

**DRAFT PROGRAMME
SUPPORT PROGRAMME FOR CROATIA IN 2001**

1. IDENTIFICATION

Beneficiary state:	Republic of Croatia
Programme:	Council Regulation (EC) No.2666/2000
Year:	2001
Cost:	€36.8 million
Expiry date:	31.12.2003 contracting 31.12.2004 disbursements
Sector:	AA
Group:	M
Budget line:	B7-541
Implementing Body:	European Commission Services

2. SUMMARY

This proposal is the second part¹ of the planned assistance to Croatia in 2001, worth € 36.8 million. The primary goal of the proposed programme is to support the implementation of the Stabilisation and Association Agreement, initialled on 14 May 2001, which largely endorses Croatia's own agenda in the European integration perspective

The specific objectives of this second part of the 2001 action programme are: to contribute to the economic and social development of Croatia, as well as to the modernisation of the state administration and other public institutions, indispensable to reinforce the rule of law and to strengthen of democracy. Moreover, the proposed programme aims at a wider impact on regional stabilisation, by promoting co-operation and trade .

The following sectors and priorities are proposed for funding:

1. Economic Development

- Human capital: vocational education and training - € 0.6 million: contribution to the establishment of a modern, flexible and high quality vocational education and training system, responsive to the needs of the labour market and the society and well integrated with the primary, general secondary and higher education systems, with an emphasis in decentralised management and the preparation of concepts for holistic curriculum and teacher training reform.
- Human capital: TEMPUS - € 4 million: promotion of the reform of higher education institutions as well as academic teaching and learning using the so-called "Joint European Projects", whose aim is to contribute to the long term development and renewal of the partner country higher education through co-operative activities between the European Union and the partner country higher education institutions.

¹ The first part, sustainable return of refugees, €23.2 million was approved by the CARDS Committee on 25 July 2001

- Human capital: labour market restructuring - € 3.0 million: contribution to improving adaptability, employability and development of entrepreneurial skills amongst employees in companies being restructured and improving prospects of unemployed people to quickly reintegrate into the labour market, by means of strengthening the institutional capacity of the employment service and providing and testing the effectiveness of demand-driven labour redeployment services.
- EU industrial standards – € 3.0 million: assistance in facilitating international trade and in meeting obligations in this area stemming from the Stabilisation and Association Agreement that requires the set-up and harmonisation of the legal and regulatory framework related to standardisation, metrology, accreditation and conformity assessment.
- Energy infrastructure rehabilitation - € 3.8 million: contribution to the interconnection of power systems in South Eastern Europe with those of Central and Western Europe, technically supporting the rehabilitation of the central power station located at the village of Ernestinovo the in Croatian Danube Region, as a complementary action of an EIB-funded project.

2. SAA Obligations

- Justice and Home Affairs: reform of the judiciary – € 1.5 million: contribution to the development of a more efficient and effective judiciary through the development of a training delivery mechanism for judges, prosecutors and other auxiliary court personnel, including curricula review and design, train-the-trainers, direct delivery of training in new legal areas, as well as some investment in training facilities and infrastructure.
- Justice and Home Affairs: reform of asylum policy – € 2.1 million: assistance in enabling Croatia to adopt and apply an asylum and migration policy in line with international and EU standards. The programme will have a legal reform assisting in reviewing and drafting the draft Law on Asylum and the Law on Foreigners, while the institution building component will focus at strengthening the capacity to implement the new pieces of legislation. The technical assistance will be supported by investment in reception facilities for asylum applicants and recognised refugees.
- Integrated border management – € 10.5 million: contribution in facilitating movement of people and goods, secure Croatia's borders and ensure regional stability through institution and capacity building for individual border agencies, as well as facilitating inter-agency co-operation. Therein investment will focus on specialised equipment for individual agencies and inter-agency co-operation. Funds will also be allocated to upgrade the infrastructure at the selected border crossing points.
- Public Administration Reform - € 1.5 million: contribution to the ongoing civil service reform based on the new Law on Civil Service and to enhance the public administration's capacity to implement the *acquis communautaire* with special emphasis on the Ministry of Justice, Public Administration and Local Government. The programme will also assist in the development of training programmes for civil servants;

- Intellectual property – € 1.8 million: assistance in alignment with *acquis communautaire* in this area and thus in compliance with the obligations of the Stabilisation and Association Agreement. The programme aims to harmonise the system intellectual property rights, the implementation of the harmonised legislation and institution and capacity building of the State Intellectual Property Office and other stakeholders necessary for the implementation.
- Competition policy - € 1.5 million: assistance in strengthening the Croatian competition authorities and alignment of legislation with the *acquis communautaire*, as well as to strengthen its institutional and administrative capacity in implementing the competition related articles of the SAA. The programme focuses on measures such as human resources development, setting up the legislative framework, improvement of the technical infrastructure necessary for enactment of the related legislation, and fostering international co-operation.
- Statistics - € 1.5 million: contribution to strengthening the statistical system of Croatia providing adequate infrastructure for data collection and processing, and approximate its methods to the European ones, through the progressive adoption of the Community *acquis* in areas such as business, agriculture, external trade and National Accounts.

3. Complementary measures

- Small scale operations - € 1.0 million: assistance in strengthening and developing the role of Croatian civil society and local institutions.
- Strategy development capacity building - € 1.0 million: assistance in improving the programming capacity of the Government of Croatia. This facility will mainly be used for four selected areas: agriculture, regional development, environment and small and medium enterprises, but shall not be limited to these areas if further programme assistance need arises and the budget allows for.

Maximum available: € 36.8 Million
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3. GENERAL BACKGROUND

3.1. Past EC Funding

From 1991 to 2000 the Community assistance provided to Croatia has totalled € 381.61 million. In the period 1991-1995, the crisis in the region required that funding be mobilised on a large scale for humanitarian assistance (€ 243.2 million of the total € 244.87 million) through ECHO.

Subsequently, Community assistance was re-focused to support the Croatian government's efforts to reconstruct private and public infrastructure, as well as community life, by promoting the respect of human rights and reconciliation (funds provided by the human rights and democratisation budget line). Since 1996, through

the EUPOP programme and OBNOVA funds a substantial package to encourage the return and reintegration of refugees and displaced persons was delivered.

The political changes that took place in 2000 brought with them a widening of the scope of Community assistance; the OBNOVA budget line provided funds for technical assistance to selected line ministries totalling € 4.5 million, in order to prepare the SAA implementation phase and programme the related CARDS assistance. Croatia has also been eligible for support in the fields of higher education, through the Tempus programme and environment through the LIFE Third Countries programmes.

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

	1991-1995	1996	1997	1998	1999	2000	Total
Humanitarian aid (ECHO)	243.2	21.15	14.5	6.95	8.0		293.8
Refugee return (OBNOVA)		7.02	8.59	14.00	13.6	10.00	53.21
De-mining				1.0	0.5		1.5
Democracy and human rights, media (national programmes)	0.77	1.74	6.59	5.5		0.96	15.56
Democracy and human rights, media (regional programmes)	0.2		0.2	0.30	6.44		7.14
Customs					1.0		1.0
Tempus (including preparatory activities)					0.1	1.50	1.6
Environment (LIFE)	0.7			0.76			1.46
Institution building (OBNOVA)						3.00	3.0
Judiciary (OBNOVA)					0.6		0.6
SMEs (OBNOVA)						2.34	2.34
Small Scale Operations					0.4		0.4
Total	244.87	29.91	29.88	28.51	30.64	17.8	381.61

3.2 Socio-political issues

Croatia's political scenario over the last years has been marked by a comprehensive transition process. Croatia declared its independence from the former Socialist Yugoslav Federation in 1991, and constituted itself as a semi-presidential Republic. However, during the first decade of its independent history Croatia had to face a very difficult period. Croatia's involvement in wars until 1995 created a difficult legacy and contributed to the maintenance of power by the nationalist regime guided by

President Tudjman. This resulted, in particular after 1995, in growing international isolation of Croatia.

The Parliamentary and Presidential elections in January 2000 determined a turning point in the Croatian democratisation process. The large victory of a centre-left, pro-European, six party coalition voiced a strong need for changes in the Croatian population for which full democratisation and economic growth had started to outweigh the nationalistic considerations upon which Tudjman's HDZ had founded its government programme.

Deepening relations with the EU, with a view to a gradual integration into the European structures, is a major objective of the political programme of the coalition Government that took power in January 2000. In this regard the new leadership stated its commitment to fulfilling the underlying political conditions indicated by the EU in its Stabilisation and Association Process (SAP).

Major improvement by comparison with the previous regime can be reported with regard to the strengthening of an overall democratic environment, the respect for human rights, the protection of minorities, improved relations with neighbouring countries, all of which are important elements of SAP conditionality. Important progress can also be reported in the implementation of peace agreements, notably as regards co-operation with the International Criminal Tribunal for former Yugoslavia (ICTY), normalisation of the living conditions in the war-torn areas and commitment to the full implementation of the return process.

A decade into the period of economic and political transition in Croatia, despite the moderate successes in the development of the market economy and the reconstruction of the social structure, there is still a clearly visible lack of public discussion and participation of civic groups in the decision-making processes. This is due in one part to the difficulty of maintaining a minimum social economic status for most of the population, and on the other hand to the lack of civic skills education.

The general scenario has contributed to a substantial improvement of the relations of Croatia with the International Community, and in particular the European Union. Accession to the NATO Partnership for Peace in May 2000, membership of WTO formalised in November 2000, Council of Europe decision to suspend human rights monitoring in Croatia, and enhanced relations with the EU were all important steps which marked the end of the international isolation of this country.

With particular regard to EU/Croatia relations, substantial progress has been achieved. Since the advent of the new leadership, political dialogue has been intensified and co-operation has been established at technical level. The main event in the bilateral relations has been the negotiation of a Stabilisation and Association Agreement with Croatia, formally concluded with the initialling of the text on 14th May 2001.

The SAA will be a comprehensive framework providing for wide-ranging co-operation in all the fields of Community competence and interest. It will represent the legal basis for the deepening of relations and will create several obligations for Croatia in terms of legal approximation, liberalisation of trade in goods and services as well as on capital movement. The commercial chapter of the SAA, together with the other trade-related provisions, is expected to enter into force early thanks to the conclusion

of an Interim Agreement, expected after the signature of the SAA, in early autumn 2001.

With regard to relations with neighbouring countries, the new Croatian leadership has accepted a key role in reconciliation and stabilisation of the whole region, having expressed its firm commitment to both improving its bilateral relations and continuing to play an active role within the region, as major conditions in the furthering of the bilateral relations with the EU.

In particular, a radical change of attitude towards Bosnia and Herzegovina should be emphasised, with most of the ruling coalition working to build much more transparent relations with Bosnians Croats, and enhance direct contacts with the Central Bosnian institutions. Relations with the Federal Republic of Yugoslavia (FRY) are also slowly improving, although territorial disputes over the Prevlaka peninsula still remain open, but should not be such as to create security problems. The former pending issues with Slovenia did particularly evolve in July 2001 and solutions have been found through regular diplomatic channels.

3.3 Socio-economic issues

Croatia implemented one of the most successful stabilisation programmes in the Western Balkans in 1993. Defence expenditures and financial costs resulted in inflation reaching 30% per month in 1993; however, macroeconomic stability was restored by 1994. With the cessation of armed conflict in 1995, reconstruction and recovery were subsequently accompanied by growing domestic demand, driven mainly by a surge in consumption and investment.

This rapid expansion of domestic demand led to greater external imbalances. Imports increased, while exports remained constant in nominal terms, reflecting an increasingly inward orientation of the economy that led to a current account deficit of 11.6 % of GDP in 1997, although the deficit decreased to 7.3% in 1999. Increased reliance on external borrowing not only augmented indebtedness, but also created a dependence on access to international capital markets.

GDP growth declined from 6.5 % in 1997 to -0.3% in 1999. Budget cuts in 2000 were adopted to restore macroeconomic stability and to initiate structural fiscal reforms. Renewed efforts in structural reforms and fiscal sustainability, as well as an improvement of the regional situation could return Croatia to a path of modest growth, perhaps in the order of 3.5 to 2.5% during the period 2000-2002. Croatia's total external debt late last year amounted to USD 10.9 billion and this year it increased by USD 450 million to USD 11.3 billion. A half of the external debt refers to the government.

In December 2000 the registered unemployment rate was 22.4% (as against the average monthly unemployment rate of 19.4% in 1999). Of the total number of unemployed, 27.8% looked for a job the first time (which is 5.8% more than at the same time last year). Persons aged 20 – 34 had a total share of 46.2% of all registered unemployed. Even persons with university degree still accounted for 3.9% of all registered unemployed. 75% of all new unemployment comes from enterprises which are being restructured or privatised.

Most of the 2.600 socially-owned enterprises have been privatised through employee buyout and voucher privatisation. However, progress in privatising large public enterprises, including those dealing with oil, electric power, railroads and telecommunications remains slow, and has inhibited investment in new technologies and changes in management.

Recovery of sustainable growth will require the maintenance of macroeconomic and financial stability. A reduction in fiscal expenditures and banking sector reforms are necessary to maintain fiscal balance and a supportive monetary policy. Other measures need to address issues such as the size and role of the state and the efficiency of public administration. A reduction in social expenditures through pension and health system reforms is essential. Public expenditures need to be reduced and managed in a transparent and efficient manner.

Accelerated privatisation of utilities still in public ownership will help reduce inefficiencies that tax development and environmental protection. With reductions in public expenditures and real sector performance, more attention will have to be paid to structural and transitional poverty through downsizing the country's expensive welfare system and better targeting cash transfers.

4. PROGRAMMING CONTEXT

4.1 The current situation

The Stabilisation and Association Agreement offers to Croatia formal political relations with the EU and a roadmap to integration. The SAA Parties committed themselves to contribute to the political, economic and institutional stabilisation in Croatia as well as in the region. In particular, the SAA intends to support the country's efforts to complete the transition to a free market economy and gradually develop a free trade area with the Community, taking into account the rights and obligations arising out of the WTO. The SAA also entails obligations in the fields of human and minorities' rights, as well as the rule of law. In order to implement the SAA commitments, Croatia will have to align legislation with EU standards and carry out extensive reforms. In fact the Agreement is a reform agenda in itself.

In this respect, the SAA implementation process poses a serious challenge to Croatia, but it provides a new impetus to the ongoing comprehensive reform process involving public, private sectors and civil society alike. The Croatian government is currently preparing the SAA implementation plan and strengthening the capacity of the Ministry for European Integration, in charge of coordinating co-operation with the Community through CARDS.

This programme targets only some selected sectors indicated in the Stabilisation and Association Process where there is the most urgent need to speed up reforms and legal approximation. The proposal also comprises support in favour of human capital development, in consideration of the severe unemployment problem and it includes capacity building for state institutions. Institution and capacity building are indispensable to assist Croatia in the complex process of modernisation and European integration.

4.2 The programming criteria

The following main criteria were adopted :

- To assist in the reform of sectors which will allow the country to comply with the obligations of the Stabilisation and Association Agreement
- To ensure that the programme is in line with the Government's own priorities and plans
- To intervene in sectors where the EU has a comparative advantage as a donor
- To ensure there is no overlapping, but complementarity and potential synergy with activities undertaken by other donors, in particular EU Member States (MS) and International Financial Institutions (IFI), such as EIB, EBRD and the WB
- To contribute to the CARDS regional programme objectives (integrated border management)

4.3 The choice of sectors

The sectors have been selected by reference to the most urgent priorities established in the Stabilisation and Association Agreement (EC industrial standards, intellectual property, competition policy, statistics, integrated border management) , as well as an assessment of the short and medium-term challenges the Croatian government needs to address or continue tackling (justice and home affairs, public administration reform, capacity building, labour market restructuring, education and skill development, energy infrastructure rehabilitation, civil society development) . The sectors and priorities have been identified after extensive consultations with the Government of the partner-country, as well as non-governmental stakeholders. Full account has been taken of the activities of other donors, EU Member States in particular.

5. IMPLEMENTATION

The programme will be implemented by the Commission Services on behalf of and in close collaboration with the relevant national and/or local authorities. Project implementation will be undertaken by the relevant Commission Services, taking into account devolution to Delegations due to begin in 2001, while decentralisation may be decided on a case by case basis

A Financing Agreement corresponding to this Financing Proposal will be concluded with the counterpart authorities.

The contracts for services, works and supplies shall be concluded in accordance with the tendering and contract award procedures laid down in the Financial Regulation, Council Regulation 2666/2000 and the "Manual of instructions for contracts concluded for the purpose of Community co-operation with third countries" (adopted by the Commission on 10 November 1999).

6. INDICATIVE DISBURSEMENT SCHEDULE (M€ACCUMULATED)

Sector	Sept 2002	March 2003	Sept 2003	March 2004	Sept 2004
Human capital	2.0	3.3	5.0	6.7	7.6
EU industrial standards	1.54	1.66	1.79	2.79	3.0
Energy infrastructure rehabilitation	0.3	3.0	3.8	3.8	3.8
Justice and Home Affairs	0.6	1.15	2.1	3.0	3.6
Integrated border management	1.5	4.5	6.5	8.5	10.5
Public Administration Reform	0.4	0.65	0.9	1.2	1.5
Intellectual property	0.5	0.8	1.1	1.4	1.8
Competition policy	0.4	0.65	0.9	1.15	1.5
Statistics	0.54	0.72	0.89	1.21	1.5
Small scale operations	0.3	0.6	0.9	1.0	1.0
Strategy development capacity building	0.3	0.6	1.0	1.0	1.0
TOTAL	8.38	17.63	24.88	31.75	36.8

7. MONITORING, EVALUATION AND AUDIT

This programme will be monitored and supervised by the European Commission services, who shall:

- a) monitor the implementation of the programme on the basis of regular reports, contacts with stakeholders and site visits
- b) carry out regular monitoring and evaluations to follow the progress of the programme and its components as well as ex-post evaluations after its completion

The accounts and operations of the programme components will be checked at intervals by an outside auditor contracted by the Commission without prejudice to the responsibilities of the European Commission, including the European Antifraud Office (OLAF), and the European Union's Court of Auditors.

8. RISK ANALYSIS²

Although the general democratisation process in a society in transition together with the regional stabilisation process is contributing to stability of Croatian political institutions, political instability should be considered a major risk element with a high impact rating, but a low likelihood.

² A more detailed risk analysis of each sectoral programme is found in the annexes to this programme

Since the governmental stakeholders have been involved in the project identification and design phase, and their participation in project implementation has also been structured, a lack of support from the government is unlikely to happen.

The fulfilment of preconditions such as the relevant legislation being in place for project implementation to begin should be considered a moderate risk, with a high impact rating. Continued Government commitment to present priorities is a major risk element, with high impact, although unlikely to happen.

Close monitoring by the relevant Commission Services will be required to counteract the above-mentioned risks. If the situation so requires, the Commission may suspend or cancel all or part of a programme.

Moderate risks such as a delayed project start due to a late contracting of the TA company and slow disbursement will be counteracted by an early launch of tender with due respect for the relevant tendering procedures.