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REPORT FROM THE COMMISSION TO THE COUNCIL

**Review of the transitional measures for the acquisition of agricultural real estate set out
in the 2011 Treaty on the accession of Croatia to the EU**

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Introduction

The Commission is presenting this report to the Council in accordance with the 2011 Act concerning the conditions of accession of the Republic of Croatia¹ ('the Act of Accession'). This Act establishes a transitional period of seven years until 2020, with the possibility of an extension of three years, during which Croatia may maintain the existing restrictions in its national legislation² on the acquisition of agricultural land. This concerns acquisitions by legal and natural persons from other Member States of the European Union and the European Economic Area.

Under the Accession Treaty, the Commission is obliged to report to the Council in the third year following the accession on the possibility to shorten or terminate the transitional period granted by the Accession Treaty ahead of the date set in the Treaty.

As a general principle, European Union law and free movement of capital favour cross-border investment. The free movement of capital is one of the fundamental principles whereby EU investors are in principle free to operate within the internal market. Foreign investment can have many benefits for agricultural and rural development. So, for example, within Europe, cross-border investments have enabled the dissemination of new farming technologies and knowledge and have provided capital for agricultural production in under-capitalised areas. Cross-border investments can also contribute to rationalising the use of land, in particular in areas where ownership structures are highly fragmented.

At the same time, it should be recalled that the EU Treaties do not oblige Member States to liberalise the agricultural land market without a possibility to impose suitable rules to attain legitimate public policy objectives. The free movement of capital principle allows for national restrictions on capital movements in the form of rules to regulate land markets if they are necessary, justified and proportionate in order to promote legitimate public interest and policy objectives. Thus, the free movement of capital is balanced with the Member States' need to ensure that land markets enable sustainable rural development and agricultural production.

The transitional period during which Croatia may maintain the restrictions that existed at the time of its accession was granted to allow the newly-acceding Member State to tackle the imperfections of the agricultural land market and the agricultural sector and make it more competitive in the internal market. This report aims to take stock of the situation of the agricultural land market and to review the need for such transitional measures. Based on the overall situation of the agricultural sector in Croatia three years after its accession to the EU, this report concludes that the transitional period should not be shortened.

¹ OJ L 112, 24.4.2012, p. 10.

² Agricultural Land Act (OG 152/08).

1. Legal basis for the Commission's report

The 2011 Act of Accession granted Croatia a transitional period during which it could maintain existing restrictions on the acquisition of agricultural land in derogation from the free movement of capital enshrined in Article 63 of the Treaty on the Functioning of the European Union (TFEU). By virtue of Article 18 of the Act of Accession, these restrictive transitional measures apply under the conditions laid down in Annex V (Transitional measures) to the Act of Accession. The chapter on the free movement of capital in this Annex stipulates that *'a general review of the transitional measures shall be held by the end of the third year following the date of accession. To this effect, the Commission shall submit a report to the Council. The Council may, acting unanimously on a proposal from the Commission, decide to shorten or terminate the transitional period [...].'*

2. Transitional arrangements

Free movement of capital is one of the fundamental freedoms guaranteed by European Union law. Article 63 of the TFEU stipulates that *'all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.'* Capital movements include investments in real estate and agricultural land. The Court of Justice of the European Union has held that exercising the right to acquire, use or dispose of agricultural land in the territory of another Member State generates capital movements.³ Therefore, the legislation of the Member States on the acquisition of agricultural land must comply with the free movement of capital principle under EU law.

However, during the accession negotiations with Croatia, the EU agreed certain transitional arrangements regarding the acquisition of agricultural land that allow Croatia to temporarily derogate from the fundamental freedom of capital movements. In particular, Annex V to the Act of Accession allows Croatia to *'maintain in force for seven years from the date of accession the restrictions laid down in its Agricultural Land Act (OG 152/08), as in force on the date of signature of the Treaty of Accession, on the acquisition of agricultural land by nationals of another Member State, by nationals of the States which are a party to the European Economic Area Agreement (EEAA) and by legal persons formed in accordance with the laws of another Member State or an EEAA State'*. At the same time, the Act of Accession provides for an exception from the transitional measures for *'self-employed farmers, who are nationals of another Member State and who wish to establish themselves and reside in Croatia'* and which *'shall not be subject to the transitional provisions (...) or to any rules and procedures other than those to which nationals of Croatia are subject'*.⁴

The main reasons underlying the Croatian request for transitional measures were similar to those raised by the majority of the EU-12 Member States (EU-10 and EU-2⁵) when acceding to the EU and mainly relate to the need to safeguard the socioeconomic environment for agricultural activities in the wake of the introduction of the internal market and the transition to the Common Agricultural Policy. In particular, the transitional measures are intended to

³ Case C-370/05 (Festersen), paragraphs 21-23; case C-452/01 (Ospelt), paragraph 24.

⁴ The Act of Accession also sets out that *'a national of a Member State or a legal person formed in accordance with the laws of another Member State, may in no instance be treated less favourably in respect of the acquisition of agricultural land than such a national or person would have been treated at the date of signature of the Treaty of Accession or be treated in a more restrictive way than a national or a legal person of a third country'*.

⁵ EU-12 refers to Member States which joined the EU in 2004 (EU-10) and 2007 (EU-2). A transitional period was agreed with the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland and Slovakia (from the EU-10), as well as with both Bulgaria and Romania (EU-2). EU-15 refers to the Member States before the enlargement in 2004.

attenuate the negative impact that suddenly opening the market could have in Croatia given the large differences in land prices and farmers' purchasing power compared with the EU-15 and given that the market for agricultural land is still subject to institutional factors which hinder the use of agricultural land such as unfinished privatisation and restitution of land, uncertain ownership, unfinished land register and cadastre. In addition, Croatia emphasised that, as a consequence of the Homeland War (1991-1995), a large percentage of the agricultural land could not be used as it was affected by mines and subject to demining activities.⁶

Furthermore, Croatia underlined that during the transitional period some measures would be implemented in order to develop the agricultural land market, improve agricultural productivity and enhance the ability of Croatian farmers to participate in a more open land market in future. To this effect, Croatia planned various mid-term and long-term projects that would be implemented during the transitional period. The projects concerned:

- regulating property rights and putting the land register and cadastral data in order;
- land consolidation;
- developing the market of agricultural land for leases and improving the rights of lessees;
- restructuring agricultural production;
- improving technology and capitalisation; and
- demining agricultural land.

The transitional period was also intended to provide the time needed to privatise state-owned land and to complete the restitution of property titles for land.

3. Objective of the report and methodology

In line with the Act of Accession, this report reviews recent developments in the Croatian agricultural sector. Its aim is to assess the need to shorten or terminate the transitional measures regarding the acquisition of land by nationals of other Member States or EEA nationals ahead of the date set in the Act of Accession. To this end, the Commission assesses the reasons put forward by Croatia during the accession negotiations as a justification for a temporary derogation and examines whether the initial concerns have been mitigated by subsequent developments.

For this purpose, the Commission sent the Croatian authorities a questionnaire in order to gather comprehensive information on developments that have occurred in the agricultural sector since the date of accession. Croatia's replies to this questionnaire, together with an analysis by Eurostat and other data, allowed the Commission to assess:

- socio-economic characteristics of the agricultural sector and developments of the relevant economic indicators including income and land prices and the degree of their convergence with other Member States;
- legislative changes concerning foreign ownership of agricultural land;
- progress made with the medium to long-term projects that Croatia planned to launch to improve the operation of the agricultural land market and to increase the efficiency of agricultural activities, in particular as regards land privatisation, restitution programmes and demining activities; and
- the state of play of foreign investments in the Croatian agricultural sector.

⁶ According to data provided by Croatian authorities, in 1998 between 42 % and 54 % of agricultural land was subject to demining activities, while the total area directly affected by mines at the end of 2006 stood at 997 km².

4. Overview of the situation after three years of EU membership

In June 2016, the Commission noted in its biennial convergence report⁷ that Croatia had been confronted by four consecutive years of negative economic growth. This recent adverse economic environment has weighed on convergence in income and productivity, including in the agricultural sector.

a) Socioeconomic characteristics of the agricultural sector

Following a period of rapid economic growth in 2007 and 2008, the economic and financial crisis has weighed on the Croatian economy. This has also affected agriculture, which has seen a decrease in gross value added (GVA), factor income and the numbers of people employed. In terms of structural indicators, the Croatian agricultural sector is still characterised by smaller holdings; lower labour productivity; lower efficiency; and lower factor income and purchasing power than the EU average.

Between 2007 and 2013, Croatia's agricultural GVA accounted on average for 2.88 % of the country's gross domestic product (GDP). In 2014, agricultural GVA accounted for 2.38 % of the country's GDP, at EUR 1.03 billion. This is a decrease of 33 % compared with the highest value in this period, registered in 2008, and is a decrease of 9 % compared with 2013. Agricultural activity generated an output value⁸ of EUR 2.28 billion in 2014, which is 10 % lower than that registered in 2013 and has followed the same negative trend as GVA since 2008.

Under the Agricultural Land Act, agricultural land in Croatia includes arable land, gardens, meadows, pastures, orchards, olive groves, vineyards, fishponds, reed-patches, marshland and other areas that can be brought to agricultural production. According to data provided by the Croatian authorities, the majority of agricultural holdings are small and not suitable for modern farming, meaning their efficiency and productivity are low.

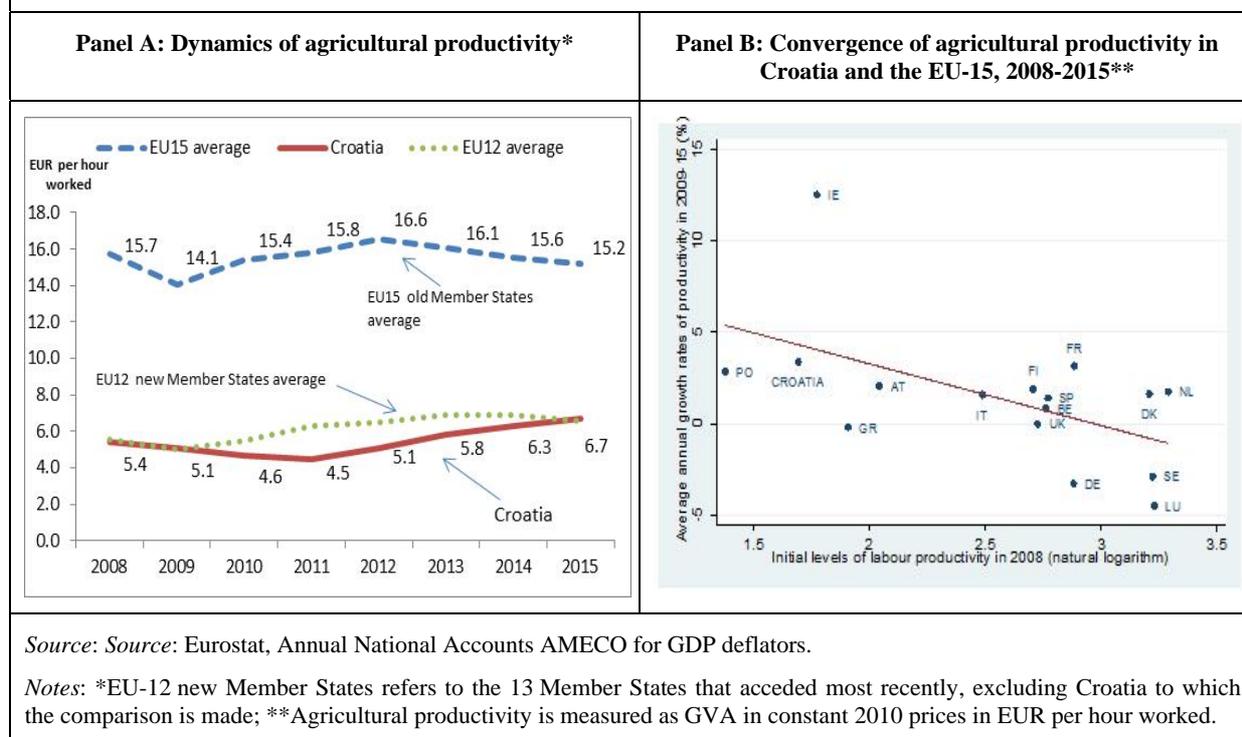
Fragmentation of agricultural holdings is one of the main factors limiting the development of the agricultural sector, although there has been a certain degree of land consolidation since 2007. 69.4 % of holdings are small holdings using up to 5 ha, and no more than 6.9 % use more than 20 ha of land. The average agricultural land used per holding in Croatia almost doubled between 2007 and 2013 from 5.4 ha to 10 ha. However, this is below the EU average of 16.1 ha.

In 2015, agricultural labour productivity in Croatia was 44 % of the EU average, but has been broadly increasing since Croatia joined the EU in 2013 (see Chart 1 below). However, it still remains well below productivity rates of the EU-15 and is close to that in the newer Member States.

⁷ European Commission, convergence report 2016, available at: http://ec.europa.eu/economy_finance/publications/european_economy/convergence_reports/index_en.htm.

⁸ GVA equals output value minus intermediate production.

Chart 1. Agricultural productivity in Croatia compared to EU-15 and EU-12



According to provisional data from the Croatian tax authorities, the average price of one hectare of agricultural land in Croatia was EUR 4 935 in 2014, which is relatively high compared to most of the EU-12 Member States, but significantly lower than in the majority of the EU-15 Member States. Land prices in Croatia rose constantly between 2000 and 2006 (based on data provided by Croatia during the accession negotiations) and were about five times higher in 2012 compared to a decade before. However, joining the EU in 2013 did not notably increase either land prices or the number and total size of land parcels transferred. In fact, land prices have even slightly decreased recently, in line with a recent increase in the available agricultural land in use (see Table 1 in the Annex). Even though the lack of available data on historic land sales prices throughout the EU should lead to caution in the analysis, it seems clear that the differences in agricultural land prices between Croatia and the EU-15 have not changed notably since accession.

The gap in GDP per capita measured in purchasing power standards between Croatia and the rest of the EU persists. According to Eurostat data, in 2014 GDP per capita in Croatia measured in purchasing power standards was one of the lowest in the entire EU, estimated at 58.8 % of the EU average. In addition, the agricultural factor income⁹ has fallen continuously since 2009. In 2014 it had declined further by 35.7 % compared to 2008 and by 11.9 % compared to 2013.

⁹ The factor income shows the net value created by using all production factors in the agricultural production.

Since 2011, real factor income in agriculture in Croatia has fallen below the average real factor income for the EU-15. This means Croatia's agricultural income is no longer catching up with that of the EU-15 (see Chart 1 in the Annex). Thus, Croatia's real purchasing power in the agricultural sector in 2014 was substantially lower than in the pre-accession period.

Therefore, the affordability of agricultural land remained relatively low for Croatian farmers given their purchasing power. According to data provided by the Croatian authorities, the affordability index (based on factor income from agriculture and land prices in Croatia in constant 2010 prices) in 2014 for Croatia, the year after its accession to the EU, was 0.79. This means that, within the EU, agricultural land in Croatia was least affordable for Croatian farmers compared to other EU farmers (see Table 2 in the Annex). Furthermore, Chart 2 in the Annex demonstrates that convergence in the affordability of Croatian agricultural land for farmers in Croatia has been slower on average since 2012, not only compared to the average of the EU as a whole but also compared with most of the 12 Member States that acceded most recently.

b) Legal restrictions on the acquisition of agricultural real estate

According to Croatian legislation in force since the country joined the EU, foreign legal and natural persons are prohibited from acquiring ownership of agricultural land by means of a legal transaction, unless otherwise provided for in an international agreement. In 2013, the Agricultural Land Act of 2008 (OG 152/08), which was referred to in the Act of Accession, was replaced by a new Agricultural Land Act (OG 39/2013) and was further amended in 2015 (OG 48/2015). The Act of 2013 maintained most restrictions previously in force but introduced the possibility for foreign natural and legal persons to acquire property rights on agricultural land through inheritance.

Under the Act of Accession, self-employed farmers who are nationals of another Member State and who wish to establish themselves and reside in Croatia, may acquire agricultural land, provided that they fulfil the conditions set by the national law that is applicable to Croatian nationals. Moreover, EU/EEA nationals are allowed to purchase agricultural land via legal entities registered and based in Croatia.

Thus, the restrictive legal framework is mitigated by the possibility granted to EU/EEA self-employed farmers and to legal entities established in Croatia, to acquire land under conditions set by national law. Moreover, there are no restrictions on EU/EEA citizens and legal entities renting agricultural land.

The applicable legal framework, which does not prohibit all foreign land acquisitions, should enable Croatia to achieve the objectives pursued during the transitional period and help move gradually to a more open system for EU/EEA nationals to acquire land.

c) Privatisation, restitution and available agricultural land

Privatisation and remaining unsolved restitution cases affect the operation of agricultural land markets. According to data provided by the Croatian authorities, 62 765 ha of state-owned land was sold under the various privatisation programmes implemented between 2001 and 2013, while the rest has been leased out. This is merely a quarter of state-owned land. Some 50 000 applications for the restitution of property have been received from interested parties and some 9 000 cases are still outstanding.

Changes in the amount of available agricultural land may also have an impact on the operation of agricultural land markets. In 2013, 17 922 ha were transformed into real estate other than agricultural land, an increase of 6.1 % compared to 2012. However, the total agricultural land in use increased from 978 670 ha in 2007 to 1 571 200 ha in 2013.

There is still land available for agricultural purposes subject to the termination of demining activities. According to data provided by the Croatian authorities, in 2016, 6 040 ha are still to be transferred into agricultural land. Given that until now, on average, 2 000 ha have been demined per year, the remaining land might take approximately three more years to demine.

d) Foreign investment

Foreign investment in agriculture generally has a positive impact on access to capital, technology transfers, the functioning of land markets and agricultural productivity. According to data provided by the Croatian authorities, foreign direct investment in agricultural activities, hunting and related services amounted to EUR 2.6 million in 2011-2014. Croatian legislation on the acquisition of land by foreigners places clear limits on the access of foreign investment to the Croatian agricultural market. There are no exact records kept on foreign and domestically-owned agricultural holdings as distinct categories.

However, given the restrictions on foreign natural persons acquiring property rights on land, the Croatian authorities estimate that the number of agricultural holdings in direct foreign ownership is negligible. At the same time, foreign owners are present in the agricultural land market through legal entities, in particular public and private limited liability companies registered and based in Croatia. Legal persons in general, irrespective of the nationality of their owners, use about one third of the total agricultural land.

e) The impact of EU accession

In general, EU accession has improved farmers' access to credit and insurance. This may have a positive impact on agricultural productivity.

In addition, Croatian farmers have received financial support from the EU's Common Agricultural Policy. The total amount of such financial support received by the agricultural sector amounted to EUR 292 million in 2013 and EUR 295 million in 2014. These aids, which have been consistently made available to Croatian farmers, have accounted for a considerable share of Croatian farm income. They may have helped to increase efficiency and demand for land, and may sustain expectations for an increase in agricultural land prices.

Overall, the subsidies have helped improve the social conditions of Croatian farmers and, coupled with better access to credit, may provide incentives for Croatian farmers to buy agricultural land in future and develop agricultural activities. This would help boost the labour productivity of the agricultural sector and lead to a further increase in farm income.

The Commission notes that the Croatian projects intended to improve the operation of the land market by addressing the specific areas identified during the accession negotiations have not yet been fully implemented. While some projects, such as the IT information system related to the cadastral data on state-owned land, are already in place, further system developments are planned, for example the possibility to track the history of contracts and to exchange data with the competent authorities. Other planned projects to foster the development of the agricultural sector include the rural management strategy; the operational programme for agricultural land consolidation; and the project for irrigation and management of agricultural land and waters.

5. Conclusions

The 2011 Act of Accession requires this report to be issued within three years of accession. The period studied is rather short¹⁰ so that extensive empirical evidence could not be fully gathered as regards the question of how Croatia's accession to the EU has affected the development of the agricultural land market and the agricultural sector as a whole.

Nonetheless, the available data show that not all the concerns expressed during the accession negotiations have been mitigated three years after accession, due in particular to the fact that some of the actions planned to be implemented during the transition period are still ongoing, such as consolidation of the land, finalisation of land register, finalisation of privatisation as well as demining of land.

In addition, the evaluation of the Croatian agricultural market indicates that there is still a large difference in the land prices and farmers' income between Croatia and the rest of the EU. However, full convergence would not be expected nor could be seen as a necessary condition for terminating the transition period. Moreover, the Commission's analysis shows a decline in land affordability by Croatian farmers: the agricultural land has not become more affordable for Croatian farmers in 2014, the year after EU accession, compared to 2013 due in particular to a decline in farmers' average income.

Overall, the analysis of the present situation in the agricultural sector in Croatia shows that several factors are still affecting the land market such as: poor general economic climate; ownership fragmentation; relatively low income levels of farmers; unfinished privatisation and restitution of land; and ongoing demining activities.

Therefore, **the Commission concludes that the time limit for the transitional measures provided for in the Act of Accession should not be shortened.**

The Commission also calls on Croatia to gradually finalise the preparation of the land market for the full application of free movement of capital once the transitional period arrives to its end. Even now, the restrictions in the legal framework on the acquisition of land by foreign natural and legal persons do not amount to a total ban, as legal entities which are owned by EU/EEA nationals are allowed to purchase land, and self-employed EU/EEA farmers are allowed to acquire land if they wish to establish themselves and reside in Croatia. In addition, the new Land Act of 2013 introduced the possibility of acquiring ownership rights of agricultural land through inheritance. It is equally important to note that the rental land market is open to foreign investors, who are therefore able to establish and operate agricultural enterprises in Croatia. Moreover, joining the EU has already improved access to capital for local farmers.

In addition, Croatia committed to undertake the following activities to allow the free movement capital by the end of its transitional period:

- (1) regulation of property rights as a prerequisite for updating and putting the land registry in order;
- (2) land consolidation;
- (3) development of the market of agricultural land for leasing and improving the rights of lessees;
- (4) restructuring of agricultural production;
- (5) improvement of technology and capital equipment; and
- (6) demining agricultural land.

¹⁰ The statistics available at the date of the adoption of this report refer to data only up to 2014.

All this provides a good basis for Croatia to continue tackling the challenges that underpinned the reasons for having a transitional period, and improve the productivity and economic position of Croatian residents engaged in agriculture and rural development.