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## Chapter 8

# ENERGY IN THE EUROPEAN UNION AND IN CROATIA

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### ABSTRACT

The objective of this work is to determine the extent of the conformity of the Croatian energy sector with the conditions for membership in the EU. According to a comparative analysis an identification is made of the state of affairs in the energy sector in the EU, in the Republic of Croatia and in the applicant countries, the level at which the conditions for membership are fulfilled and the necessary measures that have to be implemented during the reform.

The main conclusion is that the legal system itself in the area of the Croatian energy system is already mainly harmonised with the EU system. However, concrete application of the rules departs from the way rules are applied in the EU. Since these rules obtain their final form only during application, and the manner of interpretation and application is much harder to change than the rules themselves, particular attention needs devoting to practice in the process of adjustment.

### Key words:

energy, market liberalisation, single energy market, criteria for membership, Croatia, applicants, EU

*\*The views expressed herein are the standpoints of the author, are not binding upon the institution in which she works, and do not necessarily coincide with the official views of the Croatian Energy Regulatory Council (Croatian acronym: VRED)*

## INTRODUCTION

Adaptation to the EU system is a process of the gradual acceptance of its rules and standards. The membership criteria define the necessary level of harmonisation with the EU system that must be attained by applicant states. In an evaluation of fulfilment of membership criteria, the European Commission takes into account the conformity of the national political system as a whole (degree of democracy, effectiveness of the rule of law, establishment of market economy) and of individual sectors.

In the energy sector, during membership negotiations the EU first of all required from the applicants an increased level of nuclear safety. However, with reform and liberalisation of the energy sector, new requirements have been set up for states that wish to join. In this paper, these requirements are identified, their implementation in the EU, in the applicant countries, and in the Republic of Croatia. According to what has been achieved to date by certain groups of countries, the main difficulties in meeting EU demands and the measures that might help to solve them are identified.

## MEMBERSHIP CRITERIA

In each sector of the economy, fulfilment of the membership conditions is evaluated according to how much the economic and legal criteria for membership are met. The fulfilment of economic criteria for membership implies: a) the existence of a functioning market economy (liberalisation of prices and trade, demand and supply equilibrium established by market forces) and b) the capacity to cope with competitive pressure and market forces within the Union. The fulfilment of the second criterion is evaluated, however, among other things, according to an estimation of whether the proper infrastructure exists. The legal conditions imply the acceptance and application of the *acquis communautaire*.

At the level of states members and at the level of the Union no effective market economy in energy has yet been set up. For example, the system of market laws at EU level is only just developing (for more detail, see Pelkmans, 2001), and this is one of the elements for the estimation of whether there is an effective market economy. For this reason, in the energy sector the level to which membership conditions has

been fulfilled is monitored with respect to the degree of liberalisation achieved within the EU.

Hence, fulfilment of conditions for membership in the energy sector is estimated above all according to the ability to accept and apply the acquis. In this the key determinants for an estimation of the state of affairs are as follows:

- decide on an overall energy policy with clear timetables for restructuring the sector;
- prepare for the internal energy market (the Gas and Electricity directives; the Directive on electricity produced from renewable energy sources);
- improve energy networks in order to create a real European market;
- prepare for crisis situations, particularly through the constitution of 90 days of oil stocks;
- address the social, regional and environmental consequences of the restructuring of mines;
- waste less energy and increase the use of renewable energies such as wind, hydro, solar and biomass in their energy balance;
- ensure the safety of nuclear power plants in order for electricity to be produced according to a high level of nuclear safety;
- ensure that nuclear waste is handled in a responsible manner; and prepare for the implementation of Euratom Safeguards on nuclear materials.

## **CURRENT LEVEL OF FULFILMENT OF THE REQUIREMENTS FOR MEMBERSHIP**

The current level of the fulfilment of membership conditions is evaluated according to a comparative analysis of energy in the Republic of Croatia, in the applicant countries and in the EU. Elements for an evaluation of the state of affairs are bounded on key definitions for the evaluation of the conformity of the applicants with the acquis and the results of previous negotiations (Lithuania team, 2002, op. cit., European Commission, DG TREN, 2002).<sup>i</sup>

Since during membership negotiations the capacity of an applicant to take part in the single market, adequacy of reserves and nuclear safety have been defined as key points, the analysis is focused on these determinants.

## **Joining the single market**

The ability to take part in the single market is evaluated according to the institutional and technical capacities of a given country. Institutional capacity implies the acceptance and implementation of that part of the *acquis* that makes possible the establishment of a market economy in energy and technical readiness assumes an appropriate infrastructure and interoperability of systems.

## **Institutional capacity**

The creation of a single market in energy and of the corresponding *acquis* started with the liberalisation of the 1990s. In the first phase, transparent pricing was assured, and the access of third parties to the transport infrastructure was made possible. The second phase of liberalisation started in 1993. This made possible the allotment of licenses for the construction of transport capacities on a non-discriminatory basis, which thus enabled competition. Vertically integrated firms separated the accounts of individual activities (generation, transmission, distribution) and the approach of third parties to the greatest consumers of electricity and gas was made possible.

In the third phase, which started in 1996, common rules for the electricity market were adopted (Directive 96/92) and for gas (Directive 98/30), and the preconditions for the free movement of electricity and gas in the area of the Union were created. The progressive opening up of the national markets started in 1999 for electricity, when a minimum of 26% of the total annual consumption was opened up to foreign suppliers. In 2000 the opening of the gas market started, when 20% of consumption was opened. The market opening plan anticipated that in 2003 33% of the electricity market should be liberalised, after which, by 2006, there should be a further consideration of market opening. For gas, 28% of the market should be opened in a period of five and 33% in a period of 20 years.

However, the European Council at its Lisbon summit (23-24 March, 2000) required gradual and total opening of the energy market. For this reason the European Commission in March 2001 proposed amendments to the directives for electricity and gas (96/92 and 98/30) and the regulation on the conditions for access to the electricity network

(for more see: European Commission, 2001; 2; European Commission 2001; 3; European Commission 2001; 4). Since for the adoption of these decisions the co-decision procedure process is applied, after the amendment by the European Parliament, the opinion of the Economic and Social Committee was obtained, and the acceptance of the directive by the Council, in June 2002 the European Commission published an amended proposal to the directive and the regulation (for more, see European Commission 2002; 1; European Commission 2002; 2).

The proposals allow for the opening of national markets to electricity and gas by 2005, the supply of all consumers and the creation of a single energy market instead of 15 open national markets. The opening of the market means that in 2005 consumers will be able to choose which supplier of electricity and gas they want. In order to strengthen competition and the creation of a single market, access to transmission and distribution networks will have to be assured without discrimination. In turn, in order to achieve this goal it is necessary for the network to be managed by an independent body, completely detached from generation and sales; that the national regulatory body, which has to be set up in all member states, determine, publish and approve charges for access to the network before they come into force. At the same time, the demand on the infrastructure is made that says the capacity of the transmission network to neighbouring countries must attain at least 10% of domestic generation.

Although these proposals have not yet been adopted and are not applied in the EU, they could be looked upon as conditions for membership. For the European Commission (2001) in the latest Regular Reports on Candidates' Progress towards Accession specifically states that during the implementation of reforms in the energy sector, adjustments must be carried out in such a way as to take into consideration the acquis that is in the making. A similar provision is placed alongside the explanation of the amended proposal for the Directive and the regulation (European Commission, 2002), in which it is said that the new Directive and Regulation will be binding upon all new members, and that exceptions will be able to be approved only during the transitional period in justified cases. Heads of states and governments of EU members at the Barcelona Summit (March 2002) accepted the liberalisation plan and requested the European Parliament and Council to accept appropriate instruments as soon as possible, i.e., during 2002.

The fulfilment of obligations and implementation of the directives about liberalisation of the energy market in member states is monitored by the European Commission.<sup>ii</sup> All the states in the area of electricity have liberalised their markets more than Directive 98/92 requires. In the area of the establishment of a single market for gas, progress is more tardy. First of all, Finland, Portugal and Greece have been given a transitional period until 2008, while France and Germany have not adopted the appropriate legal instruments.

The main obstacles in the way of the liberalisation of the market (in the sense of limiting access to the market) are the same in both sectors. They are insufficient regulator power/delays, inadequate unbundling, high network tariffs, balancing regime, dominant incumbents, cross border issues.<sup>iii</sup>

The applicants mainly successfully accept the basic principles of the EU system: transparency of market conditions and prices, guaranteed freedom of exchange of energy in the internal market and the opening of the electricity and gas market. For this reason negotiations about energy have been completed rapidly in all the applicant countries, except in Bulgaria and Romania, which, in the judgement of the Commission, will not be able to be included in the first round of EU enlargement. Nevertheless, the adoption and application of EU legislation in some applicant states is creating difficulties, and they have sought an extended transition period. The Czech Republic has been allowed to put the gas directive into action by the end of 2004, and Estonia that for electricity by 2008.

In the Republic of Croatia the EU principles have been formally accepted, while the bases for harmonisation with the EU system, including the most recent proposals for market liberalisation, were created by the package of energy laws of July 2001 (the Energy Law, the Law on the Electricity Market the Law on the Gas Market, the Law on the Oil and Oil Derivatives Market , the Law on the Regulation of Energy Activities (NN 68/01 and NN 109/91). These laws allow for the achievement of the preconditions that the Commission considers essential for market liberalisation: first, an independent regulatory body is formed; second, vertically integrated undertakings have to unbundle by 1 July 2002, and separate organisation of market and operation of the system from sales and production by 1 January 2002; thirdly, a transparent manner of defining transmission fee has to be defined in line with EU principles.

However, the laws only theoretically enable implementation of EU principles.

First of all, the Croatian Energy Regulatory Council (below: the Regulatory Council) is only formally independent. The Law on Regulation of Energy Activities (NN 68/01) explicitly states that the Regulatory Council is an independent legal entity (Art. 1). It also defines the criteria that should prevent any conflict of interests among members of the Council: they must not be government officials, must not have duties in the bodies of the political parties, may not be employed or perform any other business in the legal entities to which the Law on the Regulation of Energy Activities applies, may not be owners, joint owners or members of the managements or competent boards, nor may they perform any jobs that might lead to conflict of interests (Article 3 Paragraph 3). At the same time, the same law says that the term of office of members of the Regulatory Council should be five years, thus reducing the political pressure on their work (cf. Petrović, 2002; 66). However, the Regulatory Council cannot choose its own staff, rather the government of Croatia defines an institution (a non-profit making legal entity) which will prepare for the Council proposals for instruments and carry out other technical matters. The Council on the other hand has to finance the work of this institution (Articles 8 and 9 of the Law on Regulation of Energy Activities). The government of the Republic of Croatia has stipulated that the Hrvoje Pozar Energy Institute (EIHP) shall be the non-profit making legal entity to carry out technical affairs for the Council (Vlada RH, Session 155, June 2002). However, EIHP is not a non-profit making legal person, rather a limited liability company. At the same time, the objective of the company is to carry out business for the Regulatory Council, but also, and among other things, for legal entities in the area of energy. Hence, one of the actual aims of the technical institution that prepares the decisions of the Council is the performance of matters that, with respect to members of the Council, are considered conflicts of interest. What is more, EIHP employees are also members of the managements and Supervisory Boards of INA and HEP, i.e., perform duties that with respect to members of the Council are considered conflicts of interest. Finally, through an amendment to the Law on the Regulation of Energy Activities (NN 109/01) the first period of office of the members of the Council has been cut from five to two years. The period of office of the first members runs out in December 2003, that is, immediately before the regular expiry of the period of office of the current government of the Republic of Croatia, which thus increases the exposure of members of the Council to political pressures.



Secondly, the vertically integrated concerns should have unbundled up by 1 July 2002. In the area of electricity this first of all means separating the generating, transmission and distribution firms, i.e., electricity supply, and the separation of the operation of the electricity system from generation and sales. Although the companies of the HEP group were founded within the statutory period, the unbundling did not take place. That is, the new tariff system (NN 101/02) does not define the prices of individual activities, which makes the independence of the separate firms that are part of the HEP group impossible. Hence it is still possible to shift resources from one activity to the other or to subsidise activities. In addition, in line with the Law on Electricity Market, a system operator has to be founded, independent of the generation and sales, and a market operator. A solution has been selected however in which the operator of the system and the operator of the market are the same legal entity. The system operator may not trade in electricity (Article 19 Paragraph 2 Electricity Market Law), while the market operator is responsible for the organisation of the electricity market (Article 21 Paragraph 1) and for collecting and selecting electricity tenders. The same legal person, then, has been assigned two assignments that are mutually contradictory.

Finally, the failure to define the transmission fee made the development of the market impossible. Formally speaking, privileged consumers have the right to choose their electricity supplier. However, they cannot put this right into practice, because there are no network rules that define conditions of access to the network nor the prices of the service of transmission.

In the area of gas, the division has been carried out more effectively. According to the Law on the Gas Market, transport is separated from production and supply. In January 2002 a gas transport firm, Plinacro d.o.o. was founded, and in March ownership of Plinacro was transferred from INA to the government of the Republic of Croatia. Plinacro should enable suppliers and privileged consumers access to the network on the principle of negotiated access (Article 8, Gas Market Law).

Third party access is made impossible by the delay in the passing of the byelaws, and to a lesser extent by certainly statutory provisions. First of all, the grid codes that define conditions of access to the network have not been defined for either gas or electricity. In the area of electricity, as has already been stated, the transmission fee has not been defined. Secondly, the third party usually gets into the market

through the construction of its own generating capacities so as to be able to satisfy the needs of the large or preferred consumers. In order to carry out this activity, the energy firm first of all has to obtain a license. The basic conditions to obtain a license are set out in the Energy Law (Article 17, Paragraph 1) and foresee, among other things, that an energy firm must employ a necessary number of professionally qualified employees for the performance of these jobs. These conditions also apply to the construction of new capacities. Thus, a new generating company must even before the beginning of construction employ a certain number of employees who will perform the activity only when the construction is concluded. New firms are thus discriminated against with respect to current firms, i.e., additional costs are forced up on them. Third, in the area of electricity, the Law on the Electricity Market, in its transitional and final provisions (Article 29), ensures the monopoly of HEP in the performance of public services without any time or any other kind of limit. Finally, the government of the Republic of Croatia and the Minister of the Economy should by March 2002<sup>iv</sup> have adopted the appropriate byelaws to make possible the implementation of the law (e.g., the programme for the implementation of the Energy Development Strategy, conditions for issuing licenses for undertaking energy activities, the General Conditions for the supply of energy). These regulations have not been adopted.

Nor have measures enabling the implementation of international obligations identified in the government's Integration Activities Plan of 1999. This refers primarily to the implementation of the obligations accepted in the Kyoto Protocol and the European Energy Charter Treaty.<sup>v</sup>

## **Technical capacity**

For the application of the energy *acquis* and for access to a single energy market the appropriate infrastructure is also necessary. The basic energy infrastructure is made up of the oil and gas and the electrical systems. Linking the systems together is necessary for the accomplishment of the single market, the creation of new jobs and the preservation of the competitiveness of the economy.

Building up and linking together the energy infrastructure in the EU are regulated by the policy of the Trans-European energy networks (TEN-E) and the regulation concerning informing the Commission about investments of common interest in the energy sector (Council Regulation European Commission 736/96, 22 April 1996).

Seventy four projects were identified as being of common interest, and 18 billion euros were required for their implementation. Among the priority projects was the construction of connections between the systems of various members (e.g., electricity connections between Italy and Greece with submarine cables), the development of the system in some members (for example, the gas systems in Greece and Portugal), as well as interconnections with third party states (including the applicant states, the former Soviet Union and the states of the Western Balkans). In line with the conclusions of the European Council of Barcelona (March 2002), member states should by 2005 construct electricity interconnections with neighbouring countries that reach at least 10% of their installed productive capacities.<sup>vi</sup> The investments required have to be covered by the energy undertakings.

From the point of view of meeting conditions for membership, applicants must link up with the EU interoperable system, primarily for the sake of securing supply. After CENTREL (the electricity network that links the Czech Republic, Poland, Slovakia and Hungary) was linked in 1995 with UCPTE (the net that covers the states of western Europe, the former Yugoslavia and Albania) the basic demand of the EU was the improvement of connections with member states. In meeting this condition applicant states make use of assistance from the PHARE programme. In 2000, this assistance programme was redefined, and from a programme for consolidating democracy, it became a pre-accession programme, and 60% of its funds are meant for the development of the infrastructure, including the energy infrastructure.

In the Republic of Croatia, the reconstruction (war damage is estimated at 37.3 billion kuna) and modernisation of the energy infrastructure are required, as well as the construction of new infrastructure. However, the Energy Development Strategy has not identified the infrastructure needs, nor is the infrastructure given as a condition for the implementation of an energy strategy<sup>vii</sup>, and the government was charged with drawing up programmes and plans for the development, maintenance and employment of energy facilities (Energy Development Strategy, NN 38/02). Financing of the development was supposed to be provided by the pricing policy, and for public services via the tariff system. The Energy Law (Article 26 Paragraph 3) and the Law on the Gas Market (Article 7 Paragraph 2) stipulate that the tariff systems should be founded, among other things, on justified costs of development that have to be approved by the Ministry of the Economy. However, the government of the Republic of Croatia in ses-

sion on 22 August 2002 approved a tariff system for the transport of gas the justification of which is grounded on, among other things, the development plan. At the moment the tariff system was adopted the Economy Ministry had not yet approved the development plan. The government only had information about the drawing up of the plan for the development, build up and modernisation of the gas transport system in the Republic of Croatia from 2002 to 2011 on the agenda at a session a week later, i.e., on 29 August 2002. Similarly, the new tariff system in the area of electricity, since it does not split the price according to activities (generation, transport, distribution, auxiliary services, operating the system) does not enable the monitoring the use of the resources gathered meant for construction per activities.

## **Preparations for emergency situations**

The EU requires the existence of a 90 day reserve of oil products (Directive 68/414/EEC and amendments to it), as determined according to the annual daily consumption of the calendar year. In states that for producers of oil themselves, the necessary reserves can be reduced by 25%.

Meeting this requirement creates difficulties for the applicant states, because it entails considerable investments in storage capacities. Hence during the negotiations they sought a transitional period for meeting this condition. Estonia, Latvia and Lithuania must construct the necessary storage capacities by 2009, Poland and Slovakia by 2008 and the Czech Republic and Slovenia by 2005.

Storage capacities in the Republic of Croatia can provide for consumption for 35 days. Domestic production covers the needs for 20-day storage, and hence to meet EU conditions, capacities that provide 35-day consumption need to be constructed. The estimated cost of this investment comes to about 200 million USD (Aron, 2002).

Apart from these capacities, it is necessary to provide capacities for the creation and renewal of operative reserves of energy. The Law on Oil and Oil Derivatives Market prescribe the maintenance of operational reserves in quantities equivalent to 15 days of average requirements in the previous year, and the manner and conditions of determining, using and renewing the operative reserves have to be prescribed by the Minister of the Economy.<sup>viii</sup>

## **Nuclear safety**

In the context of its enlargement, the EU has stressed the importance of nuclear safety. In June 2001, the Council of the EU accepted a Nuclear Safety Report in the Context of the Enlargement. This report contains recommendations to applicants about increasing their nuclear security, the implementation of national programmes for improving nuclear safety, including the management of radioactive waste, spent fuel and research reactor safety. Particular attention is devoted during negotiations to the increased security of nuclear power plants and the management of nuclear waste. The safety of nuclear plants and the need for modernisation in Lithuania, Slovakia and Bulgaria (the Ignalina, Bohunice-V, Kozluduy plants) were priorities in the negotiations with these states. The EU encourages the enhancement of nuclear safety by co-financing the closure of nuclear units that cannot be modernised as well as affording technical and other assistance for the modernisation of nuclear power plants when this is possible from PHARE programme funds, EBRD loans and by contributions to the nuclear energy account managed by the EBRD.

For the Republic of Croatia, the question of nuclear safety is linked with the Krško nuclear power plant. During negotiations with Slovenia, the Commission determined that Krško meets the safety standards of the EU. However, in line with the Nuclear Safety Report in the Context of Enlargement, seismic testing and the adoption of a national programme for emergency situations are required.

Knowing that Slovenia is in the group of most advanced applicants, it can be expected that the Republic of Croatia will negotiate about membership when Slovenia is already a member state. Hence, unsettled matters in connection with Krško, especially those to do with the management of waste and the closure of the station, will have to be settled in line with EU regulations that, as soon as Slovenia becomes a member, will be obligatory and applicable to Krško power station. This relates primarily to the rules of transfer and storage of radioactive waste (Directive 92/3/Euratom, Regulation 1493/93).

## **Other elements**

Other elements that the EU takes into consideration while evaluating the level of fulfilment of conditions for membership relate to

energy policy, the development of associated measures for the solution of the social, regional and ecological impacts of reforms and the implementation of measures for increasing efficiency.

In the area of energy policy, which is in the EU defined in the Green Paper on the Security of Energy Supply (European Commission, 2000), the main demand that is made on applicants is to adopt a policy with clear deadlines. In the applicant states, the annual plan for the implementation of appropriate measures is defined by the accession partnership, and the application of the *acquis* is facilitated by involvement in EU programmes (such as SAVE II).

Croatia has adopted its Energy Development Strategy (Official Gazette 38/02, available on the Web, [www.hrvatska21.hr](http://www.hrvatska21.hr)) the basic goals of which are increase of efficiency, diversification of sources, support to the development of renewable sources, increased security of supply, development of a better pricing policy and ensuring environmental protection adjusted to EU goals. The main objectives of the EU energy policy are security of supply for all consumers at acceptable prices, environmental conservation and the promotion of competition on the European energy market. The key measures for the fulfilment of these objectives are diversification of sources, implementation of the Kyoto Protocol and the creation of a single energy market.

However, although some of the necessary measures are identified in the Strategy, no timetable and no dates for their implementation have been defined. The energy law package has defined only the deadlines for the implementation of the first phase of reform of the energy sector, and these deadlines have not been met.

At the same time, energy sector reform policy in the applicant states, in line with EU requirements, ought to contain a plan for the solution of the social, regional and ecological consequences of the restructuring of the sector, and these matters have not even been considered by the Energy Development Strategy.

The use of renewable sources is a key factor in supply security and the fight against climate change. It is promoted by implementation of the Altener programme, and member states of the EU are bound to greater use of renewable sources by the Directive of the Council of the EU and Parliament about the promotion of the production of electricity from renewable sources (September 2001). The objective of this Directive is to step up the share of "green" energy in the EU, from 14% in 1997 to 22% by 2010. Croatia, in which the share of green energy was 15.8% in 1999, is in this respect comparable to the EU (Vuk, Marušić, 2000).

The objectives and strategy for the implementation of energy policy foresee a growth in energy produced from renewable sources of 1.33 – 2.13 times, depending on the growth scenario. However, no concrete measures to achieve these aims are foreseen, instead it is stated: “Organised and systematic concern for renewal sources *will be carried out* in the Republic of Croatia according to the National Energy Programmes *launched in 1997 by the government of the Republic of Croatia*” (Energy Development Strategy, p. 120, italics added).

No manner of financing has been defined clearly, nor have the resources required been estimated. The strategy does, it is true, anticipate the establishment of an Environmental Protection and Energy Efficiency Fund. However, although the draft law has been put forward, it is not clear how this fund would be financed. Various sources are mentioned, including commercial loans, interest on loans given by the Fund, foreign sources, the Budget, part of the price of given fuels and so on, without any indication of which parts would be financed in which way and in which ratios. Also predicted is the possibility for the redirection of resources from the profitable to the unprofitable part of the fund, without any rules and authorities being defined.

## **PERSPECTIVES AND CHALLENGES OF INTEGRATION**

The Croatian legal system is formally harmonised with the EU system. Conformity of the legal system is an essential condition for EU accession. However, the legal system of the EU is not made up only of rights and obligations that govern the mutual relations of states members of the EU but the rights and obligations that directly relate to the subjects in the member states, i.e., to legal and to natural entities. For this reason for adjustment with the legal system of the EU it is necessary to pass the regulations and byelaws that regulate particular areas in greater detail. What is more, since the legal rules come to life and obtain their final life only during application, an identical formulation of some rule does not necessarily mean it has the same meaning. Since not even the deadlines for the implementation of the energy law package are respected, nor the procedure for the adoption of the reform measures (for example, when

adopting the gas tariff rules), one of the basic principles of the reform is threatened, that is, transparency. For this reason I am of the opinion that the EU convergence process in the area of energy cannot be considered successful, for practice, the manner in which the legal rules are interpreted and ultimately applied, is developing in a way quite in contravention of the principles laid down by the EU.

However, Croatia is relatively advanced in comparison with the other states of the region, and the European Commission in its SAA Implementation Report says that Croatia has a potentially key role in the energy linkage of the region, particularly from the point of view of the development of regional energy links (physical infrastructure and market). One of the conditions for further association with the EU defined by the SAA is the development of cooperation among the states of the region. Since the SAA explicitly secures tightening of cooperation in the adoption and planning of energy policy, including modernisation of the infrastructure, security of supply, and reinforcement of efficiency, this form of cooperation with the EU should be used to overcome the initial difficulties in the reform of the sector. As part of the CARDS programme, the EU has earmarked 16 million euros for the development of the transportation and energy infrastructure in Croatia, BH, Macedonia, Yugoslavia and Albania for the period 2000-2006. The assistance is subject to the obligations deriving from the SAA being fulfilled, and any failure in this respect might put the necessary investment at risk. With increasing import dependence, lack of funds could well additionally damage the already vitiating competitiveness of the economy of the Republic of Croatia.

In its decision of June 2001, the government of the Republic of Croatia made possible the approach of the Republic of Croatia to the regional electricity market in SEE. Acceptance of this initiative necessarily involves the facilitation of the development of the regional market by 2006; customers should have the ability to choose suppliers by 2005, the network rules should be adopted by June 2003, and UCTE standards by 2003.

Accomplishment of this cooperation will make it possible to meet the regional cooperation obligation, which Croatia has bound itself to in the SAA as precondition for further rapprochement with the EU and acceptance of EU demands, thus making fulfilment of membership conditions possible.



## CONCLUSION

In adjustments to EU membership conditions, as well as formal, real conformity with EU regulations is essential. Croatia has achieved a relatively high level of formal conformity with EU regulations, but implementation of these regulations is late.

Participation in regional initiatives can make a contribution to the fulfilment of the conditions for accession. For example, joining in a regional electricity market will make possible acceptance of EU rules by 2005, and the actual establishment of regional cooperation. Since regional cooperation is a prerequisite for further convergence on the EU, and adoption of the *acquis* is necessary for joining the EU, this form of regional cooperation can be considered a measure that facilitates integration into the EU. In addition, the possibility of financing regional projects makes modernisation of the infrastructure easier, which is also necessary before EU accession. However, assistance is conditional upon strict respect for deadlines and obligations undertaken. It is necessary, then, to work out concrete implementation plans, with deadlines and clear divisions of authority and responsibility.

Since the energy sector is state owned, and will, until EU accession, remain mainly state owned<sup>ix</sup>, it is mainly state or governmental bodies that are charged with implementation of the reform. For this reason, for successful reform of the energy sector, a successful state administration is also required, i.e., it has to be reformed, or some of its authorities have to be transferred to independent bodies. From this point of view it is necessary clearly to define jurisdictions and procedural criteria. In line with the laws, part of the authority has been transferred from the state to the Energy Activities Regulation Council. However, the jurisdiction and rules of procedure, the definition of which the government and the Economy Ministry are primarily charged with, are still not defined, and the authorities of the Council are restricted. Thus the main challenge in the area of the reform of energy is an augmentation of the efficacy of the public administration.

Finally, the EU enlargement plan includes states neighbouring on the Republic of Croatia, and these states will have to implement EU regulations after accession. For this reason the acceptance and implementation of such regulations here is necessary not only for the sake of Croatia being able to join the EU, but also to make possible trade with the neighbouring states after the EU enlargement.

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<sup>i</sup> These elements derive from the classical Copenhagen criteria. A review of fulfilment for the energy sector of Croatia before the signing of the SAA and the launching of energy sector reforms is contained in: Republic of Croatia Government, *Plan of integration activities of the Republic of Croatia*, Zagreb, 1999, pp. 550-551.

<sup>ii</sup> Directives are a legal instrument to which it is hardest to adjust internal law. That is, they give the objective of the standardisation that is obligatory for a member state, but the state itself can select the appropriate method for the accomplishment of this objective within internal law. Sometimes the directives can give exhaustive instructions, but sometimes they hardly mention them at all.

<sup>iii</sup> The obstacles are put in order of importance, in line with the report of the European Commission "Completing the internal energy market" (European Commission, 2001; 1).

<sup>iv</sup> That is, within a period of six months from the time the package of laws came into force, that is, up to 26 February 2002. In this paper, however, whenever there is mention of this period, March 2002 will be stated as the time.

<sup>v</sup> The implementation of these obligations is necessary for adjustment to the EU system as well. For example, the acceptance of the rules defined in Directive 94/22 OJ L 164, 30 June 1994 concerning the transparency of rules for the exploration and exploitation of hydrocarbons coincides with the rules about non-discrimination and national treatment that derive from the European Energy Charter Treaty. In accordance with EU regulations and the European Energy Charter Treaty, it is necessary to provide access to the infrastructure for transit.

<sup>vi</sup> At the moment, in the EU area, about 8% of domestic production is swapped. HEP considers its capacities confidential.

<sup>vii</sup> The proposal of the Energy Development Strategy of 1999 contained a review of the necessary infrastructure projects, covering the following: the gasification of the Republic of Croatia; the Italy-Pula-Karlovac-GEA transport system project; Zagreb-Karlovac; Zagreb-Kutina-Slavonski Brod-Donji Miholjac; Vrbovsko-Split; Benkovac-Zadar, and minor transport gas lines; increase of the gas storage capacities (Okoli/Bokšić); development of a distribution network; development of equipment and energy users at the consumers; revitalisation and construction of new secondary refinery capacities; linking JANAF with other international oil pipelines; development of small cogeneration facilities (up to 2030 with a capacity of 1TWh of electricity); bringing two gas-fired generating stations of 300 MW on line (up to 2010); bringing the hydroelectricity generating states of Lešće, Podsused, Drenje on line; construction of a transit and distribution electricity network.

<sup>viii</sup> The deadline for adopting these regulations ran out in March 2002, and at the moment (October 2002) the working text of a new law about commodity reserves is being agreed on.

<sup>ix</sup> The Law on privatisation of INA – Industrija Nafta d.d. (NN 32/02) foresees that the Republic of Croatia will retain at least 25% plus 1 share until Croatia is received into the EU, and the HEP d.d. Privatisation Law (NN 32/02) that the Republic of Croatia will retain ownership of 51% of the shares of HEP until Croatia joins the EU.

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