

BTI 2010 | Croatia Country Report

Status Index	1-10	8.30	# 15 of 128	
Democracy	1-10	8.50	# 15 of 128	➔
Market Economy	1-10	8.11	# 15 of 128	➔
Management Index	1-10	6.61	# 17 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	4.4	HDI	0.87	GDP p.c.	\$	18308
Pop. growth	% p.a.	-0.1	HDI rank of 182	45	Gini Index		29.0
Life expectancy	years	76	UN Education Index	0.92	Poverty ²	%	<2
Urban population	%	57.0	Gender equality ¹	0.62	Aid per capita	\$	36.9

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

Executive Summary

Three events have dominated Croatia's foreign policy over the last two years: the country's formal invitation to join NATO, Croatia's election to the U.N. Security Council as a temporary member and the concluding phase of EU accession negotiations, expected to be completed by the end of 2009. Regional policy has been dominated by Croatia's recognition of the independence of Kosovo and the resulting brief deterioration in political relations with Serbia. Political disputes with Slovenia over maritime borders have not been resolved; the countries' governments have established a joint expert committee to formulate a proposal on how to resolve the dispute before an international court. But in October 2008, Slovenia de facto vetoed talks over Croatia's possible accession to the European Union. In doing so, Slovenia claimed that Croatian documents prejudice the border between two states, especially in coastal waters.

At the national level, the most important event was the 2007 parliamentary elections. The elections confirmed the incumbent party, the Croatian Democratic Union (HDZ) of Prime Minister Ivo Sanader, return to office. The HDZ formed a coalition with the Croatian Peasant Party, the Social Liberal Party and the parties of the national minorities. Macroeconomic stability has been maintained through government economic policy and the monetary policy of the Croatian National Bank (HNB). Although Croatian banks have not defaulted, unlike in other countries in 2008, and a financial crisis has so far been avoided, in 2008 the country's rate of GDP growth decreased while the rate of inflation and foreign debt increased, resulting in a policy of fiscal frugality for 2009. Privatization of companies has continued.

National politics have been dominated by anticorruption campaigns in government institutions, universities, the national healthcare system and local governments. Organized crime has become more active, and organized "street hits" have been witnessed. Also, youth and sporting event violence has been on the rise. The government has responded by enacting "anti-mafia" laws and measures and by establishing new law-enforcement agencies to enable the institutions of the

state to deal more efficiently with violence and crime. This process led to the first reorganization of the government in November 2008. Under the onslaught of organized crime and public opinion pressures, the prime minister was forced to sack his ministers of internal affairs and justice, both HDZ party members, on grounds of incompetence.

History and Characteristics of Transformation

The first stage of Croatia's transformation began in 1990 with the country's first free parliamentary elections, and ended in 2000 following the election losses of the Croatian Democratic Union (HDZ), a party that had enjoyed a decade of absolute power. This period was marked by a number of events, including a prolonged struggle for state independence, a civil and international war to defend the territorial integrity of the newly created state, the adoption of a new constitution, the establishment of democratic political institutions and the privatization of the economy. The transition of Croatia into an independent state held precedence over the country's political and economic transformation until the complete military (1995) and peaceful (1998) reintegration of Croatian territory after the end of the war. This ordering of priorities affected the transformation process, in that the country's political development was stymied as it transformed itself from a communist regime to a somewhat illiberal or "defective" democracy, in which competitive elections were held and elementary civil liberties and rights were respected. Not all civil rights and liberties were fully protected, however, in particular the rights of minorities and the freedom of the press were curbed, and the central government did not effectively control the entire territory of the state. The "defectiveness" of Croatia's democracy was reinforced by a semi-presidential system that enabled the president to concentrate in his office enormous political power, taking on the appearance of a quasi-republican monarchy. The country's economic transformation was uncontrolled and not transparent (the so-called tycoonization of the economy) and, consequently, many companies went out of business, unemployment skyrocketed and poverty spread, leaving Croatia developmentally behind other transitional countries of Central Europe. This led to an escalation of nepotism, clientelism and corruption. In Freedom House reports, Croatia was classified in the category of partly free countries until 2001.

The second phase of Croatia's development began with the defeat of the HDZ in the parliamentary and presidential elections of 2000, a watershed moment in the political and economic development of the country. The new center-left coalition government, led by Prime Minister Iвица Račan of the Social Democratic Party (SDP) and President Stjepan Mesić, who had won as a candidate of the former opposition Croatian People's Party (HNS), achieved three major goals in a very short time. First, they rescued Croatia from the international isolation in which it had found itself as a result of the policies of the HDZ-led government towards Bosnia and Herzegovina during the war. The government failed to fully cooperate with the International

Criminal Tribunal in The Hague over the issue of war crimes committed in the former Yugoslavia. The country's inadequate protections of minority rights and civil rights in addition to the authoritarian political style of President Franjo Tudjman led to further condemnation by the world community. Between 2000 and 2004, Croatia became a member of the WTO, signed the Central European Free Trade Agreement (CEFTA), joined NATO's Partnership for Peace, signed the Agreement on Stabilization and EU Accession and became a candidate for full European Union membership. Also, the new government pushed through a constitutional reform to replace the country's semi-presidential system with a parliamentary system, which has proved to be a more fitting institutional arrangement for the further development and consolidation of democracy in Croatia. The government too worked to ensure that all basic civil rights and freedoms were effectively protected, including full freedom of the press. In its 2002 report, Freedom House for the first time included Croatia in the group of free countries. During this time, negative economic trends were also reversed. While the country's annual rate of GDP growth in 1999 was -0.9%, in the following years it improved, rising to 2.9% in 2000, 4.4% in 2001, 5.6% in 2002 and 5.3% in 2003. Major infrastructure projects were launched and partly completed, including highway construction and railway modernization. Meanwhile programs helped to stimulate the housing market, consolidate the banking system, reduce enormous internal debts and unemployment and improve the nominal and real indicators of living standards. Nevertheless, the new coalition government did not fulfill one of its major electoral promises, which was to enact a sweeping revision of privatization practices that had devastated the national economy, created vast social inequalities and profoundly shocked citizens coping with the perception of widespread social injustice and insecurity. This was the main reason for the government's defeat in the parliamentary elections in 2003.

Upon its return to power, the ideologically reformed HDZ with its new political leader, Ivo Sanader, toed the foreign policy line of the former center-left government. The HDZ government extradited to the Hague Tribunal all indicted Croatian war criminals, including the fugitive General Ante Gotovina, and thus removed the obstacles for EU accession negotiations. It continued its friendly policy towards Bosnia and Herzegovina. The treatment of Croatia's ethnic minorities became much more tolerant, and the Independent Serbian Democratic Party (SDSS), the chief political representative of the Croatian Serbs, joined the parliamentary coalition supporting the HDZ minority government in 2003-2007. The country's macroeconomic stability and positive economic trends were reflected in the Croatian kuna's fixed exchange rate, low inflation rates, a positive rate of annual GDP growth, a reduced budget deficit and lower unemployment among other positive economic indicators. However, neither the center-left government of 2000-2003 nor the center-right government of 2003-2007 was able to enact radical reforms of the judiciary or government administration, or curb organized crime and corruption.

Transformation Status

I. Democracy

The consolidation of democracy in Croatia has continued. There have been six cycles of parliamentary elections (1990, 1992, 1995, 2000, 2003 and 2007), three alternations of the parties in power (1990, 2000 and 2003), and four cycles of direct presidential elections (1992, 1997, 2000 and 2005) which have consolidated the major political institutions. The political elite as well as a majority of citizens have adopted democratic political values. All citizens, including members of ethnic minorities, are integrated into the political system. The deficits in the country's democratic system are most evident in the judiciary, public administration and political culture.

1 | Stateness

After the reintegration of territory in 1998, the central government was able to effectively consolidate control of the entire country. However, organized crime groups challenged state authority through the murders of several journalists and the daughter of the lawyer who represented Vladimir Zagorec. Zagorec, a retired Croatian army general, had been charged in the 1990s with embezzling public funds and war profiteering. The government, the opposition and the general public interpreted these murders as a message by crime syndicates that they wanted to establish a sort of veto actor role to deter legitimate state institutions, such as the police, the General Attorney's Office and the courts, or even other public institutions such as the media and journalists, from looking into their activities or jeopardize their interests. The resolution of the "Zagorec affair" might seriously endanger the interests of organized crime, censure its methods and ventures and potentially disclose its connections with the government establishment during the 1990s.

Monopoly on the use of force

All citizens enjoy the same civil rights and are integrated into the political system. The country's minority ethnic communities have eight representatives in the Croatian parliament (Hrvatski Sabor) who are elected by special electoral rules in special electoral districts. Serbian citizens are represented in parliament and in the government. Within the SDP parliamentary group, there are a number of prominent delegates of Serbian nationality. The SDP is a key advocate of the idea that members of all of Croatia's national minorities should be entitled to a double vote

State identity

in parliamentary elections, which would enable them to both retain a separate political identity and be integrated into Croatia's mainstream political life. They are legally guaranteed proportional representation in local and regional authorities, which means that Serbs govern in the municipalities in which they make up the majority of the population. Serbian political parties have entered into electoral and post-electoral coalitions with Croatian parties in a number of municipalities. The Serbs in Croatia have established their own political parties, NGOs and cultural societies, as well as publish Serbian magazines and books. In ethnically mixed regions, there are schools that offer classes taught in Serbian, covering topics from Serbian national history.

The main governing party, the HDZ, considers ethnic Croat citizens of Bosnia and Herzegovina who also possess Croatian citizenship as eligible to vote in parliamentary elections. In contrast, the main opposition party, the SDP, wants to restrict voting rights to those citizens who reside in Croatia.

The state has preserved its secular character despite efforts by the influential Catholic Church to impose legal guidance more in line with religious norms and values. In 2008, the parliament adopted a liberal antidiscrimination law that establishes stiff penalties for discrimination based on gender identity or sexual orientation. The Catholic Church declared that this law represented a "legalization of homosexuality" and appealed to Catholic representatives in parliament to vote against it. Parliament also passed a decree (within the trade law) on business hours, which does not include a ban on work on Sundays (seen as a holy day), although the Church has demanded such a ban for years. The government has also ignored the Catholic Church's campaign for a ban on abortion.

No interference of religious dogmas

The state's administrative structure takes on different forms throughout the country.

Basic administration

2 | Political Participation

The major national political institutions, the parliament and the president, are elected in general and direct elections. In 2008, the parliament passed a law that declared from 2009 onward, mayors, deputy mayors and county prefects (župani) would also be elected in general and direct elections. All international and Croatian organizations affirmed that the sixth parliamentary elections held on 25 November 2007 were free, democratic and fair.

Free and fair elections

Elected rulers have the effective power to govern.

Effective power to govern

The freedom of association and assembly is guaranteed. In the past two years, there has been an upsurge in the activities of civil society associations to combat gender, family and youth violence, and to help fight against discrimination based on sexual orientation or minority status.

Association / assembly rights

The media are generally free, although some are clearly partial to the government. The low-circulation daily *Vjesnik*, which is state-owned and financed from the government budget, is the government's mouthpiece. The government's sway is also evident on public Croatian television, as the appointment in 2007 of an editor-in-chief affiliated with former President Franjo Tudjman's HDZ party indicated. Before the 2007 elections, the largest private newspaper publisher in the country and in the region, Europapress Holding (EPH), demonstrated in its political editorials a clear bias in favor of the ruling party. Observers believe this was the publisher's reward for the government's decision to reduce the VAT for newspapers from 22% to 10% less than two months before the elections.

Freedom of expression

There have been several vicious attacks on business people, public officials and journalists who have publicly denounced the activities of organized crime and its collusion with state and public institutions. A few of these attacks were "street liquidations" in downtown Zagreb. In October 2008, two journalists from Croatian political weekly *the Nacional* were killed by a car bomb.

3 | Rule of Law

In principle the government is strictly divided into the legislative, the executive and the judicial branches. Nevertheless, the judiciary is not viewed as entirely independent from politics. The parliament sought to hold the government accountable when deputies initiated a vote of no confidence following the involvement of heads of the Croatian Privatization Fund in a corruption scandal. However, parliament has not established an investigative committee to examine governmental actions.

Separation of powers

Except for the presidents of the Supreme Court and Constitutional Court, court presidents by early 2009 were appointed and dismissed by the justice minister, leaving a wide margin of discretion to the executive. The State Judicial Council has been criticized for being a politicized and insufficiently competent body and responsible for the "lustration" of judges in 1992, when a number of politically unsuitable judges were replaced by politically suitable ones, who have been blamed for the courts' inadequacy and inefficiency.

Independent judiciary

Suspensions of the judiciary's political dependence have been fueled by the case of Branimir Glavaš, a onetime prominent member of the HDZ and the "wartime governor" in the 1990s of Croatia's region of Slavonia, who was accused of war crimes that were committed in 1991 against Serbian civilians in Slavonian capital Osijek and who has been tried at the county court in Zagreb. The trial, however, has been adjourned on several occasions by both the defendant and his counsels; in late 2008, the entire process as a result had to start again. The public has gained the impression that this obstruction of justice was somehow supported by certain legal, security and political bodies.

Croatia's justice system in 2008 successfully brought to an end a trial against two retired army generals charged with war crimes; one of the generals was sentenced to several years in prison. Also, curiously, in October 2008 the municipal court in Zagreb fined Croatian President Stjepan Mesić €10,000 on charges of verbal slander injurious to the reputation and dignity of a foreign lawyer. Croatian citizens perceive the judiciary to be among the nation's most corrupt elements, but judges are rarely punished for nepotism or corruption.

The enduring problem of Croatian society and its political system is a relatively intricate network of nepotism and corruption stemming from the 1990s, a web that has yet to be torn apart. Organized crime is a huge problem that infiltrated public institutions during the war of 1991-1995 as a consequence of an illegal arms trade, established after the United Nations imposed an embargo on weapons imports, which were deemed essential for Croatia's defense from external military aggression. This collusion between criminal elements and certain economic, political and social circles was simply reorganized after the war, and many former criminals have found their way into legal businesses, laundered money and become "visible," that is, wealthy and eminent members of society. As one example, parliamentary immunity rules were abused to prevent Branimir Glavaš, a parliamentary deputy accused of war crimes, from prosecution.

Prosecution of
office abuse

The Council of Europe and the OECD- and EU-sponsored Sigma project criticized that Croatia's law on conflict of interest excludes public officeholders only for six months from employment in the private sector in the field of their public responsibility. The Commission for the Resolution of Conflict of Interest should supervise parliamentary deputies and other public officeholders, but it lacks the power and resources needed to effectively sanction rules violations.

Citizens, institutions and organizations try to protect their rights and the constitutionality of the political and social order at the Constitutional Court, which received 4,174 complaints in 2007 and 5,768 in 2008 concerning a whole spectrum of human rights violations, rights that are guaranteed by the Constitution of the Republic of Croatia. According to the European Commission's monitoring report on Croatia, many war crimes remain "unprosecuted, especially those where the victims are of a minority ethnicity (Serbs)...often due to a combination of a lack of evidence, unwillingness of witnesses to come forward, e.g., due to intimidation, and unwillingness or reluctance of police and prosecutors."

Civil rights

In July 2008, parliament adopted an antidiscrimination law. However, persons belonging to the ethnic Serbian minority are still subject to labor market discrimination, and the European Commission noted in its 2008 progress report that "there has been limited reaction of the authorities to various expressions of an extreme nationalist character which could be considered as incitement to national and religious hatred." For example, Marko Perković (with the band Thompson), a

nationalist and right-wing extremist folk singer, enjoys broad popularity. Croatian police did nothing to prevent fans from displaying the symbols of and their sympathy with the country's short-lived fascist regime, led by the Ustasha Croatian Revolutionary Movement, from 1941-1945.

Two major soccer clubs, Dinamo and Hajduk, have well-organized, partly militant fan bases that use matches as an excuse to engage in verbal or physical violence. Together with other groups, they forge a solid "fan front" when supporting the Croatian national team. These groups regularly wreak havoc at home and abroad, demonstrating a sort of Croatian jingoism by getting into brawls with the supporters of rivals teams and often demolishing the neighborhoods they stay in. These actions prompted parliament to adopt a special law against fan violence, modeled after the British law aimed at eradicating football hooliganism in the U.K. The law outlines rules of behavior at sporting events and punishment for those who do not obey its provisions.

4 | Stability of Democratic Institutions

Democratic institutions are generally stable and functional. Occasionally there have been disputes about the overlap of presidential and cabinet powers in the sphere of foreign affairs. The relatively broad competences of the president regarding foreign, defense and security policies are remnants of the former semi-presidential system and have survived intact, as the parliamentary majority and president were not able to reach consensus during the 2000 constitutional reform over the full transition of the political system to a parliamentary system and the establishment of a "pure" parliamentary democracy.

The least functional segments of the political system are the judiciary and the public administration. Out of 40 European states, Croatia has the largest number of judges per 100,000 citizens, yet is 15th in terms of judiciary budget per capita and claims among other countries the biggest number of first-instance courts per million people. However, the country is not high on the list in terms of the number of civil and criminal proceedings initiated and the number of cases resolved. Overall, the Croatian judiciary suffers from chronic problems in the provision of effective legal protection. Another element that functions poorly and is uneconomical is the territorial-administrative division of the country into a large number of small municipalities (425), towns (125) and counties (21), for a country of just 4.4 million people.

All relevant political and social players accept democratic institutions as legitimate.

Performance of
democratic
institutions

Commitment to
democratic
institutions

5 | Political and Social Integration

After the 2000 parliamentary elections, the moderately pluralist party system consolidated. The effective number of parliamentary parties has ranged from 4.5 in 2000, to 3.8 in 2003 and to 3.1 in 2007. In the last parliamentary elections in November 2007, in which 63.4% of citizens voted, there was a more marked bipolarization of the electorate and the party system, and the two biggest parties, the HDZ and the SDP, gained about 67% of the votes and 80% of the mandates. These elections brought about a comprehensive change of the composition of the political elite, with as many as 57.5% of delegates entering parliament for the first time, 26.1% of delegates returning for a second time and 11.1% for a third mandate. Only one delegate remained from the country's first parliament seating of 1990, two from the second election of 1992, and five delegates from the third parliament of 1995. Women comprise 21.6% of parliamentary representatives. The personalization and the informal presidentialization of politics have continued within the parties, in elections and in the executive branch of the government.

Party system

The system of functional representation of interest groups has also stabilized. More than 60% of employees are unionized under the Croatian Employers' Association (HUP). Representatives of the government, trade unions and employers are members of the Socioeconomic Council, in which they negotiate over labor and social legislation. The public perception is that trade unions do not sufficiently protect workers' labor and social rights, citing incompetent union leadership and bureaucracy, organizational and personal rivalries that prevent more fruitful joint action and union leaders' party biases.

Interest groups

According to a Eurobarometer survey conducted in November/December 2008, 20% of citizens polled expressed trust in the government. According to empirical research on political attitudes of Croatian citizens before the October 2007 parliamentary elections, 49.6% expressed their satisfaction with Croatian democracy and about 50% of those polled expressed the opinion that democracy is the best solution for the country in general. The broad acceptance of democratic values is, however, shallow insofar as many Croats lack awareness of or tend to gloss over crimes committed by the fascist Croatian state that existed between 1941 and 1945. For instance, an Internet survey conducted by the Croatian daily Jutarnji List found that approximately 25% of survey participants considered the members of the Ustasha movement during World War II "freedom fighters," and comparable to the Croatian "homeland defenders" of 1991.

Consent to democratic norms

The effectiveness of political and social institutions is hampered by poor social capital. In the second half of the 1990s, the level of social trust in Croatia was almost equal to the average in other post-communist countries; after 2000 it had fallen almost twice as low. It is possible that during the war and in the early postwar

Associational activities

period, networks of mutual trust were created which then later disintegrated. Social capital is unevenly distributed, and is the highest among citizens who are better educated, those who are employed, with pupils and students and in the economically most-developed areas.

II. Market Economy

6 | Level of Socioeconomic Development

A higher level of socioeconomic development has resulted from lower unemployment and the payment of the state's debt to pensioners. High structural unemployment was for years the country's main social problem, with an unemployment rate of 16.1% in 2000 that eventually dropped to 9.6% in 2007. There are more unemployed women than men, more elderly than younger people, more people with an elementary or high-school education than those with college degrees, and more unemployed workers from now-defunct industries. Large regional differences in employment and income exist; some regions and large urban areas (such as Zagreb, Istria and the Croatian Littoral region with the coastal port town of Rijeka) are by a significant factor more developed than other areas (such as Lika and parts of Dalmatia and Slavonia).

Socioeconomic
barriers

The government has launched the financially demanding project of paying its debt to pensioners. In 1998, the Constitutional Court ruled that the state had to pay funds to 463,000 retirees, as it had not honored regulations regarding the adjustment of retirement benefits to match a rise in pay in the 1990s. Between 2006 and 2013, the state will have to pay out about HRK 11 billion (about €1.6 billion). From June 2006 to June 2008, the state returned about HRK 4.8 billion (about €700 million) in five installments; the money was raised by short-term loans and by selling state shares in major Croatian companies. This has somewhat improved the circumstances of this socially disenfranchised group of retired citizens. The government has also launched a grassroots shareholding plan, so about 350,000 small shareholders were able to take part in the second phase of privatization of Industrija Nafta (INA), an energy conglomerate, and the third phase of privatization of Croatian telecom HT, as part of the push for a so-called people's capitalism in Croatia.

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	40713.2	44431.8	49037.9	58558.2
Growth of GDP	%	4.2	4.2	4.7	5.5
Inflation (CPI)	%	2.0	3.3	3.2	2.9
Unemployment	%	13.8	12.7	11.1	9.6
Foreign direct investment	% of GDP	2.6	4.0	7.0	8.4
Export growth	%	5.4	3.7	6.5	4.3
Import growth	%	4.7	3.9	7.4	6.5
Current account balance	\$ mn.	-1874.6	-2555.0	-3310.7	-4445.5
Public debt	\$ mn.	11654.3	10035.3	11109.0	14211.5
External debt	\$ mn.	32968.4	30640.8	38355.3	48583.6
Total debt service	% of GNI	13.2	12.5	16.5	15.9
Cash surplus or deficit	% of GDP	-3.4	-2.4	-1.6	-1.1
Tax Revenue	% of GDP	20.3	20.2	20.4	20.4
Government consumption	% of GDP	19.2	18.8	18.5	18.5
Public expnd. on edu.	% of GDP	4.5	4.9	4.9	4.6
Public expnd. on health	% of GDP	6.2	6.1	7.1	-
R&D expenditure	% of GDP	1.2	1.0	0.9	0.9
Military expenditure	% of GDP	1.7	1.6	1.7	1.6

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

7 | Organization of the Market and Competition

Croatia's market economy is based on the principles of business competition, the free flow of capital, goods and labor and entrepreneurs' free disposal of profits. The Croatian Privatization Fund (HFP) has the right to impose certain restrictions in the sale of state-owned companies or company shares to private entrepreneurs by requiring that the new employers formally and contractually guarantee to retain all workers for several years and to capitalize and develop the existing production. To speed up the liberalization of the Croatian economy, the government has announced

Market-based
competition

that these requirements are to be revoked in 2009; however, this decision has been strongly opposed by trade unions.

The Croatian Competition Agency (AZTN) supervises the market share of large corporations to prevent monopoly activity. The Croatian Agency for Supervision of Financial Services (HANFA) controls financial transactions on the Croatian market.

Anti-monopoly policy

Foreign trade has been liberalized and remaining restrictions are either being removed or reduced, such as in the agriculture sector, as part of Croatia's negotiations over EU accession.

Liberalization of foreign trade

Following the turbulent 1990s, the Croatian banking system has now consolidated and stabilized. Between 80% and 90% of banks in Croatia are foreign-owned. During the global banking and financial crisis of 2008, no Croatian bank defaulted nor was it necessary for the government to enact special measures to save banks. To prevent panic among depositors, the government increased the state guarantee on deposits from HRK 100,000 (about €15,000) to HRK 400,000 (more than €50,000).

Banking system

8 | Currency and Price Stability

In 2008, a long period of low inflation ended. The annual rate of inflation over the last eight years ranged from a high of 4.8% in 2000 to a low of 1.7% in 2002; the average for the period was 2.9%. However, in 2008 inflation increased at an annual rate of about 6%. This increase was a result of higher prices for energy, food, utility and health services and industrial products.

Anti-inflation / forex policy

Foreign debt has increased; at the end of 2007 it totaled almost €33 billion, rising to €38 billion at the end of 2008. Public debt (including general government debt and issued government guarantees) in the same period amounted to 44.3% of GDP, 2.4 percentage points lower than in the previous year. Generally, while total foreign debt has steadily increased, almost tripling since 2000, the share of public debt in GDP decreased by 4.4 percentage points between 2000 and the end of 2007. The Croatian kuna remained stable, and the average absolute fluctuation of the exchange rate to the euro was a mere 0.07%. As exchange rate fluctuations have stabilized inflationary projections and the price of imported goods from the euro zone, the Croatian National Bank (HNB) has continued to pursue a stable exchange rate for the national currency. The HNB has proved to be an independent and successful institution, and the bank and its governor enjoy a high level of trust from the public.

Macrostability

9 | Private Property

The right to private property is constitutionally guaranteed, and a broad legal framework to enable the development and functioning of the private industrial sector has been created. The state has not yet returned to companies or citizens all property that was confiscated or nationalized during the communist period after 1945. Among those seeking the return of property (such as apartments, buildings, land, hotels and factories), are Croatian citizens as well as people who emigrated from Croatia (when it was part of the former Yugoslavia) after World War II and have since lived abroad. The Catholic Church, which before the war was the owner of much valuable real estate, also wants its property returned, as does the Orthodox Church in Croatia. The state has been trying to solve this quandary through means of natural restitution, donating state-owned stocks and shares and direct financial compensation, among other efforts.

Property rights

The country's largest pharmaceutical company (PILVA), its largest oil producer (INA) and its largest telecom (HT) have been privatized, along with a number of companies in food processing, tourism, textiles and other industries. The privatization of the entire shipbuilding industry, totaling six Croatian shipyards, is under way. The share of the private sector in GDP is about 72%; in 1991 it was only 25%, and in 1998 about 55%. Although the privatization process has proceeded apace, it has not been completely transparent or successful. The biggest problems have been associated with the activities of the Croatian Privatization Fond (HFP) as a state agency. In 2007, law enforcement agencies acting on the directives of a sweeping anticorruption campaign called "Maestro" raided the HFP; several of its employees were taken into custody, including its three CEOs. However, other members of the supervisory board, including a few ministers and the government's vice-president for the economy, escaped prosecution.

Private enterprise

10 | Welfare Regime

Because of former socialist policies (the right to work with lifetime job security, the right to socially funded housing, free education, free or affordable medical services, early retirement and so on), citizens are very critical of the existing welfare regime as they still widely consider the state a universal "social guardian," responsible for providing jobs, housing, education, medical treatment and other basic needs. Although dissatisfaction with the welfare system is widespread, the data show that the state has constantly increased welfare benefits. Funds allocated for welfare benefits are the single largest item in the state budget, and its share has increased from 5.6% in 2006 to 8.7% in 2007. Retirement, medical benefits and various welfare benefits, such as maternity leave and veteran benefits, represent the largest percentage of these funds. Unemployment, maternity leave, disability and other

Social safety nets

benefits have increased. The system has been sustained by lower unemployment, yet it has been stymied by the steady growth of the number of pensioners, the consequence of an aging population. In Croatia, demographic trends are remarkably negative. The country's fertility rate from 2000-2005 was an average of 1.3 children per woman, and the annual population growth rate from 1975-2005 was only 0.2%. Also disquieting is the age distribution of the population: in 2007 about 18% of the population was older than 65 years, a higher percentage than in most of Central and Eastern Europe. These issues are already causing economic problems, and a strategy of how to cope with a dwindling domestic work force is being outlined.

The sensibility for the rights of minority groups and general antidiscrimination policies has increased over recent years. However, there is evidence that certain minority groups still lack equal opportunity, especially in the labor market. Women are on average paid less and have a lower employment rate than men. Members of the Serbian minority face obstacles to employment both in the private sector and within state administration.

Equal opportunity

11 | Economic Performance

The country's general macroeconomic indicators have been good for a number of years. Since 2000, annual GDP growth rates were positive (in 2007 GDP increased by 5.6%, yet in 2008 it fell to about 3%). The country's GDP per capita almost doubled between 1999 (€4,100) and 2007 (€8,452). Unemployment fell from 16.1% in 2000 to 9.6% in 2007. The currency exchange rate for the kuna has been very stable, and inflation rates low. In 2007 the deficit was reduced to 2.3% of GDP. The official deficit projection for 2009 is about 1%. At the end of 2007, gross international reserves were €9.3 billion. The most unfavorable macroeconomic indicator is the country's high foreign debt; in 2007, this debt totaled almost €33 billion or 87.8% of GDP and in 2008, foreign debt totaled €38.3 billion or 93% of GDP. Also considerable is internal debt, affecting the solvency of a number of businesses, especially small and mid-sized businesses. The country's trade balance is negative, as imports exceed exports, despite the constant increase of income from tourism, which is the country's most significant export industry at about 22% of domestic GDP. Croatia's industrial productivity and general competitiveness are also in need of improvement.

Output strength

12 | Sustainability

Recently there has been a growing awareness among citizens as well as legislators of the necessity for increased environmental protection, which had been neglected for many years in favor of other more pressing economic, political and social problems. The most significant environmental campaign was the failed

Environmental policy

implementation of a protected ecological-fishing belt (ZERP) on the Croatian side of the Adriatic Sea. ZERP was adopted in 2003, but with a one-year moratorium. In June 2004 an amendment postponed its application to EU countries. In December 2005, a decision was made to apply ZERP to all countries from 1 January 2008. However, Croatia postponed its implementation once again following ultimatums by Italy and Slovenia that they would block Croatia's negotiations over EU accession. Slovenia claims that ZERP implementation prejudices the contentious Slovenian-Croatian maritime border, while Italy was primarily motivated by economic interests, as many Italian fishermen fish in Croatian waters. The suspension of ZERP provoked a public outcry in Croatia, particularly among the fishermen in the coastal regions and on the islands.

Environmental associations and private citizens have launched many campaigns to address the number of allegedly environmentally harmful, already completed or upcoming industrial projects (a stone wool factory in Istria, an oil refinery in Sisak and a number of waste disposal plants) or have threatened to launch new campaigns if decisions are made to go forward with stated plans (the liquefied gas storehouse on the island of Krk and an international pipeline to the island). Croatians have become especially sensitive to the devastation of the Adriatic coast through illegal, and legal, land development, which has spoiled the natural beauty and the traditional architecture of the area. Croatia has signed and ratified all major international agreements on environmental protections. Activities of certain environmental groups and organizations can be categorized as "ecological populism."

The motto of the country's educational policy is "to create a society of knowledge." According to the IMF, Croatia in 2005 spent around 5.6% of its GDP on education. Public expenditure for education has increased. The literacy rate among people over 15 years old is 98.1%, and among those under 15 it is 99.6%. New elementary and high schools are being built, as well as new universities and campuses. A few private high schools and colleges have been opened. Since 2005, all universities have implemented the Bologna process, although some faculties lack adequate space, staff, and equipment necessary for modern teaching and research.

Education policy /
R&D

Transformation Management

I. Level of Difficulty

The political and economic transformation of the country has been thwarted by an unreformed legal and administrative system, the slow evolution of social capital, a democratic political culture and civil society in addition to the far-reaching social consequences of privatization in the 1990s, which inspired a pervasive public perception of the market economy and capitalism in general as an unjust and “wild” social system.

Structural
constraints

Croatia inherited a weak tradition of civil society from the communist period. The concept of social self-management, normally aimed at strengthening society at the expense of the state, in practice meant that the party state permeated all spheres of civil society. The League of Communists had its organizations everywhere; in companies, schools, universities, hospitals, local communities and writers’ unions. Croatia has since established the National Foundation for Civil Society Development. A large portion of the association is either fully or partly financed from the state budget, and other funds are obtained through international projects, foundations or donations.

Civil society
traditions

Reinforced minority rights and the pursuit of increasingly prudent politics have eased ethnic tensions since 2000. However, ethnically based discrimination persists, and returning ethnic Serbian refugees still face hostility from the populace, particularly in former war areas. Some media outlets continue to foster negative stereotypes of national minorities.

Conflict intensity

II. Management Performance

14 | Steering Capability

After the parliamentary elections of 25 November 2007, the HDZ formed a coalition government with the Croatian Peasant Party, the Croatian Social Liberal Party and the eight parliamentary representatives of ethnic minorities. The governing coalition is led by Prime Minister Ivo Sanader and has a narrow majority in parliament. The political leadership has doggedly pursued its political priorities, primarily in the sphere of foreign policy. It is highly committed to EU and NATO membership, and its national politics are shaped around the requirements and guidelines from these two organizations. This implies the pursuit of comprehensive and rapid reforms of the political and economic system. The most difficult reform has been that of the judiciary and public administration. The judiciary is not competent, independent or efficient enough, while public administration is not rationally structured or organized. What's more, there have been no major personnel replacements among the ranks of the older administrative elite. At the national level, the government primarily focuses (rather successfully) on the preservation of the country's macroeconomic stability, despite the aftershocks of the 2008 global financial crisis.

Prioritization

Political elites in many respects still follow a traditional concept of politics. For them, it is important to establish an overall political agenda from which the government can derive measures to help guide certain realms of social life. In other words, politicians have not fully appreciated the need to think comprehensively and act in a timely manner when formulating and implementing public policies (on taxes, education, scientific research, health care, welfare and so on), which can profoundly affect a government's performance as well as the outcome of policies in general. This is an example of the political elite's inadequate political education and low level of professionalization; many politicians are still largely "general practitioners" of politics.

Implementation

The habits and mindset of the political elite are still mostly traditional, and many politicians are unwilling or even incapable of learning and acquiring new or relevant knowledge. The differences among typical "party cadres" representing the older school of politicians and experts that represent the new governing elite were dramatically illustrated by the "mobster affair" in October 2008. Under an onslaught of organized crime, the prime minister was forced to sacrifice his party's ministers of internal affairs and justice, plus the top echelons of the police force, to

Policy learning

make room for experts competent enough to cross swords with organized crime and solve the mafia murders.

15 | Resource Efficiency

The government has no comprehensive strategy on economic development. Agriculture and tourism are allegedly the country's strategic industries, but investments, taxes, the country's demographics and other policies sometimes contradict this. Tourism and government policy are somewhat more in concert than the agriculture sector and its related official policies. Tourism was boosted by the construction of a broad network of highways linking continental Croatia, Central and Western Europe with the Adriatic coast, a project generally considered one of the most laudable achievements of Croatia's developmental policy since independence. The government has also lowered VAT for tourist services from 22% to 10%. In 2007, the Croatian Peasants' Party (HSS) joined the coalition government with the hope of creating a well-articulated and "more offensive" agrarian policy, particularly at the time of a global food crisis. Recently there has been more focus on the development of a knowledge industry with more investment in education and science, yet those investments have not yet reached satisfactory levels.

Efficient use of assets

Since 2000, Croatia has had coalition governments: an oversized coalition government (2000-2003), a minority coalition government (2003-2007) and a majority coalition government (since 2007). The minor coalition partners in the HDZ government after the 2007 parliamentary elections obviously play second fiddle to the ruling party, a complaint voiced on several occasions by ministers and leaders of these parties. They also complain that the prime minister has not consulted them on many major issues. Obviously, there is a sort of prime-ministerial parliamentarism at work here, a system in which the prime minister makes decisions in consultation with a very tight circle of close aides within and outside the government.

Policy coordination

Under EU pressure and a growing dissatisfaction among the Croatian public, the government has announced a sweeping anticorruption campaign. In the past two years, law-enforcement authorities have carried out a number of major anticorruption operations, for example in health care (the "Diagnosis" plan), at the Croatian Privatization Fund (the "Maestro" plan), at the Zagreb Land Registry (the "Gruntovčan" plan) and at Zagreb University (the "Index" plan). However, the public has not been satisfied with the scope, the outcomes or with the anticorruption campaign in general. According to a survey by Transparency International, the corruption index in Croatia in 2005 and 2006 was 3.4, in 2007 4.1, and in 2008 4.4. This climb in ratings cannot by any means be a source of content. After a wave of organized crime violence at the end of 2008, the government and parliament laid

Anti-corruption policy

out a more articulated policy on corruption and organized crime and created a more solid legal framework to fight it, in addition to establishing new agencies, court proceedings and rules designed for the prosecution of alleged organized criminals (the so-called sandbag courts, as one example).

16 | Consensus-Building

In Croatia, there exists a general political and social consensus on developing a political democracy and a market economy.

Consensus on goals

Amid the post-2000, or second, phase of the country's political transformation, political and social actors who used to be only partially loyal to the precepts of democracy, such as certain right-wing political parties, veterans' and volunteers' associations, war victims' associations and others, have adopted democratic rules of conduct. The most serious attempt at creating an extra-constitutional, antidemocratic veto actor in Croatian politics occurred in 2000 when a dozen generals of the Croatian army publicly expressed their disapproval of changes brought about by the parliamentary and presidential elections of that year, a signal that they were too vying for a role of arbiter in national politics. President Stjepan Mesić, also chief of staff to the armed forces, retired these generals immediately and thus foiled their intentions to play a major role in civilian politics. Since then, there have been no additional attempts at creating extra-constitutional veto actors in Croatian politics.

Anti-democratic
veto actors

While in the first half of the 1990s, Croatian politics was dominated by cleavages between Croats and Serbs in the country (first structured around a pro-Yugoslav/anti-Yugoslav axis) and between advocates and opponents of socialism, later the central patterns of polarization were between traditionalists and modernists, and increasingly by region. The regional political polarization particularly became evident in the last parliamentary elections, when the SDP won in the more-developed areas of northern and western Croatia, while the HDZ won in the less-developed eastern and southern regions. After the 2007 elections, the SDSS joined the coalition government of Prime Minister Ivo Sanader, and party leader Slobodan Uzelac was appointed vice prime minister.

Cleavage /
conflict
management

Government and the opposition have recently been more open to the initiatives and the influence of civil society associations in addressing public policy. The HDZ government has always seen the Catholic Church and war veterans' organizations as its key political allies. The Catholic Church has traditionally been biased against leftist parties and their marked secularism, while right-wing parties are seen as the nation's guardians as well as guardians of the Church's institutional interests. The Croatian government signed one of the most rigid agreements with the Vatican, which strongly and financially favors the Catholic Church. The war veterans' groups make up the pillars of the HDZ clientelistic network.

Civil society
participation

Major political actors have also managed to reach an agreement on all the strategic goals of national politics, particularly during the war against Croatian Serb insurgents and the Yugoslav army from 1991 to 1995. This war, which occurred at the very beginning of Croatia's political transformation, contributed greatly to the policy of national reconciliation that while refraining from a formal lustrative policy, in some sectors (the judiciary, public media, state-owned companies and so on) there were some unofficial communist purges.

Reconciliation

Major ethnic Croatian political actors share the notion of Croatia as a victim of Serbian aggression and reject the notion of Croatian intention of, and responsibility for, premeditated ethnic cleansing during military operations in 1995 against ethnic Serbian insurgents. This notion has also led many people to contest the legitimacy of the U.N. International Criminal Tribunal for the former Yugoslavia in conducting trials against indicted Croatian war criminals. Many people believe that the Serbian exodus had been planned and organized by authorities of the so-called Republic of Serbian Krajina and the Republic of Serbia.

In the postwar period, the major Croatian political actors reached a consensus on the country's membership in the European Union and NATO, and in 2008, on a strategy of fighting organized crime. The ruling party together with the opposition, particularly the HDZ and the SDP as the two leading political parties, have demonstrated that they understand the importance of political consensus regarding the fundamental tenets and goals of national politics, and that they are able to separate them from the dynamics of the rivalry between the ruling party and the opposition, a characteristic of democratic politics.

17 | International Cooperation

The transfer of power in 2000 ended Croatia's isolation from the international community, and since then the country has joined a number of international organizations and institutions. One priority was Croatia's military cooperation within the bilateral Partnership for Peace, which resulted in an invitation to formally join NATO in 2009. Even more significant is the country's political cooperation with EU institutions and organizations; EU accession negotiations should be completed by the end of 2009. Croatia is entitled to use pre-accession EU funds for national and local infrastructural projects, public administration reforms and for the educational system, among other priorities.

Effective use of support

The government is considered a credible and reliable partner by the international community. For example, the European Commission expressed confidence in Croatia's capacity to cope with the administrative and technical challenges of preparing for membership when it suggested 2009 as an indicative date for the closure of accession negotiations.

Credibility

The tensions in political relations with Slovenia primarily concern the as-yet undefined maritime border between the two states. After the collapse of protracted bilateral negotiations on the border issue, Croatia has insisted that the dispute be resolved by the International Court for Maritime Rights or some other international court, and that both states should pledge to accept the decision of the court. Slovenia has been reluctant to accept this proposal and is trying to extract some concessions by blocking Croatia's talks on EU accession. (In October 2008, all EU members agreed on Croatia's closing and opening a number of acquis chapters but Slovenia vetoed this process, claiming that in all of them the Croatian-Slovenian border is prejudged.) Following the proposal of the then French EU presidency, Croatia had to publicly declare that the "negotiating matter" does not contain any prejudging of the border between the two states. On the other hand, Croatia and Montenegro quickly and easily agreed to let a minor border dispute concerning the Prevlaka peninsula be resolved by the International Court of Justice in The Hague.

Regional
cooperation

Despite the heavy burden of the past and other unresolved problems, Croatia has improved its economic, political and cultural cooperation with all its neighbors. For example, the country has handed over legal materials and offered its expertise and practical experience from EU accession talks for free to Montenegro, Bosnia and Herzegovina, Macedonia and Serbia. Croatia is considered to be economically and politically the most stable country in southeastern Europe, and as such it has a very important role in helping to preserve the region's stability. The political relationship with Serbia, however, deteriorated after Croatia, together with Hungary and Bulgaria, recognized the state of Kosovo as independent. Croatia's relationship with Serbia further soured after the International Court of Justice declared it would hear the case in which Croatia accused Serbia of genocide in the 1991-1995 war. Serbia too has threatened to bring charges against Croatia in The Hague for the alleged genocide of Croatian Serbs in the "Storm" military campaign in 1995 that resulted in the collapse of the Serbian para-state in Croatia as well as for the genocide that the pro-Nazi, Ustasha Independent State of Croatia (NDH) carried out against ethnic Serbs in 1941-1945.

Strategic Outlook

Croatia's mid-term development will to a large extent depend on whether EU accession talks are successfully completed by the end of 2009 and whether Croatia will become a full-fledged EU member. Before it does, Croatia ought to carry out a thorough reform of its judicial system and public administration, efficiently eradicate corruption and organized crime at an institutional level, continue with the transparent process of privatization and increase the competitiveness of the national economy. A broad political and societal consensus is needed, however, as a guarantee that these goals will be achieved.

Yet as measured by a Eurobarometer survey in November 2008, popular support for Croatia's EU membership has dropped to just 23%. Two issues explain this very low level of support. The first is based in history; throughout its existence as a state, Croatia has rushed headlong into new organizations or alliances as soon as it gained independence, and all such arrangements have ended badly. The second is more contemporary, and stems from the belief that the EU is not a just community in which large and small countries are seen as equals. Such skepticism has been further honed by the fate of countries such as Hungary, Romania, Latvia, Greece and others, proof for many Croatian citizens that one can go bust even within the European Union. Public opinion is particularly affected by Slovenia's block of accession talks, seen as an attempt at blackmail to secure territorial concessions, and exacerbated by the EU's stance on the matter. The country's political leadership will have to address this widespread skepticism and convince citizens about the benefits of EU membership.

The legitimacy of the political and social order should be strengthened by the establishment of a fairer and more efficient welfare regime, while the effectiveness of political and social institutions should boost social capital, the country's democratic political culture and civil society in general. Internal political tensions will be defused through the closing of the Hague Tribunal, the actions and sentences from which have provoked outrage and shaken the national political scene. In Croatia, many people believe that Croats committed some war crimes during the 1991 – 1995 war and that the perpetrators must take responsibility for those actions. The traumatic experiences of World War II have led many to conclude that it is better to come to terms with one's own crimes, lest they become a political burden for future generations. Nevertheless, most people think that the Hague Tribunal is biased and unfair.

The necessary external conditions for Croatia's successful development are regional stability and regional politics. Croatia must work hard to resolve existing disputes with neighboring states and support them too in their own EU accession talks. This is why it is important to quickly solve all border disputes in the region before an international court, to settle the various border issues of southeast Europe once and for all. Nevertheless, for the full stabilization of this region it is essential that the relationship between Serbia and Kosovo is improved.