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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Enlargement Strategy and Main Challenges 2006 – 2007
Including annexed special report on the EU's capacity to integrate new members

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1. INTRODUCTION

Enlargement has been at the heart of the EU's development over several decades. The very essence of European integration is to overcome the division of Europe and to contribute to the peaceful unification of the continent. Politically, EU enlargement has helped respond to major changes such as the fall of dictatorships and the collapse of communism. It has consolidated democracy, human rights and stability across the continent. Enlargement reflects the EU's essence as a soft power, which has achieved more through its gravitational pull than it could have achieved by other means.

Economically, enlargement has helped to increase prosperity and competitiveness, enabling the enlarged Union to respond better to the challenges of globalisation. This has brought direct benefits for Europe as a whole. Enlargement has increased the EU's weight in the world and made it a stronger international player.

The accession of Bulgaria and Romania on 1 January 2007 will complete the fifth enlargement, following the accession of ten Member States in May 2004. Rigorous preparations have paved the way for their smooth integration into EU institutions and policies. The ten new Member States have reached an excellent level of compliance with EU law and have made a significant contribution to the work of the EU institutions. They have generated increased levels of economic activity, trade and investment, and have produced high rates of economic growth.

The present enlargement agenda covers the countries of the Western Balkans and Turkey. These countries have been given the perspective of becoming EU members once they fulfil the necessary conditions. The countries are at various stages on their road towards the EU. Croatia and Turkey are negotiating their accession. The former Yugoslav Republic of Macedonia became a candidate country in December 2005. The other Western Balkan countries are making progress towards fulfilling their European perspective.

The EU enlargement agenda faces a number of major challenges in 2006-2007. These challenges relate in particular to the accession negotiations with Turkey, the question of Kosovo's future status, relations with Serbia, and Bosnia and Herzegovina's assumption of greater ownership of its governance. These issues are important in their own right and touch on geo-political questions affecting the security and stability of Europe as a whole. The journey towards membership has value in itself, even if accession is many years away. As this journey involves many challenges, the EU needs to remain engaged throughout the process.

The pre-accession strategy and negotiations with candidates and potential candidates should be pursued in a rigorous manner, fully respecting the agreed conditions. The EU will provide financial support through the newly-established Instrument for Pre-Accession Assistance from

January 2007. This financial support will focus on priorities identified in the Accession Partnerships and European Partnerships.

EU enlargement is an historical project based on a vision of a united Europe and its global role. This project needs to be broadly shared and supported by the peoples of Europe to ensure full democratic legitimacy. The key decisions leading to a country's accession are taken by democratically elected bodies in each Member State and in the Union.

Member States need to take the lead in explaining why enlargement is in the EU's interest. The Commission is ready to improve the flow of objective information in user-friendly form, and to work together with Member States and the European Parliament to communicate more effectively with the public on the enlargement process.

The European Council will hold a debate on enlargement at its meeting in December 2006. The Council stated, in its conclusions of December 2005, that the strategy tabled by the Commission last year was a good basis for the 2006 enlargement debate. This strategy underlines that a carefully managed enlargement can extend and deepen European integration. It is based on three basic principles: consolidating existing commitments towards countries engaged in the process, applying fair and rigorous conditionality, and intensifying communication with the public on enlargement.

The EU has taken the concerns on the pace of enlargement seriously. To avoid an overstretch of commitments, the EU honours existing commitments towards countries already in the process, but is cautious about assuming any new commitments.

Rigorous conditionality is applied to all candidate and potential candidate countries. Any new steps in the accession process depend on each country's progress in making political and economic reforms. As the accession process is a long term effort, it is necessary to keep the countries motivated to continue reforms. The EU also needs to increase transparency in the process.

The EU's own institutions need to be reformed, in line with the European Council conclusions of June 2006. A new institutional settlement should have been reached by the time the next new member is likely to be ready to join the Union. The EU's financing is another important issue for the future. The EU's ability to take in new members while maintaining the momentum of integration will be even more important in the future. The Commission's special report, annexed to this paper, sets out an approach designed to ensure that the EU retains its capacity to function effectively while pursuing an enlargement agenda which is designed to meet the challenges of the years ahead.

Not all European countries are involved in the enlargement process. The EU has established a variety of relations with other countries, including through the European Economic Area, bilateral ties with Switzerland, the European Neighbourhood Policy, and a strategic partnership with Russia. The European Neighbourhood Policy aims to enhance prosperity, stability and good governance in the countries neighbouring the EU though a deeper political relationship and economic integration, The Commission will shortly put forward proposals for reinforcing the European Neighbourhood Policy.

Building on the EU's existing strategy, the present paper outlines an approach to draw lessons from the fifth enlargement, to support countries on their way to membership, to foster public

support for further enlargement, to address the enlargement challenges, and to ensure the EU's integration capacity. This is the basis for building a renewed consensus on enlargement.

2. THE FIFTH ENLARGEMENT

Enlargement has shown its enduring value as one of the EU's most effective policies, successfully contributing to peace, stability and democratic development throughout the continent. The ten Member States which joined in 2004 have continued their smooth integration into EU institutions and policies. The new Member States' democratic political systems have, on the whole, continued to function well. They have an excellent level of compliance with EU law and have made a significant contribution to the work of the EU's institutions. The EU's institutions have continued to function effectively. Enlargement has increased the EU's weight in international political and economic life and added to the EU's negotiating strength in different fora. It has also enriched the Union's cultural heritage.

As well as having increased security and stability in Europe, enlargement has also brought economic benefits. The new Member States are rapidly catching up with the old Member States. The old Member States have benefited from new trade and investment opportunities Enlargement has been beneficial overall for the EU economy and helped it face better the challenges of globalisation[1]. The progressive adoption of the euro by the new Member States, starting with Slovenia on 1 January 2007, will further contribute to this positive trend.

The enlarged Union has meant a more efficient division of labour and made the EU better equipped to compete globally. Overall, the latest enlargement has acted as a catalyst for economic growth and modernisation in the EU. A number of major studies have made this clear recently. For example, concrete benefits are seen in the three Member States which introduced the free movement of labour, upon the accession of the ten new Member States. They have seen benefits in terms of increased national income and tax revenues and shrinkage of the grey economy. Workers from new Member States have helped to overcome skills shortages in the labour market and have adapted well to their new cultural environment[2]. In the light of these experiences, a further five Member States have opened their labour markets and another two have partially opened them[3].

The preparation of Bulgaria and Romania for EU membership has proceeded in accordance with rigorous conditionality, with full EU support. Both countries introduced far-reaching reforms in the course of the accession negotiations. Nonetheless, the Commission's monitoring reports of October 2005, May 2006 and September 2006 highlighted areas of particular concern where further efforts were needed. As a result of the progress made, Bulgaria and Romania will be in a position to take on the rights and obligations of membership on 1 January 2007. The September report set out strict conditions to ensure continued progress in the reform process in these countries before and after accession. It also drew attention to the provisions in the *acquis* and in the Accession Treaty to ensure that EU

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1 Commission Communication – Enlargement, Two Years After – An Economic Success – COM(2006) 200, 3.5.2006.

2 Commission Communication - Report on the Functioning of Transitional Arrangements set out in the 2003 Accession Treaty (period 1 May 2004 – 30 April 2006) – COM(2006) 48, 8.2.2006.

3 Full opening: May 2004: Ireland, United Kingdom, Sweden - May 2006: Spain, Greece, Finland, Portugal - July 2006: Italy. Partial opening: Belgium, France.

policies and institutions will continue to function effectively. The Commission will not hesitate to use these mechanisms at any time, if the need arises.

The accession of Bulgaria and Romania demonstrates to countries at an earlier stage in their preparations for membership that their ultimate goal is achievable. It also provides a number of lessons which are now being incorporated into the pre-accession strategy. Thus it is clear that issues such as judicial reform and the fight against corruption and organised crime need to be tackled at an early stage. The Commission, for example, is promoting greater awareness of how best to ensure the independence, impartiality and effectiveness of the judiciary and to prevent corruption. In addition, the Commission underlines the need for sustained reforms in the public administration. An accountable and efficient civil service, based on professional career development criteria, enables a country to prepare efficiently for accession and subsequently operate as a Member State. This is to the benefit of the country as a whole.

Overall, the fifth enlargement has been a considerable success. The benefits will continue to be felt many years ahead. Over 100 million new EU citizens, with rising incomes, will help to drive the European economy forward. Enlargement has brought higher standards of democracy and the rule of law in Europe. It strengthened the security of all EU citizens and increased prosperity in the Union.

3. THE ENLARGEMENT PROCESS

EU enlargement policy is today based on three basic principles: consolidation of commitments, conditionality and communication.

Consolidation of the EU enlargement agenda means that the Union is cautious about assuming any new commitments, but honours its existing commitments towards countries already in the enlargement process. The EU has started accession negotiations with Turkey and Croatia and offered a European perspective to the other countries of the Western Balkans. This commitment is a strong incentive for the countries to continue their reforms.

Rigorous but fair conditionality is applied to all candidate and potential candidate countries. Every step forward depends on each country's own progress in meeting the necessary conditions at each stage of the accession process. This approach helps to consolidate reforms and to prepare new Member States to fulfil their obligations upon accession.

For enlargement to be a success, the EU must ensure the support of its citizens. Member States need to take the lead in communicating effectively the enlargement process and in particular the benefits that it offers for EU citizens. Democratic legitimacy remains essential for the EU accession process.

3.1. Accession negotiations

Accession negotiations with Croatia and Turkey opened in October 2005 as was unanimously agreed by the Member States, providing further encouragement for political and economic reform in these countries and for good relations with their neighbours. They are conducted on the basis of clear and rigorous negotiating frameworks agreed unanimously by the Council. The pace of negotiations depends on the pace of reforms on the ground.

During the accession negotiations arrangements are established under which the candidate countries commit themselves to applying the whole body of EU legislation and policies,

known as the *acquis*. Countries need to accept and implement the *acquis*, and to adhere to the political objectives of the Treaties. The negotiations allow the candidate countries and the EU to agree on measures that may be necessary to facilitate integration. Each country is judged on its own merits: the negotiations offer countries the opportunity to demonstrate their ability to complete the necessary reforms and meet all membership requirements.

The negotiations proceed in a structured manner. Since October 2005, the "screening" process has brought together hundreds of experts from Turkey, Croatia and the Commission to explain the *acquis*, assess the countries' level of alignment, and examine their plans for implementation. The screening process has just been completed for all the *acquis* chapters.

After a chapter has been screened, the Member States decide, upon a Commission recommendation, on whether the chapter can be opened for negotiations, or on the benchmarks to be met by the candidate country before negotiations can be opened. When opening negotiations, the Union tables its common position, including benchmarks that have to be met to provisionally close the chapter.

Benchmarks are a new tool introduced as a result of lessons learnt from the fifth enlargement. Their purpose is to improve the quality of the negotiations, by providing incentives for the candidate countries to undertake necessary reforms at an early stage. Benchmarks are measurable and linked to key elements of the *acquis* chapter. In general, opening benchmarks concern key preparatory steps for future alignment (such as strategies or action plans), and the fulfilment of contractual obligations that mirror *acquis* requirements. Closing benchmarks primarily concern legislative measures, administrative or judicial bodies, and a track record of implementation of the *acquis*. For chapters in the economic field, they also include the criterion of being a functioning market economy.

If a candidate country no longer fulfils the opening benchmarks in a chapter that is under negotiation, the Commission may propose that negotiations be suspended on that chapter. If a candidate country no longer fulfils the closing benchmarks in a chapter that has been provisionally closed, the Commission may propose to the Member States that accession negotiations on that chapter be re-opened.

The Union expects negotiating countries to comply with the political criteria and to work towards higher standards throughout the negotiations. The results of dialogue with the countries on their success in addressing issues under the political criteria will be fed into the negotiation process. The Commission will prepare the dialogue with Member States and report back to them in the relevant Council bodies. In addition, the current negotiating framework provides for a chapter on Judiciary and Fundamental Rights, under which the political issues are to be addressed. This permits progress in crucial areas to be kept under close scrutiny.

Current negotiating frameworks provide for accession negotiations to be suspended in case of serious and persistent breach of the principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law. Increased attention to political reforms will improve the quality of the accession negotiations and stimulate the necessary reforms in the candidate countries.

Henceforth, the results of dialogue with the countries on their economic reform will also be fed into the negotiation process. The Commission will prepare the dialogue with Member States and report back to them in the relevant Council bodies. This dialogue focuses on the

fulfilment of economic criteria and on convergence with the EU economies. It is essential that, before accession, acceding countries are functioning market economies able to compete on the internal market. Pre-accession assistance will be focused more precisely to help meeting this objective.

3.2. Pre-accession strategy

The Accession Partnerships and European Partnerships are the central element of the pre-accession strategy. Based on the findings of the Commission's progress reports on each country, the Partnerships set out the priorities for these countries to make progress towards the objective of EU membership. They also provide a framework for EU assistance towards achieving this objective. The current partnerships were decided by the Council earlier this year. The Commission intends to review them at the end of 2007. The Commission is now proposing a European Partnership for Montenegro, following independence.

Instrument for Pre-accession Assistance

From 1 January 2007, the Commission will use a new financial tool for promoting modernisation, reform and alignment with the *acquis*, the Instrument of Pre-Accession (IPA). This will entirely replace previous assistance instruments such as Phare, Cards, Ispa and Sapard. Candidate countries and potential candidate countries are eligible for funding under the new instrument. A single set of rules and procedures and more flexibility will provide greater impact and value for money in the allocation of EU funds. The Western Balkan countries and Turkey will benefit from almost € 11.5 billion over the next seven years. The Commission is presenting a multi-annual financial framework, which sets out indicative amounts for allocation of IPA funds for each country and for each major component.

As the essential tasks of post-conflict reconstruction have been attained in Serbia, Montenegro and the former Yugoslav Republic of Macedonia, the European Agency for Reconstruction will phase out its activities by the end of 2008. Aid implementation, with priorities adjusted to the new realities, will be taken over by the Commission's delegations and, when they are ready, by the countries' own authorities. The introduction of IPA also provides the occasion for closer coordination with the European Investment Bank, the European Bank for Reconstruction and Development, the World Bank and other international financial institutions. The Commission will build on existing co-operation, to ensure, with its partners, that the most cost-effective mix of grants and loans is mobilised to support modernisation and development throughout the region.

Implementing the road-map for the Western Balkans

All the Western Balkan countries have made progress towards realising their European perspective, on the road-map put forward by the Commission last year in its enlargement strategy paper. Each country advances on its own merits, depending on its success in meeting the requirements. In particular, a country's satisfactory track-record in implementing its obligations under the Stabilisation and Association Agreements (including trade-related provisions) is an essential element for the EU to consider any membership application.

At Salzburg in March 2006, building on the Thessaloniki agenda, the EU reiterated its commitment that the future of the countries of the Western Balkans lies within the European Union and called on the countries to take stronger ownership of the process of regional co-

operation. Regional co-operation remains essential to long-term stability, economic development and reconciliation in the Western Balkans.

The countries of South-East Europe this year agreed to establish a new framework, with greater ownership, based around the South East Europe Co-operation Process. A Regional Co-operation Council will be established, bringing together representatives of South East Europe with those of the international community. The Commission strongly supports this process. The Commission also welcomes the entry into force in 2006 of the Energy Community Treaty and the Agreement on a European Common Aviation Area.

The EU will promote people-to-people contacts, both by making available more scholarships to students and researchers and by simplifying visa procedures. Croatian citizens are exempt from short-term visa requirements. The Commission has proposed that the Council authorises the Commission to negotiate visa facilitation agreements with the other countries of the region, with a view to concluding these agreements in 2007. The proposal covers also readmission, except for Albania with which the EU already signed a readmission agreement. Furthermore, the EU will continue to provide assistance in key areas such as energy, transport, and economic co-operation.

The countries of South-East Europe launched in April 2006 negotiations for a regional free trade agreement and have set themselves the objective of concluding the agreement by the end of 2006. The Commission and the Stability Pact fully support this process[4]. The EU will soon introduce diagonal cumulation of rules of origin in its agreements with Croatia and the former Yugoslav Republic of Macedonia, and later to further countries. This will stimulate regional trade and investment. Albania, Croatia and the former Yugoslav Republic of Macedonia are already members of the WTO. The efforts that Bosnia and Herzegovina, Montenegro and Serbia will have to make in the near future to join the WTO will also help them in deepening their regional trade ties, achieving economic reforms, and implementing future Stabilisation and Association Agreements.

4. ENSURING PUBLIC SUPPORT FOR ENLARGEMENT

The enlargement agenda provides the Union with the ways and means to address many of the challenges outlined above. The prospect of EU accession offered to the countries of the Western Balkans and to Turkey is an important catalyst for reform in these countries. There are clear benefits on the whole for the EU in terms of growth, stability and security. However, these need to be better communicated to the public. It is essential to listen to citizens, address their concerns, and provide factual information. The Member States must take the lead, with the support of the European Parliament and the Commission. The Member States, with the support of regional and local authorities and civil society bodies who are closest to the public, need to communicate the benefits that this policy of enlargement has brought to citizens of the enlarged EU.

In ensuring public support for enlargement, it is necessary to increase mutual understanding. To this end, the Commission launched in 2005 a civil society dialogue between the EU and

[4] The Stability Pact for South-Eastern Europe is a regional policy framework set up by the international community in June 1999, in order to support the countries' efforts to foster peace, democracy, respect for human rights and economic prosperity, and to achieve stability in the region as a a whole. It is currently being transformed into a more regionally owned co-operation process.

the candidate and potential candidate countries. This programme aims at promoting interaction between non-governmental organisations, e.g. student exchange, study visits of journalists, as well as exchange between women's organisation, trade unions and business communities.

The Commission will take the following measures:

– The Commission supports increased transparency. It recommends that screening reports, benchmarks for opening negotiation chapters as well as the final EU common positions be made public.

– The Commission will expand its support for civil society dialogue, building on the measures taken to date for Turkey and the Western Balkan countries.

– The Commission will promote more "people to people" contacts in areas such as education, research and culture.

– The Commission will continue to monitor public opinion on enlargement and to listen to concerns of the public. It will work through its Representations in the Member States and Delegations in the candidate and potential candidate countries to communicate more effectively on enlargement policy.

– The Commission will develop user-friendly information in everyday language for the general public and for specialised users on enlargement policy issues, notably through targeted web-sites. It will also explain practicalities, in particular how conditionality and impact assessments are used.

5. MAIN CHALLENGES IN 2007

5.1. Remaining challenges from the fifth enlargement

Achieving a comprehensive settlement of the Cyprus issue and the unification of the island remains an important challenge. The Commission welcomes the steps taken in 2006 by the leaders of the Greek Cypriot and Turkish Cypriot communities towards re-launching a process leading to a comprehensive settlement under UN auspices. These efforts need to be substantially stepped up in 2007.

The Commission stands ready to support such efforts as it has in the past. The Council has adopted two of the three measures proposed by the Commission to end the isolation of the Turkish Cypriot community. Free movement of Greek and Turkish Cypriots as well as other EU citizens throughout the island has been ensured through the Green Line Regulation. The aid programme for the Turkish Cypriot community was adopted and is being implemented. The regulation on direct trade with the northern part of Cyprus proposed by the Commission remains to be adopted. Enhanced efforts and a spirit of compromise are needed to enable its speedy adoption.

5.2. Candidate Countries

Croatia

In 2006, Croatia has continued to make progress in terms of the political, economic and *acquis* criteria and implementation of its Stabilisation and Association Agreement. The main challenge in 2007 will be to build on the progress made, and to accelerate the pace of reforms, notably in the key areas of judicial and public administration reform, the fight against corruption and economic reform. Croatia needs to maintain the momentum towards EU

integration through rigorous implementation of its obligations, for example in the areas of state aid and real estate. Croatia should continue its programme of legislative alignment and further enhance its administrative capacity.

Good neighbourly relations and regional cooperation remain key and priority should be given to finding solutions to outstanding bilateral issues, especially on border demarcation. Minority rights and refugee return will need continued close attention.

Accession negotiations with Croatia have started well. Croatia has taken important steps following the screening exercise in many fields to adapt its legislation. It is in the process of developing the necessary administrative capacity. Building on this progress, and provided that Croatia addresses the challenges discussed above, negotiations can be expected to continue at a good pace.

Turkey

In 2006, Turkey has continued to make progress in reforms, notably with the recent adoption of some elements of the 9th reform package. Moreover, the number of reported cases of torture and ill-treatment is declining on the whole, in line with the zero-tolerance policy, even though the situation in the South-East gives rise to concerns in this respect. However, the pace of reforms has slowed down. In 2007, it will be important to undertake determined efforts to broaden the reform momentum throughout Turkey. It is necessary to ensure freedom of expression without delay by repealing or amending Article 301 of the Penal Code and by overall bringing the legislation into line with European standards. Apart from the freedom of expression, further efforts are needed to strengthen freedom of religion, women's rights, minority rights and trade union rights. Civilian democratic control over the military needs to be asserted, and law enforcement and judicial practice further aligned with the spirit of the reforms. At the same time, there is a need for Turkey to address the serious economic and social problems in the South-East and to ensure full enjoyment of rights and freedoms by the Kurdish population. The Accession Partnership, adopted in January 2006, provides the yardstick to measure progress in the reforms. Good neighbourly relations remain key. The Commission will intensify its monitoring of the political criteria.

As stated in the declaration by the European Community and its Member States of 21 September 2005, the EU expects Turkey to ensure full, non-discriminatory implementation of the Additional Protocol to the Ankara Agreement and the removal of all obstacles to the free movement of goods, including restrictions on means of transport. Failure to implement its obligations in full will affect the overall progress in the negotiations. The Commission will make relevant recommendations ahead of the December European Council, if Turkey has not fulfilled its obligations. It is also essential that, as stated in the Accession Partnership, Turkey takes concrete steps for the normalisation of bilateral relations with all EU Member States as soon as possible.

The former Yugoslav Republic of Macedonia

The designation of the former Yugoslav Republic of Macedonia as a candidate country in December 2005 gave recognition to this country's reform achievements. It also provided an encouragement to pursue reforms on the road towards fulfilling the country's European perspective.

The former Yugoslav Republic of Macedonia has continued to make progress, although at a slower pace in 2006. Elections in July took place generally in accordance with international standards. The shortcomings that were identified need to be fully addressed.

The government faces particular challenges still in implementing reforms of the police and judiciary, the fight against corruption, and full implementation of the Stabilisation and Association Agreement. The continued implementation of the Ohrid Agreement remains essential to foster a positive climate for reforms. It is important that reform efforts be sustained in the period ahead on the basis of co-operation and political consensus. Overall, priority should be given to advancing the pace of reforms in key areas, if progress is to be made towards the goal of moving ahead in the accession process.

5.3. Potential Candidate Countries

Albania

Albania has continued to contribute to stability in the region, particularly through its measured position on the situation in neighbouring countries. EU relations with Albania advanced with the signature this year of the Stabilisation and Association Agreement. The priority now is to focus on implementation of the Interim Agreement, which will enter into force on 1 December 2006, and which covers trade-related issues. With EU support, Albania is tackling the challenges of political, judicial and economic reform, as well as the fight against corruption and organised crime. These themes will remain priorities in the period ahead.

Bosnia and Herzegovina

The European perspective is crucial in encouraging all parties in Bosnia and Herzegovina to carry out political and economic reform, such as police reform. Full co-operation with International Criminal Tribunal for the former Yugoslavia (ICTY) is a key part of the conditionality under which the country can draw closer to the EU. The withdrawal of the Office of the High Representative (OHR) will give the people and institutions of the country further ownership of their common destiny. The completion of the negotiations for a Stabilisation and Association Agreement and its implementation will reinforce the country's European perspective. Provided that the conditions are met, these negotiations can be completed within a couple of months. Constitutional evolution is essential to build a more functional, sustainable and democratic state. The EU will need to address the question of its own future representation in the country following the withdrawal of the OHR.

Montenegro

Montenegro achieved independence in June 2006 after a referendum held in a free and fair manner under conditions agreed with the European Union. Following independence, Montenegro has begun negotiations on a separate Stabilisation and Association Agreement (SAA), under new directives which were rapidly agreed by the Council. By engaging with the EU, Montenegro has the opportunity to meet the challenges of state-building within the stable and secure setting of the pre-accession process.

It will be important to sustain the pace of reforms and continue co-operation with ICTY, so that negotiations on an SAA can be concluded in the coming months. Montenegro has much to do to strengthen its institutions sufficiently to move forward. The key measures are set out

in the European Partnership proposed together with this communication. Priority needs to be given to judicial reform and to the fight against organised crime and corruption. Montenegro needs to upgrade its administrative capacity in view of SAA implementation.

Serbia

Serbia is to be commended for its responsible approach following Montenegro's independence. The new constitution should pave the way to reinforcing the country's system of governance. Serbia has registered success in ensuring macroeconomic stability in pursuing privatisation, and in attracting foreign direct investment. Economic integration with the EU has advanced. Serbia has also made further progress with administrative reform. In negotiations with the EU on a Stabilisation and Association Agreement (SAA), the Serbian administration demonstrated its considerable institutional capacity. This augurs well for Serbia's ability to catch up with the other countries of the region on the way to the EU, once Serbia has met the condition for resuming SAA negotiations.

The Commission does not underestimate the scale of the challenges Serbia faces in current political conditions. Serbia needs to take a constructive approach on Kosovo. The prospect of eventual EU accession needs to be credible and made visible for the Serbian population through the early resumption and rapid conclusion of negotiations for a Stabilisation and Association Agreement, as soon as Serbia has met the condition of full co-operation with ICTY. The EU is also working to bring the Serbian people into the European mainstream through visa facilitation[5] and by helping Serbia to participate more fully in Community programmes in areas such as education, youth, research and culture.

Kosovo[6]

The EU has continued to engage with Kosovo, through monitoring the standards, providing assistance, and working with UNMIK, as well as supporting the status process conducted under the auspices of the UN Secretary General's Special Envoy, Mr. Martti Ahtisaari. The EU will have a major role to play in the status settlement and its implementation, once it is agreed by the United Nations Security Council.

The status settlement needs to be politically and legally clear and to set out a vision for Kosovo's future development. Kosovo's status question is *sui generis*, and hence sets no precedent.

This will give a further impetus for the Kosovo authorities to progress on the reforms that are needed in the key areas of the rule of law, economy, and public administration and provide the basis for a successful transfer of responsibility from UNMIK. Minority rights remain a vital issue, as is the participation of minorities in Kosovo's institutions.

The European perspective is crucial to provide all involved with a vision of a common future in the European Union.

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5 See page 10 for more information on visa facilitation.

6 Under UN Security Council Resolution 1244.

6. CONCLUSIONS AND RECOMMENDATIONS

Based on the above analysis, the Commission proposes the following conclusions:

1. The EU's enlargement policy continues to be based on the three principles of consolidation, conditionality, and communication. The EU honours the commitments made to the countries already in the process, but is cautious in assuming any new commitments. The pace of the accession process depends on the pace of reforms in the candidate country.

2. The current enlargement strategy, combined with ways and means to ensure the EU's capacity to integrate new members, forms the basis for a renewed consensus on enlargement.

3. The EU's capacity to integrate new members is determined by two factors:

   – maintaining the momentum to reinforce and deepen European integration by ensuring the EU's capacity to function. This is in the interest of both present and future EU citizens;

   – ensuring that candidate countries are ready to take on the obligations of membership when they join by fulfilling the rigorous conditions set. This is assessed by the Commission on the basis of strict conditionality.

4. The EU's integration capacity will be reviewed at all key stages of the accession process. In its opinions on applications for membership and in the course of accession negotiations, the Commission will provide impact assessments of accession on key policy areas. This will help Member States to define EU common positions for the negotiations of the chapters concerned, including, where relevant, transition periods or other arrangements.

5. When assessing the budgetary impact of future accessions, the Commission will examine the impact on key policies, in particular agriculture and cohesion policies.

6. The EU must ensure that it can maintain and deepen its own development while pursuing its enlargement agenda. Institutional reform is needed to improve the effectiveness of the decision-making of an enlarged EU. A new institutional settlement should have been reached by the time the next new member is likely to be ready to join the Union.

7. The Commission will further improve the quality of the accession process. Benchmarks can be laid down both for opening and closing negotiation chapters, and will provide grounds for suspending or re-opening negotiations on individual chapters. The results of political and economic dialogues will be fed into the negotiation process. Difficult issues, such as judicial reform and the fight against corruption, need to be addressed at an early stage of the accession process.

8. In order to enhance transparency the Commission recommends that key negotiation documents be made public, including impact assessments, screening reports, benchmarks for opening chapters and EU common positions for the negotiations.

9. It is essential to ensure public support for enlargement. Maintaining rigour in the process and strict conditionality is essential to safeguard this support. So is confidence about the EU's integration capacity. We also need to communicate enlargement better. It is important to listen to citizens, address their concerns through adequate policies and present factual information. Member States have a lead role to play. The Commission will play its part together with the European Parliament, national, regional and local authorities, and civil society.

10. Croatia has made a good start in the accession negotiations. The country has taken important steps following the screening exercise in many fields to adapt its legislation, and is in the process of developing the necessary administrative capacity. Croatia however needs to considerably step up efforts to meet main challenges such as judicial reform, the fight against corruption, economic reform and to continue to fully cooperate with the International Criminal Tribunal for former Yugoslavia. Good neighbourly relations and regional cooperation remain key.

11. Turkey continues to sufficiently fulfill the Copenhagen political criteria and has continued political reforms. However the pace has slowed during the past year. Significant further efforts are needed in particular on freedom of expression. Further improvements are also needed on the rights of non-Muslim religious communities, women's rights, trade union rights and on civilian control of the military. Turkey can be regarded as a functioning market economy and has improved its ability to take on the obligations of membership. Good neighbourly relations remain key.

12. As stated in the declaration by the European Community and its Member States of 21 September 2005, the EU expects Turkey to ensure full, non-discriminatory implementation of the Additional Protocol to the Ankara Agreement and the removal of all obstacles to the free movement of goods, including restrictions on means of transport. Failure to implement its obligations in full will affect the overall progress in the negotiations. The Commission will make relevant recommendations ahead of the December European Council, if Turkey has not fulfilled its obligations. It is also essential that, as stated in the Accession Partnership, Turkey takes concrete steps for the normalisation of bilateral relations with all EU Member States as soon as possible.

13. The designation of the former Yugoslav Republic of Macedonia as a candidate country in December 2005 gave recognition to this country's reform achievements. The country has continued to make progress although at a slower pace in 2006. All Western Balkans countries have made progress following the road-map put forward by the Commission last year. Each country advances on its own merits. A country's satisfactory track-record in implementing its obligations under the Stabilisation and Association Agreements (including trade-related provisions) is an essential element for the EU to consider any membership application.

ANNEX 1

Special report on the EU's capacity to integrate new members

INTRODUCTION

This special report is an integral part of its 2006 enlargement strategy paper. Following the request of the European Council at its meeting of June 2006, it focuses on medium to long term issues concerning the EU's capacity to integrate new members. It puts forward an approach for ensuring that Union can maintain and deepen its own development, in terms of policies and institutions, while pursuing an enlargement agenda with major challenges in the world today.

In 1993 the Copenhagen European Council concluded that "the Union's capacity to absorb new members, while maintaining the momentum of European integration, is an important consideration in the general interest of both the Union and the candidate countries". As set out in the Commission's 2005 Strategy Paper and confirmed by the June 2006 European Council, the pace of enlargement must take into consideration the EU's integration capacity.

The EU must ensure that it can maintain and deepen its own development while pursuing its enlargement agenda. Institutional reform is needed to improve the effectiveness of the decision-making of an enlarged EU. A new institutional settlement should have been reached by the time the next new member is likely to be ready to join the Union.

Enlargement is about sharing a project based on common principles, policies and institutions. The Union has to ensure it can maintain its capacity to act and decide according to a fair balance within institutions, respect budgetary limits, and implement ambitious common policies that function well and achieve their objectives.

The EU's absorption capacity, or rather integration capacity, is determined by the development of the EU's policies and institutions, and by the transformation of applicants into well-prepared Member States. The capacity of would-be members to accede to the Union is rigorously assessed by the Commission on the basis of strict conditionality. Integration capacity is about whether the EU can take in new members at a given moment or in a given period, without jeopardizing the political and policy objectives established by the Treaties. Hence, it is first and foremost a functional concept. The Commission will in the future prepare impact assessments at all key stages of the accession process. Where such assessments are made, the specific characteristics of each country will be taken into account.

The EU has enlarged five times, growing from six to 25 and soon 27 Member States. These enlargements made a major contribution to the unification of Europe, fostering democracy, human rights and stability across the continent. They stimulated the development of new EU policies, in areas such as economic and social cohesion, external relations, and environmental protection. The internal market, the Schengen area and the euro were developed in parallel. The fifth enlargement in 2004, soon to be completed with the accession of Bulgaria and Romania, has increased the EU's weight in the world and generated specific economic gains, in terms of trade and investment and economic growth. At the same time, the EU has continued to develop and implement new policies, for example on justice, freedom and security. Widening the EU has proceeded in parallel with the deepening of European integration.

The present enlargement agenda is based on a strategy consisting of three basic principles: consolidation, conditionality and communication. It covers countries in the Western Balkans and Turkey which are at different stages on the road towards the EU. These countries have been given by the European Council the clear perspective of becoming EU members once they fulfil the necessary conditions. The EU honours existing commitments towards countries already in the process, but is cautious about assuming any new commitments.

At present, it appears unlikely that a large group of countries will in future accede simultaneously. The candidates and potential candidates vary considerably in terms of political and economic development and administrative capacity. Further accessions are likely to occur in the medium to long term, given the present state of pre-accession preparations.

The EU can successfully welcome new countries provided its own development has progressed and candidate countries can fulfil their responsibilities as Member States. EU citizens also need to be ready for further enlargement, with a better understanding of the issues at stake. This will enhance the democratic legitimacy of the process in terms of public perception. The approach presented in this paper is based on:

– ensuring the EU's capacity to maintain the momentum of European integration;

– ensuring candidate countries fulfil the rigorous conditions;

– better communication.

The question of the ultimate borders of the European Union has been raised in recent years. This has enabled the Commission to draw a number of conclusions. The term 'European' combines geographical, historical and cultural elements which all contribute to European identity. The shared experience of ideas, values, and historical interaction cannot be condensed into a simple timeless formula and is subject to review by each succeeding generation.

The legal basis of the enlargement is Article 49 of the Treaty on European Union, which states that "*Any European State which respects the principles set out in Article 6(1) may apply to become a member of the Union*". However, this treaty provision does not mean that all European countries must apply, or that the EU must accept all applications. The European Union is defined first and foremost by its values.

A SHORT HISTORY OF THE EU'S INTEGRATION CAPACITY

The Union has assessed its capacity to integrate new members in previous enlargements. The Commission's opinions on applications for membership have served as a basis for the Council to decide on the opening of accession negotiations. They assessed the candidates' ability to assume the obligations of membership including their acceptance of EU policies. In the case of the first four enlargements, the opinions also provided a general analysis of the impact of accession on the Union, in areas such as the functioning of the rotating Council Presidency, estimates of net financial transfers based on existing common policies, or the addition of official EU languages.

The Commission presented in 2004 a study on the issues raised by Turkey's possible membership, together with its recommendation to open accession negotiations. The study envisaged that the necessary preparations for accession would last well into the next decade. It

presented estimates of the budgetary impact of Turkey's accession and identified areas where this would raise particular challenges: agriculture, cohesion, energy, migration, external borders, and foreign policy.

In preparing past enlargements the Commission examined in separate policy papers the implications for the EU of issues common to several applications for membership. The Commission has emphasised strengthening EU institutions, furthering economic integration and developing common policies as pre-requisites for European integration.

In 1997, the Commission assessed the likely impact of the fifth enlargement and proposed budgetary and policy reforms in preparation for accession. A key goal of "Agenda 2000" was to ensure that EU policies were ready for enlargement.

Economically, the EU had started to prepare the fifth enlargement round as early as 1991, when the EU signed the first Europe Agreements with Central and Eastern European countries. As a result of these agreements, the EU quickly became the first trading partner of these countries. Most of the bilateral trade in industrial goods between the EU and these countries was liberalised well before accession, which facilitated greatly economic integration.

Economic integration with Turkey is facilitated by the Customs Union which has stimulated economic reforms and dynamism. In the Western Balkans, countries are prepared through the Stabilisation and Accession Agreements which provide for progressive trade liberalisation and economic assistance. The simultaneous enlargement and modernisation of the Central European Free Trade Agreement (CEFTA) paves the way for deeper economic integration in South-Eastern Europe.

The assessment of the EU's ability to integrate new Members continued during the accession negotiations. The Commission proposed measures to address the impact of enlargement on the existing Member States in particular policy areas. In the fifth enlargement, these included the movement of workers and road transport. The Commission's evaluation of the budgetary amounts necessary for financing the fifth enlargement provided the basis for concluding the negotiations, including for agriculture payments.

The Union assisted the applicant countries in their preparations for assuming their future membership obligations. For the fifth enlargement it established a pre-accession strategy. This included close monitoring and regular reporting on progress made by each country, priority-setting through accession partnerships, and financial assistance. Far-reaching association agreements allowed the applicant states to take on some of the rights and obligations of the acquis before accession in areas of the single market, such as competition policy, intellectual property, maritime transport and certification for industrial products. Candidate countries participated in EU agencies and committees. Once the accession treaties were signed, the acceding countries participated as observers in the law-making process.

This strategy, which aimed at sound preparations by the candidate countries themselves, facilitated their smooth integration into the EU. Two years after their accession, the ten new Member States have achieved an excellent level of compliance with EU legislation, as highlighted in the Commission's internal market scoreboard and reports on the implementation of EU law. The economic impact of their accession has been positive. Institutions have continued to function and to take decisions; the new members have played an active role.

The Commission conducted a study on the economic dimension of enlargement two years after the 1 May 2004 round of enlargement. The study shows that the experience from the past two years has been largely positive[7]. Eastward enlargement has boosted growth and created new jobs in the European economy. Careful preparation of the enlargement over the previous decade has been key to achieve this successful outcome.

A majority of citizens in the EU and in the candidate countries supported enlargement. Nevertheless, much is at stake and certain anxieties and misapprehensions remain present in public opinion with regard to enlargement. These need to be addressed.

THE EU'S INTEGRATION CAPACITY TODAY

The Union needs to ensure it can maintain its capacity to function, in the interest of its present and future citizens. While the Union prepares internally for further institutional reforms, the carefully managed accession process will continue.

This section presents an approach for assessing the EU's capacity for future enlargements, building on past experience.

Ensuring the EU's capacity to maintain the momentum of European integration

The capacity of the Union to maintain the momentum of European integration as it enlarges has three main components: institutions, common policies, and budget. The Union needs to ensure that its institutions continue to act effectively, that its policies meet their goals, and that its budget is commensurate with its objectives and with its financial resources.

Institutions

The EU does not need new institutional arrangements simply for the sake of enlargement; it also needs them so that the current Union can function better. The Union needs to ensure that its institutions and decision-making processes remain effective and accountable, for the sake of current Member States as well as in view of further enlargement.

In previous enlargements, the integration of the acceding countries into the EU institutions formed part of the accession negotiations. The resulting adjustments to the institutional provisions were made in the respective Accession Treaties. The latest enlargement was preceded by institutional reforms. The institutional provisions of the Accession Treaties with the ten new Member States that joined in 2004 and with Bulgaria and Romania are based on the Nice Treaty.

The Nice Treaty provides rules for up to 27 Member States, that is, the accession of Bulgaria and Romania. But the Treaty stipulates that when the Union consists of 27 Member States, the number of members of the Commission shall be less than the number of Member States. The number of members of the Commission shall be set by the Council, acting unanimously. This rule applies to the first Commission following the entry of the 27th Member State. The Council would also adopt the implementing arrangements for a rotation system based on the principle of equality.

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[7] Commission Communication – Enlargement, Two Years After – An Economic Success – COM(2006) 200, 3.5.2006.

The Nice Treaty does not provide for adaptations to the composition and functioning of the other institutions for a Union of more than 27 Member States. The allocation of seats in the European Parliament and the weighting of votes in the Council are clearly central to the EU's capacity to take decisions. Therefore, before any further enlargement, the EU will have to decide on the scope and substance of those institutional reforms.

Enlargement will also have practical implications for the functioning of the institutions, such as the use of languages. An assessment of the impact of enlargement on EU institutions will be included in Commission opinions on any future application for EU membership.

A new institutional settlement should have been reached by the time the next new member is likely to be ready to join the Union. Making the EU function better is as much in the interest of future prospective Member States as of the enlarged Union.

EU policies

Past enlargements have strengthened EU policies, as new Member States have brought their own national experience and policy orientations to the European enterprise. The present acquis, in areas as diverse as cohesion policy, agriculture, fisheries, environmental protection, external relations, transparency, accountability and European citizenship reflect, in part, the impact of past enlargements. Some EU policies would bring even greater benefits if expanded to more countries under the right conditions, for example the internal market or the area of justice, freedom and security.

The Union needs to be in a position, as it enlarges, to continue developing and implementing common policies in all areas. Assessment of the impact of enlargement on EU policies will take place at all key stages of the enlargement process.

Each Commission opinion on a country's application for EU membership will in future include an assessment of the impact of its accession on EU policies. This will also be reflected in the framework which establishes the terms of reference for the accession negotiations.

The negotiation frameworks for Croatia and Turkey envisage a set of measures to enable their smooth integration in EU policies. They also lay down measures to ensure the proper functioning of EU policies after enlargement, such as transition periods, derogations, specific arrangements and permanent safeguards.

The Commission will examine the impact of future enlargements on agriculture and cohesion policies when assessing the budgetary impact of enlargement. This will take into account the future evolution of these policies.

In the course of accession negotiations, the Commission will provide substantial assessments of the impact of accession on key policy areas, including the movement of persons, border management, agriculture, cohesion policy and transport. Similar assessments will be conducted in the areas of energy policy and foreign and security policies, also taking into account the EU's strategic motives to enlarge in terms of increased stability, foreign and security policy assets, or secure energy supply. This will enable Member States to define the EU common positions for the negotiations in the chapters concerned, including, where relevant, transition periods or other arrangements, with a full understanding of the likely impact.

EU Budget

The Union needs to be in a position to continue financing its policies in a sustainable manner. The impact of enlargement on the EU budget will be carefully assessed throughout the enlargement process. Each Commission opinion on a country's application for EU membership will provide estimates of the budgetary impact.

Before any further accession, the EU will need to decide on the overall budgetary means required. On that basis, the Commission will propose, in any future accession negotiations, a package of necessary financial measures. The Commission's analysis will take account both of the budgetary aspects and of the increased economic dynamism generated by accessions.

Ensuring that candidate countries fulfil the rigorous conditions

Conditionality is one of the pillars of the Commission's enlargement strategy. Good preparation by candidate countries facilitates their smooth integration into the EU. Further improvement in the quality of preparations has become crucial as the scope of EU activities has developed. This warrants the strict application of conditionality during the pre-accession phase, and thorough fulfilment of the requirements at each stage of the accession process.

As part of the pre-accession strategy the Commission will closely monitor the progress made by each enlargement country. This monitoring will be based on the political, economic and *acquis* criteria for membership. The Commission will pay particular attention to the establishment of the structures needed to ensure the rule of law. This includes administrative and judicial capacity and the fight against fraud and corruption. These issues should be tackled at an early stage of the pre-accession process.

Based on its findings, the Commission will propose short and medium term reform priorities for the Accession or European Partnerships covering each country. These policy frameworks have proved to be an effective means for setting priorities during preparation for the fifth enlargement. The Commission will propose updates regularly. Financial assistance to support the enlargement countries will focus on the reforms identified as partnership priorities. The introduction in 2007 of a single new financial instrument to cover all pre-accession needs, will make EU support for membership preparations more effective.

Association agreements with the enlargement countries play a central role in the countries' preparations. The Commission will verify compliance with the obligations. A satisfactory track record in implementing bilateral obligations is an essential element for the EU to consider any membership application.

Progress in accession negotiations will be determined by success in fulfilling the accession requirements set out in the negotiating frameworks, assessed on each country's own merits. Candidate countries will be expected to demonstrate success in meeting precise benchmarks before a negotiation chapter can be opened or closed. Failure to meet a benchmark could lead to negotiations on the chapter concerned being suspended or reopened.

In future, there will be a closer link between progress in political reforms and the overall pace of the negotiations. The results of dialogue with the countries on their progress in meeting the political criteria for membership will be fed directly into the negotiation process. The Commission will prepare the dialogue with Member States and report back to them in the relevant Council bodies. New arrangements have been set up in the Council framework to

ensure that officials from Member States responsible for monitoring progress with reforms and officials responsible for accession negotiations meet in the same working group.

In addition, the current negotiating framework provides for a chapter on Judiciary and Fundamental Rights, under which the political issues are to be addressed. This permits progress in crucial areas to be kept under close scrutiny. Accession negotiations may be suspended, in case of serious and persistent breach of the principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law.

Henceforth, the results of dialogue with the countries on their economic reform will also be fed into the negotiation process. The Commission will prepare the dialogue with Member States and report back to them in the relevant Council bodies. This dialogue focuses on the fulfilment of economic criteria and on convergence with the EU economies. It is essential that, before accession, acceding countries are functioning market economies able to compete in the internal market. Pre-accession assistance will be focused more precisely to help meet this objective.

Together with the negotiation framework and the establishment of benchmarks to open or close negotiation chapters, these arrangements will ensure a rigorous approach to accession negotiations.

While countries may wish to set their own target dates for accession in order to steer their reform efforts, the EU should refrain from setting such dates until accession negotiations are close to completion. The principle should be maintained that the date for the completion of accession negotiations will depend on the progress made by the country itself.

Better communication

Democratic legitimacy is essential to the EU enlargement process. Every key decision leading to a country's accession is taken unanimously by the democratically elected governments of the Member States and candidate countries. National parliaments ratify the decision. The European Parliament, whose members are directly elected, must give its assent.

Democratic legitimacy also means a Europe which listens to the expectations of its citizens and addresses their concerns through adequate policies. For any of its policies, including enlargement, the EU has to win the support of its citizens. Maintaining rigour in the process and strict conditionality is essential to safeguard this support. So is confidence about the EU's integration capacity. In addition, better communication is an essential part of EU’s enlargement policy. Previous enlargements have generally garnered support from public opinion, but have also led to doubts and misapprehensions. Citizens need to be better prepared for future enlargements.

The EU needs to communicate better the advantages and the challenges of enlargement. It is primarily the task of the Member States and the candidate countries to explain and defend the choices they have made. Leaders at national, regional and local level are best placed to understand the concerns of their constituents and to communicate directly with them. Member States which are themselves committed to the enlargement process need to explain better to citizens the concrete benefits they expect from enlargement. The Commission will play its part together with the European Parliament, national, regional and local authorities, academic institutions and think tanks, and civil society. In particular, the Commission will improve the availability of factual information in user-friendly form. This concerns both enlargement

policy issues, and practicalities such as the application of conditionality through monitoring reforms, setting benchmarks, and making impact assessments.

The Union, its Member States and candidate countries need to intensify their efforts to foster mutual knowledge and understanding and develop ownership of the common European project. Sustained efforts are needed over many years. The Civil Society Dialogue established with Turkey in 2004 and extended to the Western Balkan countries in 2006 should be further developed. The Commission intends to extend this dialogue to further sectors of society and economy. It will do so in liaison with the Economic and Social Committee and the Committee of the Regions as well as other bodies active in the field. It is important to involve the citizens in this dialogue and to address anxieties and misapprehensions.

The Commission supports greater transparency as a means to bring the enlargement process closer to the citizens. The Commission already publishes its opinions on applications for membership as well as its reports on each country's progress. It has also published the negotiating frameworks for Croatia and Turkey. Other key documents related to the accession negotiations should now be made public. In the fifth enlargement, this was the practice of a number of candidates with respect to their own negotiation position. The Commission considers that screening reports, benchmarks for opening negotiation chapters as well as EU negotiation positions should be made public via the web.

The approach outlined in this report will reinforce the democratic basis for the enlargement process. It is in the interest of all stakeholders in this process to avoid a gap between policy makers on the one side and the public on the other side. Lessons learned in the course of the fifth enlargement will assist the Union when carrying the process forward in the years ahead.

ANNEX 2

Conclusions on Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia, Kosovo[8], Turkey

Albania

As regards **political criteria**, Albania has made some progress on democracy and the rule of law, including fighting corruption, which is a key European Partnership priority. A constructive policy towards the region has been maintained. More work is needed on other Partnership priorities.

Some progress has been made on ***democracy and the rule of law***. However, this progress has been uneven. The *parliament* is assuming a full role politically and its committee on European integration has been very active. The parliament is now more transparent and its relations with other constitutional bodies have been effective, but it still faces technical and administrative shortfalls. More co-operation between government and opposition is needed to enable important work, such as electoral reform and addressing Stabilisation and Association Agreement (SAA) obligations, to go ahead.

The *government* has adopted a plan to fulfil European Partnership and SAA obligations. It is creating structures to co-ordinate the substance of EU reforms and manage the resources to implement them. Co-ordination between these structures is essential. Better use of expertise in drafting legislative proposals is needed. The restructuring of many ministries has temporarily reduced capacity in some areas of the *public administration*. It is important now to build upon the changes to strengthen effectiveness. Some staff changes have taken place without due attention to the civil service law. Appointments in the administration continue to be politically influenced. Public service management, career structures and pay remain poor.

A new law should improve the career structure and case allocation methods for judges. Transparency has been increased somewhat *in the judicial system*. Some progress has been made in enforcing judgements. However, overall progress in improving the justice system has been limited. Progress is needed on improving recruitment procedures for judges and employment conditions for judicial administrators. The competences of the two judicial inspectorates need to be properly divided. Co-operation between the police and the judiciary needs to be improved. Execution of judgements remains poor overall. Legal certainty is needed to provide a positive climate for trade and investment.

The *fight against corruption* has led to large-scale public service dismissals. The number of public officials prosecuted for corruption has increased. A high-level anti-corruption task force has been set up and the law on conflicts of interest has been improved. The High Inspectorate for Disclosure and Verification of Assets is now more effective and steps have been taken to increase public administration transparency. Where anti-corruption measures have gone beyond constitutional limits, the constitutional court has intervened. Further institutional measures to prevent corruption are now needed, as it remains a serious problem. The fight against corruption is a priority for the implementation of the SAA.

[8] Under UN Security Council Resolution 1244.

Limited progress has been achieved regarding ***human rights and the protection of minorities***. Human rights training for justice personnel is now obligatory. Pre-trial detention rules have improved. Albania's ombudsman has been more active on human rights. However, enforcement of international standards on torture prevention, prison conditions, and the rights of detainees, particularly in pre-trial detention, remain weak. Recent changes to the composition of the media supervisory authority should be implemented appropriately. The legal framework for media freedom remains inadequate and poorly implemented. Fostering media freedom is a key European Partnership priority. A new executive agency may speed up property restitution, also a key Partnership priority, but currently the process remains very slow. Certainty on property ownership is vital to fulfil SAA commitments. Albania has begun to create a legal framework to protect minorities; implementation of international commitments remains incomplete and further efforts are needed to promote tolerance. Albania's Roma strategy has led to some worthwhile initiatives, but suffers from a lack of resources. Roma children are particularly vulnerable to human trafficking.

Regarding ***regional issues and international obligations***, Albania has continued to play a positive role. It is an active member of regional initiatives in the political, trade, environmental, economic, security, aviation and energy fields. Albania has further developed its relations with neighbouring and other countries in the region, notably maintaining a constructive position on Kosovo.

As regards **economic criteria**, Albania has broadly achieved macroeconomic stability. This has contributed to its progress towards being a functioning market economy. Further considerable reform efforts must be vigorously pursued also to enable it to cope with competitive pressure and market forces within the Union.

Political consensus on the essentials of economic policy has generally been maintained. Albania broadly maintained macroeconomic stability. Economic growth continued to be strong and reduced poverty levels. The macroeconomic policy mix remained adequate. Monetary policy was credible and managed to keep inflation low. Fiscal consolidation further advanced and reforming the public and tax administration contributed to improved fiscal stance. Administrative barriers to market entry were reduced.

However, the deficits of external accounts markedly widened and the export base remained very weak. Albania's legal framework for procurement, privatisation and concessions needs to be improved. Shortcomings in the business climate, such as legal uncertainty and weaknesses in law implementation, poor infrastructure, or unreliable power supply impede economic development. Enforcement of property rights continued to be weak and only marginal progress was achieved in improving efficiency of the judicial system. Strengthening of the regulatory and supervisory framework for the non-bank financial sector constitutes a major challenge. Efforts in tackling and formalizing the considerable grey economy need to be further accelerated. The privatisation process is not yet completed and the restructuring of state-owned enterprises, in particular of the electricity utility, needs to be pursued without delay.

Albania has made progress in aligning its legislation, policies and capacity with ***European standards***, particularly in the fields of fighting organised crime, of customs and of competition. Pushing forward reform in areas such as public procurement, intellectual property and veterinary and phytosanitary control is vital for successful SAA implementation.

Progress has been made in some ***internal market*** fields, but in others much work will be needed to fulfill Albania's SAA obligations. There has been some progress in adopting and monitoring standards. Capacity for accreditation, metrology and market surveillance is being strengthened, but legislative improvements and better co-ordination are needed. Coherence of structures for consumer and health protection has improved. They now need to be strengthened. The SAA includes commitments regarding the *movement of workers,* freedom of *services* and freedom of *establishment*. There have been no notable developments regarding movement of workers. Discrimination on registration fees for foreign companies has been removed. Procedures for business registration have been simplified but remain relatively unclear. Barriers to establishment and restrictions on capital movement remain.

An effective customs system is vital to implement the SAA. Customs revenue has risen following substantial customs reforms. Progress has been made on computerisation, customs rules and management of origin. Cooperation between police and customs has been strengthened. Improved infrastructure and further acquis alignment is now needed. The administration of taxation has been simplified, and progress made on computerisation and risk analysis. Further alignment with EU legislation and a comprehensive tax collection and control strategy are now needed.

Albania has undertaken commitments in the area of *competition* under the SAA. Regarding *anti-trust*, the functioning of the Competition Authority has improved, but it is held back by the scarcity and inexperience of its staff. *State aid*-related SAA preparations are on track. The legal framework and inventory is now complete. The State Aid Department's operational independence now needs to be ensured.

A new *public procurement* law is pending, and public procurement training has been expanded, but the current legal framework is not in line with the acquis. The Public Procurement Agency remains weak. Progress in this field is vital for improving public sector governance, a key European Partnership priority, and for fulfilling SAA obligations. Regarding *intellectual property rights (IPR)* a trademark, patent and industrial design database has been launched. An IPR unit has been set up in the customs administration. However, the copyright office is not yet operational and IPR enforcement remains weak. Considerable strengthening is required to fulfill SAA commitments.

Progress has been limited in the area of *employment*. Some progress can be reported in the area of *education*, including approval of national strategies for secondary and vocational training. However, participation rates in education remain relatively low.

Progress can be reported on some ***sectoral policies***. Regarding *industry and SMEs,* a revised action plan on removing administrative barriers to business and a new umbrella organization to promote investment, export and SMEs are in place. However, progress on improving the business environment and reducing the informal economy continues to be slow. Progress in *agriculture* has been very limited. An increase in sales and in investment in some products has taken place, but productivity and competitiveness remains low. Compliance with EU *veterinary and phytosanitary* requirements, vital to successfully using SAA and interim agreement trade conditions, remains poor. The *fishery* service controls the landing of fish, but the illegal damaging of stock continues.

Regarding both *environment* and *transport*, some progress has been made on horizontal legislation, but implementation and infrastructure development remain weak. The *energy* sector remains very weak. Albania has ratified the Energy Community Treaty and has begun

to adopt the relevant laws, but electricity losses have increased and bill collection has dropped. Albania is lagging behind in its preparedness to take on SAA commitments on *information society and media***.** Regarding electronic communications and information technologies, liberalisation laws need to be implemented and enforced. The regulatory framework is not yet in line with the acquis. The telecommunications regulator is not sufficiently active. Regarding *financial control*, the Public Internal Financial Control Policy Paper has been endorsed by the government. Legal and regulatory progress has been made but it remains at an early stage. There has been reasonable progress in the area of *statistics*.

In the field of ***justice, freedom and security*** there has been progress in some areas; however, all fields require determined and sustained attention. Training and document security for *visa* administration have improved. No centralised IT network is in place, and legal changes are still required. New equipment and better co-ordination has led to some progress on *border management*, but an integrated border management strategy is not yet in place. Border management infrastructure needs to be strengthened. Laws on *asylum* comply with international standards, but implementation needs to improve. Albania has improved its internal coordination and cooperation with neighbouring countries to combat illegal *migration*. It is important that Albania ensures sufficient staffing to fulfil its obligations under readmission agreements.

Regarding the fight against *money laundering*, the Financial Intelligence Unit (FIU) and the prosecutor's office have been reinforced and international cooperation improved, but both need to be further strengthened and the legislative framework needs to be further developed. Greater political impetus and better international co-operation have increased arrests of large-scale *drug* traffickers, but better criminal intelligence capacity, domestic inter-agency co-ordination and procedures for seized drugs are required. Drug trafficking remains a serious problem. Efforts are underway to improve the organisation of the *police*. Cooperation with the customs and intelligence services has improved, but improvement of case management and internal control structures is needed.

Progress has been made in the *fight against organised crime*, a key European Partnership priority. Strong political will to tackle organised crime has led to police operations against major criminal groups. Operational cooperation with Albania's neighbours has greatly improved. Cooperation between police and the judiciary at central level has somewhat improved. However, much scope remains for improvement in concrete results. Better co-ordination between police and judiciary at local level and greater efforts to combat high level corruption in these bodies are needed. Stronger witness protection is required. The government has adopted a national strategy against *trafficking in human beings* and improved structures to implement it. Successful prosecutions and convictions of traffickers have continued. However, trafficking remains a problem. Further resources and better domestic and international coordination are required. The police counter-*terrorism* directorate has seized large quantities of arms, although infrastructure and inter-agency cooperation needs to be strengthened. The situation as regards the protection of *personal data* remains a matter of concern.

Bosnia and Herzegovina

Bosnia and Herzegovina's progress towards meeting the **political criteria** has continued, although at a slower pace. Key political priorities identified in the European Partnership have been only partially addressed. A number of important issues remain to be tackled before negotiations for a Stabilisation and Association Agreement can be concluded.

Partial progress has been made regarding ***democracy and rule of law*.** The general elections of 1 October were the first elections since the Dayton/Paris Agreement to be fully administered by the authorities of Bosnia and Herzegovina. Preliminary conclusions of the OSCE Office for Democratic Institutions and Human Rights (ODIHR) indicated that these elections represented a step forward in consolidating democracy and rule of law, and were conducted generally in line with international standards. However, failure to amend the *Constitution* made it impossible for the elections to comply fully with the requirements of the European Convention for Human Rights (ECHR).

Some steps have been taken towards ensuring that State-level ministries and institutions have the necessary resources to implement their tasks, but further efforts are necessary to meet this key European Partnership priority. Limited progress has been made in providing the State *Parliamentary Assembly* with sufficient technical resources and personnel. State-Entity co-ordination remains inadequate and no new mechanisms have been put in place to improve it. Overall performance of the executive and legislative institutions has remained insufficient.

Bosnia and Herzegovina's achievements over recent years in terms of stability and security have allowed the Peace Implementation Council to decide on the closure of the Office of the High Representative (OHR) by 30 June 2007. This decision is to be reviewed in early 2007.

The adoption of a comprehensive strategy for *public administration* reform partly addressed a key priority of the European Partnership. The law on the State Ombudsman was also a positive development. The Public Administration Coordination Office has been strengthened and the Civil Service Agencies have improved recruitment procedures. The implementation of the public administration reform is now necessary to strengthen overall administrative capacity.

Little progress has been made as regards the key issue of *police reform*. The work of the Directorate for Police Restructuring has been held back, largely due to Republika Srpska's approach. This has led to delays in implementing the October 2005 Agreement on police restructuring, which is a key European Partnership priority.

As regards the *judicial system*, the State Court, the Prosecutor's Office and the High Judicial and Prosecutorial Council have performed their duties well. They are progressively gaining ownership and reducing their reliance on the international community. Nonetheless, the independence of the judicial system needs to be further strengthened, and its efficiency improved.

A new strategy against *corruption* has been adopted. Corruption remains a serious issue in Bosnia and Herzegovina. Cases need to be investigated and prosecuted more vigorously.

Limited progress has been made in relation to ***human rights and protection of minorities***. The Human Rights Commission within the Constitutional Court has continued to work efficiently. Enforcement of human rights-related rulings and proper implementation of international human rights conventions require more attention. Ethnic discrimination remains a critical issue. Further efforts are needed to combat intolerance and improve prison conditions. Concrete steps need to be taken to support the Roma minority.

In the framework of freedom of expression and media, the State-level public broadcasting laws have been adopted. The corresponding Entity-level legislation has been adopted in

Republika Srpska, but not in the Federation. Implementation of the public broadcasting reform has been partial. The relevant European Partnership priority has not been fully met.

The Refugee Return Fund is operational and Bosnia and Herzegovina has actively participated in the Sarajevo process. Further action is necessary to support the return of refugees and internally displaced persons and, in particular, their social and economic integration.

Limited progress has been achieved in relation to ***regional issues and international obligations***. Some efforts have been made to ensure cooperation with the ICTY – a key European Partnership priority – but there is room for improvement. Further action is required to locate the indictees remaining at large and to fight networks supporting them. There has been progress in the prosecution of war crimes by the State Court. Prosecution at Entity-level needs to be improved.

Bosnia and Herzegovina's relations with its neighbours have continued to be good. Some bilateral issues, notably on border demarcation and trade, remain to be addressed.

As regards **economic criteria**, Bosnia and Herzegovina has made limited progress towards being a functioning market economy. Considerable additional efforts are also needed in order to be able to cope with competitive pressure and market forces within the Union.

Coordination on fiscal policies deepened and a value added tax (VAT) was successfully introduced in January 2006 across the country. The analytical capacity to support policy making improved to some degree. Economic growth remained robust. Fiscal consolidation continued. Reported exports picked up in the first half of 2006, supported by the VAT introduction and increased production for some commodities. Privatisation continued, in particular in the Republika Srpska, and certain legal changes were adopted to support enterprise restructuring.

However, reforms in many areas remained slow. Imbalances in the trade and current accounts continued to be very large, reflecting an insufficiently dynamic enterprise sector and strong private consumption. The base for economic growth continued to be narrow. The fiscal stance in the country has not properly reflected the large macroeconomic imbalances. Decision-making processes on economic and fiscal policy in the country remain complex and not sufficiently coordinated. In addition, pressures on public spending increased in spite of its already relatively large size. Also the efficiency of public expenditure is still relatively low. The business climate and corporate governance remained overall weak. Privatisation and corporate restructuring was slow, in particularly in the Federation. Large parts of the enterprise sector are still not sufficiently restructured.

Bosnia and Herzegovina has made limited progress in aligning its legislation and policies with **European standards**. Bosnia and Herzegovina will need to further enhance its capacity to respond to the requirements of the European Partnership in this respect.

Regarding ***internal market***, little has been achieved in the area of *free movement of goods*. Preparations in the field of standardisation, certification, metrology and market surveillance remain at an early stage and new legislation is not being properly implemented. A lack of conformity assessment bodies and procedures continues to hinder export capacity. The establishment of a market surveillance structure based on appropriate product legislation and the phasing out of contradictory pre-market controls require urgent action.

There are no particular developments to report with regard to the *movement of workers*. Limited progress has been made in the area of *services* and no significant changes have occurred in relation to *right of establishment* and *company law*. Banking supervision has not been brought to the State level and remains an Entity responsibility.

No significant development has taken place in the area of *free movement of capital*, but Bosnia and Herzegovina's preparations in this area are well underway. Limited additional progress has been made in relation to *customs rules***.** Customs legislation is in place and is largely aligned to the *acquis*. Its full implementation needs to be ensured, especially in areas such as origin, valuation and simplified procedures. As for *taxation*, the successful introduction of the value added tax (VAT) was a positive development. There has been limited progress in the field of direct taxation.

As regards *competition*, Bosnia and Herzegovina is progressing steadily in the area of anti-trust control, but no progress has been made with regard to state aid. Some developments have taken place in the field of *public procurement*, in particular with the establishment of the Public Procurement Agency and the Procurement Review Body. Limited progress has been made regarding implementation and enforcement of *intellectual property rights*.

Few developments have occurred in relation to *employment policies*. Bosnia and Herzegovina's labour market remains challenged by unemployment, a high degree of fragmentation and the lack of a sound employment policy. Little progress has been made in the field of *education*. The Higher Education Law and other key laws have not yet been adopted. Separation of children at schools along ethnic lines remains a serious issue.

Little additional progress has been made towards ensuring the existence of a real internal market within Bosnia and Herzegovina, which is a key priority of the European Partnership.

As far as ***sectoral policies*** are concerned, no significant developments can be reported in the area of *industry and small and medium enterprises (SME)*. The industrial strategy and the SME Development Strategy have not yet been adopted.

Overall, limited progress has been made in the field of *agriculture*. Policy is still being developed at Entity level and coordination is insufficient. The development of a comprehensive agricultural strategy is delayed, partly due to the lack of the necessary legal and institutional framework at State level. Implementing legislation has been adopted in the veterinary field. Implementation remains limited, mainly due to inadequate human and financial resources and weak coordination between State and Entity veterinary services. Bosnia and Herzegovina's preparations in the field of *environment* remain at an early stage. A State-level Environmental law to create the framework for nationwide, harmonised environmental protection has not been adopted and the State Environment Agency has not been set up.

Sustained progress continues regarding Bosnia and Herzegovina's involvement in developing the trans-European *transport* network. Bosnia and Herzegovina is implementing the June 2004 Memorandum of Understanding on the South East Europe Core Regional Transport Network. It has signed the European Common Aviation Area Agreement (ECAA), aimed at creating a single European aviation market where EU aviation standards are applied. It has made significant progress in alignment to the aviation acquis.

Some positive developments have taken place in the field of *energy*. The Energy Community Treaty has been ratified. In the electricity sector, transmission has been unbundled, and the Independent System Operator (ISO) and the Transmission Company (Transco) have been legally established. Nonetheless, the transfer of assets and liabilities between ISO and Transco remains to be completed. This is preventing these bodies becoming fully operational. A countrywide energy strategy has not yet been developed.

As regards *information society and media*, the independent Communications Regulatory Authority has been active in preparing for effective competition in the telecommunications market. However, limited progress has been made on public broadcasting and the establishment of the Information Agency. No significant developments have occurred in the area of *public internal financial control* (PIFC).

Steps have been taken in the field of *statistics*, in particular with the signature of a co-operation agreement between the country's statistics institutions at State and Entity level. Nonetheless, further significant efforts are necessary to establish an effective, EU-compliant statistics system in Bosnia and Herzegovina.

In the area of ***justice, freedom and security***, some progress has been made in the fields of *visa administration, border management, asylum and migration*. The lifting of visa requirements for all EU citizens has been confirmed. Bosnia and Herzegovina has concluded several readmission agreements with EU Member States and third countries, and it has expressed readiness to negotiate such an agreement at EU-level. The number of visas issued at the border-crossing points has been reduced. There has been further progress in establishing a functioning asylum system and in addressing illegal migration. Some progress has been made on border management, with the update of the 2005 National Integrated Border Strategy and the finalisation of the Integrated Border Management Action Plan. However, funds for their implementation are lacking. There is room for improvement as regards border controls. Shortcomings in staffing and facilities still need to be addressed in all areas.

Limited progress has been made on *money laundering*. The Financial Intelligence Unit (FIU) within the State Investigation and Protection Agency (SIPA) remains inadequately staffed. No new legislation against money laundering has been adopted and law enforcement remains limited. Some steps have been taken as regards the fight against *drugs* through the adoption of the Law on the Prevention of Narcotics and Precursor Abuse. A State-level drug policy in line with EU standards needs to be developed.

Bosnia and Herzegovina has made some progress as regards the *fight against organised crime, trafficking in human beings and terrorism*. A national strategy to combat organised crime has been adopted. The legal framework to fight organised crime is in place, although law implementation needs to improve further. SIPA has conducted more investigations and arrests. It needs now to reach its full capacity, notably in terms of staff. The 2005-2007 National Action Plan for Combating *Trafficking in Human Beings* is being implemented. Inconsistencies between State- and Entity-level legislation continue to hinder prosecution. Bosnia and Herzegovina has also adopted a strategy to fight *terrorism*. As regards *data protection*, the law on the protection of personal data has been adopted, but the Data Protection Agency has not yet been established. The situation as regards protection of personal data remains a matter of concern.

Croatia

Croatia continues to meet the **political criteria**. Progress has been made overall but further sustained efforts are required in a number of areas. The short-term priorities of the Accession Partnership have been partially addressed.

Democracy and the rule of law have been further strengthened. However, there is considerable scope for improvement in the judiciary, public administration and in the fight against corruption. Significant improvements in these areas are indispensable if a solid basis for full implementation of the *acquis* is to be created.

Work preparing a strategy for *public administration reform* has begun. The Government adopted a policy paper in September 2006 committing it to drafting a revised General Administrative Procedure Act by July 2007. However, the adoption of an overall strategic framework for addressing this crucial issue is long overdue. The existing legal administrative system is cumbersome and needs simplification. The wide discretionary scope in legislation leads to inefficiency and legal uncertainty and facilitates corruption. A new civil service law entered into force in January 2006 and some related implementing legislation has been adopted. However, the civil service continues to suffer from undue political influence, high staff turnover and a lack of qualified personnel.

Implementation of a *judicial reform* strategy, a key Accession Partnership priority, has begun. Legislative and organisational changes have been made aimed at improving the functioning of the judiciary. The case backlog has been reduced but remains large. Reform is at an early stage and the judicial system continues to suffer from severe shortcomings. More needs to be done to reduce the length of court proceedings, improve case management, rationalise the court network and ensure proper enforcement of judgements. To ensure impartiality the procedures for the appointment, training and disciplining of judicial officials need to improve. A new *anti-corruption* programme was adopted in March 2006. The Office for the Prevention of Corruption and Organised Crime (USKOK) has been strengthened. Measures have recently been taken in some hitherto uninvestigated corruption cases. These actions partially address a key priority under the Accession Partnership. However, corruption remains a serious problem. Many allegations of corruption remain uninvestigated and corrupt practices usually go unpunished. Implementation of the anti-corruption programme is at an early stage. USKOK and other bodies involved in this programme need further strengthening and coordination among them needs to be improved. Full implementation of the programme and strong political will to step up efforts are needed, especially on high level corruption.

In the area of ***human rights and the protection of minorities*** progress continues to be made, albeit at a slow pace. An appropriate legal framework is in place. However, actual implementation of legislation needs to be accelerated.

In June 2006 the Penal Code was amended to, *inter alia*, abolish prison sentences for libel and to include a wider definition of "hate crime". With regard to minorities, there has been a significant increase in funding and greater attention paid by the Government to the action plan under the Decade of Roma Inclusion. High level politicians have demonstrated commitment to integrating minorities.

However, more efforts are needed to combat intolerance and to encourage reconciliation as well as to properly investigate and prosecute those responsible for apparently ethnically motivated crimes. Implementation of the Constitutional Law on National Minorities continues to be slow, particularly as regards its employment provisions for minorities. These issues are

key priorities under the Accession Partnership. A comprehensive strategy and action plan on all forms of discrimination has not yet been adopted.

There have been instances of political interference in the media. Plans aimed at improving women's and children's rights have been adopted and should now be implemented.

As regards ***regional issues and international obligations***, full cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY) has continued, as required by a key Accession Partnership priority and overall compliance with the Dayton and Erdut agreements has been ensured. The prosecution of war crimes in Croatia has continued to improve. However, bias against Serb defendants still needs to be fully addressed. The issue of witness protection is being tackled seriously by the State Prosecutor. However, this issue is not being addressed sufficiently in the wider judicial system. Progress on refugee return - a key Accession Partnership priority - has been uneven. While the issues of reconstruction and repossession have generally been well addressed, implementation of housing care programmes for former tenancy rights holders wishing to return to Croatia is particularly weak; no progress has been made on validating pension rights. Efforts to create the economic and social conditions necessary for the sustainability of refugee return need to be accelerated.

There has been continued general progress in the area of regional cooperation. This progress needs to be sustained. However, little progress has been made towards finding definitive solutions to various pending bilateral issues with Croatia's neighbours, particularly as regards border demarcation. This issue is a key Accession Partnership priority. Efforts are needed to further develop cooperation and good neighbourly relations.

As regards **economic criteria**, Croatia can be regarded as a functioning market economy. The country should be able to cope with competitive pressures and market forces within the Union in the medium term, provided that it vigorously implements its reform programme to remove the significant remaining weaknesses.

Political consensus on the essentials of economic policy has generally been maintained. Stability-oriented macroeconomic policies have contributed to low inflation, exchange rate stability and a slight acceleration of growth. Private investment has risen and unemployment has declined. Gradual fiscal consolidation has continued, backed by strong revenue growth. Some measures have been taken to better control health care spending. Business registration procedures have been further simplified. The banking sector has continued to grow and a new supervisory agency for the non-banking financial sector has been established. Road infrastructure has improved. Further progress has been made in enhancing competition in the telecommunication sector. Initial steps have been taken to restructure the loss-making railway system. Croatia's economy is well integrated with that of the EU.

However, significant and rising imbalances in the trade and current accounts and a high external debt imply potential risks to macroeconomic stability. Subsidies to loss-making enterprises and a high level of current spending continue to burden the government budget. The pace of structural reforms has generally been slow. Little progress has been made in implementing privatisation plans and in enterprise restructuring. The development of a more vivid private sector has been hampered by deficiencies in public administration and the judiciary, undermining market entry and exit procedures and the enforcement of property and creditor rights. State intervention in the economy remained significant. Increased efforts are required to raise participation in lifelong learning.

Croatia has improved its **ability to take on the obligations of membership**. In most areas there has been some progress, mainly in terms of legislative alignment. Progress has varied considerably between chapters As regards the overall level of alignment and administrative capacity, much remains to be done. Short-term priorities under the Accession Partnership remain to be fulfilled in many areas.

Progress in *free movement of goods* has been limited and uneven. Progress on new and global approach has not been matched in the old approach area. Considerable efforts are still needed on legislation and administrative capacity across the board. On *free movement of workers* there has been limited progress. Considerable efforts are needed in terms of developing capacity for coordination of social security systems. Limited progress has been made on the *right of establishment and the freedom to provide services.* Overall alignment is reasonable, although considerable efforts are still required in some areas. Croatia made some progress on the *free movement of capital*. However increased efforts are needed, especially as regards money laundering and procedures for acquisition of real estate by EU nationals.

Progress in the area of *public procurement* has been limited. Considerable further efforts are needed to design an overall strategy for alignment and to strengthen the institutional set-up. As regards *company law* progress has been good. There were significant legislative changes in the field of corporate accounting and auditing. Alignment is on track, although monitoring and enforcement of corporate compliance requires continued efforts. Some progress has been made on *intellectual property law*, particularly on enforcement. However continued efforts are needed.

In the field of *competition policy*, Croatia has continued to make some progress, both as regards anti-trust and state aid. However, it needs to intensify its efforts. There is a need for important further legislative alignment, strengthening of administrative capacity and a more efficient enforcement record. Viable restructuring plans in steel and shipbuilding sectors need to be urgently adopted. Fiscal aids remain problematic. The relevant obligations under the Stabilisation and Association Agreement remain to be fulfilled.

Croatia has made some progress on *financial services*, particularly by enhancing the alignment of insurance legislation and by establishing an integrated supervisory authority for the non-banking sector. Alignment is moderately advanced but efforts need to increase.

Some progress has been made in the area of *information society and media*. Competition in the telecoms market has been enhanced. Alignment in electronic communications and information technologies is moderately advanced. However, further strengthening of Croatian Agency for Telecommunications is needed. Further legislative alignment is also needed in the media and audiovisual field.

In *agriculture* reasonable progress has been achieved, notably on the implementation ofrural development programmes, quality policy and organic farming. However, setting up of administrative structures for the implementation, management and control of the Common Agricultural Policy is at an early stage. Concerning *fisheries*, Croatia has made some progress with further alignment on resource and fleet management and some strengthening of inspection services. Increased efforts are needed to close some major gaps including the establishment of a computerised fishing fleet register, VMS, data collection and a strengthened inspection system. State aids also need to be aligned. Some progress was made in aligning the *veterinary, phytosanitary and food policy*. Substantial efforts are needed

however, including the adoption of a comprehensive food safety strategy as well as the necessary framework legislation.

Good progress has been made in *transport policy*. Alignment has continued on road, air and maritime transport. Further implementing legislation needs to be adopted, however, and increased efforts are needed notably as regards administrative capacity. On *energy* there has also been some progress, including on security of energy supply and on the internal energy and gas market. Croatia ratified the Energy Community Treaty. However, increased efforts are needed, particularly on energy efficiency, nuclear safety and regulatory strengthening.

There has been limited progress on *taxation*. Overall progress with legislative alignment remains limited. The tax administration needs to be modernised significantly and IT interconnectivity improved. Croatia has made some progress in the field of *economic and monetary union*. Overall, preparations are well underway. However, further efforts are needed, especially to ensure full independence of the Central Bank. Croatia has made good progress across the board on *statistics*. Continued efforts and especially sustainable national funding are necessary.

As regards *social policy and employment*, limited progress has been made. Considerable efforts are needed to strengthen the weak administrative capacity in this area. Croatia has made uneven progress on *enterprise and industrial policy*. While there has been good progress on the business environment and SME policy, major challenges remain on enterprise restructuring, in particular in the steel and shipbuilding sectors. Some progress has been made on *Trans European Networks*. There has also been some progress on *regional policy and coordination of structural instruments*. However, considerable efforts are needed to set up the administrative structures necessary for implementation of EU funding.

As regards the *judiciary and fundamental rights* some progress has been made. However, significant improvements are needed on judicial reform and in the fight against corruption. There is further scope for improvement in fundamental rights. In the area of *justice, freedom and security* Croatia has made progress, particularly in border management, visa policy and asylum. However, the integrated border management action plan should be updated and equipment needs upgrading. Considerable andsustained efforts are needed to strengthen enforcement and administrative capacity, particularly as regards organised crime.

Reasonable further progress has been made in the chapters *science and research* and *education and culture*. In both cases, a good overall level of preparation has been reached. As regards the *environment* good progress has been made overall, especially on air and water, nature protection, chemicals and GMOs. However, in view of the scope and complexity of this chapter, very significant efforts are still needed. Administrative capacity is weak and strategies for financing the significant investments necessary are lacking. On *consumer and health protection* Croatia has made limited progress. Much legislative alignment remains and market surveillance is far from EU standards.

In the area of the *Customs union*, Croatia has made some progress, notably by further aligning customs procedures and customs protection of intellectual property rights. However, significant strengthening of administrative capacity and IT interconnectivity is necessary. Croatia has made some progress in the area of *external relations*. As regards *Foreign, Security and Defence Policy*, progress has continued. Croatia has continued to systematically align with EU declarations and other CFSP instruments.

There has been some progress on *financial control*, notably as regards Public Internal Financial Control, external audit and protection of the Euro against counterfeiting. More capacity for internal audit and financial management is needed, however. Structures to protect the EU's financial interests need to become operational. No particular progress has been made on *financial and budgetary provisions*.

The former Yugoslav Republic of Macedonia

As noted in last year's Opinion on its application for membership, the former Yugoslav Republic of Macedonia is well on the way to satisfy the **political criteria**. However, the pace of reforms has slowed down in 2006 and the country needs to step up its efforts. The short term political priorities in the European Partnership have been partially addressed.

The continued implementation of the Ohrid Framework Agreement has contributed to the country's stability and to consolidating ***democracy and the rule of law***. To achieve further progress, all political parties need to make the necessary efforts to build consensus, in full compliance with the letter and spirit of the Agreement.

The former Yugoslav Republic of Macedonia made progress in strengthening the electoral process to prepare for the July *parliamentary* elections. The legal and institutional framework for elections has been reformed, in line with ODIHR recommendations and a key priority of the European Partnership. In July, the electoral process was conducted largely in accordance with international standards. However, there were still irregularities before and during the elections. Major efforts will be required to ensure that standards are fully met during the next elections. A constructive dialogue, in particular in Parliament, among all political parties in the government and the opposition is needed to ensure the proper functioning of the institutions.

As regards *public administration reform*, the 2000 Law on Civil Servants has been further implemented. Steps were taken to improve the management of the administration and transparency in public decisions. The decentralisation process has moved forward and public services started to improve. Continued strong commitment from the government and the municipalities is required to address the remaining challenges. However, appointments and dismissals in the administration continue to be politically influenced. Large scale changes occurred in the administration after the change of government. Independence and professionalism of the administration, as well as administrative capacity, need to be strengthened.

An important reform of the *judicial system* has been initiated, as required in the European Partnership. The constitutional and legal framework for an independent and efficient judiciary is now largely in place. Successful implementation of the reform remains a major challenge and a key priority of the European Partnership, which will require continuous efforts and a sustained track record. Further steps remain to be undertaken to secure effective rule of law throughout the country. The adoption of a new police law met a key priority of the European Partnership, after delays which slowed down the reform in the police. Constructive cooperation is needed between the government and the opposition to ensure its smooth implementation.

The legal and institutional framework for *fighting corruption* has been strengthened. The cooperation and coordination among the bodies involved have improved. However, corruption remains widespread. Many allegations of corruption have yet to be investigated. Full implementation of the legislation and strong political will to step up efforts are needed.

As regards ***human rights and the protection of minorities***, implementation of the Ohrid Agreement has gone ahead. In general, inter-ethnic relations have continued to improve. However considerable further efforts are needed in a number of fields. The Penal Code was amended to abolish prison sentences for libel. Mechanisms for investigating ill-treatment of

detainees need to be strengthened, including through the co-operation between the Ombudsman and the Ministry of Interior. Telecommunication tapping still takes place in absence of a proper legal framework. Further efforts are needed to develop trust between ethnic communities. The representation of the different communities in the public administration is uneven. There has been some progress in the implementation of the action plans under the 2005-2015 Decade of Roma Inclusion. However, the situation of the Roma community continues to cause concerns.

Regarding ***regional issues and international obligations***, the former Yugoslav Republic of Macedonia has maintained full cooperation with the International Criminal Tribunal for the former Yugoslavia. Further progress in the reform of the judiciary is essential to prepare for the transfer of the cases to be returned by the ICTY. The country maintained a constructive position on Kosovo status talks. The bilateral non-surrender agreement with the United States of America is still not in line with the relevant EU guiding principles concerning arrangements between a state party to the Rome Statute of the International Criminal Court and the USA.

The former Yugoslav Republic of Macedonia has remained an active partner in regional cooperation. Bilateral relations with neighbours have developed; however, there has been no progress on the name issue, which remains an open problem. Renewed efforts are needed, with a constructive approach, to find a negotiated and mutually acceptable solution on the name issue with Greece, under the auspices of the UN, thereby contributing to regional cooperation and good neighbourly relations.

As regards **economic criteria**, the former Yugoslav Republic of Macedonia is well advanced in establishing a functioning market economy. Continued stabilisation and reform efforts are needed to enable it to cope with competitive pressure and market forces within the Union in the medium-term.

The country has maintained a broad consensus on the essentials of economic policies. As a result of a sound policy mix, macroeconomic stability and predictability have further increased. Inflation has remained under control. Public sector accounts have been kept close to balance and the relatively low level of public sector debt has declined further. Price and trade liberalisation are largely completed, and the privatisation of state-owned enterprises has proceeded. Barriers to market entry and exit have been reduced by simplifying and accelerating bankruptcy and, in line with a key priority of the European Partnership, registration procedures. The financial sector's stability has improved. Furthermore, measures have been taken to improve the quality of human capital and to upgrade the country's infrastructure. Foreign direct investment inflows increased significantly, mainly driven by privatisation efforts. Economic integration with the EU is well advanced.

However, the functioning of the market economy is still impeded by institutional weaknesses, such as the slow speed of administrative procedures, corruption, red tape and a low degree of legal certainty. Shortcomings in the judiciary continue to be bottlenecks, impeding a faster improvement in the business climate. Furthermore, labour and financial markets are still poorly functioning, which hinders the reduction of the particularly high unemployment and hampers credit provision to enterprises. The education system does not sufficiently reflect the country's needs. These factors allowed only moderate economic growth. The considerable informal sector continues to cause major distortions in the economy. The commodity structure of exports is very concentrated.

The country has made further efforts to improve its **ability to assume the obligations of membership**. The country still faces major challenges in implementing and effectively enforcing the legislation. There was some progress in the fulfilment of the short-term priorities of the European Partnership.

In the *free movement of goods*, there was some progress as regards horizontal measures. However, most of the sectoral *acquis* remains to be transposed and implemented. Development has been limited in the area of *free movement of workers* and preparations are at an early stage. There has been no progress on the *right of establishment and freedom to provide services.* Further efforts are needed to align with the *acquis*. Some progress has been made in the area of *free movement of capital*, in particular as regards payment systems. However, further efforts are needed. In particular, the legislative and institutional framework regarding money-laundering needs to be reinforced.

Significant progress can be reported in the area of *public procurement* where the basis for developing an effective public procurement system has been established. However, further efforts will be needed, in particular in setting up an effective remedy system. Notable progress has been made in the area of *Company law*, in particular the introduction of the one-stop-shop system for company registration, as requested by the European Partnership. Further efforts are needed to ensure the effective implementation of the rules adopted. On *Intellectual property law*, there has been some progress in particular in the area of industrial property rights. However, efforts need to be stepped up to strengthen enforcement capacity, administrative structures and political will to fight piracy and counterfeiting in order to comply with the SAA. Preparations to align with the *acquis* are still at an early stage.

In the field of *competition*, some progress can be reported, mostly limited to the legal framework. Considerable efforts are needed to implement existing legislation much more effectively, in particular as regards the functioning of the Commission for Protection of Competition.

There was some progress in the area of *financial services*, as the country has continued its efforts to align its national legislation with EU standards in the various sectors. Nonetheless, some deficiencies remain, in particular as regards the standard of supervision in the banking and the insurance sectors.

Progress has been notable in parts of the area of *information society and media*. There was further alignment of the legislation in the areas of electronic communications and information technologies, as well as in the audiovisual sector. However, progress is needed in the liberalisation of the telecommunications market, ensuring the principle of non discrimination between operators and the independence of the regulatory authority in order to end the breach of the Stabilisation and Association Agreement and meet a key priority of the European Partnership.

There has been some progress in the area of *agriculture and rural development.* Alignment has been initiated but is at an early stage. Progress has been made in parts of the area *food safety, veterinary and phytosanitary policy.* However, the enactment and implementation of legislation to align with the *acquis* is lagging behind. Preparations to align with the *acquis*, where relevant, in the area of *fisheries* are at an early stage.

Good progress has been made in some areas of *transport policy*. However, considerable efforts to align and strengthen the administrative capacity in all transport sectors are needed.

There has been notable progress in part of the energy sector. Adoption of implementing legislation is a matter of priority, in particular in view of commitments under the Energy Community Treaty which was ratified by the former Yugoslav Republic of Macedonia in May 2006.

Progress in the legislative alignment could be reported in the area of *taxation*. However, significant efforts will be needed to further align legislation, ensure effective implementation of the legislation, as well as to strengthen the administrative capacity in the area of tax collection.

Progress in the area of *economic and monetary policy* has been limited. However, overall, preparations are well advanced. There has been some progress in the area of *statistics*. Further alignment with the *acquis* is needed and administrative capacity needs to be substantially strengthened.

Notable progress has been made in the area of *social policy and employment*, mainly in the field of labour and equal opportunities legislation. However, much of the *acquis* remains to be transposed, notably in the area of health and safety at work, and considerable efforts in the employment policy are required to address the difficult labour market situation. There has been limited progress in the area of *enterprise and industrial policy*. The country still lacks industrial, technology and innovation strategies and further efforts are needed to develop instruments and sector policies. As regards Trans-European networks, the former Yugoslav Republic of Macedonia participates in the regional initiatives. The need for substantial financial input remains a bottleneck to upgrade the infrastructures. Progress has been limited in the area of *regional policy and co-ordination of structural instruments*. Considerable efforts will be needed to align the legislation on regional development and strengthen the institutional framework and administrative capacity.

In the area of the *judiciary and fundamental rights*, the Constitution and the legal framework were amended to allow for the implementation of the judiciary reform. Some progress has been made in the legal and institutional framework to fight corruption. However, improving the independence and the efficiency of the judiciary remains a major challenge and very strong political will is needed to tackle corruption. There is further scope for improvement in fundamental rights. The situation as regards protection of personal data remains a matter of concern. There has been progress in parts of the area of *justice, freedom and security*, notably as regards migration and visa policy, and border management. Further implementation of the border management strategy is needed. Progress has been more limited in judicial cooperation, police cooperation, the fight against organised crime and drugs. Considerable efforts and sustained efforts are needed to strengthen enforcement and administrative capacity.

The former Yugoslav Republic of Macedonia has started to prepare a more integral policy in the field of *science and research*. Progress has been made in the area of *education and culture*. As regards *environment*, some progress has been made to strengthen the legislative framework. However, preparations to align with the *acquis* in this chapter are at an early stage and very significant efforts will be needed to ensure the implementation and the enforcement of the legislation. On *consumer and health protection*, some legislative progress has been made, mainly in the area of safety related measures. Further legislative alignment is needed as well as sustained efforts to establish a functioning system of consumer and health protection throughout the country.

Substantial legislative progress took place in the area of *customs union*. Fees which were breaching the SAA have been abolished, in line with a key priority of the European Partnership. However, further strengthening of the administrative capacity in terms of staff, IT and other equipment will be necessary to allow enforcement of the legislation.

There has been progress in some areas of *external relations*, in particular in the field of dual use goods and regional integration through the CEFTA initiative. Progress has been made in parts of the area of *foreign, security and defence policy*. Further alignment will be needed, notably as regards international restrictive measures.

Legislative progress has been made in the area of *financial control.* However, considerable efforts will be needed, in particular to strengthen the public internal financial control, external audit and anti-fraud capacities. In the area of *financial and budgetary provisions*, progress has been limited. However, basic principles and institutions are in place.

Montenegro

As regards **political criteria**, Montenegro has made some progress. It has broadly addressed the key priorities of the European Partnership, but significant results remain to be produced.

Montenegro has managed smoothly the overall process leading to independence including the organisation and conduct of the referendum on 21 May 2006 in line with the requirements of the Constitutional Charter and the recommendations of the European Union. Montenegro is in the process of putting in place the legal and institutional set-up required by its new competences as an independent state. In particular, it will have to adopt a new Constitution. The Constitution should be in line with European standards and adopted by a broad consensus. Montenegro will also have to sign and ratify the international agreements to which the State Union of Serbia and Montenegro was a party.

Regarding ***democracy and the rule of law***, the parliamentary *elections* of 10 September 2006 were conducted in line with international standards.

The *government* and the *parliament* have made sustained efforts to increase their efficiency. The government has set up coordination mechanisms in key areas of its activity. The parliament has adopted new rules of procedure. Elements for the establishment of a political consensus on key choices including on European integration have started to emerge. This process needs to be pursued with determination and reflected in particular in the work of the parliament.

Progress in establishing the legislative framework for *public administration* reform has continued and a new recruitment system is in place. The training of civil servants has been upgraded. However, the public administration continues to suffer from serious weaknesses. Its de-politicisation and professionalism need to be fully ensured, in line with a key European Partnership priority.

The overall strengthening of the *judicial system* has continued. This is a key European Partnership priority. The adoption of a law on judicial training and the establishment of a state Judicial Education Centre have been steps to the right direction. However, problems of efficiency and independence in practice remained. The emerging consensus on judicial reforms should be followed by concrete steps on implementation and plans should be finalised soon and matched by the allocation of appropriate resources. Appointments and advancement

of judges and prosecutors needs to be de-politicised and based on professional and objective criteria.

Willingness to advance in the area of the *fight against corruption* has increased, in particular through the adoption of a number of planning documents by the Government and in improvements in reporting. The Anti-Corruption directorate has started to send cases to competent bodies. However, corruption remains a widespread problem in Montenegro and the overall legal and institutional set-up presents loopholes which allow for corruption and limit the capacity of the state to effectively prevent and prosecute corruption. The Parliament failed to amend the law on conflict of interest, which needs to be substantially reviewed and enforced with determination.

In the area of ***human rights and protection of minorities*** Montenegro is at an early phase in the process of putting in place a legal and institutional set-up following independence. In the next period particular attention needs to be paid to constitutional guarantees for human and minority rights, including in prisons, religious freedom, non-discrimination and the situation of Roma and refugees. Media independence and professionalism need to be strengthened and the law on access to information be implemented with more determination. The independence of the broadcasting authority should be maintained.

Concerning ***regional issues and international obligations***, *co-operation with the ICTY* is currently satisfactory, in line with a key European Partnership priority. This should be maintained. The ongoing investigation in relation to the case of the disappearance of a number of Bosnian refugees in 1992 is a matter of concern. Montenegro is committed in *regional cooperation*. It is an active participant of regional initiatives such as in the fields of aviation, transport infrastructure and energy. It enjoys good relations with neighbouring countries. Following independence, the smooth settlement of pending issues with Serbia has been a contribution to regional stability. Montenegro maintained a constructive approach on Kosovo, which was a key priority under the European Partnership.

As regards **economic criteria**, Montenegro has made some progress towards being a functioning market economy. Further reform efforts must also be pursued in order to enable it to cope with competitive pressure and market forces within the Union.

The country has maintained a broad consensus on the essentials of economic policies. Macroeconomic stability is getting firmer. In particular, economic growth has gained pace and inflation has remained subdued. Public debt has been reduced and budgetary revenues increased further. Foreign direct investment remained robust. Price liberalisation is almost complete. The privatisation programme is well advanced and business registration has been further facilitated. The capacity of the judiciary to deal with commercial disputes has improved. Financial intermediation has deepened and the restructuring of network industries is underway.

However, economic growth remains dependent on a few key sectors and enterprises. External imbalances widened. The labour market remains rigid and unemployment high. The financial audit system, both for internal and external controls, needs to be upgraded. The business environment is still hampered by the regulatory environment, including at municipal level. The level of infrastructure investment is low. Debt and arrears from some public enterprises to the government are very significant. The state aid structure must be strengthened. A system of ex ante control of all new aid measures needs to be set up. Public enterprises are still awaiting further restructuring and the privatisation plan is only partly completed. Trade openness and

trade integration with the EU has recently risen, but is still at fairly modest levels. Privatisation procedures need to be efficient and fair.

Montenegro has made some progress in approximating its legislation and policies with **European standards** in most areas and has advanced in strengthening its administrative capacity in particular in coordination of European integration matters including on the negotiation of an SAA. However, it is still at an early stage of preparations and considerable resources need to be allocated for finalisation of the legislative process and implementation.

Concerning ***internal market***, Montenegro has started legislative and administrative preparations to fully assume the new competences in the fields of standardisation, certification, metrology, market surveillance and intellectual property rights. Consumer and health protection including veterinary, fisheries and phyto-sanitary controls remain also at an early stage of preparation. Improvement is needed in reinforcing implementation of intellectual property rights legislation. Montenegro will also have to accede to all international agreements in this area the State Union was a party to.

Progress has been made in the area of *services* and the *right of establishment* and *free movement of capital.*

Customs reform has advanced but significant problems remain regarding the legal framework and the implementation of rules of origin. An adaptation to the EU standards in this area is essential for the conclusion and subsequent implementation of the Stabilisation and Association Agreement. Duty free shops have recently been established at land borders, which is a matter of concern, as it increases the risk of smuggling. Reforms in the area of taxation should be pursued.

Some progress has been achieved in the area of *competition*. However, further progress is needed in establishing the operational independence and providing resources for the competition authority and in advancing preparations to introduce and implement the legal framework for state aids. Some progress has been made in the field of *public procurement* and currently prepared amended legislation and secondary legislation is expected to strengthen the performance of the relevant bodies. However, the overall implementation of public procurement legislation has not been satisfactory and needs to be upgraded. Progress in all these fields is essential for the implementation of the SAA. Limited progress has been registered in relation to *employment policies*. Unemployment is still a significant problem in Montenegro, with inadequate actions to match needs and skills. Much of the *acquis* remains to be transposed, notably in the area of health and safety at work and gender equality. In the field of *education,* ongoing reforms mean that integration into the European area of Higher Education in the context of the Bologna process is on track. However, significant efforts are still needed to develop skills in line with the requirements of the economy.

As far as ***sectoral policies*** are concerned, Montenegro has moderately advanced in implementing the European Partnership priorities in the area of industry and SMEs. However, Montenegro has made little progress in streamlining licensing systems. The business environment needs to be improved by simplifying administrative procedures. The steel sector requires restructuring to achieve viability and competitiveness.

Some progress has been made in the field of *agriculture*. Strategies for agricultural development and fisheries have been adopted by the Government and put up for public discussion. Montenegro has designed plans for the development of the veterinary sector.

Overall it has moderately advanced on reforms with EU support and allocation of budget resources. However, implementation is still below European standards and needs to be upgraded.

Preparations in the field of *environment* remain at an early stage. Strategic and legislative documents have been adopted but the environment-related administrative capacity in management and control bodies should be substantially strengthened.

As for *transport* and *energy*, some progress can be reported. Montenegro is participating actively in regional transport networks and deciding its priorities accordingly. Progress has been registered in the adoption of the law on road transport. In energy progress has been registered in particular in the area of restructuring of the electricity and gas sectors and in promoting energy efficiency. Montenegro has ratified the Energy Community Treaty.

Progress has been noticed in the areas of *public internal financial control* and external *audit.* The State Audit institution progressed in strengthening its capacity. However, Montenegro will have to substantially upgrade its system of internal and external control and the State Audit institution should be upgraded into a supreme audit institution with constitutional guarantees and in line with EU best practices.

In *statistics*, some progress has been made regarding the establishment of a national statistical system in Montenegro. However, the overall quality of statistics remained low. The Statistical Office of Montenegro and the other parts of the national statistical system need substantial upgrading in order to implement commitments and to deliver timely, reliable and accurate statistics in accordance with EU standards.

In the area of ***justice, freedom and security***, some progress has been achieved concerning *border management.* Montenegro has assumed full responsibility in the area of *visa policy, asylum and migration* following independence. Preparations have started to put in place the legal and institutional framework required for implementation.

Some progress has been registered in the area of *anti-money laundering*. The Directorate against Money Laundering, which operates as a Financial Intelligence Unit, upgraded its cooperation with law enforcement bodies and with neighbouring countries. However, coordination and exchange of information needs to be substantially enhanced.

Some progress has been made in the fight against *drugs*. Montenegro is a transit country for drug trafficking, and drug use is increasing.

Some progress has been made regarding overall *police* restructuring. However, the resources and means available for police, in particular in the area of the fight against organised crime, remain inadequate.

Montenegro has achieved some progress as regards the *fight against organised crime*. An action plan to implement the strategy for the fight against corruption and organised crime was adopted in August 2006. It should be followed by an upgrading of the implementation capacity of law enforcement bodies. Some progress has been achieved in the *fight against trafficking in human beings*. A shelter for victims has been established with public funding. Preparations are advancing to prepare a law on the protection of personal data, a key requirement of the SAA. The situation as regards protection of personal data remains a matter

of concern. Montenegro is in the process of upgrading its capacities in the area of the fight against *terrorism*.

Serbia

As regards **political criteria**, Serbia has made progress in line with the European Partnership. However, a number of challenges remain to be addressed. In particular, Serbia has not yet met its international obligation to fully co-operate with the ICTY, which is the condition for resuming the Stabilisation and Association Agreement negotiations.

Concerning ***democracy and rule of law***, further to Montenegro's independence Serbia has become the successor state of the State Union of Serbia and Montenegro, in accordance with the State Union Constitutional Charter. The authorities have handled by this process in a responsible manner. The resolution of issues between the two Republics has been proceeding smoothly. Serbia has taken over the State Union policies and institutions. This process is not yet fully completed.

The adoption of a new *Constitution* is a welcome development. However, there are some areas of concern, related in particular to the independence of the judiciary. The constitutional framework needs to be soundly developed and implemented to strengthen democracy and rule of law, and to ensure its future compatibility with EU membership. As regards Kosovo, its future status will be determined by the political process established under UNSCR1244.

The Serbian *parliament* has continued with intensive legislative activity. It has become more transparent and open to the general public. The revision of its rules of procedure is welcome. However, its functioning has shown some weaknesses. In particular some members of the Parliament were deprived of their mandates in a controversial manner. The *Government* activities have become more transparent. The European Integration Office has continued its good work, notably with regard to the Action Plan for the implementation of the European Partnership. However, the lack of coordination within the Government persisted. The line ministries still have widely varying capacities and resources to deal with European integration issues.

As regards the *public administration reform*, a key priority of the European Partnership, there has been further progress in setting the legal framework for the civil service. This is now in line with general European standards. Serbia has a good administrative capacity in a number of areas. This capacity needs to be developed further throughout the administration. The Parliament has not yet appointed an Ombudsman as required by the relevant law.

The reform of the *military* has continued but with difficulties and resistance from some elements within the army. Civilian oversight of the military, which is a key European Partnership priority, is still insufficient. The new Constitution and the revised parliamentary rules of procedures set out the bases for a more effective civilian oversight.

The *judicial* reform strategy has been adopted and its implementation has started. However, the independence of the judiciary, an issue which mentioned in a key priority of the European Partnership, is still affected by political influence. Positive trends can be seen as regards speeding up of proceedings in commercial courts. Still, the efficiency of the administration of justice is not satisfactory. The establishment administrative and appellate courts has been delayed further.

The National strategy and the relevant Action Plan for *fighting against corruption* were adopted. Tangible results were achieved in some sectors. However, corruption remains a source of concern. A clear and effective institutional set-up still needs to be put in place.

As regards ***human rights and the protection of minorities***, overall the human rights situation has continued to improve. The State Union Ministry for Human and Minority Rights has been replaced by an Office under the Prime Minister. However, the performance of the Office remains to be tested. The new law on churches and religious organisations does not guarantee the equal treatment of religious groups. A comprehensive anti-discrimination law is still lacking and further efforts are needed to promote tolerance. Further efforts are also needed to prevent torture. The issue of property restitution remains outstanding.

Measures have been taken to promote the participation of members of *minorities* in the education system and their representation in public administration. Problems persisted, however, in the area of information in minority languages. The interethnic situation in Vojvodina has continued to improve. The situation in South Serbia remains tense. In Sandžak, incidents have occurred within the Bosniak community. The Government has adopted a number of Action Plans concerning Roma people. However, their situation remains precarious. Local integration of refugees, in particular the most vulnerable ones, remains difficult.

As regards ***regional issues and international obligations***, Serbia has continued to contribute to *regional* co-operation and to pursue policies aimed at improving relations with its neighbours. Progress has been made concerning regional co-operation in the fields of aviation, transport infrastructure and energy. Serbia has not yet met its international obligation to fully co-operate with the ICTY, which is a key priority of the European Partnership. The Serbian authorities participate in the political talks on the future status of Kosovo, launched in 2005 under UN auspices. However, Belgrade has discouraged the participation of Kosovo Serbs in the Provisional Institutions of Self-Government. Serbia needs to take a constructive approach in line with the key priority of the European Partnership.

As regards **economic criteria**, Serbia has made notable progress towards being a functioning market economy. Stabilisation and reform efforts need also be continued in order to enable it to cope with competitive pressure and market forces within the Union.

Consensus on the direction of economic policy and reform has generally been maintained in 2005. Economic growth has continued. The current account deficit has narrowed, helped by recovering exports. Foreign currency reserves have been boosted by strong capital inflows in the form of privatization proceeds as well as corporate and commercial banks' foreign borrowing. Foreign direct investment (FDI) has continued to grow predominantly related to privatisation. Monetary policy has been tightened and fiscal consolidation continued in 2005 due to cuts in expenditure and strong tax receipts. General government debt has declined. Tangible progress has been made in pension reform and company registration. Privatisation of socially-owned companies and of the banking sector has advanced. Preparations for restructuring and privatisation of state-owned companies have intensified. There was a certain progress in creating the necessary regulatory framework for network industries. Economic integration with the EU advanced.

However, inflation and external deficits remained relatively high. Since early 2006, fiscal consolidation has stopped. The envisaged acceleration of public investment risks jeopardising further fiscal consolidation and macroeconomic stability. External debt has risen as borrowing

of the private sector has increased. Unemployment has further risen. Greenfield investment remained negligible. The enterprise sector remained overall weak, also due to lack of competition in domestic markets and slow progress in corporate restructuring, privatisation and market exit procedures. The new bankruptcy legislation is not yet applied frequently. Capital markets remained in an infant stage. State intervention in the economy has remained prevalent.

Serbia has made good progress to approximate its legislation and policies with **European standards** in most areas. Overall, Serbia has continued to strengthening its administrative capacity to be able to implement the SAA properly. However, on its way towards future integration into the EU, efforts are needed for completing the legislative process and implementation notably in areas where there are strong vested interests.

Serbia has advanced well in its legal and administrative approximation to the EU ***internal market*** *acquis*. With the objective to fulfil the requirements of the Stabilisation and Association Agreement, Serbia has made sustained efforts to approximate the country's legislation to that of the EU during the past year. Particular progress is reported in the areas of *standardisation, conformity assessment and accreditation, metrology, movement of services, anti-trust, company law and customs*. The legislative framework in the area of standardisation, certification and metrology is now in place and needs to be implemented. A set of laws in financial services has been adopted to further approximate rules to the EU. An independent anti-trust body has finally been set up. The customs administration has made substantial progress in the control and management of the customs legislation.

In some areas Serbia needs to make efforts not only to implement but also to fully benefit from the future Agreement. Serbia needs to strengthen administrative structures, particularly in some the areas such as *taxation, state aid control, public procurement, intellectual property rights and consumer protection.* The legislative framework is relatively well advanced in public procurement and in intellectual property rights. Further efforts are needed to reach adequate implementation and enforcement. Serbia needs to revise discriminatory taxation of foreign goods and to commit itself to the EU code of conduct on business taxation. The legal framework for state aid control remains to be adopted and the administrative capacity, strengthened. The Consumer Protection Council needs to be further reinforced.

In relation to ***sectoral policies***, Serbia has made good progress in a number of areas: education, employment and social policy, *SME policy, agriculture policy, statistics, energy, aviation and transport infrastructure*. Serbia has established a new legal framework for higher education. Serbia has continued implementing effectively the European SME Charter. Serbia has made further efforts to reform and modernise its agricultural sector and has actively taken part in the improvement of transport networks in the region. Serbia has signed the European Common Aviation Area Agreement. Serbia is actively participating in the implementation of the Memorandum of Understanding on the Development of the Core Regional Transport Network and the South East Europe Transport Observatory. Serbia has ratified the Energy Community Treaty.

In certain areas more efforts are needed to fulfil the future SAA obligations and the priorities of the European Partnership. This includes EU approximation in the area of *food safety, environment, information society and financial control.* On food safety, administrative capacity needs to be further strengthened, especially in the phytosanitary area. Concerning environment, Serbia needs to strengthen administrative capacity, to develop new legislation and to ensure proper implementation and enforcement. As regards information technologies,

the telecommunication regulatory authority needs to be strengthened to improve competition in the sector. As regards the media, the legal framework raises concerns, notably in relation to the capacities of the regulatory body. In the area of financial control, Serbia needs to introduce a strategy to establish a Public Internal Financial Control system.

As regards ***justice, freedom and security***, Serbia has taken over the relevant State Union competences in the areas of *visa* administration, *border management, asylum* and *migration*. The Law on Foreigners which is to define the future visa regime has still to be adopted. The national integrated border management strategy and the implementing action plan were adopted. The Law on State Borders has not been adopted. The transfer of border control from the military to the civilian authorities is proceeding. In the field of asylum, the implementing legislation to regulate procedures for reception and protection of the asylum seekers remains to be adopted. There is a lack of adequate infrastructure and qualified staff. A number of readmission agreements has been signed. The legal and financial framework for integration of people who have been readmitted is still lacking. Some results have been achieved in the fight against illegal migration but this continues to be an area of concern.

The implementation of the new Law on *Police* has been rather slow. The legislation on the security services has not yet been adopted. Concerning the fight against *money laundering*, the legislation has been improved but there is still insufficient cooperation between the competent agencies.

Organised crime remains a source of serious concern. The action plan to implement the National Strategy for the fight against Organised Crime has not yet been finalised. There is a need to further reinforce specialised services within police, especially the ones tasked with investigating financial crime. Appropriate legislation on seizure and freezing of assets, bank accounts and the proceeds of crime remains to be adopted. The implementation of the Law on Witness Protection has revealed deficiencies. Concerning *trafficking in human beings*, the criminal legislation has been amended and there have been some first convictions. *Terrorism* and its financing have been introduced as specific offences in the Criminal Code. The ratification and implementation of the relevant international conventions needs to be accelerated. The situation as regards protection of *personal data* remains a matter of concern.

Kosovo

As regards **political criteria**, Kosovo has remained stable and made progress in the transfer of responsibilities to the provisional institutions of self government (PISG). Increased efforts are needed to strengthen the rule of law. Key short-term priorities of the European Partnership have only been partly addressed.

As regards ***democracy and the rule of law***, the *status issue* has dominated Kosovo's politics. The main Kosovo Albanian political parties have developed a more constructive dialogue which will need to be sustained. The focus on status has led to the swift implementation of some UN standards but has delayed reforms. The status settlement should provide the basis for a stable democracy for all Kosovans regardless of their ethnic background, consolidating the rule of law and promoting human and minority rights. Kosovo's institutions must start to develop a vision for Kosovo's future beyond status with a focus on sound policy-making, prudent fiscal policies, efficient institutions and good governance at all levels.

Progress has been made in strengthening the *Assembly's* role. An important reform package was adopted, improving executive oversight, financial accountability and transparency.

However, Assembly committees are not always able to fulfil their role in the legislative process, partly due to a lack of qualified staff working for the secretariats of the committees. They do not yet have the practice of appointed *rapporteurs*.

The succession of the late President Rugova and the establishment of a new *government* went smoothly. Kosovo's progress under the Stabilisation and Association Process is now a top government priority. The government established an agency for European integration and adopted an action plan to address European Partnership priorities.

As regards *public administration*, the provisional institutions have set up an independent oversight board and a senior public appointments committee. They have established new ministries of justice and of the interior. The government has made some progress in improving its coordination and policy-making capacities. The authorities exercise limited control over certain Kosovo Serb areas, particularly in the northern municipalities. However, Kosovo's administrative capacity remains weak and the civil service overstaffed. A comprehensive reform of the civil service is needed. Appointments in the administration continue to be politically influenced.

As regards the *judicial system*, the Kosovo Judicial Council and the Kosovo Judicial Institute were set up. Substantial responsibilities were transferred to the provisional institutions in order to increase local ownership and accountability. The current role of the Assembly in the appointment of judges and prosecutors undermines the independence of the judiciary and allows political and ethnical considerations to interfere in what should be an objective and technical recruitment process. Kosovo's judicial institutions have made little progress in civil and criminal justice. The backlog of cases has increased and judgements are not always enforced. Rendering judgements in the high profile cases in relation to the March 2004 riots remains problematic due to a lack of diligence in case investigations by the police, lenient sentencing and a lack of cooperation from witnesses.

In response to a key European Partnership priority, the government approved an anti-*corruption* action plan, an anti-corruption council was established and the Assembly appointed the director of the anti-corruption agency. Nevertheless, corruption in Kosovo is still widespread and little progress has been made in effectively tackling corruption.

In the area of ***human rights and the protection of minorities*** an advisory panel has been established to deal with complaints from persons claiming to be the victims of *human rights* violations by UNMIK. The mandate of the international ombudsperson expired at the end of 2005 and the assembly nominated a Kosovan acting ombudsperson.

In spring 2006, the President and the Prime Minister started a highly visible outreach campaign towards *minorities*. Both called on minority communities to consider Kosovo their home and to work together with Kosovo's provisional institutions of self government. However, minorities continue to be in a disadvantaged position and further efforts are needed to combat intolerance. There have been a number of violent attacks against Kosovo Serbs particularly during the summer of 2006. The conditions remain difficult for a sustainable return of refugees and displaced persons.

Relations between Kosovo Serbs and Kosovo Albanians have remained strained. Belgrade has discouraged the Kosovo Serbs' participation in the provisional institutions and Kosovo Serbs have continued to boycott them.

Concerning ***regional issues and international obligations***, Kosovo has enhanced its participation in regional fora and cooperation initiatives, a key European Partnership priority, particularly in the areas of transport and energy. A free trade agreement with the former Yugoslav Republic of Macedonia entered into force and free trade agreements were signed with Croatia and Bosnia and Herzegovina.

As regards **economic criteria,** Kosovo has made limited progress towards being a functioning market economy. Considerable additional efforts are also needed in order to be able to cope with competitive pressure and market forces within the Union.

Consensus on the essentials of economic policy in Kosovo has been broadly maintained. Monetary stability continued to be underpinned by the use of the euro as sole legal tender. Fiscal policy has been tightened, reflecting a rapid decline in donors' support and foreseeable exhaustion of the reserve of accumulated cash deposits. In line with a key European partnership recommendations, a medium-term economic policy framework for Kosovo has been established, which aims at ensuring a sustainable fiscal stance. The first Medium-Term Expenditure Framework was adopted, providing a consolidated overview of budget and off-budget financing needs, including public investment projects. Privatisation of socially-owned enterprises progressed markedly. Considerable progress has been achieved in the incorporation of publicly-owned enterprises which is a key European Partnership priority.

However, macroeconomic stability has not yet been satisfactorily achieved so far, mainly due to the fragile fiscal and unsustainable external position. Unemployment remains high, also due to excessive labour costs. These costs also dampen private sector development and export competitiveness. Serious challenges remain in implementing the policy commitments taken by the authorities, in particular as regards a sustainable fiscal policy stance over the medium term. An inefficient judiciary and legal uncertainty with respect to enforcement of property rights continue to hamper economic activity. Access of small and medium-sized enterprises to external finance is limited. Infrastructure remains insufficient and often of poor quality. The power supply remained unreliable, hindering economic development. Restructuring of publicly-owned enterprises, in particular of the Kosovo Energy Corporation, need to be further accelerated.

Kosovo has made good progress to approximate its legislation and policies with **European standards**. However, limited progress has been made on the effective implementation and enforcement of legislation passed. More efforts are needed to create an administrative environment that will ensure further approximation to European standards.

In the area of the ***internal market***, some progress has been made on the establishment of a system for *standardisation*, *certification*, *metrology*, *accreditation* and *conformity assessment.* Little progress can be reported in a number of important areas such as *public procurement, competition,* and the protection *of intellectual property rights*. Little progress has been made in the areas of *employment*, social policy and *education*. Limited progress has been made on the *free movement of capital*.

Customs legislation is broadly in line with the *acquis* and good progress has been achieved in response to European Partnership priorities in several areas related to administrative capacity in the customs area (e.g. computerisation, risk analysis, fight against corruption). A revised Integrated Tariff for Kosovo entered into force. A comprehensive reorganisation of UNMIK customs took place and the intelligence unit and the investigation unit were strengthened.

Some progress has been made in the area of *taxation*, although domestic tax collection remains weak.

As regards the development of ***sectoral policies***, good progress has been achieved in the *transport* sector as prioritised in the European Partnership. The government adopted a multi-modal transport policy paper. Kosovo signed the agreement on the establishment of a European Common Aviation Area.

There has been some improvement in relation to the restructuring of the *energy* utilities. The energy regulatory office became operational and issued substantial implementing legislation. Kosovo ratified the Energy Community Treaty. However, the financial viability and reliability of the energy sector remain precarious. Bill collection rates remain at unsustainably low levels and technical losses and theft remain very high.

Regarding the *environment*, progress has been fairly good in legislative terms. Some progress has been achieved in the agricultural sector, particularly in the veterinary area. Good progress has been achieved in the area of *financial control*.

Good progress was achieved on *audiovisual* policy and media. The law on Radio and Television of Kosovo was promulgated in April 2006. Little progress was made in the area of electronic communications and information society.

There has been some progress in *statistics*. Preparations for a housing and population census are ongoing. An international monitoring operation has been established to help the statistical office prepare for the census and ensure it will be carried out in line with international standards. Efforts have also been undertaken to encourage minority participation in pilot census exercises. The statistical office's capacities generally remain weak.

As regards ***justice, freedom and security***, some progress has been achieved in the areas of *border management*. A memorandum of understanding was signed between the border police and customs in January 2006 to facilitate integrated border management.

The Financial Information Centre has revised the *anti-money laundering* regulations with input from the banking and payment authority of Kosovo.

No progress can be reported in the fight against *drugs*. Local policing capacities to fight drugs need to be strengthened.

The Kosovo police service has continued to make progress towards becoming a professional *police* force. A Kosovan deputy police Commissioner and four Kosovo police service assistant police commissioners were appointed. Further efforts are needed to develop an effective police service and strengthen local investigation capacities in relation to corruption and organised crime.

Efforts are underway to intensify the fight against *organised crime* which remains a serious problem in Kosovo. Criminal networks extend to various socio-economic sectors and into politics. Finding the highly skilled Kosovan police personnel remains a major challenge. Legislation is still lacking to keep the identity of informants confidential in court. Little progress has been made in the fight against *trafficking human beings* and Kosovo remains a source, transit, and destination point for trafficking. No progress has been made with regard to the protection of personal data, which is a matter of concern.

Turkey

Turkey continues to sufficiently fulfill the Copenhagen **political criteria** and has continued political reforms. However the pace has slowed during the past year. Significant further efforts are needed in particular on freedom of expression. Further improvements are also needed on the rights of non-Muslim religious communities, women's rights, trade union rights and on civilian control of the military.

As regards ***democracy and the rule of law***, in the area of *public administration* a law establishing an Ombudsman was adopted. No progress is reported with regard to civil service reform.

In the area of *civil-military relations* the parliament passed revised procedures for military courts enhancing guarantees for defendants. However, senior members of the armed forces have continued making public statements to influence areas beyond their responsibilities.

There was progress in the area of *judicial reform*. However, implementation of the new legislation by the judiciary presents a mixed picture so far and the independence of the judiciary needs to be further established.

There was some limited progress on legislative reforms in the fight against *corruption*. Corruption remains widespread. Anti-corruption policies are weak and the authorities responsible for the fight against corruption need to be strengthened.

Concerning ***human rights and the protection of minorities***, there has been a further decrease in reports of *torture and ill-treatment.* However, allegations of torture and ill-treatment outside detention centres and in the South-East give cause for concern. Impunity for perpetrators of torture also remains a problem. The impact on fundamental freedoms of the amendments to the anti-terror law needs to be followed closely. Such amendments introduced a wide list of terrorism offences and weakened guarantees for defendants.

In general, open debate has increased in Turkish society on a wide range of issues, including traditionally sensitive subjects. Notwithstanding this trend, *freedom of expression* in line with European standards is not yet guaranteed by the present legal framework. A recent ruling of the Court of Cassation establishes jurisprudence on Article 301 of the Penal Code which restricts free speech. Moreover, a significant number of persons have been prosecuted for expressing non-violent opinions. Article 301 and other provisions of the Turkish Penal Code that restrict freedom of expression need to be brought in line with the European Convention of Human Rights (ECHR).

Restrictions on *freedom of assembly* and *freedom of association* have eased, with improved implementation of measures taken in recent years. However, in some cases security forces made use of excessive force during demonstrations. Difficulties in establishing associations promoting a specific cultural identity remain.

With regard to *freedom of religion*, the adoption of a law that was expected to improve the situation of *religious minorities* has been postponed several times, and there has been no change in the difficulties faced by the non-Muslim communities on the ground. There has been no change in the situation of the Alevi community. A legal framework should be established in line with the ECHR so that all religious communities can function without undue constraints.

Women's rights receive growing public attention in Turkey, and civil society is increasingly able to play a positive role in this area. The legal framework is broadly satisfactory. However, in practice women's rights are not always protected, in particular in the poorest areas of the country. 'Honour crimes' need to be investigated more systematically and where appropriate followed-up with prosecution and convictions.

There has been little change in the situation as regards *children's rights*. Implementation of legal provisions concerning education and employment under the age of fifteen needs to be improved.

On *trade unions' rights* there was no legislative progress. Turkey does not yet meet EU and ILO (International Labour Organisation) standards, in particular as regards the right to strike and the right of collective bargaining.

Turkey's approach to *minority rights* remains restrictive. Turkey did not ratify the international legal instruments on minority rights. As regards *cultural rights*, limited broadcasting is allowed in languages other than Turkish. Restrictions on learning such languages are maintained for the public schooling system. All private establishments offering courses in Kurdish language closed down in August 2005. General restrictions on the use of languages other than Turkish remain tight both in political life and when accessing public services.

Turkey has been the subject of increased terrorist attacks, in particular from the PKK, which is on the EU list of terrorist organisations. The EU has strongly condemned these terrorist acts.

There is a need for Turkey to address the serious economic and social problems of the *South East* and ensure full enjoyment of rights and freedoms by the Kurdish population. The large numbers of internally displaced persons continues to cause concern.

With regard to ***regional issues and international obligations***, Turkey has expressed continued support for UN efforts to find a comprehensive settlement of the *Cyprus problem*. However, there has been no progress towards normalisation of bilateral relations with the Republic of Cyprus. Since signing the Additional Protocol to the Association Agreement in July 2005 Turkey has not moved towards its full implementation and the removal of all obstacles to the free movement of goods, including restrictions on direct transport links with Cyprus. At its June 2006 meeting, the European Council recalled that the Council would review implementation of the Additional Protocol in the course of 2006 and ensure follow-up to the issues included in the EU declaration of 21 September 2005.

Relations with Greece have evolved positively but no progress has been made in resolving the outstanding border dispute. At a meeting of Foreign Ministers of the two countries a new package of confidence-building measures was agreed. Good neighbourly relations remain key.

As regards **economic criteria**, Turkey can be regarded as a functioning market economy, as long as it firmly maintains its recent stabilisation and reform achievements. Turkey should also be able to cope with competitive pressure and market forces within the Union in the medium term, provided that it firmly maintains its stabilisation policy and takes further decisive steps towards structural reforms.

The consensus on the essentials of a market-based economy has remained broadly intact. Stability-oriented macroeconomic policies have contributed to strong economic growth and growing resilience to shocks. Budget deficits and government debt levels have been significantly reduced and some key measures have been taken to enhance the social security system. The independence of regulatory and surveillance agencies has been confirmed and special privileges of state-owned banks are being phased out. The privatisation process has gained momentum. The banking and non-banking financial sectors have continued to deepen, and supervision has been further strengthened. The economy has become more open to foreign trade and investment. The Central Bank and the government continued to implement disinflation policy.

The relatively high external and government financing needs remain highly vulnerable to investor sentiment, which implies a potential threat to macroeconomic stability. Therefore, fiscal consolidation needs to be further strengthened and effectively backed by structural measures. Combating unregistered employment requires attention. Labour market imbalances persist. Employment rates are very low and falling, in particular for the female population. Policy responses to these imbalances were limited and non-wage costs of hiring remained large. Average educational standards are relatively low and large disparities persisted. The business environment was negatively affected by barriers to exit and low transparency as regards state aids. The process of restructuring of the energy sector advanced fairly slowly.

Turkey has improved its **ability to take on the obligations of membership**. In most areas some progress was made. However, fulfilment of short-term priorities under the Accession Partnership is lagging behind in many areas. A number of obligations by Turkey under the Customs Union remain unfulfilled. Much remains to be done to improve the level of alignment and the institutional and administrative capacity.

Progress in *free movement of goods* has been uneven. There were improvements in areas such as accreditation, standardisation and conformity assessment. However, a number of provisions remain contrary to the general principles of free circulation of goods, and technical barriers to trade continue to exist. On *free movement of workers*, there were no developments. Alignment with the *acquis* on the *right of establishment* and *the freedom to provide services* remains limited. Turkey made very little progress on the *free movement of capital*. Alignment is incomplete in particular concerning the fight against money laundering. Acquisition of real estate by foreigners is restricted.

Progress in the area of *public procurement* is very limited. The scope of application of the legislation narrowed through the introduction of exemptions. Turkey does not have an organisation that guarantees a coherent policy in all areas related to public procurement. As regards *company law*, some limited progress was made. Turkey has adopted most international accounting standards. However, these are not legally binding for the majority of Turkish companies, which are only subject to tax-based reporting requirements. The level of alignment is low. On *intellectual property law*, alignment is well advanced and administrative capacity improved. However, further progress remains necessary, in particular on enforcement addressing organised piracy and counterfeiting. Furthermore, cooperation and coordination between relevant authorities needs strengthening. Non-specialised lower courts have difficulty in properly implementing legislation.

Progress in the field of *competition policy* is mixed. Alignment of anti-trust acquis is well advanced and enforcement by the Competition Authority is satisfactory. However, on state aid there is no progress: Turkey does not have the necessary legislative framework, nor

administrative structures to implement EU rules. The relevant obligations under the Association Agreement remain to be fulfilled.

Turkey has made some progress on *financial services*. A new banking law, and insolvency legislation in the insurance and supplementary pension sectors, are improvements. Alignment of legislation in insurances is limited. In the area of investment services and securities markets the investor compensation scheme, cross border provision of services, disclosure requirements, and prospectuses need further adaptation. Supervisory capacity needs to be further strengthened, in particular in the insurance and securities market sectors.

Progress has been made in parts of the *information society and media* areas, including local broadcasting in other languages. Turkey achieved a good basis for further alignment in electronic communications and information technologies. Overall alignment in media and audiovisual policy remains very limited.

In *agriculture* some limited progress was achieved on rural development. However, implementation was put into risk by delays in adopting related legislative measures and administrative structures. Most administrative structures to implement the Common Agricultural Policy (CAP) remain to be developed. Turkish policy to increasingly link financial support to the production level is not in line with the reform of CAP. Overall, alignment is limited. Concerning *fisheries*, Turkey made no progress. Important elements of the *acquis* are missing in Turkish legislation. Structures to implement the Common Fisheries Policy are not in place. Limited progress was made in aligning the *veterinary, phytosanitary and food policy*. Neither the legislative framework nor the administrative structures are in place to allow implementation of the *acquis*. In general, control systems are weak. The main difficulty is in the veterinary sector, in particular in view of the animal health situation, the lack of an effective animal disease control system.

Some progress has been made in *transport policy*. Alignment is fairly advanced on road transport, but uneven in the other sectors. Implementation and enforcement capacity require attention. A decision on the structure of the railway sector is pending. International maritime and air transport agreements are not complemented by the transposition of applicable acquis. Limited progress was made on *Trans European Networks*. On *energy* there was some progress. However, legal alignment is uneven. A framework law for energy efficiency remains to be developed. The administrative capacity, and the independence of regulatory bodies, needs strengthening.

There was limited progress on *taxation*. The Turkish fiscal regime is partially in line with the *acquis*. Incomplete are particularly the scope and rates of VAT, the structure and rates of excise duties, as well as direct taxation in general. All discriminatory elements on the taxation of alcoholic and tobacco products need to be abolished urgently.

Turkey made progress on the field of *economic and monetary union*. In general, preparations are well under way. However, legislation to prevent monetary financing of the public sector, as well as prohibition of privileged access of public authorities to financial institutions is not in line with the *acquis*. Furthermore, a lack of efficient coordination and cooperation practises reduces the effectiveness of economic policy. Turkey made some progress in the use of uniform classifications and the availability of sector *statistics*. Alignment remains limited, but new legislation is providing significant progress.

Turkey made some limited progress on EU *employment and social policy*, in particular in the field of social protection and as regards the implementation of the new law for people with disabilities. However, full respect of trade union rights needs to be ensured. Combating unregistered employment requires attention. The administrative capacity needs to be enhanced to ensure implementation.

Turkey made good progress on *enterprise and industrial policy*, particularly on the legal establishment of an Investment Support and Promotion Agency. Privatisation, alignment of the SME definition, and policy programming, also progressed. Alignment is well advanced.

Progress was made on *regional policy and coordination of structural instruments*, notably with the adoption of the law establishing development agencies. However, the role and functioning of these agencies raise some concern. Ownership and accountability need improvement, including considering a repartition of competences between ministries at both central and regional level. Alignment remained modest.

As regards the *judiciary and fundamental rights* some progress was made. Overall, there was continued progress in the area of judicial reform. However, implementation of the new legislation by the judiciary presents a mixed picture so far and the independence of the judiciary needs to be further established. There has been some progress in the fight against corruption, notably on increasing transparency in the public administration. However, corruption remains widespread and anti-corruption authorities and policies are still weak. The scope of parliamentary immunity is too wide. On fundamental freedoms, limited legislative progress was made, though implementation of reforms continued.

In the area of *justice, freedom and security*, Turkey made progress on asylum, border management, the fight against trafficking in human beings, customs and police cooperation. Alignment is underway, but incomplete in areas such as migration, the fight against organised crime, money laundering, as well as judicial cooperation in civil and criminal matters.

Some further progress was made on *science and research*, notably in participating in EU research programmes, and on budget allocations. Further good progress was made in *education and culture*. Alignment in both areas is well advanced.

Alignment is on track as regards waste management and noise. On other aspects, including international conventions, alignment in the area of *environment* remains low. Lack of progress on horizontal legislation, in particular on trans-boundary issues and on public consultation, is of increasing concern. Limited progress in transposing the acquis was achieved in the field of air quality, nature protection and water quality. When implemented, the amended Environmental Law will strengthen the institutional capacity. The track record on enforcement is weak.

On *consumer and health protection* consumer protection improved, notably through the introduction of a market surveillance system. The public health area also improved, in particular by setting up a network for the epidemiological surveillance and control of communicable diseases. However, in both areas implementation remained weak.

The *Customs union* has prepared Turkey for a high level of alignment in this area. However, on some specific issues, such as free trade zones, customs duty relief, fight against counterfeit goods, and post-clearance, legislation is not aligned. The customs administration needs strengthening, including starting preparations for IT interconnectivity.

Turkey reached an advanced level of alignment in the area of *external relations*. However, alignment with the EU's Common Commercial Policy is not complete. Alignment with EU Common *Foreign and Security and Defence Policy* continued. Turkey has intensified its foreign policy activity in the Middle East, promoting regional stability. The border with Armenia remains closed. Turkey participated in ESDP missions. However, Turkey's participation in ESDP continues to present difficulties. Turkey continues to block the participation of Cyprus and Malta in EU-NATO strategic cooperation. Similarly, Turkey opposes Cyprus' accession to the Wassenaar Arrangement. Turkey has yet to sign the International Criminal Court statute.

There was some progress on *financial control*. Some administrative structures and implementing legislation are in place. However, the Public Financial Management and Control Law is not fully operational. Although some temporary measures have been adopted, structures to protect the EU´s financial interests are not complete yet. In relation to the *financial and budgetary provisions*, Turkey will need to establish in due course the coordination structures and implementing rules to ensure the correct calculation, collection, payment and control of own resources.