



FRIEDRICH NAUMANN
FOUNDATION *For Freedom.*

Western Balkans

Assessing Croatia's policy performance within the European Union



Daniel Hinšt

Imprint

Author:

Daniel Hinšt

Editorial Team:

Dušan Dinić

Michael Roick

Layout:

Dina dizajn

Print:

Manuarta

Number of copies:

100

Publisher:

Friedrich Naumann Foundation for Freedom

Western Balkans

Bulevar Kneza Aleksandra Karadjordjevica 13/A8,

11040 Belgrade

Serbia

Tel.: + 381 11 3066 824

westbalkan@freiheit.org

<http://westbalkan.freiheit.org>

 @FNFWesternBalkans

 @FNFWestbalkans

YT /FreedomTVEurope

Copyright © 2020

by the Friedrich Naumann Foundation for Freedom

All rights reserved.

This publication reflects the opinion of the author and not necessarily the position of the Friedrich Naumann Foundation for Freedom

Contents

- Foreword 4
- Summary 6
- 1. The path to improved political institutions and
aligning with the EU law 6
- 2. The European Semester policy challenge after EU accession 16
- Concluding remarks 32
- Author 34

Foreword

Croatia has recently been subjected to several severe trials: In addition to the on-going Covid pandemic, which led to a sharp decline in the tourism sector, the country was also hit by two earthquakes in the course of a year.

Although the country as a whole can be described as politically stable, a growing political disenchantment has been a topic of public discussion for years.

In the general satisfaction with life, which the statistical office of the European Union Eurostat measures every year for all EU countries, Croatia regularly occupies one of the lowest ranks. Continuing emigration, low birth rates, and low voter turnout, especially among young people, are further indicators that document below-average trust in the political system and a lack of confidence.

What is often missing in such an analysis, however, is an awareness of the development that has actually taken place in the past decades and what the initial conditions were. For in the case of Croatia, these were anything but easy. The wars in the former Yugoslavia in the 1990s set the country back politically and economically by many years in the transformation process that had just begun.

After the first wave of accessions in 2004 and 2007, the subsequent negotiation process with the European Union also proved more difficult and complex for Croatia, as the impression grew within the EU that it might have overreached itself with these admissions. After six years of negotiations, however, the time had come in 2013 and Croatia became the 28th EU member.

30 years after the proclamation of independence on 25 June 1991 is a good time to present and take stock of the development that has taken place. This analysis by the renowned economist Daniel Hingst shows clearly and in detail how the path to the European Union and the eventual membership was for the country's development, full of hurdles, difficult but ultimately successful, and how the political institutions in the country also adapted and changed during this period.

As difficult as the individual processes were for the country and its people, all in all, it is a success story that can be documented in many political fields¹ and may serve as an example for other countries.

¹ On the great importance that the EU accession negotiations and later EU membership had for the

"Although many things still need to be repaired and improved, Croatia has achieved much in geopolitical terms by becoming an EU Member State (as well as a NATO member). Had it not done so, Croatia would have been left under the significant influence of the authoritarian Russian regime. In this way, Croatia's example can help Serbia and other countries of the Western Balkans and Eastern Partnership on their path towards (more) freedom and the EU".



Michael Roick
Head of Western Balkans Office

Friedrich-Naumann-Foundation for Freedom

further development of LGBT* rights, for example, see the FNF brochure "How Europe works for LGBT* Rights. The Croatian Story": <https://www.freiheit.org/western-balkans/how-europe-works-lgbt-rights>

Summary

The purpose of this article is to provide examples of Croatia's policy performance within the European Union. In an age of rising populist disinformation against EU institutions, it is important to present certain policy benefits of Croatia's EU membership, especially concerning political and economic liberalisation. The article will therefore focus on the importance of developing a long-term institutional framework for liberal democracy and the coordinated public management of some structural reforms, despite many institutional and political barriers. The first part of the article describes the political barriers and circumstances, which influenced the European integration process. As a follow-up, the second part provides an overview of Croatia's fiscal consolidation, business environment and market reforms within the European Semester, subsequent to EU accession. It is important to note that assessing Croatia's policy performance within the EU, including the economic benefits after EU accession, is possible only by understanding the political background, which has changed to meet EU policy criteria.

1. The path to improved political institutions and aligning with the EU law

1.1. Barriers to European integration during the 1990s

After the fall of communism, the countries of Central and Eastern Europe started their European integration processes, resulting in the big 2004 EU enlargement. To become EU Member States, these countries began moving towards integration and applied for EU membership in the early 1990s, while negotiations started in the late 1990s.¹

This was not the case with Croatia, which was facing massive war damage, casualties and territorial occupation, and was left on its own to defend itself. After international recognition by the European Community in 1992, Croatia faced certain objections from the European Commission. In May 1993, the European Commission cancelled its first fact-finding mission to Croatia, which would have assessed the possibilities of signing a Croatia-EU agreement, because of the Croat-Bosniak ethnic

1 There were two waves of accession negotiations which both finished in 2002. The first started in 1998 (with Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia) and the second in 2000 (with Bulgaria, Latvia, Lithuania, Malta, Romania, the Slovak Republic). https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/archives/pdf/press_corner/publications/corpus_en.pdf

conflict in Bosnia and Herzegovina. The EU consequently delayed Croatia's entrance into the pre-accession PHARE programme² until March 1995, although, due to war crimes committed mostly after the legitimate military operation Storm,³ the EU froze the PHARE programme in August 1995 and suspended the Croatia-EU trade and cooperation agreement.⁴

Croatia missed the chance of solving these problems, participating in the accession negotiations and joining the EU in 2004, representing nine years of missed opportunities concerning internal market integration, EU funding and other membership benefits.⁵ This put Croatia into the same regional package as the Western Balkans. The EU expected Croatia to fully cooperate with the war crimes tribunal, ensure the return of ethnic Serbs and rebuild their homes, ensure human and minority rights etc.

According to Petak (2019), centralised governance was introduced in the 1990s with "numerous authoritarian features" which led to "distinctive weaknesses of governance in Croatia".⁶ Croatia is still a semi-consolidated democracy (according to Freedom House).⁷ If democracy is justified by free elections (only), this does not prevent the ruling party's authoritarian policies in certain areas: electoral democracy is therefore not the same as liberal democracy. In addition, Pusić (1998) notes that while nationalists and populists won the first multi-party parliamentary elections, many of them were former communists. Multi-party elections were understood as a synonym for democracy, and not as a continuous process which would constantly confirm the democratic nature of power. Instead of broadly accepted democratic values, political hybrids arose combining democratic institutions with a political culture inherited from totalitarianism.⁸ Therefore, during the 1990s, there was a lack of hu-

2 https://www.europarl.europa.eu/enlargement/briefings/33a1_en.htm

3 <https://www.hrw.org/reports/1996/Croatia.htm>

4 <https://www.europe.hr/kronologija-odnosa-eu-rh/>

It is important to differentiate legitimate military action to restore the state's control of previously occupied territory and war crimes within and after this operation.

5 It is hard to estimate EU membership's contribution to economic growth, although it could certainly be at least 1 percentage point to GDP, mostly related to market liberalisation effects and EU funded investments. The missed chance period (2004-2013) certainly contributed to lower GDP growth and prolonged the economic crisis, which was also due to public investment cuts in years of commenced fiscal consolidation (especially in 2014).

6 Petak, Z. And Kotarski, K. (2019): Policy-making at the European periphery: The Case of Croatia; Palgrave Macmillan <https://www.palgrave.com/gp/book/9783319735818>
Zdravko Petak is Croatian political scientist and public policy expert <https://www.fpzg.unizg.hr/staff/zdravko.petak>

7 <https://arhivanalitika.hr/blog/mjerenje-liberalne-demokracije-i-slucaj-istocne-europe/>

8 Pusić, V. (1998): Democracies and Dictatorships; Durieux <http://durieux.hr/wordpress/knjige/esejistika-publicistika/demokracije-i-diktature/>

man capital for liberal democracy, in comparison with the new structures of unreformed ex-communists, crony étatists and ethnic nationalists.

Concerning this problem, Croatia needed to show the political will to start fulfilling the European integration Copenhagen criteria⁹ in three major policy areas. The first requires stable institutions guaranteeing democracy, the rule of law, and human and minority rights; the second relates to a functioning market economy able to cope with the competitive pressure of the EU market; the third emphasises the ability to undertake membership obligations, the capacity to effectively implement the EU law,¹⁰ accept various EU rules, standards and policies, as well as political, economic and monetary union.

1.2. Political changes after 2000 opened the way to the EU membership

Considering the previous barriers, after (additional) democratic change in early 2000 (strongly backed by the EU and the USA), Croatia systematically began its European integration process which included many important steps of political decision-making. The process started with the 2000 Zagreb Summit, which launched the Stabilisation and Accession Process with the countries of South-Eastern Europe (signed in 2001). In 2003, Croatia applied for EU membership and in 2004 the European Commission issued a positive opinion, while the European Council confirmed Croatia as a candidate country. That year the Croatian Parliament established the Croatia – EU Joint Parliamentary Committee, to monitor accession negotiations, launched in 2005 and closed in 2011. The same year Croatia signed the EU accession treaty, after the European Parliament's consent. In 2012, Croatian citizens voted mostly in favour of joining the EU. Therefore, the Croatian Parliament was able to ratify the accession treaty. All these political and institutional decisions led to EU membership in 2013.¹¹

This was a complex and demanding political process¹² which would not have happened without a broad political consensus of mainstream parties (at least nominally committed to the framework of liberal democracy), which decreased the relevance of ethnic nationalist populists whose policy preferences were completely unaligned with the EU requirements. Regarding particularly important political requirements,

9 https://eur-lex.europa.eu/summary/glossary/accession_criteria_copenhagen.html

10 https://ec.europa.eu/neighbourhood-enlargement/policy/conditions-membership/chapters-of-the-acquis_en

11 Croatian Parliament: Chronology of important dates in the EU accession process <https://www.sabor.hr/en/european-affairs/croatias-path-eu/chronology/chronology-important-dates-eu-accession-process>

12 <https://uprava.gov.hr/kako-je-izgledao-put-republike-hrvatske-ka-punopravnom-clanstvu-u-europskoj-uniji/12417>

the accession process was demanding mostly due to systematic problems with the rule of law and corruption. In particular, in relation to the rule of law, the accession negotiations were officially opened in late 2005 after the war crimes tribunal (ICTY) in the Hague confirmed Croatia's full cooperation (which was challenged by strong political and public resistance, despite the constitutional law on cooperation with this tribunal). Furthermore, Croatia also needed to improve the implementation of constitutional law on national minority rights. However, a big political and institutional challenge was ensuring respect for property rights and removing barriers to the return of ethnic Serbs, which obliged Croatia to rebuild their homes (destroyed in 1995). The EU requirements thereby focused attention on resolving issues related to war crimes, the legacy of ethnic nationalism, authoritarianism and the democratic deficit.

1.3. Progress in meeting the EU policy criteria

The European Commission's 2011 progress report,¹³ published after the accession negotiations had closed, assessed Croatia's level of progress in policies, which were necessary for accession, in line with the Copenhagen criteria.

The Commission noted good progress, with refugees continuing to return to Croatia, since *"housing care programmes for returnees are being implemented"*. Despite reported progress in public administration reform, the Commission stated that *"further efforts are needed in improving professionalism"*, that the *"legal framework for developing a merit-based professional civil service has still to be completed"* and that *"dismissal procedures need to be further developed"*.¹⁴

With regard to the economy, the Commission stated that a *"consensus on the fundamentals of a market economy was maintained, but efforts need to be intensified to implement the necessary structural reforms"*, mostly due to the fact that *"only limited progress was made with the privatisation of publicly held assets"* and that *"the investment climate still suffers from difficulties in obtaining the necessary licences, building permits and other authorisations, as well as from the unpredictability of*

13 European Commission (2011): "Croatia 2011 Progress Report" https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key_documents/2011/package/hr_rapport_2011_en.pdf

14 Public administration reforms concerning a merit-based system have constantly been delayed. For example, there was no agreement within the 2012-2015 Government to introduce evaluation of public employees and potential dismissals. The 2012 initiative came from the Government's first vice president, who strongly emphasised the necessity of public sector layoffs and wage bill cuts. However, the main party in the Government did not accept the initiative. The 2017-2020 Government created a draft bill, which would focus on improving the rewarding system. However, the legislative procedure was on hold during 2020.

administrative decisions, in particular at local level". Furthermore, the Commission notes the serious impact of the judiciary and corruption on the investment environment and that *"foreign direct investment is held back by the various shortcomings in the business environment"*. The Commission also stated that *"state intervention in the enterprise sector remained substantial"* and that *"restructuring the shipyards in difficulty is a key priority in the accession process"*,¹⁵ while limited progress has been reported on restructuring the state-owned railway due to high subsidies. In the energy sector *"gas and electricity markets remain dominated by single suppliers, preventing effective competition"* and *"the restructuring of the large electricity company has not advanced"*, which *"constrains competition in network industries"*.

1.4 Liberalisation benefits in particular EU policy chapters

The Commission's progress report¹⁶ also assessed the fulfilment of the criteria from the 35 chapters of EU law (which were subject to negotiations and parliamentary monitoring).¹⁷ Many of these EU policies are related to market liberalisation and required strengthening administrative capacities. Therefore, it is important to look at the general and concrete benefits concerning specific public policies.¹⁸

To ensure the free movement of goods, tariffs for goods and duplicate product tests were abolished. While regulations for many goods were harmonised, mutual recognition was established for goods which were subject to different national regulations. The remaining national regulatory requirements for products need to be transparent via the notification procedure (to ensure justification) and the Product Contact Point (which provides information on applicable rules). The security of products and their quality control have also been increased. Furthermore, Croatia aligned its standardisation, accreditation and metrology system.

-
- 15 The process of restructuring included bankruptcies in 2012 (for example the Kraljevica shipyard <https://vlada.gov.hr/UserDocImages//2016/Sjednice/Arhiva//82028.%20-%207.pdf> Rapid actions were needed in 2012 in order to fulfil the EU criteria under chapter 8 (Competition), taking into account the accession date, versus slow progress up to 2012 <https://www.tportal.hr/biznis/clanak/tko-pogodi-broj-zavarivaca-u-kraljevici-castim-ruckom-20120719>
- 16 European Commission (2011): Croatia 2011 Progress Report https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key_documents/2011/package/hr_rapport_2011_en.pdf
- 17 <http://www.mvep.hr/hr/hrvatska-i-europska-unija/pregovori/kako-smo-pregovarali/nacionalni-odbor-za-pracenje-pregovora-o-pristupanju-republike-hrvatske-europskoj-uniji/>
- 18 <http://www.mvep.hr/custompages/static/hrv/files/pregovori/120112-stodonosi.pdf>

To ensure the right of establishment of free provision of services, in line with the EU Services Directive,¹⁹ service providers (in many services sectors) established in other EU/EEA states are not required to establish in Croatia in order to provide cross-border services on a temporary basis. However, there is a freedom of establishment on a permanent basis, without discrimination based on nationality or residence. Furthermore, in cases where licences are required for specific services sectors, administrative procedures needed to be simplified (and there is even a requirement to digitalise them). Information for service providers on how to start a business and obtain licences was published via the Point of Single Contact,²⁰ while the ENIC-NARIC office became the responsible authority for recognising professional qualifications. To ensure regulatory proportionality and administrative transparency, the justification of many entry and conduct services market requirements needs to be assessed and notified (to the European Commission and Member States). Recognition of professional qualifications from EU nationals was also ensured, as well as market opening for posted workers.

The free movement of workers has been ensured by abolishing work permits for EU nationals and the same is applicable for Croatian citizens within the whole internal market.²¹ Equal workers' rights are applicable, regardless of nationality. Furthermore, Croatia has also abolished quotas for foreign workers (from third countries), although this is not an EU requirement. In the meantime, Croatia fulfilled the criteria for the Schengen zone, which will mean no internal border checks. So far Croatian citizens can enter the Schengen zone without a passport, although biometric passports guarantee faster airport checks. Regarding the labour market, Croatia joined both the EURES portal, and a coordination mechanism for social security. Croatian citizens have been granted the European health insurance card.

The free movement of capital required the liberalisation of capital, deposit transactions and payment systems. Croats can open bank accounts in other EU Member States, loans can be approved to non-residents, while cash can freely circulate in and out of the State. Consumer protection, choice and the transparency of financial services have been increased. Furthermore, EU citizens are free to buy real estate in Croatia under the same conditions as Croatian citizens. This is not yet the case, however, with agricultural land, where the transitional restriction remains until mid-

19 https://ec.europa.eu/growth/single-market/services/services-directive_en

20 Point of Single Contact <http://psc.hr/en/>

21 Maximum transitional periods ended by 1 July 2020.

2023.²² In this area, Croatia also needed to implement anti-money-laundering and counter-terrorism measures.

Croatia was required to open its public procurement to the EU internal market, improve the management of remedies, and liberalise concessions and public private partnerships. In the meantime, Croatia introduced e-procurement, which has reduced the administrative burden. Croatian businesses can compete on the EU market, and EU competitors can freely access the Croatian market. Under the competition policy, Croatia needed to align and to control sectoral state aid (steel industry, shipyards etc.), conduct antitrust policies and merger controls, prevent abuses of dominant positions, detect (with the leniency policy) and sanction cartels and their influence on prices, and improve capacities for protecting competition.

When it comes to company law, Croatia needed to improve stakeholders' rights, corporate accounting and audits, and the transparency of financial reports. In addition to the European Economic Interest Grouping, the European joint stock company was introduced as a new legal form, which ensures simple cross-border company mergers and transfers of offices, without liquidation.

Under the enterprise policy, Croatia introduced regulatory impact assessments²³ and economic impact assessments,²⁴ the first e-government services, e-business support and became a part of the *Enterprise Europe Network* (EEN)²⁵. Furthermore, the EU framework against late business payments was transposed, as were state aid rules, which prevent uncontrolled sectoral subsidies to different industries.

Financial services institutions are free to enter the EU market with a license from their home member state. Market oversight has been strengthened to ensure consumer protection and financial stability.

Concerning the information society, consumers are free to choose and to change electronic communication services. Furthermore, consumers can opt for lower mobile phone roaming prices within the EU, e-signatures have been introduced, as well as the unique European emergency phone number 112.

22 <https://vlada.gov.hr/vijesti/vuckovic-moratorij-na-prodaju-poljoprivrednog-zemljista-strancima-je-vazna-odluka/29755>

23 <https://zakonodavstvo.gov.hr/procjena-ucinaka-propisa/postupak-procjene-ucinaka-propisa/226>

24 https://narodne-novine.nn.hr/clanci/sluzbeni/2017_05_43_982.html

25 <https://een.ec.europa.eu/>

Concerning the internal energy market, Croatia has liberalised its gas, electricity and oil markets by ensuring freedom of establishment for competitors (to domestic state-owned companies) and price deregulation. Opportunities to invest in energy efficiency and renewable energy as well as in hydrocarbon exploration and exploitation where licenses are not discriminative towards nationality and legal form, were offered. Croatia was obliged to manage its strategic oil reserves. Furthermore, to ensure competition in natural gas supply, the EU supported the Croatian LNG terminal. Finally, to ensure the security of natural gas supply, Croatia established a new gas interconnector with Hungary.

The transport system was integrated into the EU market, with a certain level of liberalisation. Air passengers are entitled to accommodation and food in cases of flight delays or cancellations, while disabled persons are protected during reservations and boarding. Croatia also joined the Trans-European networks of road, rail and air transport. Large-scale EU-funded investments in transport infrastructure are under way in Croatia.

Agriculture was integrated into the competitive EU market, where food safety and supply stability are important. The chance to participate in the Common Agricultural Policy contributes to the reduction of domestic subsidies and improves how they are controlled.

In the area of social policy, Croatia needed to implement anti-discrimination law and train judges in this area, increase the social inclusion of disadvantaged groups, improve health and safety standards, increase active labour market policies and support lifelong learning. Economic and monetary policy needed to be prepared for economic policy coordination. Croatia has started its integration into the Eurozone and entered the ERM II mechanism. To ensure transparent and comparable EU-wide data, also relevant to economic policy, Croatian statistics have been integrated into Eurostat.

In addition to the areas mentioned, there have been many other policy improvements, which include alignment of SME definitions; alignment of VAT rules (where standard rates need to be between 15 and 25%); protection of the EU's external border (including control of illegal immigration); measures to combat organised crime; cross-border mobility of scientists and their participation in joint European programmes and in the European Research Area; vocational training, e-learning and life-long learning programmes; increased opportunities to study; improved waste man-

agement and environmental protection standards; air and water quality; consumer protection and alternative dispute resolution; reduced risks of dangerous products; medically assisted fertilization; smoking restrictions in public places; transparency of health services; cooperation in containing infectious diseases; digitalised customs service; Common Commercial Policy and free trade with many third countries; Common Foreign and Security Policy; containing illegal trade of weapons; shift towards digital television broadcasting; intellectual property rights protection; independent budgetary audits; financial controls and anti-fraud activities etc.

1.5. Public administration adjustments and size

Finally, Croatia is participating in the EU institutions and can actively participate in European decision making concerning many public policies. In all the areas mentioned, public administration needed to develop and train sufficient administrative capacities to carry out European policies. Conversely, the administration has still been burdened with massive bureaucracy, an organisational culture which continues to create widespread institutional barriers to Croatian competitiveness.

While it is common to generalise about the administration and the whole public sector, it is important to make a clear distinction between the necessary (basic and EU) institutional functions and administrative capacities, and those which create excessive bureaucratic costs and heavy burdens for taxpayers. Considering many public discussions on the need to reduce public sector employment, it is important to differentiate state administration and public (welfare) services, where the latter account for around 75% of public sector employment. For example, during 2012-2015 state administration employment was slightly reduced (by cca 5%), despite the Government abandoning its outsourcing plan.²⁶ In the following years (2016-2020), public sector employment was generally fixed, although there were visible increases in the health and police sectors.²⁷

26 Data comparison for 2012-2015 period shows cca 5% decrease in public administration (without public services) <https://www.sdlisn.hr/broj-drzavnih-sluzbenika-i-namjestenika-smanjen-za-4912-u-odnosu-na-2004-godinu/>

Despite the opposition of its junior coalition partner, in 2014 the Government gave up an outsourcing plan which could have led to additional public employment reductions, since "namještenici" represent cca 10% of total employment.

It is important to note that police employment makes up around 40% of total public administration (without public services).

27 Yearly data calculation is based on the Ministry of Administration's reports (Statistički prikaz).

However, there is still no precise data on overall employment in hundreds of public companies,²⁸ including local utilities (which could possibly make a difference). The influence of state-owned companies on the economy, especially in network sectors and utilities, represents one of the main structural challenges of Croatian political economy (distortions of market competition, reduced FDI opportunities, large size of government, risks of corruption, political clientelism, etc.). The problem of SOE scope and their involvement in network sectors is analysed further in the text, concerning the OECD Product Market Regulation report.

1.6. Croatia's readiness and key challenges before accession

While the Croatian Government reported on the results of negotiations,²⁹ the Commission's report on Croatia's membership readiness³⁰ (three months before the accession) concluded that Croatia had generally fulfilled its pre-accession obligations and requirements in all negotiation chapters. However, the Commission highlighted several open priorities where policy improvements were necessary, including judicial efficiency, reducing the backlog of court and enforcement cases, continued prosecution of domestic war crimes, prevention of conflict of interest, the right to access public information, minority and human rights protection, ensuring housing for refugees, privatisation and restructuring of shipyards etc.

Prior to joining the EU, the European Commission confirmed Croatia's dedication to the core principles of liberal democracy: *"Croatia's accession reaffirms that the perspective of European integration remains open to all aspirant countries which show the necessary will to implement political and economic reforms and prove their respect for European values such as the rule of law, democratic principles and human rights."*³¹

.....
28 Rare research was carried out by the Institute of Public Finance in 2010. As a reference to this research, Croatia has a large public sector when it comes to SOE employment in relation to overall employment, according to Šimović, H. & Deskar-Škrbić, M. (2020): Ekonomika javnog sektora s hrvatskim primjerima (Economic of public sector with Croatian examples); Arhivalitika – Ekonomski Lab (pg 51) <https://arhivalitika.hr/product/hrvoje-simovic-i-milan-deskar-skrbic-ekonomika-javnog-sektora-s-hrvatskim-primjerima/>

29 [http://www.mvep.hr/hr/vanjska-politika/multilateralni-odnosi-staro-ijvhj/europska-unija-\(eu\)/pregled-dokumenata-iz-pregovarackog-procesa/](http://www.mvep.hr/hr/vanjska-politika/multilateralni-odnosi-staro-ijvhj/europska-unija-(eu)/pregled-dokumenata-iz-pregovarackog-procesa/)

30 European Commission (2013): Izvješće o praćenju pripremljenosti Hrvatske za članstvo u EU (26.3.2013.); COM (2013) 171 final <http://www.mvep.hr/hr/hrvatska-i-europska-unija/pregovori/izvjesca/europska-komisija0/>

31 European Commission (2013): "Croatia's accession to the European Union https://ec.europa.eu/commission/presscorner/detail/de/MEMO_13_629

2. The European Semester policy challenge after EU accession

As an EU Member State, Croatia became a part of the European Semester,³² a process of coordinating economic and structural reform policies between the Member States and the European Commission. The reasons behind this is that the European economy wants to keep public finances and deficits under control and support structural reforms which would lead to more competitiveness and reduced macroeconomic imbalances. In addition to the obligation of EU Member States to transpose and implement EU directives and regulations, they regularly receive reform recommendations³³ to improve public management. Croatia also receives annual EU reports, which assess progress in different policies and point out problems with implementing reforms, in accordance with which the country needs to align its annual national reform programmes.³⁴ While the overall effects of EU membership are mainly related to Single Market liberalisation, EU budgetary funding³⁵ and other benefits, this article puts the focus on fiscal and regulatory policy.

2.1. Fiscal consolidation even with certain expenditure adjustments

In 2012, the government inherited a large deficit (cca 5% of GDP) in a period of deep economic decline. The 2012 budget was actually the only one in Croatia with nominal (total) spending cuts (compared with a previous year) worth 3.4 billion HRK (cca 1% of GDP). These cuts were focused on the public wage bill (2 billion HRK), and subsidies to railways (0.5 billion HRK) and agriculture (0.8 billion HRK). The 2012 budget also had a three-year plan to freeze the total cost of public wages, reduce and freeze subsidies and social welfare entitlements, and reduce material costs. At the same time, the government needed to plan the first tranche of the EU membership.³⁶ There were even more ambitious plans for spending cuts within the 2012 govern-

32 European Commission: European Semester https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester_en

33 European Commission: 2020 European Semester – Country Specific Recommendations https://ec.europa.eu/info/publications/2020-european-semester-country-specific-recommendations-commission-recommendations_en

34 Government of the Republic of Croatia (2020): National Reform Programme 2020 https://ec.europa.eu/info/sites/info/files/2020-european-semester-national-reform-programme-croatia_hr.pdf

35 EU funds are a horizontally large policy area which is not covered by this article. It is, however, worth mentioning that the 2014–2020 EU financial framework for Croatia was €10.7 billion (cca 80 billion HRK). In addition to that, the newly agreed 2021–2027 EU framework opened €24.2 billion for Croatia (cca 180 billion HRK).

36 Ministry of Finance (2012): Proračun 2012.–2014. (2012–2014 budget) https://vlada.gov.hr/UserDocImages//2016/Sjednice/Arhiva//2012-2014_20proracun1.ppt

ment.³⁷ However, the structural reform potential remained moderate and limited (although high in comparison to general fiscal policies).

Since Croatia joined the EU in 2013, its public debt has seen a significant increase and reached a peak in 2014 at 86% GDP. This was due to a prolonged GDP decline as well as to enlarged EU methodology.³⁸

The European Commission activated the Excessive Deficit Procedure (EDP) in early 2014. It required correction by 2016 and estimated 2.3% of GDP in structural consolidation measures in 2014 and 1% of GDP in 2015 and 2016, which would reduce the nominal deficit below 3% of GDP by 2016 and ensure the sustainability of public debt. In response, Croatia introduced a package of structural measures of 1.9% of GDP for 2014 and additional fiscal measures to the amount of 0.4% of GDP for 2014 and 1% of GDP for 2015 and 2016. While budgetary revenues increased by 1.7% of GDP during 2013-2015, the expenditure consolidation cut during the same period was 1.8% of GDP. In 2014 consolidation was mostly expenditure-driven and included cuts in gross public wages of 3% in 2013 (in addition to the 2012 cuts), cancellation of holiday bonuses, abolition of service loyalty bonuses, reduction of subsidies, restraining intermediate consumption and public investment cuts. Therefore, the nominal general government deficit of 5.3% of GDP in 2013 transformed into a surplus of 1.0% of GDP in 2016. However, the consolidation package *“led to weaker economic activity” and “in case of the implementation of a more growth-friendly fiscal consolidation package, recession in Croatia could have ended in 2014”*.³⁹ Furthermore, the transition of political power between Governments during 2015 also contributed to the consolidation in terms of lower expenditure for public investments and procurement.

37 The government also had a “second line of defence” with more radical spending cuts <https://www.poslovni.hr/vijesti/vlada-planira-snaziti-deficit-sredisnje-drzave-za-53-milijarde-kuna-195582>. However, these initiatives represented a more ambitious approach based on a “radical diet” <https://vijesti.hrt.hr/142036/stedljiv-proracun-i-smanjenje-mase-placa>.

38 ESA 2010 methodology included the Croatian highway system and Croatian Bank for Reconstruction and Development in the debt measurement. For ESA 2010 effects on public debt calculation see (for example) in <https://www.hnb.hr/-/bilten-2-1>

39 Deskar-Škrbić, M. and Milutinović, D. (2021): Design of fiscal consolidation packages and model-based fiscal multipliers in Croatia; Public Sector Economic (forthcoming article); For more information see <https://www.hnb.hr/-/milan-deskar-c5-a0krbi-c4-87-i-darjan-milutinovi-c4-87-iz-hnb-a-dobitnici-nagrade-zaklade-han-c5-beekovi-c4-87>

MEASURES,% OF GDP	2013	2014	2015	2016
Structural revenue measures				
Increase of the health contributions rate		0.5	0.2	
Increase of the pension contributions revenues		0.1	0.1	0.01
Increase of intermediate VAT rate		0.2		
Increase in excises on oil derivatives		0.1	0.1	0.04
Increase of excise rate on tobacco		0.03	0.04	0.01
Charges in tax on games of chance		0.03	0.01	
Limitation of CIT tax relief			0.1	
Introduction of tax on interest on savings			0.1	
Total structural revenue measures		1.0	0.7	0.1
Structural expenditure measures				
3% cut of public sector wages	-0.2	-0.1		
Cancellation of the holiday bonus	-0.1			
Abolishment of the service loyalty bonus		-0.1		
Reduction of subsidies		-0.3	-0.1	-0.2
Constraining intermediate consumption		-0.2		-0.1
Government investment cut		-0.4	-0.1	-0.1
Social benefits savings		-0.2	-0.1	
Total structural expenditure measures	-0.3	-1.3	-0.2	-0.3
Total structural measures	0.3	2.2	0.9	0.4

Table 1. Structural consolidation measure (% of GDP)

3

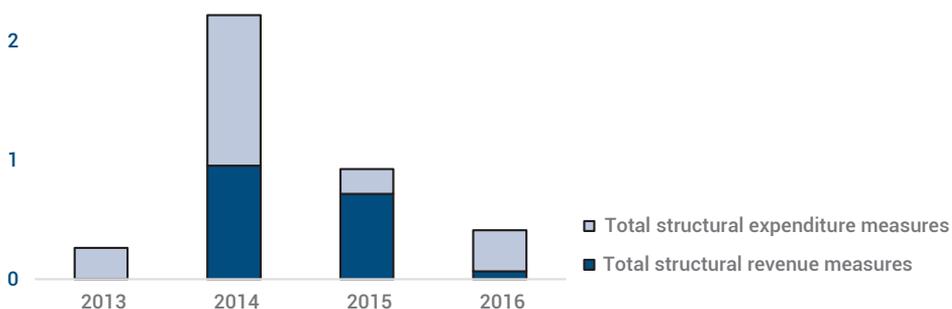


Figure 1. Structural consolidation measures, % of GDP

Note: The structural increase of pension contribution revenues is related to the transfer of public employees with accelerated pension plan from the 2nd to the 1st pension pillar.

Source: Deskar-Škrbić, M. and Milutinović, D. (2021)

Furthermore, the public debt to GDP ratio started to decrease in 2015 and reached 73% in 2019.⁴⁰ The 2015 budget also reached a primary surplus, while the (structural) cyclically adjusted primary surplus reached 1.7 % of GDP,⁴¹ mostly due to adjustments

40 Croatian National Bank (2020): HNB bilten, br. 263, November 2020 <https://www.hnb.hr/analize-i-publicacije/redovne-publicacije/bilten> This data is prior to the COVID-19 crisis.

41 https://www.ecb.europa.eu/pub/pdf/other/mb201203_focus13.en.pdf

and cuts in budgetary expenditures, starting with the 2012 budgetary spending cuts. Therefore, this consolidation led to a budgetary surplus and paved the way for tax cuts from 2017.⁴² It is also important to note that in 2015 Croatia spent 3.4% of its GDP on interest, while the economic recovery in the following years, as well as more favourable financing conditions, reduced this cost, due to improved macroeconomic policy and the expansionary monetary policy of the European Central Bank.⁴³ Croatia was therefore able to reach an overall general government balance in its 2017-2019 budgets. Croatia exited the Excessive deficit procedure in 2017⁴⁴ and tax cuts were possible.⁴⁵

Taxes	Amount (bil HRK)	Ratio
Income	4.5	45%
VAT	3.0	30%
Contributions	0.8	8%
Profit	0.7	7%
Excises	0.3	3%
Real estate transfer	0.2	2%
Other	0.6	6%
Total	10.1	100%

Table 2. Total tax cuts relief 2017-2020 in Croatia

Note: 2015 and 2021 tax cuts are not included

Source: Ministry of Finance (2020), presentation - author's table

However, due to moderate GDP growth rates during 2017-2019 (prior to the COVID-19 crisis) there was a general reluctance to cut or at least freeze budgetary spend-

42 Deskar-Škrbić, M. and Raos, V. (2018): Karakter fiskalne politike i politička ekonomija fiskalne konsolidacije u Hrvatskoj u post-kriznom razdoblju; EFZG working paper series, (02), 1-23 <https://hrcak.srce.hr/192453>

43 Šimović, H. & Deskar-Škrbić, M. (2020): Ekonomika javnog sektora s hrvatskim primjerima (Public sector economics with Croatian examples); Arhivanalitika – Ekonomski Lab <https://arhivanalitika.hr/product/hrvoje-simovic-i-milan-deskar-skrbic-ekonomika-javnog-sektora-s-hrvatskim-primjerima/>

44 https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/corrective-arm-excessive-deficit-procedure/closed-excessive-deficit-procedures/croatia_en

45 According to Ministry of Finance estimates, total 2017-2020 tax cuts represented cca 10 billion HRK of financial relief, mostly due to personal income tax cuts, while there was relief in corporate income tax for SMEs, real estate transfer tax, with a lower non-standard VAT rate and total contributions. In addition to this, 2015 income tax relief was cca 1.8 billion HRK, while it is hard to estimate relief from previous tax cuts since a part of them were reversed (for example, health contribution was restored to 15% and reinvested profits relief abolished). 2021 tax cuts ensured an additional cca 2 billion HRK tax relief concerning personal income (36 to 30% marginal rate reduction) and corporate tax (12 to 10% lower rate reduction relevant for approximately 93% of companies). This gives a cumulative 2015-2021 total of almost 14 billion HRK.

ing. Government public spending therefore stayed constant at around 47% of GDP (according to Eurostat), which is higher than in comparable countries - Slovenia and Poland (42%), Slovak Republic (41%), Estonia (40%), Latvia (39%), Romania (35%) and Lithuania (34%). Consequently, the high cost of overall public spending to taxpayers represents a key challenge. Structural budgetary measures against the total wage bill, privileged pensions, SOE subsidies and other costs that required extra taxes are still not present.

2.2. Business environment regulatory reform

The first attempts to improve the overregulated business environment started in 2006 with only the partial implementation of a whole recommended package of measures recommended for abolishing and simplifying business regulations.⁴⁶ However, systematic support for the reform decreased due to high institutional procrastination. In early 2013 Croatia decided to focus on improving ease of doing business results, removing detected private investment barriers and reducing some non-tax and parafiscal charges.⁴⁷ The first tranche of services deregulation started, especially for gas and electricity, construction, architects, engineers, retail and real estate agents. Concerning specific regulatory areas, some simplifications of starting a business via simple limited liability company, labour, construction and bankruptcy regulations have been completed.

After EU accession in 2013, Croatia became a part of the EU Better Regulation Network (regular meetings of EU/EEA administrative representatives for exchanging good policy practices concerning reducing administrative and regulatory burdens). Croatia also developed institutional cooperation with the European Commission on the EU Better Regulation policy.⁴⁸

In 2013, Croatia started to reduce the financial burden on the economy, which derives from various non-tax and parafiscal fees. However, the reductions were moderate and very limited.⁴⁹ A more ambitious approach would clearly define unnecessary

46 "In 2009, the World Bank (IFC) assessed HITROREZ's impacts and concluded that HITROREZ impacted 66 million USD annual savings for Croatian economy" (approximately 0.3 billion HRK). For more information see <https://zakonodavstvo.gov.hr/UserDocsImages//dokumenti//2014%20SIGMA%20Izcjesce%20o%20RIA%20EN.pdf>, https://www.researchgate.net/publication/330358961_A_story_on_successful_regulatory_reform_in_Croatia

47 <http://investcroatia.gov.hr/odrzana-1-sjednica-radne-skupine-za-poslovanu-klimu-i-privatne-investicije/>

48 https://ec.europa.eu/commission/priorities/democratic-change/better-regulation_en

49 The official information on non-tax and parafiscal burden reduction is scattered through different sources. The government's annual national reform programmes (2014-pg 29, 2015-pg 28, 2016-

and disproportionate burdens (chambers, tourist boards, administrative fees etc.), against the need to finance certain public goods (the majority of the burden goes for radio and television, renewable energy, environmental protection, water supply, monuments, radio frequency spectrum).⁵⁰ Therefore, the question is how to rationalise the financing of these public goods and what potential fiscal and/or market alternatives there might be.

Faced with a burdensome business environment, in order to catch up with EU-wide trends in dealing with red tape, Croatia started to use the Standard Cost Model (SCM) methodology for measuring and reducing the administrative burden for the economy in 2014⁵¹ and increased the areas measured.⁵² This resulted in red-tape cuts worth more than 2 billion HRK⁵³ in dozens of regulatory areas, including safety

.....
pg20) report in total more than 50 reduction measures of cca 0.7 billion HRK of financial relief during 2013-2015, while total planned cuts during 2017-2021 are cca 1.1 billion HRK via 50 measures (of which 0.3 billion have been implemented by the end of 2020) <https://gospodarstvo.gov.hr/print.aspx?id=12682&url=print>. This brings to the total cca 1.8 billion HRK during 2013-2021.

50 The 20 largest non-tax and parafiscal fees charge and represent almost 90% of their total register, which is worth 8.7 billion HRK. See: National Reform Programme 2020 (pg 19) <https://vlada.gov.hr/UserDocImages/Europski%20semestar%202020/National%20reform%20programme%202020.pdf>

51 The Government of the Republic of Croatia (2014): Odluka o odabiru Standard Cost Model (SCM) metodologije za mjerenje administrativnog opterećenja radi provedbe pilot projekta (Decision on selection of Standard Cost Model (SCM) methodology for measuring administrative burden for implementation of pilot project <https://vlada.gov.hr/UserDocImages//2016/Sjednice/2014/195%20sjednica%20Vlade//195%20-%2019.pdf>

For information on the SCM pilot project and the methodology see <https://zakonodavstvo.gov.hr/UserDocImages//dokumenti/TWL%20SCIRIAS/Trening%20materijali//SCM%20DH%20HR.pdf>

52 The Government of the Republic of Croatia (2014): Odluka o proširenju primjene Standard Cost Model (SCM) metodologije za mjerenje i ciljano smanjenje administrativnog opterećenja gospodarstva (Decision to expand the application of Standard Cost Model (SCM) methodology for measuring and targeted reduction of the administrative burden on the economy) <https://vlada.gov.hr/UserDocImages//2016/Sjednice/2017/06%20lipanj/43%20sjednica%20Vlade%20Republike%20Hrvatske//43%20-%2011.pdf>

53 The total administrative burden reduction, according to the SCM methodology, was 2.2 billion HRK (by April 2020, while the reform continues with more red-tape cuts). See: National Reform Programme 2020 (pg 23) <https://vlada.gov.hr/UserDocImages/Europski%20semestar%202020/National%20reform%20programme%202020.pdf>

However, the total cumulative planned reduction is 2.7 billion HRK (with three action plans – 2017, 2018 and 2019), while the 2020 action plan aimed for a further 0.7 billion reduction <https://gospodarstvo.gov.hr/aktualno/novih-10-mjera-administrativnog-rasterećenja-donosi-ustedu-od-686-milijuna-kuna/12676>. This will lead to total 3.4 billion HRK reduction by end 2022, based on four action plans for administrative burden reduction (2017, 2018, 2019, 2020). It is important to note that the SCM methodology measures gross wage working time and overhead costs of dealing with procedures and requirements, related fees, frequency and population of affected enterprises (while non-tax and parafiscal fees represent a direct financial burden). It is important to mention that the SCM methodology also measures obligations, which derive from EU legislation (which cannot be cut by domestic measures, even if it is considered disproportionate and excessive). Furthermore, more than 390 measures of administrative burden reductions have been implemented (by October 2020) – See: Izveštće o provedbi Nacionalnog programa reformi 2020 (pg 2)

at work, tax administration, sanitary requirements, waste management, public procurement, company law, business start-ups, many service sectors, statistics, metrology, sick leave, remote working, electricity connection, construction permits, food donation, precious metals etc. Furthermore, faced with many anti-competitive sectoral barriers, Croatia has also implemented many services market liberalisation measures⁵⁴ in different professions including construction site managers, accountants, tax advisers, auditors, lawyers, taxi drivers, driving schools, tourist agencies, tour guides, private security, private detectives etc. Further examples of deregulatory results based on the OECD PMR methodology are described in the text.

It is certain that Croatia will need to continue with regulatory reform. Despite many improvements, simplifications and deregulations, the economy and citizens still face certain bureaucratic obstacles, especially at the local level. Digital and AI based solutions will further foster the process of systematic regulatory cleaning.

2.3. The EU's assessment of Croatia's business reforms and barriers to them

The European Commission regularly assesses Croatia's reform performance in many policy areas. This article puts the focus on business environment reforms, and those which influence regulatory and fiscal policy. The Commission's report recognises that *"efforts to reduce the administrative burden and improve the competitiveness of the services' sectors are advancing"*, as a part of business environment and market reform. Concerning other policies, the Commission sees certain progress with curricular reform, active labour market policies, electronic communication in the judiciary, and R&D investments. On the other hand, it sees slow progress in *"selling off its holdings in state-owned enterprises"*, reforming the public administration, social benefits and healthcare systems, while pension reforms have been reversed.⁵⁵

<https://vlada.gov.hr/UserDocsImages//2016/Sjednice/2020/Studeni/19%20sjednica%20VRH//19%20-%2010%20Izvje%C5%A1%C4%87e.pdf> In total, more than 500 measures of administrative burden reduction are planned to be implemented by 2022. By adding measures of parafiscal cuts, services market liberalisation and removal of other different investment barriers, the total number of business environment simplifications during 2012-2022 surpasses 1,000 measures where particular administrative and regulatory barriers are removed

54 By end 2020 services market liberalisation consisted of total 250 deregulatory measures in more than 50 activities and professions. Sources: Ministry of Economy and Sustainable Development <https://mingor.gov.hr/o-ministarstvu-1065/djelokrug/uprava-za-trgovinu-i-politiku-javne-nabave/slobodno-trziste-usluga-i-roba/liberalizacija-trzista-usluga/7028> and Izvješće o provedbi Nacionalnog programa reformi 2020 (pg 2) <https://vlada.gov.hr/UserDocsImages//2016/Sjednice/2020/Studeni/19%20sjednica%20VRH//19%20-%2010%20Izvje%C5%A1%C4%87e.pdf>

55 European Commission (2020): 2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews; SWD(2020) 510 final <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020SC0510&from=EN>

The Commission also sees progress in mergers of administrative bodies, mandatory financial and strategic reporting in SOE's and certain privatisations, while among key problems are health sector debt, the functioning of the judiciary and the high risk of corruption within SOE's at local level.⁵⁶

In addition to the Commission's assessment reports, it is important to compare Croatia with its main competitors from Central and Eastern Europe, as well as the whole EU. Therefore, several worldwide methodologies can be used to measure and estimate Croatian positions concerning economic freedom, ease of doing business, market deregulation, competitiveness and digitalisation.

2.4. Moderate improvements of economic freedom due to Doing Business reforms

Croatia has moderately improved its economic freedom according to the Fraser Institute's reports.⁵⁷ Comparing 2014 and 2018,⁵⁸ Croatia's score has increased from 70 to 74%, while the ranking improved from 84th to 61st place. In relation to comparable countries in Central and Eastern Europe, this result places Croatia before Slovenia and Poland, close to Hungary, but still far behind the Czech Republic, Romania and the Baltic states.⁵⁹ Therefore, the result shows limited progress with just certain reforms (as described below), while comprehensive large-scale (Baltic style) free market reforms as part of a broader policy package remain largely off the agenda.

Comparing 2010 and 2018,⁶⁰ EU membership-related direct improvements are in the area of trade policy, in particular due to the reduction of *regulatory trade barriers* (score improved from 66% to 84%), *non-tariff trade barriers* (score improved from 56% to 67%) and *compliance cost of importing and exporting* (score improved from 75% to 100%).

56 European Commission (2019): Review of progress on policy measures relevant for the correction of macroeconomic imbalances https://ec.europa.eu/info/sites/info/files/economy-finance/hr_mip_specific_monitoring_report_2019_to_epc.pdf

57 Fraser Institute: Economic Freedom of the World <https://www.fraserinstitute.org/studies/economic-freedom>

58 Fraser Institute's economic freedom annual reports use data with two-year distance.

59 Centre for Public Policy and Economic Analysis (2020): Economic freedom – Croatia before Slovenia and Poland but far from Czech Republic and the Baltics <https://www.cepa-policy.hr/ekonomiske-slobode-hrvatska-ispred-slovenije-i-poljske-ali-daleko-od-ceske-i-baltika/>

60 These years are used in the 2020 report <https://www.fraserinstitute.org/sites/default/files/economic-freedom-of-the-world-2020.pdf> for long-term comparison. Furthermore, these years represent enough time distance before and after Croatia's EU accession (in Mid 2013).

EU membership can also indirectly foster certain reform improvements in fiscal and regulatory policy. For example, *transfers and subsidies* score has slightly improved (from 48% to 57%), in relation to EU state aid rules, which prevent sectoral subsidies to loss making companies. Croatia needed to restructure and privatise certain shipyards to fulfil the accession criteria regarding competition policy. This policy also contributes to saving taxpayers money on subsidies. On the other hand, subsidies are mostly horizontally oriented to support SME competitiveness via EU budget programmes and national co-financing.

In terms of regulatory policy, *credit market regulations* have improved (from 90% to 93%), especially *private sector credit* (from 79% to 100%) and *interest rate controls* (from 90% to 100%). This means that Croatia has improved its banking sector and the Government does not interfere in credit and interest rates. Furthermore, *freedom to own foreign currency bank accounts* has been improved (from 50% to 100%), which is a direct result of EU membership.

Where business regulations are concerned, *bureaucracy costs* have been moderately lowered (score improved from 62% to 69%). *Licensing restrictions* have been significantly lowered (score improved from 47% to 85%), while there is still room for improvement due to the 2019 legislative reform of construction permits.⁶¹ Furthermore, *regulatory restrictions on the sale of real property* have been lowered (score improved from 64% to 84%). When it comes to *starting a business*, the reported 93% score will be increased due to the new one-stop-shop online procedure (START).⁶²

In contrast, there has been no significant improvement with regard to the rule of law (*judicial independence, impartial courts, protection of property rights and integrity of the legal system*). Furthermore, stagnant scores related to *impartial public administration, labour market regulations, government consumption and state ownership of assets* show constant weakness.

The economic freedom methodology of measuring business regulation is complementary with the Doing Business report,⁶³ which places Croatia 51st in the world and 19th in the EU (ahead of Hungary, Cyprus, Romania, Italy, Bulgaria, Luxembourg, Greece and Malta). While the last annual ranking saw an improvement of seven plac-

61 <https://mgipu.gov.hr/vijesti/poduzetnici-i-gradjani-brze-do-dozvola-za-gradnju/9090>

62 Point of Single Contact: Establishment <http://psc.hr/en/establishment/>

63 Centre for Public Policy and Economic Analysis (2019): Here's what Doing Business 2020 report means for Croatia <https://www.cepa-policy.hr/evo-sto-za-hrvatsku-znaci-doing-business-2020-izvjesce/>

es, the ranking position over then years has been halved (from 103rd to 51st). Since the report has not considered the new online one-stop-shop system for starting a business (without notary and stamp, and with reduced registration fee), it may be estimated that the real time ranking would be at least 45th (the same as Slovak Republic and very close to the Czech Republic and Poland). Furthermore, this ranking estimate was based on the 2019 legislative simplification of construction permits, even though the result also depends on the performance of local implementation in the City of Zagreb when dealing with permits. Finally, simplifications in connecting to the electricity grid and digitalisation of tax payments would further confirm the improved results of regulatory reforms.

Reforms stated by the Doing Business report were focused on simplifying several procedures, including reduced initial capital for company founders, fewer requirements for starting a business, reduced water contribution costs in construction permits, reduced real estate transfer tax, abolition of (special) tax on companies, reduced times for registering property and connecting to electricity, as well as improved minority shareholder protection.

However, despite a certain level of progress in making it easier to do business, a number of structural challenges remain, and the report still detects several barriers. They include initial capital for company founders, a long and costly bankruptcy procedure, long waits for construction permits (in the City of Zagreb), as well as multiple mandatory payments (administered by the tax authority), which are in fact parafiscal charges for the economic chamber and tourist board. Solving structural problems in these areas could bring Croatia closer to the TOP 20 countries (such as Latvia and Estonia).

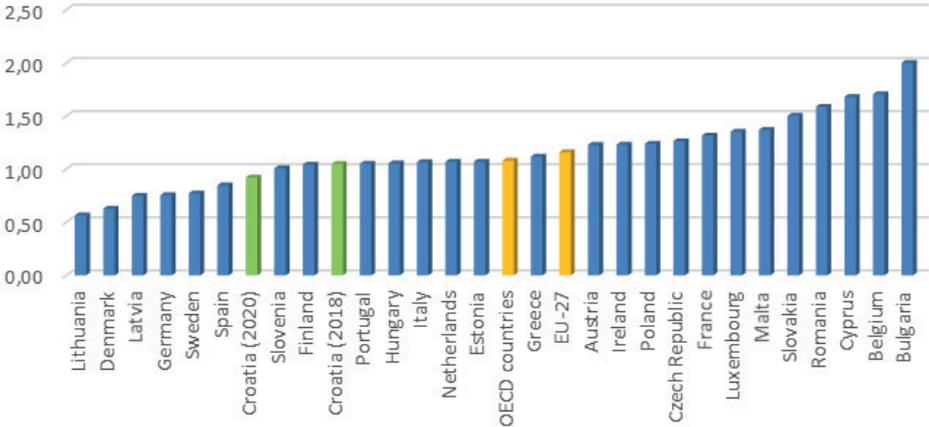
2.5. Significant market deregulation despite only limited privatisation

Even though reforms are missing in many policy areas, EU membership and the European Semester coordinated services market liberalisation contributed to more than 30% deregulation in 2013-2018 period. In line with the OECD's report *Product Market Regulation 2018*,⁶⁴ the Croatian economy has decreased its overall regulatory restrictiveness score from the highest in the EU (2.08 in 2013) to the EU / OECD average (1.43 / 1.38 in 2018).

64 OECD: *Product Market Regulation 2018* <https://www.oecd.org/economy/reform/indicators-of-product-market-regulation/>

In the meantime, the reduced *administrative burden for start-ups* has decreased the overall score o 1.35 by end 2019.⁶⁵ The 2018 deregulation result is lower than in EU member states such as Poland, Slovak Republic, Malta, Bulgaria, Romania, France and Belgium, while the further 2019 deregulation result (1.35) is almost the same as of Slovenia, Latvia and the Czech Republic.

Looking at the two main segments that the OECD PMR report measures, Croatia is at 1.05 (0.92 after 2019 simplification of *administrative burden for start-ups*), below the EU / OECD averages considering regulatory market barriers (*barriers to domestic and foreign entry*) where starting a business, services market regulation, trade and investment have been measured. Within the stated policy areas, Croatia is among the ten EU Member States with the lowest level of market regulations and barriers. Among the new EU Member States from Central and Eastern Europe, the Croatian level is similar to Slovenia, while only Lithuania and Latvia are more deregulated in this area.

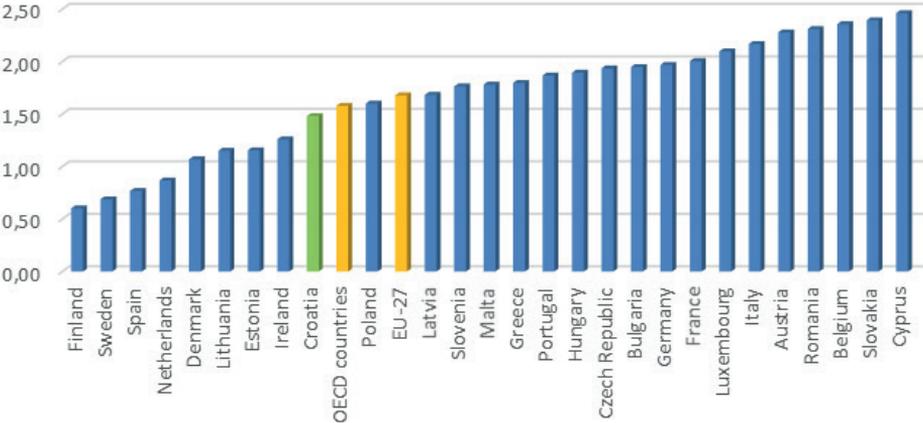


Graph 1: De-regulation of market entry (starting business, network and services sectors, trade and investments)
Source: OECD, 2019 (author’s graph based on the OECD PMR data)

However, the OECD data show higher regulatory restrictiveness than the EU / OECD average for retail of medicines (pharmacies) and lawyers. Concerning lawyers, among the new EU Member States of Central and Eastern Europe Croatia is more regulated than Lithuania and Latvia, while less regulated than Hungary, Poland, the

65 OECD’s 2019-reform simulation is based on cutting the *administrative burden for start-ups* by changing several procedures with a single online START service, abolishing notary procedure and decreasing fees.

Czech Republic, Slovak Republic and Slovenia (which clearly illustrates a consistent Central European pattern⁶⁶). Concerning notaries, Croatia also shares almost the same regulatory pattern as the whole of Central and Eastern Europe (along with the Baltic States, Luxembourg, Germany and Spain), unlike the Nordic and Anglo-Saxon states which do not regulate them. On the other hand, overall regulation of market professions (accountants, architects, civil engineers, estate agents and lawyers) is lower than the EU / OECD average, mostly due to the services market liberalisation.



Graph 2: De-regulation of key market professions (accountants, architects, engineers, estate agents, lawyers)
Source: OECD, 2019 (author’s graph based on the OECD PMR data)

The OECD data show that most market sectors are open to competition (including professions, energy, transport, telecommunications, post etc.), although monopolies in water and primary health insurance still exist. Furthermore, prices are mostly market-driven, except for legal services and prescription medicines. Croatia is open for free trade, with no internal market tariffs, and reduced administrative barriers to trade. Croatia has fully competitive public procurement, free from nationality-based discrimination, with less administrative requirements and with a digitalised procedure.

Most sectors are free from specific barriers for foreign investors according to the FDI restrictiveness level,⁶⁷ which is below the OECD average, while FDI regulation is stronger in transport and professional services.

66 In civil law (continental) countries of the Central Europe, market regulation tend to be more restrictive in comparison to Nordic and Anglo-Saxon (common law) countries.

67 OECD (2019): FDI restrictiveness <https://data.oecd.org/fdi/fdi-restrictiveness.htm>

The OECD data further recognise the reduced *complexity of regulatory procedures* and improvements in *simplifying licenses and permits*, due to regulatory reforms focused on the measurement and targeted reductions of the administrative burden on the economy.

While access to the market was facilitated, the same OECD report indicates significantly different results in terms of *distortions induced by state involvement*. Regarding this policy area, Croatia is above the EU / OECD average, with high scope of SOEs, but still lower than Lithuania, Poland, Finland and France.

2.6. Competitiveness lowest in the EU, with some improvement in digitalisation

While Croatia has downsized its general business and sectoral market regulations, the World Economic Forum's data show that Croatia has the lowest EU ranking regarding overall competitiveness. The Global Competitiveness Report⁶⁸ shows that Croatia is ranked 63rd in the world, after Romania and Bulgaria and far behind the Czech Republic and the Baltic States.

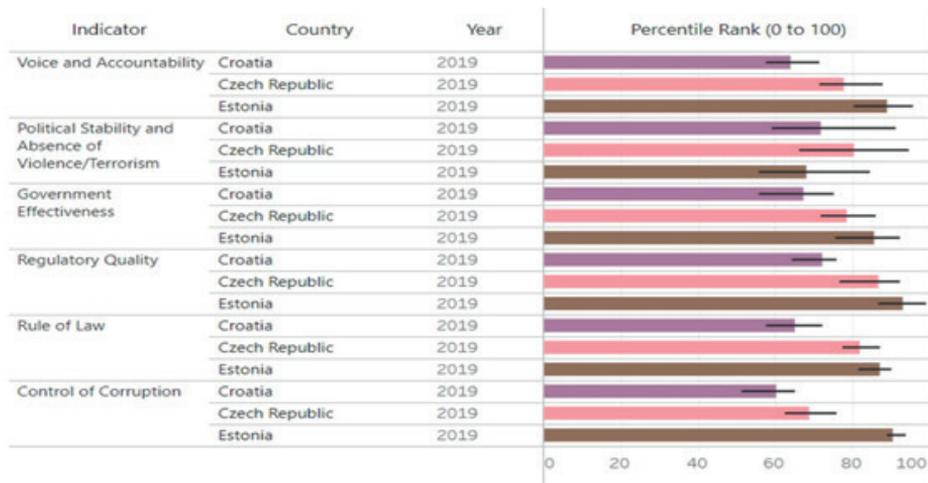
The overall result depends on many indicators of public and private sector performance,⁶⁹ including social capital. The main public sector problems relate to property rights, the judiciary and public administration indicators, high taxes and subsidies, lack of future orientation, labour market inefficiency, and lack of critical thinking in education. Furthermore, the private sectors lags behind in (for example) accepting disruptive ideas, delegating authority, entrepreneurial risk taking, innovation and cluster development.

On the other hand, Croatia has made certain improvements with regard to macro-economic stability and a low inflation rate; reducing the costs of starting a business; active labour market policies; digital skills in education; access to SME financing and venture capital; market capitalisation; reduction of bad loans; growth of innovative enterprises; scientific publications; patent applications; R&D investments; quality of research institutions; increased internet usage and broadband internet; and quality of road infrastructure and electrification.

68 World Economic Forum (2020): The Global Competitiveness Report 2019 http://konkurentnost.hr/wp-content/uploads/2019/10/WEF_TheGlobalCompetitivenessReport2019.pdf

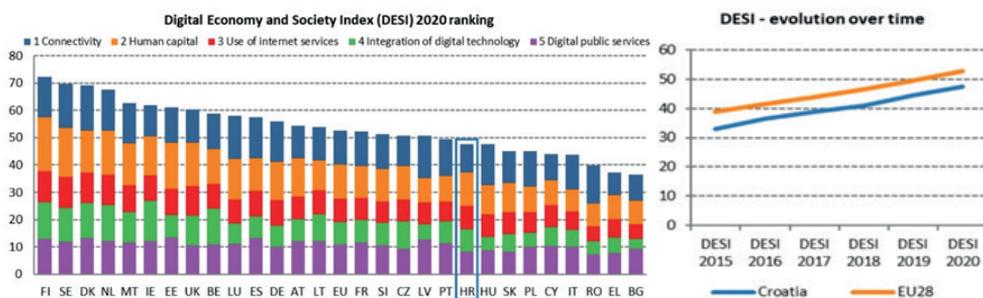
69 Centre for Public Policy and Economic Analysis (2020): Competitiveness depends on holistic public policy management <https://www.cea-policy.hr/konkurentnost-ovisi-o-cjelovitom-upravljanju-javnim-politikama/> For deeper analysis of methodology see also: <https://www.cea-policy.hr/hrvatska-68-prema-konkurentnosti-amerika-prva/>

Low public management is also illustrated by the Worldwide Governance Indicators,⁷⁰ where Croatia is below the Czech Republic and especially Estonia (in terms of governmental accountability, political stability, policy effectiveness, regulatory quality, rule of law and control of corruption).



Graph 3: Public management performance of Croatia (in comparison to the Czech Republic and Estonia)
Source: World Bank (2020): Worldwide Governance Indicators

In 2020 Croatia was ranked 19th in the EU-27 for the level of digitalisation,⁷¹ and better than comparable member states such as Poland, Hungary, Slovak Republic, Romania and Bulgaria, while not very far behind Latvia and the Czech Republic. Croatia is 24th in the EU-27 for digital public services, and 13th in human capital.



Graph 4. Croatia's digitalization score within the EU
Source: European Commission (2020)

70 <http://info.worldbank.org/governance/wgi/#home>

71 Digitalisation is measured by the European Commission's *Digital Economy and Society Index (DESI)* <https://ec.europa.eu/digital-single-market/en/digital-economy-and-society-index-desi>

Regarding the flexibility of labour market regulations, Croatia is 22nd in the EU, or the 5th least flexible.⁷² While certain reform plans mainly target the simplification of distance working,⁷³ the only and partial increase in flexibility happened in 2014.⁷⁴

2.7. Improving democratic capacities for implementing structural reforms

It must be underlined that Croatia's progress in implementing reforms – albeit limited and only in certain areas – has been predominantly motivated by the European integration process, initially through the alignments required for accession, and then by the European Semester.

However, it would be incorrect to conclude that there have only been outside motivations (despite the fact that the EU has become Croatia's internal policy matter). Croatia needed to invest a lot of its political will and administrative capacities to become an EU Member State and create this policy progress, which is beneficial for its overall political and economic performance. Therefore, any populist trivialisation of this complex situation is far from reality, since it undermines the policy process that lies behind it.

However, what would have happened if Croatia had not gone through this European integration process remains a key question. The reason behind the lack of reform orientation lies in the functioning of Croatian political parties. Despite their crucial democratic role in mediating the will of the citizens (people) through specifically oriented and targeted public policy programmes, Croatian parties have mostly avoided initiatives for rigorous structural reforms, which would bring democratically elected politicians face to face with considerable resistance. A procrastination-based comfort zone is therefore more pleasant than a cold shower therapy for a country that still needs to finish its political and economic transition.

72 <https://arhivanalitika.hr/blog/radno-zakonodavstvo-u-hrvatskoj-koliko-je-rigidno/>

73 For example see <https://www.jutarnji.hr/vijesti/hrvatska/promjene-na-pomolu-u-zakon-o-rad-u-uci-ce-i-mogucnost-zaposljavanja-uz-trajni-rad-od-kuce-15022772>

74 Due to the 2014 Labour Law changes, Croatia reduced its *employment protection legislation* (EPL) index from 2.6 to 2.2. Specific increases in flexibility included giving employers' more freedom to determine shortened or prolonged (but still limited) working time; simplified layoffs due to reduced number of protected workers' categories; faster collective dismissal (of at least 20 workers); lower court costs; notice period not limited by annual or paid leave and limited to 6 months even in the case of sick leave. Employers are not obliged to offer workers alternative jobs. Recruitment through temporary employment agencies is simplified by extending the employment opportunities from one to three years.

In addition, Širinić (2019) states that *“weak programmic differentiation is confirmed by the practice of governing coalitions starting their mandates with policy-blind agreements or to present very vague and general policy objectives in coalition manifestos”* and that *“a lack of initial programme differences between party options simply transfers into agenda setting. If parties cannot be distinguished based on policy positions and their coalition agreements do not state clear policy objectives, their attention allocation will not be guided by party preferences but will mostly be a reaction to outside events”*.⁷⁵ This increases the risk of populism, especially if engaging PR support for easy political messages is generally more important for parties than the rational and systematic long-term engagement of political scientists and policy analysts, macro-economists and other experts. Croatian democracy’s policy choice is based on selling general messages rather than transparent and serious policy commitment to long-term improvements. Taking this into account, the implementation of necessary reforms has mostly been initiated by the European Commission, the World Bank and the International Monetary Fund, business and entrepreneurial associations, think tanks and civil associations.

75 Petak, Z. & Kotarski, K. (2019): Policy-making at the European periphery: The Case of Croatia; Palgrave Macmillan.
Daniela Širinić is a Croatian political scientist <https://www.fpzg.unizg.hr/staff/daniela.sirinic>

Concluding remarks

In political science, numerous public policy decisions influence political, economic and broader social outcomes. Many policies are almost forgotten and only a small number of individuals and experts can reach their number and complexity, give them systematic institutional meaning, and understand their importance. It is also common to perceive negative policies with more emotional intensity than positive ones. Therefore, certain policy improvements can be easily trivialised.

Considering the complexity of policies, this article does not try to describe the complete European integration process in Croatia and all the benefits of EU membership. It rather places the focus on describing Croatia's European path in changing its political institutions, which was necessary to be able to align with the EU rules and then realise certain economic liberalisation benefits.

The social mentality in Croatia still tries to live in the significantly disorganised and "relaxed" culture which predominates in the Western Balkans, along with the Mediterranean influence. These cultures usually go against the Central-European influence of the former Austro-Hungarian Empire. Although it would be difficult to expect Croatia to become like the Protestant cultures of Northern Europe (in most cases), Croats (as many as possible) seriously need to learn new norms and rules of organisation if they want to become more competitive (for example, like the Czechs, Estonians, Latvians and Lithuanians).

Despite many factual structural challenges, and despite the exaggeration of these problems, which leads to imprecise public conclusions, this article aims to highlight some hidden reforms and policy improvements, which show the importance of Croatia's EU framework.

Regarding that, the Centre for Public Policy and Economic Analysis (CEA) continues to be the Croatian frontrunner in deep policy analysis, advocating ambitious, measured and methodologically based free market reforms. The project Croatia 2025⁷⁶ aims to provide concrete solutions so that Croatia can transform its generally moderate improvements into more ambitious ones. However, the first step is for everyone to strive to become a better person, since real reforms start from the inside.

76 Centre for Public Policy and Economic Analysis: Project "Hrvatska 2025" <https://www.cea-policy.hr/hrvatska-2025-prosperitetna-uz-mjerljive-strukturne-reforme/>

Although many things still need to be repaired and improved, Croatia has achieved much in geopolitical terms⁷⁷ by becoming an EU Member State (as well as a NATO member). Had it not done so, Croatia would have been left under the significant influence of the authoritarian Russian regime. In this way, Croatia's example can help Serbia and other countries of the Western Balkans and Eastern Partnership on their path towards (more) freedom and the EU (as well as NATO).

Finally, as an EU Member State, Croatia has the chance to be active in combating widespread disinformation.⁷⁸ This affects many of our European policies and even national security with the NATO alliance. Whenever populists use disinformation to relativise core liberal values and trivialise Western democratic institutions, many people are at risk of losing immunity to the blurring smoothies of fake information and delusions, relativised facts and demagoguery. When irresponsible and irrational people try to create hybrid lines of political division by imposing ideological extremes, it is the duty of liberal-democratic political forces to restore the old liberal international order based on the rule of law, individual liberty, differences in fact-based policies and strong transatlantic ties.⁷⁹

77 <https://talas.rs/2020/10/21/geopolitika-ekonske-slobode/>

78 <https://talas.rs/2020/06/09/dezinformacije-se-najbolje-sire-kroz-populizam/>

79 <https://www.gmfus.org/topic/future-liberal-international-order>

Author

Daniel Hinšt completed his Advanced Master of European Studies and graduated in Political Science with specialisation in public policy and public management, as well as international relations and diplomacy, at the University of Zagreb, Croatia. Daniel is Vice President of the Centre for Public Policy and Economic Analysis (CEA), a Croatian think-tank based in Zagreb, focused on researching economic and national security policy, designing methodologically based policy solutions for institutional and market reforms, and also on detecting disinformation risks against individual liberty and EU / NATO institutions.



