession Register, the supervision of financial institutions, the detection and prevention of money laundering, the inspection of foreign exchange and foreign trade transactions and of business processes referring to the activities of financial management, the contracting, the implementation, payment, accounting and financial reporting within the framework of the decentralized implementation system of the European Union aid and other aid funds, human and material resources management at the level of the entire ministry as well as accounting and general tasks, system support, communication technologies and information systems security within the systems of the State Treasury and of the EU funds management, performs other tasks determined by the Head of the Independent Division.

The Department for Internal Auditing of the Customs System performs an internal audit of systems and business processes relating to the customs system and to the policy of customs and extra customs protection, to a special tax system, the supervision and inspection of tasks in the area of customs and special tax, system support, communication, technologies and information systems security within the customs system and the special tax system and performs other tasks determined by the Head of the Independent Division.

2.1.2.2. The Agency for the Audit of European Union Programmes Implementation System

The Department for Internal Auditing of the Tax System performs internal audit of systems and business processes relating to the tax system and tax policy, supervision and inspection tasks in the area of taxes, organising games of chance and entertaining games, system support, communication technologies and information systems security within the tax system, performs other tasks determined by the Head of the Independent Division.

The function and responsibilities of the Audit Authority under the IPA Framework Agreement are performed by the Agency for the Audit of European Union Programmes Implementation System.

The agency was established by the “Regulation on the Establishment of the Agency for the Audit of European Union Programmes Implementation System” adopted by the Government of the Republic of Croatia at its session on 20th June 2008. According to this regulation, the activities of the Independent Service for the Audit of the IPA Programme and the Verification of SAPARD within the Ministry of Finance were transferred, along with the financial rights and obligations and such documents and equipment were taken over by the newly established agency.

The statutory role and responsibilities of the agency are laid out in the Statute of the Agency for the Audit of European Union Programmes’ Implementation System. According to the statute, the activity of the agency is to audit and verify the harmonised implementation of European Union programmes, the management of, and responsibility for which have been transferred to the Republic of Croatia, together with objectives, tasks
and procedures defined under internationally undertaken obligations of the Republic of Croatia.

The directing bodies of the agency are the Management Council and the Director of the Agency who represents and directs the agency. The agency may have other supervisory, expert and advisory bodies, if so regulated by the agency’s statute.

The agency functions independently from all individuals in the management and control system of pre-accession funds. The agency performs its activities in compliance with internationally accepted auditing standards. It is responsible for the verification of the effective and sound functioning of the management and control systems, it has the role of the external audit in the system of EU funds.

The agency performs the following tasks: establishes and fulfils strategic and annual checks and balances and audits those activities undertaken by those bodies responsible for, and included in, the system of EU programmes implementation; aiming to ensure the focused use of EU funds; inspecting and verifying the reliability of accounting data; giving recommendations for the improvement of activities in the implementation of EU programmes and the follow-up of their implementation; co-operating with bodies included in the implementation of EU programmes; checking whether the reports on the implementation of EU programmes are in compliance with EU regulations; establishing and submitting opinions and reports on the audit of EU programmes' implementation to the Competent Accrediting Officer, the National Authorising Officer, the European Commission and other.

The agency informs the European Commission, the National Authorising Officer and the Competent Accrediting Officer when audits are completed.

The agency informs the European Commission of its Annual Audit Work Plan before the beginning of the year, and presents its Annual Audit Activity Report for the previous twelve month period by 31st December each year having a cut-off date of 30th September. The Annual Audit Opinion covers the same periods with the same deadline as the its Annual Audit Activity Report and an opinion on any final statement of expenditure submitted to the European Commission by the National Authorising Officer, for the closure of any programme or of any part thereof. It is sent at the same time as the relevant final statement of expenditure submitted by the National Authorising Officer, or at least within three months after the submission of that final statement of expenditure.

To the National Authorising Officer the Agency delivers Annual audit work plan, Annual audit activity report with a cut-off date 30 September for the previous 12-month period by 31 December each year, Annual audit opinion covering the same period and having the same deadline as the annual audit activity report.

To the Competent Accrediting Officer the Agency delivers Annual audit activity report with a cut-off date 30 September for the previous 12-month period by 31 December each year (for IPA programme), Annual audit opinion covering the same period and having the same deadline as the annual audit activity report (for IPA programme) and Opinion on any final statement of expenditure submitted to the Commission by the National Authorising Officer, for the closure of any programme or of any part thereof. It is sent at the same time as the relevant final statement of expenditure submitted by the National Authorising Officer, or at least within three months after the submission of that final statement of expenditure (for IPA programme).
For the SAPARD programme, the agency delivers both the confirmation of audit as well as the audit report itself to the European Commission and to the National Authorising Officer.

As regards the methodology of audit work, audit reports and opinions, the Audit Authority should follow international audit standards, especially with respect to risk assessment area, audit materiality and sampling. This methodology may be completed with further guidelines and definitions provided by the European Commission, especially regarding the appropriate general approach to sampling, confidentiality levels as well as materiality.

According to the report submitted by the agency, the National Authorising Officer decides whether improvements in the management and control system are necessary and makes any necessary adjustments of the requests for payment which are communicated to the Commission.

For its part, the European Commission decides whether it will take further action or require the beneficiary country to take certain actions, in which case the European Commission informs the National Authorising Officer and the Competent Accrediting Officer of its decision.

2.1.3. The Croatian Parliament

The Croatian Parliament is representing the legislative power in the country. The Croatian Parliament is a unicameral legislative body. The number of the parliament members can vary from 100 to 160. They are all elected by popular vote to serve four-year terms. The plenary sessions of the parliament take place from January 15 to July 15 and from September 15 to December 15. Under the terms of the Croatian Constitution, the Parliament represents the people and is vested with the legislative power. Members' mandate can be extended only during a war. Most representatives come from the Croatian mainland counties, but there are also some minority and Diasporas seats. Currently the members' number is 153. 140 of them are from the counties, 8 from the minorities and 5 from abroad. The Parliament is presided by a President (sometimes referred to as Speaker or Chairman), who is assisted by at least one deputy president (usually four or five).

The Croatian Parliament decides on the enactment and amendment of the constitution, passes laws, adopts the State Budget, decides on war and peace, passes documents which express the policy of the Parliament, adopts the Strategy of national security and the Strategy of defense of the Republic of Croatia, exercises civil control over the armed forces and the security services of the Republic of Croatia, decides on alternations of the borders of the Republic of Croatia, calls referendums, carries out elections, appointments and reliefs of office, in conformity with the constitution and law, supervises the work of the Government of the Republic of Croatia and other holders of public authority responsible to the Croatian Parliament, in conformity with the constitution and law, grants amnesty for criminal offenses, conducts other affairs as specified by the constitution.

The Croatian Parliament makes decisions by majority votes provided that a majority of representatives are present at the session. However, laws which regulate the rights of national minorities, decisions of border-crossing the patrolling of the borders by the armed forces, or altering the border lines, are passed by the Croatian Parliament by a two-thirds majority vote of all representatives.

Laws which clarify constitutionally defined human rights and fundamental freedoms, the electoral system, the organisation, authority and operation of government bodies and the
organisation and authority of local and regional self-government are passed by the Croatian Parliament by a majority vote of all representatives.

Currently the Croatian Parliament is composed of the following parties: The Croatian Democratic Union (HDZ) with 66 members, The Parliamentary Club of the Social Democratic Party with 56 members, The Social Democratic Party of Croatia (SDP) with 55 members and one independent party, Croatian People's Party-Liberal Democrats (HNS) have 7 members, The Croatian Peasant Party (HSS) - 6 members, The Croatian Democratic Assembly of Slavonija and Baranja (HDSSB) - 3 members, The Istrian Democratic Assembly (IDS) - 3 members, The Croatian Social Liberal Party (HSLS) - 2 members, The Croatian Party of Rights (HSP) - 1 member, The Croatian Pensioners’ Party (HSU) - 1 member, The Parliamentary Club of National Minorities - 8 members, which comprises The Party of Democratic Action of Croatia (SDA HR) with 1 member, The Independent Democratic Serbian Party (SDSS) with 3 members and four independents. The current Speaker (President) of the Croatian Parliament is Luka Bebic, elected on January 11, 2008.

Parliamentary elections of the Croatian Parliament were held on 25th November 2007 in Croatia and on 24th November and 25th November 2007 abroad. The campaign officially started on 3rd November. The President of Croatia announced elections on 17th October and 14 days were allowed for candidate lists to be submitted. Prior to these dates, the previous parliamentary elections were held on November 23rd, 2003.

2.1.4. The Croatian Judicial System

Croatia has a three-tiered judicial system, consisting of the Supreme Court, County Courts, and Municipal Courts. The Constitutional Court rules on matters regarding the Constitution. Law enforcement in Croatia is the responsibility of the Croatian Police Force, which is under the control of the Ministry of the Interior. In recent years, the force has been undergoing reform with assistance from international agencies, including the Organisation for Security and Co-operation in Europe since its mission to Croatia began on 18 April 1996.

Croatia's legal system is strongly influenced by the legal heritage of Austria-Hungary. The institutional framework was built upon the basis of Austrian institutions. Nowadays, it is almost completely harmonised with that of the European Union.

The Supreme Court of the Republic of Croatia is the highest court. Court hearings are open, and judgments are made publicly, except in issues of privacy of the accused. Judges are appointed by the National Judicial Council and the length of judicial office is permanent (up until seventy years of age). The President of the Supreme Court is elected for a four-year term by the Croatian Parliament after a proposal from the President of the Republic.

The Constitutional Court of the Republic of Croatia decides on the constitutionality of laws and has the right to repeal a law it finds unconstitutional. It can also impeach the president. The constitutional court is made up of thirteen judges for an eight-year term. The President of the Constitutional Court is elected by the court for a four-year term.

The National Judicial Council of the Republic appoints all judges. It is a body consisting of a president and fourteen members proposed and elected by the Parliament for four-year terms; a maximum of two terms is permitted.
2.2. THE POLITICAL CONTEXT

Since 2003, HDZ has been kept in power by joining different coalitions. Whilst it was in coalition with the Croatian Social Liberal Party (HSLS) and the Croatian Party of Pensioners (plus minority representatives) from 2003-2007, since 2007 it has created a coalition with the Croatian Peasants' Party (HSS) and HSLS (plus minority representatives). The coalition has a narrow majority with 81 out of the 153 seats in parliament (Sabor). The strongest opposition party is the Social Democratic Party (SDP) with 56 seats in parliament, which came out at the 2007 general elections almost as strong as the HDZ. Only the votes from the significant Croatian Diaspora decided in HDZ’s favour. The SDP supports the government’s EU agenda. In July 2009, Jadranka Kosor became Prime Minister and the HDZ party leader following the surprise resignation of Ivo Sanader. She had to take over this position at a very critical moment, when the EU accession negotiations had been held up and an economic crisis had severe repercussions within the country. Besides the lost presidential elections, where the HDZ candidate Andrija Hebrang was already eliminated in the first round, she has succeeded in unblocking the accession negotiations. Furthermore, she is seen as the person who has been the most successful in boosting efforts to fight corruption.

Overall, the government’s key priorities are EU accession in 2012, economic reform and the fight against corruption. The government’s objective is to complete the negotiations for EU accession in mid-2010.

In April 2009, Croatia became a member of the North Atlantic Treaty Organisation (NATO) together with Albania.

2.2.1. Latest news

Ivo Josipovic from the opposition Social Democratic Party, SDP, was elected as President of Croatia on 10th January 2010 in the second round of the presidential elections by 60.3 % of the vote. His opponent Milan Bandic, the Zagreb mayor and former member of the SDP, won 39.7 % in the final vote. The other candidates, including the HDZ candidate, Andrija Hebrang, had already been eliminated in the first round on 27th December 2009. The ODIHR2 election monitoring mission stated in its preliminary findings that the elections complied with OSCE3 standards.

President’s Josipovic’s victory was clearer than initially expected. Even in Zagreb, where Bandic had won the last four mayoral elections, Josipovic scored 62 % of the vote. It appears that the main pledge of Josipovic’s campaign, namely the fight against corruption, was the reason for his clear victory. The fight against corruption is a priority for both President Josipovic and for Prime Minister Kosor, despite their differing political views.

On 3rd January 2010, the former Prime Minister Ivo Sanader announced - without having informed his party colleagues - his return to politics in order "to tackle the evident leadership problems in the HDZ". This came as a shock to both the Prime Minister as well as to the coalition parties. As a consequence, the HDZ board expelled Sanader from the party on 4th January 2010 with the majority of HDZ members supporting this decision. Jadranka Kosor has further strengthened her position and her control over the party.

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2 The Office for Democratic Institutions and Human Rights
3 The Organisation for Security and Co-operation in Europe
Overall, the government has focused its efforts on completing the reforms required for accession on the conclusion of accession negotiations by mid-2010. In order to achieve this it must further pursue the public administration reform and obtain results in the fight against corruption and organised crime. Furthermore, it must continue to co-operate with the International Criminal Tribunal for Former Yugoslavia (ICTY) and implement economic reforms.

The Croatian government is currently preparing constitutional amendments in order to prepare for EU accession. Amongst the various amendments, it will include a legal basis for the referendum on EU accession where only a simple majority will be required.

According to the latest Croatian surveys\(^4\) however, if a referendum on Croatia's European Union membership were organised now, the majority of Croats who would vote would opt for accession. The results show that 76% of Croats would vote in a referendum on the country's accession to the EU, of whom 53% would vote for accession, 40% would vote against and 7% would abstain.

The government's second priority is to mitigate the impact of the economic crisis. The analysis shows that Croatia's economy will only recover very slowly towards the end of 2010. Industrial output continued to drop in December 2009 and January 2010, although these contractions were less severe than in previous months. At the same time, unemployment continued to rise and the government faces more and more growing public disquiet about the worsening economic situation. A recent survey by the Chamber of Economy suggests that around 70% of households had insufficient income to meet their daily living costs in 2009.

In January 2010, the government adopted anti-recession measures aimed at boosting credit activity. Furthermore, the World Bank provided a EUR 200mn loan to the Croatian government in mid-January 2010, which will be used primarily for the repayment of liabilities.

### 2.3. SENSITIVE TOPICS

Although Croatia has achieved significant progress, three key areas have continuously caused concern among EU institutions and Member States - the fight against organised crime and corruption, the competence, the efficiency and independence of the judiciary, and the problems of the International Criminal Tribunal for the Former Yugoslavia (ICTY) to access important documents.

#### 2.3.1. Fight Against Organised Crime and Corruption

Corruption remains one of Croatia's biggest challenges. According to the European Commission 2009 Progress Report, it is still prevalent in many areas, particularly in the field of public procurement. Although the legal and institutional framework - such as USKOK, the Office for the Fight Against Crime and Corruption - is in place, the actual number of prosecutions remains low. In particular, the prosecution of high-level cases is very limited. Prime Minister Kosor has stepped-up efforts to fight corruption, particularly in state-owned companies.

The 2009 Commission Progress Report states that corruption remains widespread and that the existing tools are not efficiently deployed, especially against political corruption. The

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\(^4\) Hina, Croatians would vote for EU accession if referendum were held today, Brief News Bulletin 7496, 02 May 2010
lack of progress in preventing conflict of interests and the absence of a culture of political accountability are the main reasons for this situation. Furthermore, shortcomings with regard to party financing have not been properly tackled.

2.3.2. Judiciary

Judicial reform and the restructuring of the police have been successfully completed. However, the European Commission has expressed its concern about the selection procedure for judges and prosecutors, which still lacks transparency and the application of objective criteria. Furthermore, the enforcement of court rulings remains a major problem. In addition, the length of judicial procedures is often excessive. Overall, the accountability, independence, and competence of the judicial system need to be significantly improved. An unresolved problem continues to be the potential for undue political influence over the judiciary.

As regards war crime prosecutions, Croatia faces a similar situation as the other Western Balkan countries. Court sentences for comparable crimes often continue to be ethnically biased. However, Croatia has started to tackle the problems related to the extradition of suspects in cases of war crimes and crimes against humanity from other Balkan countries.

On 10th February 2010, Croatia and Bosnia and Herzegovina signed an agreement on the mutual recognition and enforcement of final court rulings in criminal matters, thereby ensuring that convicted criminals cannot escape from judgement in another Western Balkan countries.

2.3.3. ICTY Co-operation

Although the overall co-operation with the ICTY is ensured, there is a problem in accessing important documents (artillery log books) in the on-going trials against Gotovina and other generals. In order to find these documents, the government set up an inter-agency Task Force in October 2009. In his address to the United Nations Security Council in December 2009, the ICTY Chief Prosecutor, Serge Brammertz stated that, “...the central issue of concern remains the still unresolved request to locate and obtain key military documents related to Operation Storm of 1995...” Brammertz welcomed the personal initiative of Prime Minister Kosor to set up a Task Force in October 2009, which is aimed at locating these documents. He also stated that a recent report of the Task Force was helpful in revealing gaps in the administrative investigation and in identifying further investigative steps to be taken. Brammertz concluded by saying that, “...these and all other available investigative steps must be urgently undertaken in order to complete a comprehensive and credible investigation into locating the missing documents...”.

As a result of the increased efforts of the government and other authorities to find the necessary documents, the Dutch government lifted its reservations to the EU starting negotiations with Croatia on chapter 23 “Judiciary and Fundamental Rights” on 12th February 2010. The United Kingdom, Denmark, Finland and Belgium had dropped similar reservations earlier in the same month. The Dutch Foreign Minister Verhagen, explained to the Dutch Parliament that this step was intended to “...encourage Croatia to continue to vigorously reform its judicial sector ”.
2.4. **NEIGHBOURING COUNTRIES**

2.4.1. **Croatia's Relations with Serbia**

Relations between Serbia and Croatia have become strained due to, on the one hand, the official visit of the former President Mesić to Kosovo at Christmas and on the other hand, Serbia's countersuit filed with The International Court of Justice (ICJ), against Croatia in January 2010 for genocide allegedly committed during the war in the 1990's and during World War II. The lawsuit was a response to Croatian charges of genocide against Serbia filed at the ICJ in 1999, demanding that Belgrade punish all perpetrators of war crimes, return cultural property to Croatia and pay for war damages. In addition, the Serbian President Tadić refused to participate at Josipović's inauguration ceremony in February 2010.

However, President Josipović (as well as Croatian Prime Minister Kosor) emphasized the need to continue developing good relations with Serbia. Apart from EU accession, maintaining and improving relations with neighbouring countries and in particular with Serbia is a foreign policy priority for President Josipović. Croatia has recognised Kosovo and Josipović was one of the key authors of Croatia's genocide case against Serbia before the International Criminal Tribunal for former Yugoslavia (ICTY) but more effort is required to improve relations.

2.4.2. **The Border Dispute with Slovenia**

The EU-Croatia negotiations had been blocked during most of 2009 due to the unresolved border dispute between Slovenia and Croatia. The reason for Slovenia's blockage was that the Croatian Government had submitted documents, which according to Slovenia would prejudge the outcome of the border dispute in Piran Bay. The main issue was the exact demarcation of the maritime border which was a legacy of Yugoslavia's disintegration.

Croatia insisted on a solution before an international court, while Slovenia preferred an out-of-court settlement. Both sides were attempting to advance their interests through the accession process. The European Commission had made it clear from the beginning that this border dispute was a bi-lateral issue and would need to be resolved by the two countries involved. Nevertheless, the European Commission helped to find a solution. The European Commission proposed the setting up of an international arbitration tribunal consisting of five members to decide on the exact border. However, in June, the two sides failed to agree on this proposal. With the appointment of Kosor, the discussions gained a new momentum over the summer, which resulted in the September agreement and the signing ceremony on 4th November 2009. The key points of this agreement are as follows:

- the establishment of an international arbitration tribunal to determine the border at sea and on land as well as Slovenia's access to the high seas;
- the tribunal will apply international law in determining the borders;
- it will also apply the principle of equity and the principle of good neighbourly relations when it decides on Slovenia's access to the high seas.

However, whereas the Croatian Parliament has already ratified the agreement on 23rd November 2009, the Slovenian Parliament still needs to do so. The ratification requires a \( \frac{2}{3} \) majority.
The Slovenian referendum is scheduled for 6th June 2010. So far the opinion polls show that 46% of voters would vote in favour of the arbitration deal and 38% against. However, public opinion could change radically during the one-month campaign.\(^5\)

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\(^5\) Hina, Brief news bulletin 7499, Campaign for referendum on Arbitration Agreement starts Friday, 5th May 2010
3. ECONOMIC SITUATION

3.1. ECONOMIC REVIEW

The following is a brief review of the economic situation in Croatia, its structural funds and pre-accession programmes.

**Croatia - Financial Assistance (IPA - Instrument for Pre-accession Assistance)**

<table>
<thead>
<tr>
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<th>2010</th>
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</tbody>
</table>

Legend

- Transition Assistance and Institution Building
- Cross-border Co-operation
- Regional Development
- Human Resources Development
- Rural Development


Since 2007, Croatia has been receiving EU financial aid under the Instrument for Pre-accession Assistance (IPA). The main objective of the IPA programme is assisting candidate countries as well as potential candidate countries in their progressive alignment with the *acquis communautaire* of the European Union, and in the implementation of the coherent
regulations, as well as in preparing the use of funds which will be at the disposal of the Republic of Croatia when it becomes a member state (Structural and Agricultural Funds, Cohesion Funds).

The allocation for 2008 totals EUR 146 million.

IPA assistance to Croatia is implemented under decentralised management criteria according to the five IPA components available to candidate countries (see below).

Assistance under these three components is deployed in the context of the 2007-2009 Operational Programmes on Regional Competitiveness, Transportation, Environment, Human Resources Development as well as in the framework of the IPARD 2007-2013 on Agriculture and Rural Development Programme.

Annual or multi-annual programmes (depending on the component) are designed in accordance with the strategic MIPDs (Multi-annual Indicative Planning Documents). They are adopted by the Commission following discussions with beneficiary countries and other stakeholders. They are implemented in one of three ways: centralised, decentralised or shared.

In the past, the EU has provided support to Croatia by way of various financial instruments, including Community Assistance for Reconstruction, Development and Stabilisation (CARDS) (programming years: 2001-2004), PHARE and ISPA (2005-2006) as well as SAPARD (2006).

**IPA Component I: Institution Building**

The core activity under **IPA Component I** is **Institution Building**, with priorities in the fields of the **political** and **economic criteria** as well as the **ability to assume the obligations of membership**. Institution building also includes **supporting programmes** aimed at strengthening the institutional capacity for the management of EU funds as well as covering Croatia’s participation in community programmes:

**Civil society:** EUR 3mn aim to foster the dialogue between Civil Society organisations and Croatian state administration / EU institutions on issues that are crucial for Croatia's accession to the European Union: transparency and accountability of public administration, anti-corruption, anti-discrimination and sustainable development.

**IPA Component II: Cross-border co-operation**

The core activity under **IPA component II** is **Cross-border Cooperation**. IPA 2007 and 2008 programmes support co-operation with bordering Member States (Hungary, Italy and Slovenia) and also include a new generation of cross-border programmes (Bosnia and Herzegovina, Montenegro and Serbia) as well as Croatia’s participation in the European Territorial Co-operation Trans-national Programmes: "South-East Europe" and "Mediterranean".

**IPA Components III, IV & V: Preparation towards the European Community's Cohesion Policy and the European Community's Agriculture and Rural Development Policy**

Assistance under **IPA Components III** (Regional Development), **IV** (Human Resources Development) and **V** (Agriculture and Rural Development) aims at preparing Croatia for
participation in the Community’s Cohesion Policy as well as its Agriculture and Rural Development Policy.

The Republic of Croatia, as a candidate country for the membership in the European Union, is eligible to participate in pre-accession EU funds, it is eligible to use financial resources through programmes and projects financed or co-financed from the European Union’s budget.

The system of pre-accession EU funds is characterised by comprehensive regulations establishing it while the implementation of the system includes a large number of stakeholders.

The regulatory framework of the EU programmes implementation consists of strategic, legal, operational and implementing documents which on one side define priorities and amounts of the resources while on the other side they define the rules of implementation and implementing systems.

Namely, the institutional framework for the system of pre-accession funds consists of:

- authorised national officers and institutions responsible for coordination of activities at the level of the whole system,
- authorised national officers and institutions responsible for coordination of activities at the level of each component, and
- institutions responsible for the implementation of activities

The Central Office for Development Strategy and Coordination of EU Funds (CODEF) is responsible for the overall coordination over preparation and monitoring of IPA programme implementation, i.e. the coordination of preparatory tasks and monitoring of the programme implementation in the Republic of Croatia. Within CODEF there are also National IPA Coordinator (NIPAC) and Strategic Coordinator for Components III and IV.

National IPA Coordinator bears an overall responsibility for: complying the use of IPA programme funds with the needs of the preparation processes for European Union membership, the coordination of each IPA programme component in order to achieve their optimum effect, the coordination of project proposals preparation within Component I – Transition Assistance and Institution Building at the national level, the coordination of the Republic of Croatia’s participation in the programmes of cross-border, interregional and trans-national co-operation as well as monitoring the IPA programme implementation and submitting reports to the European Commission.


The coordination of financial management for the overall system falls under competence of the Ministry of Finance, i.e. the National Authorising Officer.

The National Authorising Officer bears an overall responsibility for the financial management of EU funds in the Republic of Croatia. He or she is responsible for legality and regularity of underlying transactions and for effective functioning of the management and control systems of all pre-accession EU funds. He or she also stands for submitting to
the European Commission the Statement of Assurance, which includes the confirmation of the effective functioning of the management and control systems, the confirmation regarding the legality and regularity of the underlying transactions and the information concerning any changes in systems and controls as well as elements of supporting the accounting data.

The responsibilities of the National Authorising Officer enable him or her to require the information on effectiveness of internal control systems, i.e. to require reports of the internal audit from institutions where EU programmes are implemented.

The National Fund functions as a state treasury in charge of tasks regarding the financial management of all pre-accession programmes. The National Fund falls under the responsibility of the National Authorising Officer.

For each component under IPA an Operating Structure is established and responsible for the management and implementation of IPA programme. This Operating Structure consists of the following:

- ministries responsible for operational programmes,
- ministries responsible for priorities/measures, and
- implementing bodies/agencies.

Ministries responsible for operational programmes coordinate the preparation of annual and multi-annual operational programmes for each component under IPA and coordinate their monitoring (for IPA Component I the annual national programme is drafted, for IPA Components II and V Operational programmes covering seven-year period are drafted, while for IPA Components III and IV Operational programmes covering three-year period are drafted).

The ministries responsible for priorities are accountable for monitoring programme implementation and for the management of sectoral monitoring committees; ensuring documentation necessary for monitoring the quality of programme implementation; preparation of sectoral annual and final reports on the implementation; submitting the reports to the Commission, the National IPA Co-ordinator and the National Authorising Officer; ensuring that the activities being financed are selected and approved in accordance with criteria and mechanisms applicable to those programmes, ensuring that they respect relevant rules of the European Commission and national rules; set up of procedures which ensure the safeguarding of all documents needed for providing appropriate audit trail.

Implementing bodies/agencies are responsible for tendering, contracting, payments and for the technical implementation of pre-accession projects.

SAPARD is a special pre-accession programme for agriculture and rural development. Its primary purpose is to contribute to the adoption of EU acquis communautaire concerning the Common Agricultural Policy (CAP) and other complementary policies on basis of a seven-year EU budget plan. This programme also supports the implementation of measures for development of rural areas. It includes a system of measures aimed at assisting the adjustment of agriculture and rural development to the EU organisation, marketing and legislation.
Possible beneficiaries entitled to use the SAPARD funds are agricultural holdings and legal and natural persons engaged in food industry.

The Central State Office for Development Strategy and Co-ordination of EU Funds is the body responsible for the overall coordination over the preparation and monitoring of the implementation of SAPARD programme in the Republic of Croatia.

The coordination of financial management for the SAPARD programme falls under responsibility of the Ministry of Finance - the National Authorising Officer.

The Managing Authority is the body within the Ministry of Agriculture, Fisheries and Rural Development - Directorate for Sustainable Development of Rural Areas, responsible for the effectiveness and accuracy of coordination and reporting on monitoring and evaluation of the SAPARD programme.

The SAPARD Agency is the body established by the Republic of Croatia and functioning under its authorisation while performing implementation and executing payments for the SAPARD programme. The Directorate for Structural and Market Support Measures in Agriculture, within the Ministry of Agriculture, Fisheries and Rural Development has the function of the SAPARD Agency.
3.2. CHAPTER 32 OF THE STABILISATION AND ASSOCIATION AGREEMENT

3.2.1. Chapter Content

Four main policy areas are present in this chapter. They include public internal financial control (PIFC), external audit (EA), the protection of the EU’s financial interests and the protection of the Euro against counterfeiting.

The first two areas do not require transposition of the Community legislation into national law. The screening concerns mainly the commitment of the candidate country to adopt international control and internal audit standards and EU best practice. Therefore the country should adopt a PIFC Policy Paper with a short and long term action plan having realistic deadlines.

PIFC supports the candidate country in upgrading its internal control systems. It is mainly related to the entire public budget, central government income and expenditure and foreign funds (excluding those treated under other chapters).

PIFC is based on three principles, 1) managerial accountability carried by sound financial management and control systems, 2) decentralised and functionally independent internal audit (IA) and 3) centralised harmonisation of the financial management and control and IA systems.

The external audit is related to the application of the rules of the International Organisation of Supreme Audit Institutions - INTOSAI, moreover these supreme audit institutions should be functionally institutionally and financially independent.

Under this chapter also falls the protection of EU financial interests. The other relevant policy area under this chapter concerns the protection of EU financial interests. First, it comprises operational co-operation of Member States, which must have the capacity to cooperate effectively with the European Commission and to communicate all suspected cases of irregularities and fraud. They must ensure the protection of EU funds at an (at least) equivalent level to the protection of national funds. Member States are also obliged to assist and co-operate on-the-spot checks carried out by EC services. While some of this acquis applies directly to Member States and thus does not need to be transposed, effective co-operation and coordination structures and capacities in the candidate country need to be set up. In order to facilitate the required co-operation by future Member States, the nomination of national anti-fraud co-operation services – AFCOS – as a single contact point with OLAF is considered very useful.

Furthermore, this part of the chapter also includes the convention on the protection of the EU’s financial interests ("PIF-Convention"), including the harmonisation of penal law and the reinforcement of co-operation.

Finally, this part of the chapter comprises the non-penal aspects of the protection of the Euro against counterfeiting, such as the prohibition of metals or tokens similar to Euro coins, the obligation for financial institutions to withdraw counterfeit notes and coins and effective anti-counterfeiting bodies and procedures.
3.2.2. Country Alignment and Implementation Capacity

This part summarises the information provided by Croatia concerning its alignment and implementation capacity. Croatia indicated that it can accept the relevant standards and acquis regarding Internal Financial control.

3.2.2.1. Public Internal Financial Control (PIFC) and External Audit

The Government of the Republic of Croatia passed the first PIFC Strategy in September 2004 providing the main PIFC development guidelines. With the overall PIFC system development and previous experience in mind, Croatia decided to elaborate and improve the existing Strategy. Thus, the Government of the Republic of Croatia passed, in June 2005, a new Development Strategy of PIFC. The strategy aims at ensuring a harmonisation with international internal control and internal audit standards and EU best practices, effective, economic and efficient collection and utilisation of public resources in line with policies and objectives of the government, as well as accountability and fiscal transparency. The strategy is comprehensive and covers all public budgets and funds including EU funds. In particular it explains PIFC and discusses managerial accountability, financial management and control (FMC), functional independence of internal audit (IA), the role of Central Harmonisation Units (CHU) and describes the existing institutional and legal framework. It also concludes that there is a need for further development of PIFC in particular in the field of FMC and IA. It provides for an action plan including a timetable for aligning the existing PIFC system with the requirements under Chapter 32.

As foreseen in the PIFC strategy action plan, Croatia is developing a PIFC framework law defining requirements for the expected PIFC system, training of persons involved in financial management and control as well as in functionally independent internal audit, reporting requirements on PIFC to the government as well as the actions to be taken in cases of irregularities and fraud. In addition, the Ministry of Finance has already passed implementing regulations such as a code of ethics, a charter, a rulebook and a manual for internal audit. Internal audit are formally established in 12 out of 13 Ministries.

Furthermore, a programme for professional training and taking exams for qualification of certified public sector internal auditors has been adopted. Training and certification of internal auditors are on-going within the functional responsibility of the CHU. These aspects still need to be scrutinised. In the field of FMC, Croatia foresees to develop implementing regulations such as a rulebook, risk management methodology, and a FMC manual and a training programme for management and other persons involved in FMC.

Croatia has committed itself to take into account comments by DG Budget of the European Commission before primary and secondary PIFC legislation is finalised, in line with the 2004 Memorandum of Understanding on the administrative Co-operation between the Ministry of Finance and DG Budget. To this end, all PIFC related policy papers, acts or draft legislation or regulations will be sent to the DG Budget for comments, allowing for sufficient time for scrutiny.

Regarding external audit, the State Audit Office (SAO), a member of INTOSAI, adopted a Strategic Development Plan (SDP) 2003 – 2007 in the beginning of 2003. The SDP was
based upon the conclusions from the 2000/2001 self-assessment and SIGMA’s\(^6\) 2002/03 recommendations following an independent external evaluation. The SDP contains elements to harmonise and approximate the work methodology used by the SAO to generally accepted standards and best European Standards. It regulates aspects such as legal framework, audit methodology, the audit cycle, support processes, human resource structure and external relations and considers the Lima declaration, the INTOSAI Auditing Standards, and the European Implementing Guidelines for INTOSAI Auditing Standards as well as the Prague declaration.

A State Audit Act was adopted by the Croatian Government in July 2003 and its latest Amendment dates from 2004 in accordance with the conclusions from the self-assessment and SIGMA’s recommendations.

The State Audit Act provides for functional, operational independence of the SAO but there is no legal basis in the constitution. The Financial independence of the SAO has been strengthened by a new Act affecting certified state auditors’ salaries. However, Croatia plans to improve the financial independence of the SAO, since its budget is included in the State budget prepared by the Ministry of Finance.

Taking further steps towards achieving full financial independence is a part of the SAO’s strategy. The State Audit Act provides for the SAO to perform financial audits and performance audits and obliges it to report its audits to the Parliament. INTOSAI Auditing Standards have been translated to Croatian and published in the Official Gazette.

The State Audit Office is the supreme audit institution of the Republic of Croatia. It was founded in 1993, pursuant to State Auditing Act, and became operational in November 1994. In April 1994, the Croatian Parliament appointed Ms. Sima Krasic as the first Auditor General in Croatia. In April 2002, she was reappointed for 8-year mandate as Auditor General.

The Auditor General has a Deputy and Assistants, who help the Auditor General run the Office and coordinate audits and other business tasks together with heads of departments and heads of regional offices. The Auditor General has his/her own advisory body, the Expert Council, comprised of Deputy, Assistant Auditors General and independent experts in economics, law, auditing and finances, lecturers from the University of Zagreb.

The State Audit Office is set up as an independent and autonomous institution, accountable to the Croatian Parliament. The scope of Office authorities and responsibilities is stipulated under the State Audit Act.

The Office performs audit of the state budget and state budget users, the budget of local units, legal entities being partly or wholly financed from the budget, and audits of public

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\(^6\) The Support for Improvement in Governance and Management in Central and Eastern European Countries (SIGMA) is a joint operation of the European Union and the Organisation for Economic Co-operation and Development (OECD) based on two objectives: expertise in the field of public administration reform and management of public funds. It particularly aims at strengthening implementation of Community legislation and alignment with the acquis in the ten new Member States, acceding countries, candidate countries and Western Balkans potential candidate countries. SIGMA falls within the framework of the PHARE programme. Initiated in 1992 it is a two-year-term, renewable programme.
enterprises, companies and other legal entities in which the Republic of Croatia or the local units have majority ownership of stakes or shares.

The Office is also responsible for the audit of EU funds and funds of other international organisations or institutions, used for financing public needs in the Republic of Croatia.

Audit includes the examination of documents, reports and statements, internal control and internal audit systems, accounting and financial procedures and other records with the aim of determining whether financial statements give a true and fair view of financial status and results of financial transactions in accordance with accounting standards and principles.

Audits also examine if financial transactions representing state revenue and expenditures were performed in accordance with the legislation and give an assessment of economy, efficiency and effectiveness achieved in accomplishing the planned goals.

Audits of the state budget, the budget of local and regional self-government units, and of funds or institutions at state level are performed once a year, in manner and scope determined in the Annual Work Programme of the State Audit Office.

Audits are performed by certified state auditors in accordance with procedures, methods and methodology indicated in the INTOSAI auditing standards, i.e. the auditing standards of the International Organisation of Supreme Audit Institutions, and the Code of Professional Ethics for State Auditors.

Criteria applied in selecting entities are legal regulations, findings and opinions of previous audits, reports filed and information on the entity which was obtained from other institutions or the media. The final decision on performing an audit is made by the Auditor General.

Increase in the number of audits performed greatly resulted from increase in the number of state auditors and their expertise, use of IT, specialisation and improvement of procedures and work methodology.

The Office adopted a Strategic Development Plan for the period between 2003 and 2007, which includes adjustments of methods and methodology used in the Office and alignment with EU standards and best practice, this being one of the requirements the Republic of Croatia needs to meet to become member of the European Union.

The above plan foresees the vision, mission, goals, values, strategy and strategy application, thus providing external audit development guidelines in the Republic of Croatia.

The vision of the State Audit Office is to contribute to the increase of the common and collective good by checking regularity, efficiency, economy and effectiveness in public property management.

The mission of the State Audit Office is to perform audits, increase the efficiency of legal entities pursuant to the State Audit Act and to increase the awareness of the Croatian Parliament, government and citizens of how audited entities manage their funds.

The objectives of the State Audit Office are to accomplish the tasks laid down in the State Audit Act, to decrease irregularities in the business of audited entities and to increase their efficiency and effectiveness.
State Audit Office is a member of INTOSAI since 1994 and EUROSAl since 1996. Commitments that arise from this membership connote process of continued intercession and including of the Office in the activities of those organisations and their working groups organised for development of areas of special interest for state auditing and with the purpose of methodology complying and encouraging co-operation among SAIs.

The State Audit Office also develops bilateral contacts with other SAIs, in a form of joint seminars, visits by delegations of other SAIs to State Audit Office or visits of delegation of State Audit Office to SAIs of other countries, exchange of experiences, documents and other information related to audit work.

Referring to the relations with EU (ECA), State Audit Office is a member of a committee of liaison officers, established within ECA and group of Central and Eastern European Countries, Cyprus, Malta and Turkey, and also participates actively in the work of their working groups, while Auditor General participated in the annual meetings of the presidents of those SAIs. Within the Group, SAO chairs the PIFC Expert Group.

Starting with the end of 2004, Office participates in the work of EU SAIs' Contact Committee.

State Audit office is actively involved in the process of pre-accession negotiations with EU, through the Chapter 32: Financial Control.

Besides co-operation with other SAIs and professional organisations, State Audit Office continuously establish and maintain contacts with other international institutions/organisations such as: OECD\textsuperscript{7}, SIGMA\textsuperscript{8}, World Bank, IMF\textsuperscript{9}, GRECO\textsuperscript{10}, etc.

At the end of 2004 Office started to implement 30 months long twinning project in co-operation with National Audit Office of United Kingdom. Project named Strengthening of external oversight of budget execution will cover main development components and activities fortified in the Strategic Development Plan for 2003-2007.

The project is financed by the European Commission within the framework of the CARDS\textsuperscript{11} programme.

The project is worth 1.6 million EUR, with a further 400,000 EUR spent on the purchase of IT hardware and software.

The objective of the project is to contribute to a well-functioning Public Internal Financial Control (PIFC) system by strengthening the external oversight of budget execution. This will be achieved by:

- strengthening the legal framework for external audit (whenever necessary);
- the application of core external audit processes in line with international standards and good European practice;

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\textsuperscript{7} Organisation for Economic Co-operation and Development
\textsuperscript{8} Support for Improvement in Governance and Management in Central and Eastern European Countries
\textsuperscript{9} International Monetary Fund
\textsuperscript{10} Group of States against Corruption
\textsuperscript{11} Community Assistance for Reconstruction, Development and Stabilisation
• strengthening the organisation, management of human resources and information systems of the SAO;

• improving information technology of the SAO.

Within the framework of the project, a range of activities including training courses, seminars, the development of manuals and pilot audits have been performed.

Implementation of the project ensures that the Office (SAO) is in line with international standards and best practice of state audits in Europe.

3.2.2.2. Protection of EU Financial Interests and Protection of the Euro

Article 280 TEU requires Member States to fight protect the Community's financial interests in the same way as national financial interests. Croatia has yet to formally align its legislation to this requirement. The same applies for the immediate communication of irregularities and fraud in the Common Agricultural Policy, Structural Funds and Cohesion Fund.

Regarding co-operation for on-the-spot checks by EU investigators, Croatia stated that it intends to fully support such activities. However, no formal rules are yet in place, which ensure that EC inspectors as well as information and evidence produce by them are treated like national ones. The same applies for the obligation to safeguard evidence, to actively cooperate with and participate in EC inspection missions, and to support such missions, if requested, vis-à-vis economic operators.

Croatian penal law already punishes the principal offences of fraud, corruption and money laundering. Liability of heads of business as well as legal persons for criminal acts, including against the EU's financial interests is equally established. Currently, there are no plans for further alignment.

Within the system of decentralised implementation of EU pre-accession funds, Croatia is subject to provisions requiring the National Authorising Officer to regularly communicate on suspected irregularities and fraud. A whistle-blowing system is in place which protects those officials who report suspected wrongdoings in the administration. Croatia stated that it plans to establish a central office to treat and coordinate suspected cases of irregularities and fraud, which would serve as a contact point (AFCOS) for the Commission's Anti-Fraud Office.

With regard to the protection of the Euro against counterfeiting, Croatian law provides for a definition of such acts referring to both notes and coins. The Croatian National Bank (CNB) has been appointed with respect to technical analysis and central collection and processing of information on counterfeit Kuna banknotes and coins. The technical analysis of counterfeit Euro is carried out by a specialised centre within the ministry of the interior. The criminal police directorate within the ministry of the interior centralises all information relating to counterfeits and informs Europol and Interpol. The CNB plans to prescribe, until the end of 2006, the obligation for all financial institutions to withdraw suspected counterfeits from circulation and procedures for such cases.

Cooperation with the Member States, the Commission and the European Central Bank (ECB) takes place in terms of exchange of information (via Interpol, Europol and the European Commission’s Pericles programme). Croatia recognises the need for legislation to provide for communication or transmission of counterfeits to the ECB.
Regarding counterfeit and sale of medals and tokens similar to Euro coins, Croatia plans to pass relevant legislation until the end of 2006.

3.3. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTATION CAPACITY

As regards the relevant international standards and the acquis under this chapter, Croatia has achieved a satisfactory level of alignment. A comprehensive strategy paper has been adopted and primary legislation is being developed. Croatia is aware of the need for further development and implementation, which can be achieved in the medium term.

3.3.1. Public Internal Financial Control (PIFC) and External Audit

The strategy for development of the PIFC system and the Strategic Development Plan for the State Audit Office are comprehensive and aim at upgrading the PIFC system and external audit towards meeting EU requirements. These documents are of dynamic nature and may need to be updated based upon experience having in mind also that implementation deadlines for actions might be prolonged. Croatia is therefore requested to provide the European Commission with updates of action plans including actions to be taken, deliverables, owners and expected completion time on a regular basis.

The development and adoption of the PIFC framework law is important in order to provide a clear and authoritative basis for upgrading the internal control system. Once the new law is adopted, the internal audit implementing regulations already passed by the Ministry of Finance needs to be revised for consistency with the new law. The capacity of the Central Harmonisation Units for internal audit and financial management and control will have to be kept at levels in such a way that they can carry out their responsibilities adequately and timely. Training and certification of internal auditors needs to continue. In particular, the focus needs to be on development of implementing regulations for financial management and control and on related training of management and staff.

Croatia has been accredited for the Decentralized Implementation System of Community assistance in February 2006. The implementation of the system will be monitored closely.

In the field of external audit, the Commission welcomes Croatia's commitment to provide the State Audit Office with a legal basis in the constitution in order to strengthen the State Audit Office's position and independence. Croatia also needs to strengthen the State Audit Office's financial independence by introducing in its legislation that it can submit its draft budget directly to the Parliament for its deliberation and decision. The audit manuals needs to be adopted taking into account the relevant standards and training of staff should continue.

3.3.2. Protection of EU Financial Interests and Protection of the Euro

Croatia must still take the necessary decisions to nominate and establish the instruments ensuring the coordination and co-operation with OLAF for the fight against fraud in the field of the protection of the EU Financial Interests. Constructive discussions on the establishment of an AFCOS have taken place with OLAF and Croatia has committed itself to take such decision shortly.
In order to comply with the requirements of the PIF-Convention and its protocols, Croatia’s criminal law identifies certain offences. However, Croatia must still undertake further efforts to align its provisions with the Convention and the Protocols:

- The penal law protection against the misappropriation of funds should be completed.
- The existing fraud and corruption provisions should be assessed as to whether a further amendment of national law is required in the light of Croatian jurisprudence.
- The jurisdiction granted to Croatian courts should also be aligned in detail with the requirements of the PIF-Convention and its protocols.

With respect to the protection of the Euro against counterfeiting Croatia needs to designate national analysis centres for coins and notes where all suspected counterfeits will be transmitted for identification. An adequate level of police capacity appears to be in place.

Croatia should provide specific sanctions for credit institutions failing to withdraw counterfeits from circulation and hand them over to the competent national authorities. Moreover, there should be a provision for sanctions against medals and tokens similar to Euro coins.
3.4. STATISTICAL DATA, THE CRISIS AND ECONOMIC PROBLEMS

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<td>47364.8</td>
<td>45143.3</td>
<td>46884.7</td>
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</tbody>
</table>

Source: Eurostat, 28/04/2010

The economic situation in Croatia has been affected severely by the economic downturn. The Gross Domestic Product (GDP) contracted by 5.7 per cent in the third quarter of 2009 (after a drop of 6.5 per cent during the first six months of 2009). The IMF had initially foreseen a slow recovery towards the end of 2009. However, the negative result for the third quarter and the low industrial output in November and December 2009 suggest a slower pace of recovery. It is estimated that real GDP contracted by 5.7 per cent in 2009 and the economy will only recover towards the end of 2010. According to the IMF, GDP will grow marginally by 0.4 per cent in 2010. This slowdown has led to a rise in the unemployment rate. In January 2009, unemployment rose to 17.7 per cent, which is the highest rate since March 2006.

It should be noted that Croatia is the country with the highest external debt of the Western Balkans (83 per cent of GDP). This debt and the sizeable external financing needs in 2009 and 2010 have given rise to serious liquidity risks in the current adverse financial environment. The World Bank provided a 200 million euro loan to the Croatian government in January 2010, which will be used primarily for the repayment of liabilities due in the first two months of 2010.

Due to the weak economies in the main export markets, Croatian exports contracted by 16.1 percent in 2009. However, the larger drop of imports by 21 per cent helped the current-account deficit to reduce to 5.5 per cent of GDP in 2009 (compared to 9 per cent in 2008).

The adopted 2010 budget foresees a budget deficit of 2.8 per cent, which is at a similar level to that of 2009. In January 2010, the government adopted two anti-recession measures designed to aid economic recovery through boosting credit activity. The first measure will help private companies to improve their financial situation through co-funding from the state and private banks. The second measure provides companies with public (state) guarantees of up to 50 per cent of their credit lines through the establishment of a guarantee fund. However, the details for how these measures will be implemented have not been clarified yet. There has been some criticism that these measures are not well targeted and do not exclude non-profitable companies.

According to the Croatian Finance Ministry\(^\text{12}\), budgetary revenues in the first four months went down 3.2 percent compared with the same period in 2009, while expenditure rose by 1.7 percent and expenditures in April was almost negligible.

The ministry believes that reducing the income tax rate and abolishing the so-called crisis tax would bring an additional HRK 1.5 billion to citizens, while the reduction or

\(^{12}\) Hina, Croatia’s budget revenues down 3.2 pct, Brief News Bulletin 7499, 06 May 2010
Cancellation of tax reliefs would bring them HRK 500 million less so in the end, citizens can count on HRK 1 billion a year more.

The total budget revenues in the first four months totals HRK 35.2 billion, down HRK 1.16 billion or 3.2 percent in relations to the same period in 2009. In the same period total expenditures amount to HRK 40.8 billion, this is HRK 681 million or 1.7 percent more than in the first four months last year. The budget deficit in the first four months totals HRK 5.5 billion.

In April alone, budget revenues and expenditures were nearly balanced - revenues totalled HRK 9.85 billion, which expenditures coming to HRK 9.91 billion, Total deficit amounted to HRK 66.8 million. The ministry expects the positive trend to continue. Tax revenues in the first four months total HRK 19.7 billion, up 2.5 percent year-on-year.

The consumer goods basket of the Federation of Independent Trade Unions of Croatia (SSSH) shows that the minimum living costs of a four-member family in April were HRK 6,490.15, an increase of 0.07 per cent from March. The SSSH consumer goods basket covers minimum monthly expenses for food, housing, transport, hygiene, clothing, education, and culture.

The average net salary for February, according to the Central Bureau of Statistics, was HRK 5,157, which covered 79.45 per cent of living costs, the SSSH said.

The minimum living costs of a family living in rented accommodation increased 0.20 per cent to HRK 8,081.62, which covered 63.81 per cent of the costs.

Car-owning families spend at least an additional 919.16 kuna per month. The minimum costs of a retired couple were HRK 3,694.43, down 0.06 per cent from March. The average pension for March was HRK 2,162.17, which covered only 58.53 per cent of the costs.13

In a macroeconomic general scope, Croatia's economic performance largely depends on the tourism sector. The tourist season 2009 was largely satisfactory with only a small decrease in the number of tourists and overnight stays despite the economic downturn. However, it is too early to make any projections for 2010.

Croatia is an open economy dominated by the service sector (mainly tourism), which accounts for around 65 per cent of total GDP followed by the industrial sector with around 27 per cent. Tourism is the biggest source of revenue representing 20 per cent of GDP in 2009. Other major sources of revenues include the export of machinery and ships. The heavily subsidised shipbuilding industry is responsible for 10 per cent of all exports. In addition to the shipyards, the food processing and chemical industries are the other major industrial sectors.

Agriculture represents around 6 per cent of total GDP and continues to be an important source of employment. Its total share of employment has remained large and is slightly over 13 percent. However, land fragmentation and low level of production compared to the EU have remained a major constraint.

Croatia's main trading partner is the EU and its share in total Croatian exports and imports is at around 61 and 64 per cent respectively. The main export goods to the EU are basic...
machinery and transport equipment. The CEFTA countries (i.e. other Western Balkan countries) accounted for approximately 10 per cent of all Croatian trade in 2009.

Croatia has the highest GDP per capita among all Western Balkan countries. It is also higher than those of the EU member states Bulgaria, Romania, Latvia, Lithuania and Poland. The GDP per capita (in purchasing power parity) was around 63% of the EU average in 2009.

The restructuring of the Croatian shipyards appears to be one of the most difficult economic issues in the accession negotiations. In February 2010, the Croatian Privatisation Fund, after the Commission had agreed to this plan, issued a new call for tenders for the six shipyards after the first call failed in August 2009. The closing date to submit offers is 19 April 2010. Four of the shipyards are offered at a symbolic price of one kuna according to the publications. The only solvent shipyard 'Uljanik' in Pula is being offered at the price of 54 million euro (for a 59.25-percent majority stake). The sixth special constructions shipyard, Brodosplit-Brodogradiliste, is offered at an opening price of 2.5 million euro. The six state-owned Croatian shipyards employ between 11,500 - 12,000 people and lot more depending on the industry directly or indirectly. The economic importance of the Croatian shipyard industry is determined by the fact that the sale of ships is Croatia's single most important export product. All six shipyards are entirely dependent on state aid due to low productivity, overstaffing, outdated technology and the overall situation in the world shipbuilding industry. The pre-accession procedures and documents imply that state aid does not allow subsidies to uncompetitive industries. Moreover, the Commission has insisted on the restructuring of the shipbuilding sector before Croatia can join the EU.

After a failed attempt to restructure the shipyards in 2008, the Croatian government had to cancel the first tender for privatisation at the end of September 2009 due to lack of interest.

4. RELATIONS WITH THE EUROPEAN UNION

4.1. STATE OF CROATIA'S ACCESSION PROCESS

The European Council granted Croatia the status of a candidate country in June 2004. Accession negotiations were opened in October 2005. Earlier, Croatia and the EU had signed the Stabilisation and Association Agreement in October 2001, which entered into force in February 2005. The European Commission has opened 30 out of 33 accession negotiation chapters and provisionally closed 17 chapters. The latest inter-governmental conference between the EU and Croatia took place on 19 April 2010, at which one negotiation chapter (Free Movement of Goods) was closed.

The Commission enlargement strategy of 14 October 2009 concluded that the accession negotiations could be concluded in 2010 provided that Croatia meets all outstanding benchmarks. Although Croatia has achieved significant progress in most areas and intensified its efforts in the field of rule of law, further efforts are needed particularly in areas such as judicial and administrative reform, the fight against corruption, minority rights and refugee return.

Other open issues with Serbia include refugee return, property-related matters and the genocide lawsuit before the International Court of Justice. There are similar problems with Bosnia and Herzegovina, where the ratification of the 2005 agreement on demarcation of borders has remained on hold.
4.2. THE EUROPEAN PARLIAMENT'S POSITION

The latest European Parliament Resolution is from 10 February 2010 on Croatia's 2009 progress report. The European Parliament commended Croatia for its continued progress towards meeting the EU accession criteria. The Resolution also stated that the accession negotiations could be concluded in 2010 and Croatia's successful accession would give a positive impetus to the process of integrating the rest of the Western Balkan region within Europe.

The Resolution further mentioned that Croatia would be expected to fully co-operate with the ICTY and allow the Court access to documents requested for use in war-crime trials. The EP also recommended that the Council should decide as soon as possible to open the negotiation chapter on "Judiciary and Fundamental Rights".

Finally the EP expressed its concern that public support for membership was diminishing in Croatia.

4.3. THE EUROPEAN COMMISSION 2009 PROGRESS REPORT

On 14 October, the European Commission issued its Enlargement strategy and main challenges 2009-2010 and its 2009 Progress reports on the individual Western Balkan countries. The Commission enlargement strategy confirmed that Croatia had made good progress in meeting the benchmarks. It stated that the accession negotiations could be concluded in 2010 if Croatia meets all outstanding conditions.

The main findings of the 2009 progress report are:

The road map included in last year's Strategy Paper has successfully galvanised efforts in Croatia aimed at meeting the benchmarks in order to open and close the chapters according to the roadmap's indicative timetable. The good overall progress achieved by Croatia in numerous chapters means that technical preparations in the negotiations are now nearing their final phase.

**Political criteria**

Croatia continues to meet the Copenhagen political criteria. New legislation and organisational changes have been introduced to reform the judiciary and to fighting against corruption and organised crime. Case backlogs before courts have been reduced. The anti-corruption body USKOK is increasingly active. Public administration reform has received increased attention. Croatia has taken some steps to address problems of minorities, particularly the Roma. The provision of housing care for returning refugees is much improved. Croatia has continued to participate actively in regional co-operation.

However, considerable challenges remain in key areas, such as improving the independence and efficiency of the judiciary, overhauling the functioning of public administration and in fighting organised crime and corruption, which remains prevalent in many areas. Further attention needs to be paid to minority rights, including completing the process of refugee return. The prosecution of war crimes requires continued attention. Problems of access by ICTY to important documents in Croatia remain. Regional co-operation needs to continue, as do efforts to solve outstanding bi-lateral problems with neighbours, especially on border delimitation.
**Economic criteria**

Croatia is a functioning market economy. It should be able to cope with competitive pressures and market forces within the Union, provided that it further implements its comprehensive reform programme with determination in order to reduce structural weaknesses.

Although the economy of Croatia has been increasingly hit by the global crisis, macroeconomic stability has been preserved. Croatia adapted its fiscal policy, including successive budget revisions and spending adjustments. External imbalances have narrowed, exchange rate stability has been preserved, and inflationary pressures have subsided. The banking sector has remained sound and resilient to the crisis.

However, the government’s economic policy has sometimes lacked a clear medium-term orientation. Structural reforms have advanced at a slow pace and there were limited improvements in the business environment. Employment rates are low and the labour market overly rigid. Little progress has been achieved in increasing the efficiency of public spending. The fiscal deficit increased significantly. A high level of external indebtedness and large repayment obligations are key vulnerabilities of the economy.

**EU legal order**

Croatia has improved its ability to take on the obligations of membership. Preparations for meeting EU requirements have continued to progress well and there is a good degree of alignment with EU rules in most sectors. However, further efforts lie ahead, in particular as regards further reinforcement of the administrative structures and capacity necessary for proper implementation of the acquis communautaire and in difficult chapters such as judiciary and fundamental rights, competition policy and agriculture and rural development. Also, vigilance is required to ensure the budget cuts necessary in the context of the economic downturn do not disproportionally affect preparations for EU accession.

**4.4. EUROPEAN FINANCIAL ASSISTANCE TO CROATIA**

The financial assistance Croatia has received under the Instrument of Pre-accession Assistance (IPA) begins in 2007. A total amount of 154.2 million euro is foreseen for 2010.

The current priorities of IPA assistance are in the fields of judiciary. They include the fight against organised crime and corruption, public administration reform, de-mining, the protection of minorities and local community development. There will also be a reinforced emphasis on support for the civil society aimed at assisting civil society organisations in developing, implementing and monitoring public policies as well as raising awareness on the challenges of EU accession.

As regards economic development, the priorities will be in the fields of public finance, statistics, health care and social policy, improvement of incentive structures and flexibility in the labour market and development of active labour market policies as well as improvement of the economic environment.

Furthermore, the IPA will continue to provide assistance for the institution’s building projects as well as to strengthen the country’s ability to assume the obligations of future EU membership.

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14 Directorate-General for External Policies of the Union, Policy Department, Croatia-Country Briefing 2010, March 2010
In addition to IPA funds, the EU created a crisis package in 2009 comprising EUR 200 mn for all seven Western Balkan countries in order to counter the impact of the global economic crisis. Around half of the funds will go to municipal investments. Funds are apportioned to certain projects to increase energy efficiency, as well as to provide micro-credits for small and medium enterprises. Some funds are also earmarked to strengthen co-operation among financial sector regulators in the region. This crisis package is expected to leverage an amount of at least EUR 1 bn in loans from more international financial institutions.

Before 2007, Croatia received around EUR 278.8 mn from the CARDS programme between 2000 and 2004, and another EUR 252 mn from the three pre-accession funds (PHARE, ISPA and SAPARD) in 2005 and 2006.
ANNEX A - BASIC INFORMATION ON POLITICAL STRUCTURE AND COUNTRY DATA

Political structure

Form of state - Democratic republic
Legal system - Based on Croatian Constitution of 1990 (and subsequent amendments).
National legislature - Unicameral Assembly (Sabor) with currently 153 seats
Head of State - Ivo Josipovic (SDP)
Parliamentary Speaker - Luka Bebic (HDZ)
National Government - Coalition of centre-right Croatian Democratic Party (HDZ), Croatian Peasants' Party (HSS), Croatian Social Liberal Party (HSLS), and minority representatives
Prime Minister - Jadranka Kosor, (HDZ)
Opposition parties - Social Democratic Party (SDP), Croatian People's Party (HNS), Croatian Party of Rights (HSP), Croatian Pensioners' Party (HSU), and Istrian Democratic Party (IDS) - all represented in Parliament

Country data

Total area - 56,542 km²
Population - 4.49 (estimate July 2008)
Main cities - Zagreb (779,000 estimate July 2008), Split (221,000 - est. July 2007), Osijek (115,000 - 2001 census)
Official languages - Croatian.
Currency - Croatian kuna (HRK), 1 euro = 7.22 kuna
### ANNEX B - TIMELINE OF EVENTS

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 January 1998</td>
<td>The United Nations Transitional Authority for Eastern Slavonia, Baranja and Western Sirmium returns control over eastern Croatia, restoring the country’s full sovereignty for the first time since the Croatian War of Independence.</td>
</tr>
<tr>
<td>4 March 1998</td>
<td>Ministry of European Integration formed within the Croatian Government.</td>
</tr>
<tr>
<td>29 October 2001</td>
<td>Croatia signs the Stabilisation and Association Agreement.</td>
</tr>
<tr>
<td>21 February 2003</td>
<td>Formal application for membership submitted.</td>
</tr>
<tr>
<td>9 October 2003</td>
<td>Croatia submits answers to the Commission’s Questionnaire.</td>
</tr>
<tr>
<td>20 April 2004</td>
<td>European Commission replies to the answers with a positive opinion (Avis).</td>
</tr>
<tr>
<td>18 June 2004</td>
<td>Croatia receives official candidate status.</td>
</tr>
<tr>
<td>20 December 2004</td>
<td>European Council sets the date for the entry negotiations to begin 17 March 2005.</td>
</tr>
<tr>
<td>1 February 2005</td>
<td>SAA (Stabilisation and Association Agreement) comes into force.</td>
</tr>
<tr>
<td>16 March 2005</td>
<td>Negotiations postponed.</td>
</tr>
<tr>
<td>3 October 2005</td>
<td>The beginning of negotiations.</td>
</tr>
<tr>
<td>20 October 2005</td>
<td>Beginning of the screening process.</td>
</tr>
<tr>
<td>12 June 2006</td>
<td>1 chapter is opened and closed: Science and Research.</td>
</tr>
<tr>
<td>28 June 2006</td>
<td>2 chapters are opened: Competition Policy and Customs Union.</td>
</tr>
<tr>
<td>20 July 2006</td>
<td>1 chapter is opened: Social Policy and Employment.</td>
</tr>
<tr>
<td>11 December 2006</td>
<td>1 chapter is opened and closed: Education and Culture.</td>
</tr>
<tr>
<td>29 March 2007</td>
<td>1 chapter is opened: Intellectual Property Law.</td>
</tr>
<tr>
<td>26 June 2007</td>
<td>6 chapters are opened: Company Law, Financial Control, Financial Services, Information Society and Media, Right of Establishment and Freedom To Provide Services, and Statistics.</td>
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<tr>
<td>Date</td>
<td>Events</td>
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<tr>
<td>12 October 2007</td>
<td>2 chapters are opened: Consumer and Health Protection and External Relations.</td>
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<tr>
<td>20 December 2007</td>
<td>2 chapters are opened: Trans-European Networks and Financial and Budgetary Provisions.</td>
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<tr>
<td>21 April 2008</td>
<td>2 chapters are opened: Energy and Transport Policy.</td>
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<tr>
<td>17 June 2008</td>
<td>2 chapters are opened: Freedom of Movement For Workers and Social Policy and Employment.</td>
</tr>
<tr>
<td>25 July 2008</td>
<td>1 chapter is opened: Free Movement of Goods. 1 chapter is closed: Enterprise and Industrial Policy.</td>
</tr>
<tr>
<td>30 October 2008</td>
<td>1 chapter is closed: External Relations.</td>
</tr>
<tr>
<td>19 December 2008</td>
<td>1 chapter is opened: Public Procurement. 3 chapters are closed: Economic and Monetary Policy, Information Society and Media, and Intellectual Property Law.</td>
</tr>
<tr>
<td>23 April 2009</td>
<td>EU calls off talks with Croatia due to the latter having a border dispute with Slovenia over the Bay of Piran.</td>
</tr>
<tr>
<td>11 September 2009</td>
<td>Slovenia agrees on an immediate ending of its blockade of Croatia’s EU accession and further negotiation of the Gulf of Piran border dispute between the 2 countries.</td>
</tr>
<tr>
<td>2 October 2009</td>
<td>Croatia closed 5 chapters and opened 6 new. Chapters that were closed: Company Law, Customs Union, Freedom of Movement of Workers, Statistics, and Trans-European Networks. As of October 2, Croatia has closed 12 chapters and 16 are still open. Croatia plans to open remaining chapters by the end of this year and conclude negotiations on remaining EU chapters by March 2010.</td>
</tr>
<tr>
<td>27 November 2009</td>
<td>3 chapters are closed: Consumer and Health Protection, Energy, and Financial Services.</td>
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<tr>
<td>21 December 2009</td>
<td>2 chapters are closed: Right of Establishment and Freedom To Provide Services and Social Policy an Employment.</td>
</tr>
<tr>
<td>19 February 2010</td>
<td>2 chapters are opened: Environment and Fisheries.</td>
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<tr>
<td>19 April 2010</td>
<td>1 chapter is closed: Free Movement of Goods</td>
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### ANNEX C - CHAPTERS CLOSED SO FAR

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<tr>
<th>Acquis chapter</th>
<th>EC Assessment At Start</th>
<th>Screening Started</th>
<th>Screening Completed</th>
<th>Chapter Frozen</th>
<th>Chapter Unfrozen</th>
<th>Chapter Opened</th>
<th>Chapter Closed</th>
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<td>8. Competition Policy</td>
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<td>End Date</td>
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<td>22. Regional Policy &amp; Coordination of Structural Instruments</td>
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<td>18 out of 33</td>
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2. European Commission, Screening report Croatia, Chapter 32 - Financial control, 28 September 2006
8. European Parliament resolution of 10 February 2010 on the 2009 progress report on Croatia, 10 February 2010
Role
Policy departments are research units that provide specialised advice to committees, inter-parliamentary delegations and other parliamentary bodies.

Policy Areas
- Budgets
- Budgetary Control

Documents