

# BTI 2016 | Croatia Country Report

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This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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**Key Indicators**

Population	M	4.2	HDI	0.812	GDP p.c., PPP \$	21252.3
Pop. growth <sup>1</sup>	% p.a.	-0.5	HDI rank of 187	47	Gini Index	32.0
Life expectancy	years	77.1	UN Education Index	0.770	Poverty <sup>3</sup>	% 0.0
Urban population	%	58.7	Gender inequality <sup>2</sup>	0.172	Aid per capita	\$ -

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

## Executive Summary

In the period from 2013 to January 2015, Croatia's democracy and economy experienced difficult times. On 1 July 2013, Croatia joined the European Union after years of complex, conflictual negotiations and numerous efforts to implement the political, economic and administrative reforms required to prepare the country for the EU. Political elites and most citizens supported the membership, but popular enthusiasm had waned already prior to the date of accession. Membership did not entail the economic turnaround expected by its advocates. Rather, the economy remained in the state of recession triggered by the global financial and euro zone crisis.

The protracted recession and the government's failure to generate economic growth weakened the electoral support for the incumbent center-left coalition led by the Social Democratic Party, in office since November 2011. The opposition parties led by the center-right Croatian Democratic Union won the subnational elections of May/June 2013, the presidential elections of December 2014/January 2015, and the two elections of representatives for the European Parliament of April 2013/May 2014. These elections were considered as free, fair and competitive, with the exception of the subnational elections, which were accompanied by several irregularities.

Opposition parties and civil society organizations organized several referendum campaigns and protests that weakened the government further. In December 2013, a majority of the participants in a referendum voted for a constitutional ban on same-sex marriage. Pressured by another referendum campaign, the government abandoned its plans to privatize the management of Croatia's motorways. A referendum campaign initiated by war veterans to restrict the use of Cyrillic letters on official signs in Serb-minority areas was stopped by the Constitutional Court in August 2014. In fall 2014, war veterans staged protests and organized a permanent protest camp to achieve the dismissal of the Minister for Veterans' Affairs and a constitutional law to enshrine their privileges.

Unresolved issues of the past evoked many public controversies during the period under review. Croatia's governing majority refused to surrender an influential former Communist secret service chief wanted for the murder of an exiled Croat dissident in Germany. The government extradited him only in January 2014, after the EU had threatened to sanction this violation of the European Arrest Warrant rules. In January 2015, the Constitutional Court rescinded a ruling convicting a wartime Croat general and political leader on procedural grounds, enabling his release from prison.

The social democrat-led coalition government of Prime Minister Zoran Milanović tried to liberalize the labor market and to make the pension system more sustainable, but failed to consolidate Croatia's public finances, reform public administration and effectively supervise state-owned enterprises. As the public budget deficit increased to 5.7% of GDP and the gross public debt grew to 85% of GDP, Croatia had to enter the EU's Excessive Deficit Procedure in January 2014. Conflicts within and among the governing parties, Constitutional Court vetoes and popular protest campaigns hindered more far-reaching economic reforms with regard to taxation and privatization.

## History and Characteristics of Transformation

Croatia's transition to democracy and a market economy in the 1990s was accompanied and constrained by the wars following the breakup of the former Yugoslavia. Political liberalization, long-term economic and political crisis and Slobodan Milošević's nationalist mobilization campaign in Yugoslavia enabled the nationalist Croatian Democratic Union (HDZ) and its charismatic leader, Franjo Tuđman, to win the country's first democratic elections in May 1990. The new political leadership transformed Croatia into an ethnic nation-state by adopting a new constitution and by holding (and winning) a referendum on independence in May 1991. These actions evoked protests and militant resistance among ethnic Serb residents of Croatia (approximately 12% of the population in 1991). Croatia declared its independence in June 1991. Anticipating and responding to this act, ethnic Serb insurgents and units of the Yugoslav People's Army occupied territories in Northern Dalmatia, Lika, Kordun, Banija, Baranya and Slavonia that had been inhabited by ethnic Serb majorities. In 1995, Croatia's army re-established control over these territories, and most ethnic Serbs fled or were forced to leave. Few have returned since then.

After a decade of semi-authoritarian rule of by President Tuđman and the HDZ, an opposition coalition led by the Social Democratic Party (SDP) won the parliamentary elections in 2000. These critical elections heralded a break with the previous hybrid regime and they forced HDZ to reform itself. During its period in office, the new government introduced institutional changes aimed at strengthening the role of parliament and government in creating and implementing policies, stemming irregularities in the privatization process (which were common in the previous decade and destroyed part of the economy), and increasing the level of civil and political rights and freedoms in the country. Constitutional changes affected the abandonment of a semi-presidential system of government in favor of a parliamentary system. The presidency was thus deprived of the ability to control the government, and thereby each subsequent office holder who might attempt to replicate the autocratic style of President Tuđman has been stymied.

Further steps toward democratization were difficult as the legacy of the 1990s wars weighed heavily on politics and society. Citizens continued to be split over Croatia's responsibility for crimes committed during the wars linked to the disintegration of the former Yugoslavia. Right-wing opposition parties, influential associations of Croatian war veterans and political actors within the SDP-led coalition government opposed the extradition of Croatian army generals indicted of war crimes by the International Criminal Tribunal for the former Yugoslavia (ICTY). In 2002, the coalition government collapsed, and during the entire period, the political right criticized cooperation with the ICTY. However, the HDZ-led government, which took office in 2003, extradited indicted Croatian war criminals to the ICTY. The best example of this was the arrest of fugitive former wartime General Ante Gotovina in 2005. In 2012, the ICTY acquitted Gotovina and another former army general, Mladen Markač, as the court was unable to prove their responsibility in organizing a "joint criminal enterprise" of ethnically cleansing Serb-populated areas of Croatia.

Croatia joined NATO in 2009 and became an EU member state on 1 July 2013.

Economic reforms began in 2000 and in general strengthened economic activity for a nine-year period, facilitating GDP growth. Reforms worked to help increase living standards and real incomes, boost consumption and investment in the economy, housing and tourism, and bolster savings. The downside of the new economic policy was a sharp rise in external debt and faster growth in imports than exports. Growth was based on an increase in spending, which was largely financed by borrowing from international financial markets. It thus made Croatia extremely vulnerable to the global financial crisis begun in 2008. Croatia experienced economic recession from the last quarter of 2008 to the end of the review period. The economic crisis and exposure of corruption scandals involving the ruling elite were the main reasons why the HDZ lost the parliamentary elections on 4 December 2011. A four-party coalition led by the SDP formed a government headed by Prime Minister Zoran Milanović.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

Question  
Score

There is no competition with the state's monopoly on the use of force throughout the entire territory. There are no armed forces or criminal organizations that question the state's monopoly on power. Extremist political actors in Serbia claim that a "Republika Srpska Krajina," created by Croatian Serb insurgents in 1991, continues to exist, but these actors are not supported by Serbia's government and the broad majority of its citizens.

Monopoly on the  
use of force  
10

The preamble of the Croatian Constitution defines Croatia as the state of the Croatian people and as the state of individuals belonging to 22 explicitly mentioned national minorities and to a residual group of "others." According to the 2011 census, ethnic Serbs constituted the largest non-majoritarian community, accounting for 4.4% of the population. Their share has, however, declined from 12.2% (1991 census) due to the wars in the 1990s.

State identity  
9

Some political representatives of Croatia's ethnic Serbs continue to express dissatisfaction that their group has lost the coequal status of a "people" due to a constitutional amendment in 1997 that deleted the reference in the preamble of the 1990 Constitution to "persons belonging to another nation" in addition to the Croat nation as the state-forming group.

In 2014, Croat war veterans initiated a referendum to restrict the use of Cyrillic letters on official signs in areas with ethnic Serb residents. Their proposal envisaged increasing the minimum share of ethnic Serb residents required for the use of Cyrillic letters from one-third to one-half of a municipality's population. Although the veterans succeeded in collecting more than 500,000 signatures, in August 2014 the Constitutional Court prohibited the holding of the referendum, arguing that the proposed restriction of minority rights was not "reasonably justified." However, the

Court confirmed the parliament's right to increase the percentage of a minority necessary for the provisions of Croatia's minority law to apply.

The Republic of Croatia grants citizenship to foreign nationals who consider themselves ethnic Croats or descendants of ethnic Croats (according to the State Office for Diaspora Croats, the size of the diaspora is approximately 4 million, 94% of Croatia's resident population). Croat citizens residing in Bosnia and other states are entitled to vote in parliamentary elections if they register prior to an election. Since the 2011 parliamentary elections, the number of their representatives has been limited to three.

All children born in Croatia acquire Croatian citizenship at birth if they have at least one parent who is already a Croatian citizen.

According to Croatia's Constitution, all religious communities are equal and separated from the state. However, the Catholic Church has a substantial impact on political life. The Catholic Church is the dominant religious community. In the 2011 census, 86.3% of the population declared itself as Catholic. Drawing on the support of the Catholic Church, the conservative-Catholic civil society organization In the Name of the Family (U ime obitelji) campaigned for a constitutional ban on same-sex marriage. On 1 December 2013, 66% of the participants in a referendum (38% of eligible voters) voted for a constitutional amendment defining marriage as a union between a man and a woman. The campaign mainly served purposes of political mobilization, reinforcing the political hegemony of Catholic conservatism, and of a symbolic outlawing, as ordinary law had defined marriage exclusively as a union between a woman and a man prior to the referendum. In another example of political role-taking, in June 2014 Croatian Catholic bishops celebrated the release of Dario Kordić, a Bosnian Croat wartime leader who had been imprisoned for ordering the killing of Bosniaks.

No interference of  
religious dogmas  
9

The state has a differentiated administrative structure throughout the country that provides all basic public services. The effectiveness of public administration in Croatia is limited due to clientelism, politicization of civil service positions, a lack of qualified staff, organizational slack and overly bureaucratic procedures.

Basic  
administration  
10

## 2 | Political Participation

There are no constraints on free and fair elections. Presidential elections were held on 28 December 2014 and 11 January 2015, and local and regional elections took place on 19 May 2013 and 2 June 2013. The turnout was 47% and 59% in the first and second round of the presidential elections respectively, and 47%/42% in the respective subnational elections. On 25 May 2014, Croatia's citizens participated in elections to the European Parliament (EP), with a turnout of 25%. These elections took place only one year after the first election of EP deputies necessitated by Croatia's accession. While international observers did not monitor any of these elections, none of the main political actors questioned their fairness and the validity of the results.

A local non-governmental organization that observed the subnational elections, GONG, reported several irregularities, including the intimidation of voters, instances of vote-buying and electoral commissions influencing voters. Bloated voting registers, which contained numerous voters lacking a real residence in Croatia, provided opportunities for manipulation. In 2013, the government revised the voting registers and reduced the number of registered voters by about 17%. In early 2015, the parliament amended the electoral law to introduce, amongst other amendments, preferential votes and mandatory minimum quotas of 40% for candidates from both genders on party lists.

Parliamentary elections are organized in a proportional electoral system that comprises 10 multi-seat constituencies and two additional constituencies, one for voters belonging to national minorities (8 seats) and the other for voters from the Croatian diaspora. Although the number of diaspora-elected seats was reduced and limited to three in 2011, the vote-seat relations are highly uneven. Due to lower electoral turnout, about 5,000 diaspora votes enabled the Croatian Democratic Union (HDZ) to win a seat in the 2011 elections, whereas the electoral alliance led by the Social Democratic Party (SDP) required 12,000-13,000 votes to win a seat in the electoral constituencies covering the Zagreb area.

Diaspora votes were decisive for the victory of the right-wing presidential candidate, Kolinda Grabar-Kitarović, over the incumbent President Ivo Josipović in the 2015 presidential elections. Grabar-Kitarović won in the second round by a narrow margin of 32,509 votes (1.5%), benefitting from 33,737 diaspora votes. The share of invalid votes cast in the second round of the presidential elections more than doubled in comparison to the first round and accounted for 2.7% of the total votes cast, indicating a significant number of dissatisfied voters. In early 2015, the Constitutional Court rejected a complaint demanding that invalid votes be included in the total number of votes cast, which would have deprived the winner of her absolute majority.

Free and fair  
elections

9

In principle, there is no political actor who has the right to veto the actions and decisions of democratically elected authorities. In practice, the army was one such actor but was depoliticized many years ago. The clergy, veterans' organizations and business elites constitute powerful lobbies, but cannot prevent the parliamentary majority from formulating and enforcing policies. Some segments of the security and intelligence services remained loyal to the former government for months after the political change took place. Today, there are influential actors but no group or individual has de facto veto power.

Effective power to govern

9

The constitution guarantees freedom of assembly and association. There are restrictions on gatherings for security reasons, such as gatherings in the square in front of governmental and parliamentary buildings, but protests or gatherings of citizens in general are not prohibited and not discouraged. The constitution prohibits the foundation of political parties whose programs or activities are directed against the democratic order or threaten the existence of the Republic of Croatia, but this prohibition is not applied to political opponents. In June 2013, the parliament adopted a new law on associations that, amongst other provisions, enabled public access to the financial reports of civil society organizations and defined their economic activities more clearly.

Association / assembly rights

10

Freedom of expression is occasionally subject to interference, but there are generally no incidents of blatant intrusion such as outright state censorship or media shutdowns. The constitution guarantees the freedom of media as well as citizens' right to information and expressly prohibits censorship. Media outlets continue to be subject to significant political influence. The state-owned Croatia Radiotelevision (Hrvatska radiotelevizija, HRT) has been criticized for political bias and for censoring its journalists. Local electronic media tend to be particularly biased in favor of incumbent local political elites.

Freedom of expression

7

Media pluralism is limited. The TV market is dominated by HRT and two private broadcasters, Nova TV and RTL. Two companies and a single distribution network dominate the market for print media. Years of economic recession and a shrinking market for advertisements have eroded the financial basis of many media outlets. Journalists and editors have become increasingly dependent on private sources of funding and are forced to take the economic and political interests of these sponsors into account. In November 2014, an influential Zagreb-based lawyer, Marijan Hanžeković, bought Europa Press Holding (EPH), the company owning Croatia's influential daily newspaper title Jutarnji list. EPH had been facing bankruptcy proceedings.

Critical journalists continue to be subject to intimidation and physical attacks. For example, in February 2014 an unknown attacker dumped a bucket of feces over Ante Tomić, a journalist working for Jutarnji list, and said: "Now you can write about me again."



In March 2014, a Zagreb court convicted Jutarnji list reporter Slavica Lukić of defamation, because she had published about excessive financial transfers from the public health insurance fund to a private hospital. The conviction was based on the vaguely defined offence of “shaming” in the Croatian Criminal Code (Art. 148), enabling powerful actors to criminalize investigative journalism and to exert pressure on critical journalists. In July 2014, police arrested an individual for offending and patronizing police officers on Facebook.

Citizens who publicly criticize powerful interest groups and the foundational beliefs underlying the Croat nation-state risk disadvantages and relegation. For example, in December 2014 the management of Varaždin town hospital removed a psychiatrist from his position as head of the psychiatry department after he had publicly described the photograph of a wheelchair-bound war veteran participating in the veterans’ protests as “four-wheel-drive patriotism... fueled by clerical fascism.”

### 3 | Rule of Law

There is a functioning separation of powers with mutual checks and balances. However, the parliament lacks capacities to analyze policies. Individual deputies and the political parties’ parliamentary groups have only limited staff to support an in-depth analysis of bills. Judicial review is performed by the Constitutional Court, which in Croatia is not considered part of the judiciary. The Court played an active political role during the period under review when it rescinded the verdict against Branimir Glavaš, a right-wing politician accused of war crimes. In addition, the Court rejected two motions for referenda on restricting the official use of Cyrillic letters and on introducing preferential voting. In 2013, the Court blocked five decisions of the government: the taxation of profits, sex education, alignment of textbooks with the new orthographic rules, VAT increases for daily newspapers and the guidelines for the appraisal of academic positions. Croatia’s directly elected president has weak formal powers with the exception of national security and foreign policy. The president has the constitutional power to shape foreign policy together with the government.

Separation of powers

9

The judiciary is largely independent, even though occasionally its decisions are subordinated to political authorities or influenced by corruption. It is institutionally differentiated. Judges and public prosecutors are appointed, promoted, supervised and dismissed by the State Judicial Council (SJC) and the State Prosecutorial Council. The independence of these self-governing bodies is guaranteed by the Constitution, and the majority of their members are judges and prosecutors elected by the respective professional groups. In 2013 and 2014, the SJC dismissed five judges and deposed seven judges conditionally. In 2013, the parliament amended the SJC law in order to enable the reelection of SJC members. This amendment increased

Independent judiciary

8

the risk of informal networks determining the appointment, promotion and dismissal of judges.

In October 2014, the parliament adopted a judicial reform that envisaged reducing the numbers of municipal courts, criminal courts and municipal public prosecutors and aligning their territorial jurisdictions with the boundaries of Croatia's 21 counties. The aims of this reform were to distribute cases more evenly among courts, to enable the specialization of judges and to harmonize court practices.

In a survey conducted by the World Economic Forum in 2014, company managers rated the independence of the judiciary 3.2 (on a scale ranging from 1 to 7 (best)). This was better than in the preceding two years, but worse than in Slovenia (3.5) and Montenegro (3.4).

Officeholders who break the law and engage in corruption are generally prosecuted under established laws and often attract adverse publicity, but occasionally slip through political, legal or procedural loopholes. In June 2014, the Supreme Court confirmed the conviction of Croatia's former Prime Minister Ivo Sanader, who had been sentenced to 10 years in prison for corruption. Sanader was found guilty of accepting bribes for brokering a loan between the government and an Austrian bank in the mid-1990s, and for providing MOL, a Hungarian oil company, control over the Croatian energy company INA in 2008.

Prosecution of  
office abuse

7

In October 2014, the Office for Suppression of Corruption and Organized Crime (USKOK) arrested the mayor of Zagreb, Milan Bandić, on charges of corruption, abuse of office and embezzlement of €2.6 million. He was suspected, amongst other offences, of having signed a contract for waste disposal with a private company without a public tender.

In November 2013, police arrested the president of the Croatian Economic Chamber (HGK), who was suspected of embezzling €4.5 million of HGK's assets.

In October 2014, the parliament lifted the immunity of SDP MP Marina Lovrić Merzel, who was suspected of embezzlement, bribery and abuse of office. The authorities also investigated the former mayor of Vukovar, Željko Sabo, and the Director General of the Tax Administration, Nada Čavlović Smiljanec.

In October 2014, Croatia's State Prosecution (DORH) investigated the environment minister because he had approved the move of his ministry and related agencies to a building whose private owners charged very high rents from the ministry.

Civil rights are codified by law, but are not properly respected and protected. Mechanisms and institutions to prosecute, punish and redress violations of civil rights are in place, but are not consistently effective. National minorities are guaranteed civil and political rights that are commonplace in liberal democracies, but in practice, some groups (especially Roma and Croatian Serbs) still face discrimination. In a report published in early 2015, the human rights watchdog organization Amnesty International noted that Croatian Serbs faced discrimination in public-sector employment and the restitution of tenancy rights to social housing vacated during the 1991-1995 war. According to this report, the European Court of Human Rights contacted the government on 17 cases of civilian victims of war who claimed that the state had failed to effectively investigate the killing or disappearance of their relatives. In June 2014, the Court fined Croatia for not adequately investigating the murder of a Croatian Serb civilian in November 1991.

Civil rights  
8

According to the human rights NGO Human Rights Watch, more than 8,200 people with disabilities were trapped in long-term care institutions, many of them without their consent. Croatia's guardianship regime deprived approximately 18,000 disabled people of the right to make basic decisions. Members of vulnerable groups, such as the lesbian, gay, bisexual and transgender (LGBT) community also experience discrimination.

In 2013 and 2014, the ombudsman office initiated 3,021 and 2,594 procedures respectively to examine alleged human rights violations. In 2014, the office received 263 complaints relating to discrimination, 24% of which were discrimination based on nationality, ethnicity, race or religion. However, of the 139 complaints of discriminations examined by the ombudsman office in 2014, the office found only 35 complaints justified and intervened to support the claimants.

In January 2014, a new law on free legal aid entered into force, facilitating access to legal aid for vulnerable groups.

#### 4 | Stability of Democratic Institutions

Democratic institutions perform their functions in principle, but are sometimes inefficient due to friction between institutions. Since 2000, the government has been accountable only to a parliament that has been unicameral since 2001. During the period under review, there were no major conflicts between the government and the directly elected president, whose political orientation was close to the governing political majority.

Performance of  
democratic  
institutions  
8

Interest groups and civil society organizations affiliated with the parliamentary opposition increasingly used referendum campaigns to block policies of the parliamentary majority.

The conservative-Catholic NGO coalition In the Name of the Family successfully campaigned for a referendum on a constitutional ban on same-sex marriage. In October 2014, the trade union of traffic workers, other trade unions and NGOs collected 500,000 signatures to hold a referendum against the privatization of Croatian highways envisaged by the government in August 2014. The broad mobilization led the government to abandon its plan in early 2015.

During the presidential election campaign in 2014, Ivan Sinčić and his NGO Living Wall, which supports insolvent families threatened by forced evictions, advocated a fight against banks, the “EU’s dictate” and the political establishment. Sinčić’s mixture of nationalist, socialist, anti-EU and anti-establishment rhetoric attracted 16.4% of the voters in the first round of presidential elections, placing him behind the two main contenders.

In October 2014, war veterans staged protests and started a permanent protest camp in front of the Ministry of Veterans’ Affairs to achieve the dismissal of Minister Predrag Matić. The veterans opposed Matić, who fought to defend the Croatian city of Vukovar in 1991, because of his alleged pro-Yugoslav attitudes. The government claimed it had not constrained the veterans’ privileges except for reducing high pensions by 10%. Leaders of the veterans criticized Prime Minister Milanović for not having fought for Croatia during the war in 1991.

All relevant political actors accept all democratic institutions as legitimate. Right-wing extremists contested the scope of rights granted to national minorities, glorified Croatia’s fascist state of 1941-45 and incited hatred of Serbs and Serbia. However, these political forces did not question the principle of democracy or the core institutions and procedures of Croatia’s democracy.

Commitment to democratic institutions

9

## 5 | Political and Social Integration

The party system is fairly stable, socially rooted and characterized by limited polarization, moderate volatility and moderate fragmentation. The center-right Croatian Democratic Union (HDZ) and the center-left Social Democratic Party (SDP) continued to be the two largest political parties during the period under review. The governing coalition, led by the SDP, includes the liberal Croatian People’s Party (HNS), the regionalist Istrian Democratic Assembly (IDS) and the pro-pensioner Croatian Party of Pensioners (HSU). The coalition obtained 41% of the vote and 80 of 151 seats in the December 2011 parliamentary elections. Having lost approximately 11 percentage points, the HDZ received 24% of the vote and 31% of the seats in 2011. Among the right-wing extremist and radical parties, only the Croatian Pure Party of Rights-Ante Starčević (HCSP) entered parliament (0.6% of the vote and 1 seat), whereas the Croatian Party of Rights (HSP) failed to win a seat (but received 3.1% of the vote). The right-wing populist Croatian Democratic

Party system

7

Alliance of Slavonia and Baranja (HDSSB) won 3% of the vote and six seats. This party and the Independent List of Ivan Grubišić (2 seats) claim to represent regional interests. Other legislative parties include the Croatian Laborists – Labor Party (5% of the vote, 6 seats), the Independent Democratic Serbian Party and several HDZ split-offs. The effective number of legislative parties was 4.6 after the December 2011 elections and has increased since then. Electoral volatility (the sum of the 2007-2011 percentage point changes in vote shares of legislative parties, divided by two) was 17%.

During the review period, the SDP and its allies lost popular support, whereas the HDZ and other right-wing parties regained strength, winning the January 2015 presidential elections, the subnational elections of May/June 2013 and the successive European Parliament elections of April 2013 and May 2014.

In October 2013, following a conflict with Prime Minister Milanović, his former Minister of Environment, Mirela Holy, established the new, pro-environmental party Sustainable Development of Croatia (ORaH), which obtained 9.4% of the vote in the European Parliament elections in May 2014.

Clientelism has been present mostly in the HDZ, which is closely tied to several organizations, especially church and veterans' associations, whose many members are HDZ supporters, and in turn financially benefit from state grants. The HDZ enjoys strong support among the ethnic Croatian diaspora.

There are a number of interest groups in Croatia, and some are notably active in society. However, a few strong interests dominate, producing a latent risk of pooling conflicts.

Interest groups  
8

Trade unions and business associations cooperate with the government through tripartite arrangements. War veterans constitute a powerful interest group that became more vocal and engaged as an extra-parliamentary opposition to the government during the period under review. There are approximately 500,000 war veterans who receive pension benefits and numerous additional privileges. In winter 2014/15, veterans' activists set up a camp in front of the Ministry for Veterans' Affairs to call upon the minister to resign and to achieve a constitutional law protecting their status.

While the Minister for Entrepreneurship advocated abolishing obligatory Croatian Economic Chamber membership fees for small businesses, the Minister of Economy preferred retaining the fees.

Croatian citizens and political elites support the democratic political system. In a Eurobarometer survey conducted in November 2014, 22% of Croatia's citizens declared that they were fairly satisfied with the way democracy worked in their country, which was 21 percentage points less than the unweighted average of satisfied citizens in 28 EU member states. However, trust in democratic institutions continues to be very low: according to a representative opinion survey carried out by local survey researchers (Pilar Institute) in the period from March 2014 to May 2014, 87% of citizens did not trust political parties, while 81% lacked trust in the government and 78% lacked trust in the parliament.

Approval of  
democracy  
7

Popular dissatisfaction with democracy is also manifested in public protests and protest voting, such as during the presidential elections in January 2015.

There is a fairly high level of trust among the population and civil society is characterized by a substantial number of autonomous, self-organized groups, associations and organizations. According to a representative opinion survey conducted by the European Bank for Reconstruction and Development (EBRD) in 2010, 29% of Croatia's citizens were active members of civil society organizations, which was the second-highest share among 17 East-Central and Southeast European countries. By campaigning for referenda and collecting numerous signatures, civil society organizations such as In the Name of the Family demonstrated their capacity to mobilize citizens.

Social capital  
7

According to the EBRD survey, 60% of respondents believed most people can be trusted, which was below the unweighted regional average share of 61%.

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Poverty and inequality are limited and barely structurally ingrained. According to the EU statistical office (Eurostat), the share of individuals with a disposable income (after social transfers, adjusted for household size) below 60% of the national median income was 30% in 2013. This at-risk-of-poverty rate was nearly 2 percentage points lower than in 2011 and close to the (unweighted) average rate of 30% for 12 East-Central and Southeast European EU member states in 2013. Income inequality was higher than in the East-Central European countries, but lower than in the Baltic states or in Southeast Europe. In 2013, Croatia had a Gini coefficient of 31, which had not changed significantly since 2010 (Eurostat data). Croatia's HDI in 2013 was high (0.812, up from 0.796 in 2011), placing it among the countries with very high human development. Gender inequality is limited, with a Gender Inequality Index score of

Question  
Score

Socioeconomic  
barriers  
8

0.172 in 2013, down from 0.183 in 2010. This score placed Croatia 11th among the countries compared by the UNDP.

Social inequality and forms of social exclusion are primarily due to differences in gender, age, education and geographic region. Women, the elderly and the uneducated, as well as those living outside Zagreb, Istria and northwestern Croatia, have fewer chances of making a living above state average levels or finding a job to match their educational qualifications. Social exclusion is still very high with respect to the Roma population even if their social status as regards to education (and to some degree employment) has improved in recent years.

Economic indicators		2005	2010	2013	2014
GDP	\$ M	45416.1	59665.5	57868.7	<b>57222.6</b>
GDP growth	%	4.2	-1.7	-0.9	<b>-0.4</b>
Inflation (CPI)	%	3.3	1.0	2.2	<b>-0.2</b>
Unemployment	%	12.6	11.8	17.7	-
Foreign direct investment	% of GDP	3.9	1.4	1.0	-
Export growth	%	4.6	6.2	3.0	<b>6.3</b>
Import growth	%	5.2	-2.5	3.2	<b>3.0</b>
Current account balance	\$ M	-2460.0	-900.1	715.8	-
Public debt	% of GDP	38.6	52.8	80.8	<b>85.1</b>
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-
Cash surplus or deficit	% of GDP	-2.4	-4.4	-	-
Tax revenue	% of GDP	19.8	19.2	-	-
Government consumption	% of GDP	18.3	20.1	20.0	<b>19.8</b>
Public expnd. on education	% of GDP	-	4.3	-	-
Public expnd. on health	% of GDP	6.0	7.2	5.8	-
R&D expenditure	% of GDP	0.87	0.75	-	-
Military expenditure	% of GDP	1.8	1.7	1.7	<b>1.5</b>

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

## 7 | Organization of the Market and Competition

Market competition has a strong institutional framework, but the rules for market competition are not consistent or always uniform for all market participants. Prices are fully liberalized, except for petroleum products and natural gas. The business environment is weakened by numerous forms of taxation, lengthy judicial proceedings and an outdated insolvency law. According to the World Bank's 2015 Doing Business report, Croatia ranks 27th in the EU-28 with regard to the ease of doing business. State-owned enterprises comprise 25% of total corporate employment and are burdened with governance problems. According to a report published by the European Commission in 2015, the market entry and exit rates of firms in Croatia were significantly lower than in other East-Central European countries and new market entrants did not contribute to enhancing productivity. The informal sector is estimated to account for 23% to 28% of employment and about 25% of GDP. In July 2014, Croatia adopted a law aimed at liberalizing its labor market in order to increase its comparatively low employment rate.

Market-based  
competition  
8

Competition laws to prevent monopolistic structures and conduct exist, but are enforced inconsistently. Market competition in Croatia is regulated via the Market Competition Protection Act and by several bylaws. The scope of state aids has been much higher in Croatia than the EU average. Since November 2010, the Croatian Competition Agency (AZTN) has been in charge of implementing leniency programs against cartels, following U.S., Canadian and EU models. In 2014, AZTN took 632 decisions in cases of violations of competition rules and seven decisions related to the provision of state aids, imposing fines of approximately €660,000. Following Croatia's accession to the EU, the AZTN ceased to approve state aids and the related tasks were assigned to the European Commission and the Ministry of Finance.

Anti-monopoly  
policy  
8

Foreign trade is fully liberalized, with uniform, low tariffs and few non-tariff barriers. By joining the EU in July 2013, Croatia has delegated the representation of its foreign trade policy interests to the EU.

Liberalization of  
foreign trade  
10

The banking system is solid and oriented towards international standards with functional banking supervision and minimum capital requirements. Capital markets are open to domestic and foreign capital with sufficient resilience to cope with sudden capital flow stops and reversals. The share of nonperforming loans to total loans grew further to 15.7% and 16.7% at the end of 2013 and 2014 respectively. A relatively high average capital adequacy ratio of 21.5% (as at the end of 2014) enabled banks to cover the risks associated with these loans. However, some smaller banks have been insufficiently capitalized.

Banking system  
9



## 8 | Currency and Price Stability

Inflation and foreign exchange policies are brought into concert with other goals of economic policy and are institutionalized in a largely independent central bank. During the period under review, the inflation rate declined further to 2.2% in 2013 and turned negative (-0.2%, annual average change in consumer prices) in 2014, reflecting lower prices for imported food and energy. The Croatian central bank (HNB) works independently and has the mandate to set and implement monetary and exchange rate policy. Its independence is protected by the constitution and its influence has strengthened in recent years, with bank governors occasionally voicing dissenting opinions to those of the government. The HNB has not officially pegged Croatia's currency, the kuna, to the euro but it has tried to limit excessive exchange rate fluctuations. That led to an appreciation of the country's exchange rate in the 2000s. High shares of foreign currency denominated loans necessitate a fixed exchange rate regime, as large-scale depreciations would trigger corporate and private insolvencies.

Anti-inflation /  
forex policy

9

The government's fiscal and debt policies generally promote macroeconomic stability, but lack institutional safeguards and are prone to populist policy changes. In January 2014, Croatia entered the Excessive Deficit Procedure envisaged by the EU to achieve fiscal consolidation. In 2014, the public budget deficit grew to 5.7% of Croatia's GDP and the gross public debt increased to 85% of the GDP (Eurostat data). In March 2014, the European Commission also noted excessive macroeconomic imbalances in Croatia. According to a report published by the IMF in 2015, the aggregate debt-to-equity ratio of private companies was the highest in East-Central Europe and the corporate sector was, in contrast to regional peers, unable to repair and improve its balance sheets. The macroeconomic imbalances led Standard & Poor's to downgrade Croatia's sovereign credit rating to BB in January 2014. The current account balance became positive in 2013 due to improved exports and lower prices of energy imports, with surpluses of 0.8% and an estimated 0.7% of GDP in 2013 and 2014 respectively (IMF data).

Macrostability

6

In July 2014, the European Commission recommended reducing the salaries of public sector employees, social spending and subsidies and controlling public expenditure more effectively. However, the government decided to reduce the budget deficit by means of privatization and by drawing on the funded pillar of the pension system. To stimulate private consumption, the government also reduced personal income taxes by realigning tax brackets in its 2015 budget law.

To cut public spending, the government encouraged early retirement of public sector employees and reduced the number of vacant positions due to retirements. The public sector accounts for approximately 22% of total employment.

## 9 | Private Property

Property rights and regulations on acquisition, benefits, use and sale are well defined and enforced. Property rights are limited by overriding rights of constitutionally defined public interest. In the accession negotiations, Croatia agreed with the EU on a seven-year transitional period during which EU nationals would not be entitled to purchase agricultural land in Croatia.

In September 2013, the Milanović government tried to renegotiate the shareholder agreement concluded in 2009 between Croatia and the Hungarian oil company MOL, which acquired 49% of the shares in Croatia's former state-owned oil company INA. According to the government, the agreement was achieved in 2009 by bribing Croatia's then Prime Minister Ivo Sanader, and deprives the Croatian state, who continues to own 45% of INA, of any influence on managerial decisions. In October 2013, the public prosecutor issued an international arrest warrant against MOL's CEO. The government argued that MOL was exploiting INA, did not make promised investments and caused significant financial damage to the Croatian state. The MOL management refused to renegotiate the control rights, denied any involvement in bribery during the purchase and claimed that the government had violated its contractual obligation when it withdrew from the agreed repurchase of INA's natural gas supply business. In December 2014, the International Centre for Settlement of Investment Disputes accepted MOL's complaint and ruled that Croatia had violated the sales agreement.

Private companies are viewed institutionally as important engines of economic production and are given legal safeguards, but concentration of market power (in state companies and oligopolies) is tolerated, partly due to the small size of Croatia's economy. The private sector accounts for approximately 80% of total employment. However, state-owned enterprises hold almost a third of all corporate assets. An empirical study by the Zagreb-based Economic Institute found that wages in state-owned enterprises were 7% higher than the wages of employees in similar positions in the private sector. According to the European Bank for Reconstruction and Development, Croatia lags behind other East-Central European countries in privatizing and restructuring its large state-owned enterprises. The privatization of state companies does not always proceed consistently with market principles. The government failed to privatize several large companies, including the Croatian Postal Bank (Hrvatska poštanska banka), Croatia Airlines, the cargo railway company HZ Cargo, and the fertilizer producer Petrokemija. The government also failed to privatize the management of Croatia's highways since trade unions and NGOs collected signatures for a referendum against the privatization. In 2014, the State Office for State Property Management offered up three state-owned hotels, the state-owned shipping company Jadroplov and the Rijeka shipyard Treći Maj for

Property rights  
9

Private enterprise  
7

privatization. The port of Ploče, the Croatian Postal Bank, KONČAR - Electrical Industry and the state's remaining 3.5% stake in Croatian Telekom were also offered up for sale. In order to restructure and rescue companies at risk of insolvency, the government introduced a pre-bankruptcy procedure, which, however, turned out to be susceptible to political and clientelistic intervention. A conflict of interest led Prime Minister Milanović to dismiss his deputy minister of finance in February 2014. This decision triggered a political conflict between Milanović and the Minister of Finance, Slavko Linić, leading to the minister's dismissal and his exclusion from the governing Social Democratic Party in June 2014.

## 10 | Welfare Regime

Social safety nets are well developed, but do not cover all risks for all strata of the population.

Social safety nets

7

The Croatian social security system is largely public, financed through the state budget and local government budgets. A small share of the overall system is covered by other social organizations and the Catholic Church (through its humanitarian institutions). Social security covers unemployment benefits, benefits for maternity leave (and three months of paternity leave as well) and supports those who live below poverty level and war veterans, as well as supporting the pension and health care systems. The two largest parts of the social security system – pensions and health care – have been the source of problems for several years. All employed Croatian citizens are legally obliged to pay contributions toward health and pension insurance, but these contributions do not suffice in covering current health and pension expenses. Repeated arrears in the health care system have required compensation payments from the state budget. In 2012, the average life expectancy at birth was 76.9 years, which was higher than in most Southeast European countries, but below the EU average.

In January 2014, a social welfare law took effect that enabled the payment of pension benefits to pensioners in part-time employment. In 2014, an amendment to the pension insurance law increased the retirement age from 65 to 67 years and the early retirement age from 60 to 62 years. Conditions for early retirement were tightened, high special pensions were cut and the eligibility rules for invalidity pensions became more restrictive. In November 2014, the government prepared a decree to write off debts of up to €3,250 for unemployed individuals and low-income pensioners lacking assets. The European Commission criticized that early retirement rules were too generous and wages had increased too rapidly during the crisis.

In a report published in March 2014, the European Committee of Social Rights noted that Croatia did not guarantee means of subsistence to individuals whose social assistance was withdrawn as a penalty for having refused a job offer, that levels of

social assistance were far below the poverty threshold and that nationals of other states were subject to excessive length of residence requirements to be eligible for social assistance.

Women and members of ethnic, religious and other groups have near-equal access to education, public office and employment. There are a number of legal provisions against discrimination, but their implementation is at times insufficient. Croat veterans of the Yugoslav wars in the 1990s enjoy a privileged status that also extends to members of their families. Roma remain locked in a vicious circle of poverty, social exclusion and widespread prejudice. Few Roma complete secondary school and rarely reach the tertiary level. Marginalized groups include people with learning disabilities, people with mental health problems, the disabled, individuals living with HIV/AIDS, sexual minorities and asylum seekers. These individuals sometimes do not have the same opportunities as their neighbors because of the persistence of prejudice in some institutions as well as at a wider societal level. However, positive developments in recent years have become obvious following an increase in public awareness. This especially applies to sexual minorities, who can more freely express their sexual orientation in society than previously. Women continue to be disadvantaged in the labor market and are underrepresented in politics and leading managerial positions. However, Croatia elected a female president in January 2015, the share of female professors in higher education has increased and there are more female than male university graduates.

Equal opportunity  
8

## 11 | Economic Performance

In 2013 and 2014, Croatia's economy continued to shrink by 0.9% and 0.4%, respectively, mainly due to weak private investment, while exports contributed positively to containing the impact of the recession. However, exports of goods and services accounted for only 43% of Croatia's GDP in 2013, whereas the unweighted average share of the other East-Central and Southeast European EU member states was 72%. This gap indicates the weak export orientation and underlying competitiveness problems of Croatian companies. Foreign direct investment increased in 2014 as net inflows grew from 2.0% (2013) to 2.7% of GDP (IMF data). However, past FDI inflows were mainly directed into real estate and construction, causing price increases that provided disincentives for productivity-improving FDI inflows into the tradables sector (exporting industries).

Output strength  
5

The unemployment rate increased from 15.2% (2012) to an estimated 17.1% at the end of 2014 (IMF data). According to the EU statistical office Eurostat, Croatia's employment rate of 59.2% in 2014 is the lowest of all East-Central and Southeast European EU member states. This rate increased only slightly from 58.1% in 2012.

To raise employment, in 2013, the Milanović government reduced the health insurance contributions of employers and introduced a new VAT rate for goods and services that had not been taxed previously. Publicly owned enterprises continue to be characterized by overemployment and recruitment according to political criteria. In 2013, the parliament adopted a law on employment incentives that removed the social insurance payment obligations for employers who employed long-term unemployed individuals. In January 2015, employers offering a permanent contract to young workers no longer had to pay social security contributions for up to five years. A law on the liberalization of the labor market adopted in July 2014 increased the admissible duration of fixed term contracts from 1 to 3 years, the maximum number of hours per week from 48 to 50 hours and facilitated the dismissal of employees. The governing Social Democratic Party also wanted to introduce a property tax to raise state revenues, but this was rejected by its junior coalition partner, the Croatian People's Party.

## 12 | Sustainability

Environmental concerns are taken into account but are occasionally subordinated to growth efforts. Environmental regulation and incentives are in place, but their enforcement at times is deficient. One of the biggest problems is landfills, many of which do not meet international standards. During the period under review, Croatia established regional centers for waste disposal, but the government was unable to meet its commitment from the accession negotiations to reduce the share of biologically degradable waste within the total amount of waste.

With regard to greenhouse gas emissions and particulate matter, Croatia is at an intermediate level among East-Central and Southeast European EU member states. The share of renewable energy in gross final energy consumption increased to 18% in 2013, which was higher than in East-Central European countries, but lower than in Slovenia or the Baltic states. Croatia's resource productivity (i.e., GDP divided by domestic material consumption) increased to 1.62 purchasing power standards (euros adjusted for purchasing power) per kilogram in 2013, which is the third-highest level among the East-Central and Southeast European EU member states (Eurostat data).

Environmental  
policy  
7

Education policy ensures a nationwide system of sound education and training, and the research and technology sector is fairly advanced. Public expenditure on education and training was 5% of GDP in 2012, which was below the EU average of 5.3%. The rate of university graduates is one of the lowest in Europe. Most primary and secondary schools are publically run and demand no tuition. Significant mismatches exist between the professional skills produced by the education system and the skills demanded by the labor market. In the 2012 PISA assessment of the educational achievement of 15-year-old pupils, Croatia reached an average score of 482, lower than the other East-Central European (and Baltic) EU member states.

Public spending on research and development decreased to 0.4% of GDP in 2013. Weak innovation capabilities and limited R&D investment in the business sector constrained the demand for innovation-oriented services and research.

Education policy /  
R&D  
8

# Transformation Management

## I. Level of Difficulty

The structural constraints on governance are very low. The number of HIV/AIDS cases in Croatia is very small. The labor force is relatively well educated and only a small percentage of the population has completed only primary school. Road infrastructure is among the most developed in Central and Eastern Europe, but the problem of railways and railway infrastructure was not seriously addressed until 2012. One of the major structural constraints to the development of infrastructure is the geographical shape of the country, which requires a great length of road network in relation to the country's territory. In addition to the drought, which often occurs during summer in rural regions, Croatia was affected by flooding following heavy rainfalls in May 2014.

Structural  
constraints

2

Yugoslavia was considered as one of the most liberal countries in the communist world, and Croatia, after Slovenia, was the most developed federal unit in Yugoslavia. Like other communist countries, Yugoslavia sought to provide support for the regime through mass participation of citizens in the regime's organizations, but as a result of the higher level of civil rights and freedoms, there were also informal groups that have operated freely. Yugoslav citizens were free to travel abroad, working as temporary workers in Western European countries and bringing information and ideas from these countries to Yugoslavia. Therefore, after the beginning of the democratic transition in Croatia, there was a larger human capacity and knowledge of how to organize civil society than in most other post-communist countries. The war and hybrid political regime in the 1990s complicated the development of civil society, but civil society has been growing in strength since 2000 and it influences the formation of public opinion and the actions of the political elite. NGOs are growing and have become more prominent. They are usually present at public hearings on certain social issues, and even launch protest actions. Among the broader population the level of social trust and consequently social capital, however, remains rather limited.

Civil society  
traditions

4

Croatia does not suffer from politically motivated violence. The 2011 Census showed that Croatia is a country that is ethnically quite homogeneous. Over 90% of the population are ethnic Croats and over 83% are Catholics. There is an ethnopolitical cleavage between the ethnic Croat majority and the Serb minority, especially in the region of Eastern Slavonia, which was inhabited by many ethnic Serbs and saw major battles during the Yugoslav wars of 1991-95. In the capital of Eastern Slavonia, Vukovar, there are separate kindergartens, schools and coffee shops for ethnic Croats and ethnic Serbs. This segregation has been caused by nationalistic political representatives from both communities who rely on this division, on some veterans' organizations as well as on the tendency of local ethnic groups to continue to function within their own ethnic communities, distrusting the other in a collective manner. Such informal division is often criticized by many political and non-governmental organizations, but also accepted as a reality caused by the devastating war in this region.

Part of the population in some Croatian regions shows disappointment in the center, but the gap is bigger in relation to politicians and other members of the social elite from Zagreb than at the level of average citizens.

Conflict intensity  
2

## II. Management Performance

### 14 | Steering Capability

The Milanović government sets strategic priorities, but sometimes postpones them in favor of short-term political benefit. In April 2014, the government adopted a national reform program in accordance with the EU process of economic policy coordination. In November 2014, the government adopted a new strategy for the period from 2015-2017, which comprised the national reform program and the convergence program. The government has been committed to reducing public spending and to addressing the structural problems Croatia's economy has been faced with. Steps have been taken to restructure and privatize state-owned enterprises, to reform the regulatory framework of the labor market and to construct a more cost-efficient pension system.

However, the government has shown deficits in prioritizing and organizing its policy measures accordingly. According to a report published by the European Commission in 2015, half of the laws adopted in 2014 were not envisaged in the government's legislative plan. Only a small part of the electoral legislation was subject to regulatory impact assessment and the process of assessment is strongly controlled by line ministries with stakeholders participating only symbolically. The quality of strategic planning has been relatively low, and the core executive lacks capacity and powers

Question  
Score

Prioritization  
8



to evaluate and coordinate the activities of line ministries, relying mainly on informal coordination mechanisms. Prioritization is hampered by powerful vested interests that exploit rifts within the governing party and coalition, as well as departmental self-interests.

The government has limited success in implementing its policies. Powerful interest groups, an activist constitutional court, a heterogeneous governing coalition and conflicts within the main governing party, the SDP, have obstructed and derailed policy reforms.

Implementation  
8

The Constitutional Court prevented the government from reforming the taxation of profits, introducing a reformed curriculum of sex education, aligning textbooks with the new orthographic rules, increasing VAT for daily newspapers and amending the guidelines for the appraisal of academic positions.

Conservative-Catholic groups successfully mobilized for a referendum to define marriage as a union of man and woman in the constitution. Trade unions and NGOs campaigned for a referendum against the privatization of Croatian highways, forcing the government to abandon its plan. The interest associations of war veterans ran a protest campaign to force the government to dismiss its minister of veterans' affairs and to cement the privileges of veterans. Their public pressure caused the government to refrain from cutting their benefits. To reduce the misuse of pension benefits by individuals who were not eligible war veterans, the government published a public register of veterans. However, this measure enabled the authorities to identify only 55 non-eligible veterans, who were deprived from their benefit entitlement.

The SDP planned to introduce a real estate tax to increase state revenues, but this policy was rejected by its coalition partner, the Croatian People's Party (HNS). HNS politicians warned against imposing higher taxes on Croatia's middle class.

The government demonstrates a general ability of policy learning, but its flexibility is limited. Learning processes inconsistently affect the routines and the knowledge foundation on which policies are based. The Milanović government tried to devise policies that were supposed to balance public spending and create a more efficient economy, drawing lessons from the failed fiscal and economic policies of its predecessors. These reforms are driven by the country's needs, but also by lessons learned from the failures of past economic policies. The government has been open to public discussions and consultative processes in which policy proposals and existing policies can be scrutinized, adjusted or substantively changed.

Policy learning  
7

## 15 | Resource Efficiency

The Milanović government made partially efficient use of available human, financial and organizational resources. The government did not reduce the number of public sector employees, although Croatia's public administration is considered to be oversized in international comparison. According to the European Commission, Croatia's government does not effectively control public expenditure as the allocation of public tasks among subnational tiers of government blurs responsibilities and accountability. The Commission also levelled the criticism that Croatia's fiscal monitoring body, the Fiscal Policy Commission, lacked independence and capacity to perform its task. The system of social benefits is overly complex and not efficiently targeted. State-owned enterprises are not effectively supervised. Political patronage and nepotism are widely practiced in the public sector. In the hiring process for public administration or institutions, there are many cases in which tenders are crafted to suit a particular candidate, or in which a state official intervenes to do so. The government planned to reform the law on public servants in order to simplify recruitment and dismissal procedures and to improve the efficiency of the civil service. However, the resistance of interest groups led the government to withdraw its proposal and postpone this reform. In addition, the government failed to reduce the number of deconcentrated state administration offices (in order to overcome the fragmentation of local self-governments).

The government has implemented a tax reform to simplify taxation and to raise revenues. In September 2014, the government established the new Office for Fighting Tax Evasion to investigate cases of large-scale tax evasion.

The government tries to coordinate conflicting objectives, but friction, redundancies and gaps in task assignment are significant. During the period under review, the government of Prime Minister Zoran Milanović (Social Democratic Party, SDP) consisted of the Croatian People's Party–Liberal Democrats (HNS-LD), the Istrian Democratic Assembly (IDS) and the Croatian Party of Pensioners (HSU). In January 2015, the Milanović cabinet had 21 members, including a first deputy prime minister representing the HNS and three additional deputy prime ministers from the SDP with cross-sectoral task areas. While 13 cabinet members are affiliated with the SDP, four members belong to the HNS. The governing coalition controlled 80 of 151 seats in the parliament. Among the smaller coalition parties, the HSU is not represented by a minister in the Milanović cabinet, and the IDS has only one minister. The large number of ministers, the complex structure of the three levels of hierarchy of the cabinet, overlapping responsibilities and the absence of HSU and IDS leaders in the cabinet has caused major problems in political and policy coordination. During the period from Milanović taking office to the end of January 2015, eight ministers left his cabinet due to conflicts. Policy coordination was also hampered by conflicts

Efficient use of assets

6

Policy coordination

6

between leading SDP politicians. In May 2014, Prime Minister Milanović dismissed the Minister of Finance, Slavko Linić, and later managed to exclude him from the SDP, because Linić had approved the purchase of overpriced land to prevent the insolvency of a wood-processing firm.

The government is often successful in containing corruption. Most integrity mechanisms are in place, but some function only with limited effectiveness. Due to more effective fighting of corruption since 2009, public awareness of corruption's penetration into society has increased. In the period under review, courts sentenced former Prime Minister Ivo Sanader and several ministers in his government for abuses of office. Parliamentary parties are financed from the state budget according to the number of seats each has in parliament, yet attempts toward tighter legal controls have failed. Holders of public office are obliged to abandon positions and activities in the private sector and report all of their assets. To enforce the law on the prevention of conflicts of interest, the Commission for the Resolution of Conflicts of Interest was established in 2003. In 2013, this Commission examined 118 conflicts of interest involving public officeholders and sanctioned violations in 58 of these cases. In an evaluation published in 2015, the Group of States against Corruption (GRECO) noted that Croatia's parliament was lacking a code of ethics and internal mechanisms for self-control and responsibility. Moreover, the ethical code for civil servants does not extend to other public employees.

In December 2014, police arrested an influential businessman and media owner in the Croatian city Zadar on suspicions of embezzlement. In November 2014, Croatia's Office for the Suppression of Corruption and Organized Crime started investigating the case of Đuro Gavrilović, a major meat producer suspected of war profiteering, abuse of office and abetting the abuse of office in 1991/92. In September 2014, the government created the new Office for Fighting Tax Evasion, aimed at prosecuting cases of large-scale tax fraud.

## 16 | Consensus-Building

All major political actors agree on consolidating democracy as a strategic, long-term goal of transformation. Political actors differ about the extent to which ethnicity, religious norms, principles of social justice and equality should be embodied in democratic institutions and policies. Right-wing extremist political actors do not oppose core democratic institutions, but contest the civil rights of individuals belonging to minorities and the civic character of the nation-state.

All major political actors agree on consolidating a market economy as a strategic, long-term goal of transformation. Political actors differ about the extent to which social rights and redistribution should constrain and counteract market-based coordination and allocation mechanisms.

Anti-corruption  
policy

8

Consensus on goals

10

Reformers can exclude or co-opt actors with anti-democratic interests. Right-wing extremist political parties and civil society organizations constitute important political actors as they are linked to and accepted by larger segments of society and the political scene. In the European Parliament elections of 2014, the center-right Croatian Democratic Union formed an electoral alliance that included the right-wing extremist Croatian Party of Rights dr. Ante Starčević (HSP AS). The then HSP AS leader Ruža Tomašić, who claimed in the electoral campaign that Croatia belongs to ethnic Croats and all others are guests, received the largest number of preferential votes among the right-wing candidates.

Anti-democratic  
actors

9

In August 2014, approximately 100,000 nationalist Croats celebrated their victory over Serb forces in 1995 at a festival in Čavoglave, near the town of Knin. The crowd hailed Dario Kordić, a Bosnian Croat wartime political leader and convicted war criminal who had been imprisoned for ordering the killings of Bosniaks. The fact that the leader of the conservative-Catholic NGO In the Name of the Family also attended the event indicated that there are no clear boundaries between center-right mainstream groups and right-wing extremists. Another instance demonstrating the widespread tolerance of right-wing extremism occurred in November 2013, when Josip Šimunić, a player in Croatia's national soccer team, chanted a slogan associated with Croatia's fascist Ustaša regime together with fans to celebrate Croatia's victory against Iceland in a World Cup qualifying match.

The political leadership prevents cleavage-based conflicts from escalating. Veterans of the Yugoslav wars and other right-wing political actors have tried to mobilize political support by appealing to resentment of ethnic Serbs and historic grievances. For example, the interest association of veterans collected more than 500,000 signatures for a referendum to constrain the official use of Cyrillic letters in municipalities with ethnic Serb residents. Their proposal aimed at raising the threshold of the local Serb population required for the use of Cyrillic in addition to Latin. This would prohibit the use of Cyrillic signs in a city like Vukovar, which was particularly contested during the war and has become a symbol of Croat national assertiveness. In August 2014, the Constitutional Court ruled that such a referendum was unconstitutional because the restriction of minority rights was not sufficiently justified.

Cleavage /  
conflict  
management

8

In November 2013, interest associations of veterans organized a demonstration in Vukovar to prevent President Josipović and Prime Minister Milanović from participating in the commemoration of victims of the city's siege.

In October 2014, war veterans began to camp in front of the Ministry of Veterans' Affairs to protest against the minister and to campaign for a constitutional law protecting their status. The main opposition party, the HDZ, supported the veterans' protests as a means to mobilize its voters and to delegitimize the government.

In the first round of the presidential elections held in December 2014, 16.4% of voters supported Ivan Sinčić, a 24-year old political newcomer and independent civil society activist advocating a mix of left-wing, populist and nationalist ideas. Some observers have viewed this electoral support as a protest against the political establishment and as an indication of citizens' dissatisfaction with the candidates of the main parties.

The political leadership permits civil society participation. It takes into account and accommodates the interests of most civil society actors. The prime minister and cabinet members frequently met with representatives of NGOs and social organizations, such as trade unions, employers' associations, churches and veterans' organizations

Civil society  
participation  
7

The political leadership recognizes the need to deal with historical acts of injustice, but its attempts for reconciliation encounter difficulties.

Reconciliation  
8

In January 2014, the Croatian government extradited Josip Perković to Germany. Perković headed the Croatian section of the Communist secret service and was responsible for establishing Croatia's secret service after 1990. Germany's federal police agency had issued an arrest warrant for Perković, who was suspected of directing the murder of an exiled Croat dissident in Germany in 1983. Croatia's parliament had previously adopted a law to prohibit the extradition of individuals wanted on crimes committed prior to 2002, but had to revise the law because it violated EU law. By adopting this so-called "Lex Perković," a majority of parliamentary deputies decided to protect Perković, who had significant political influence, also because his son is charged with guaranteeing the security of leading Croat politicians. The parliament's refusal to facilitate the judicial investigation of the charges indicates a lack of willingness to confront crimes committed during the communist era.

In January 2015, the Constitutional Court rescinded a ruling convicting wartime general Branimir Glavaš, enabling his release from prison and return to Croatia. Glavaš, a former leading politician of the Croatian Democratic Union, had been convicted of war crimes committed against ethnic Serbs in 1991-92. To escape imprisonment, Glavaš had fled to Bosnia and Herzegovina where he was jailed following a request by Croatia to enforce his sentence. The Constitutional Court found that the Supreme Court and the county courts had convicted Glavaš on the basis of inapplicable international law conventions. The Constitutional Court returned the case to the Supreme Court and ordered it to investigate whether Glavaš's right to a fair trial had been violated. Representatives of Croatian Serb refugee associations criticized the verdict as "shameful" and "scandalous."

In September 2014, Croatia's president dismissed his chief analyst, Dejan Jović, because Jović had claimed that the 1991 independence referendum was not held under conditions that permitted the freedom of expression.

A broad coalition of non-governmental organizations from all ex-Yugoslav countries advocated establishing a regional commission for the establishment of facts about war crimes and other serious violations of human rights committed in the former Yugoslavia from 1 January 1991 to 31 December 2001. This commission had not been institutionalized by the end of January 2015.

## 17 | International Cooperation

Political elites and public opinion in Croatia perceive the conditions and rewards established by the European Union and the United States as externally imposed pressure. Compliance with these conditions has therefore not been primarily motivated by intrinsic convictions but by cost-benefit considerations. For example, the government only extradited a former Communist secret service chief wanted for the murder of an exiled Croatian dissident in Germany after the European Commission had threatened to sanction the country for its violation of the European Arrest Warrant rules. However, a small part of the political elite has carried out suggested changes because of a commitment to democracy. Croatia has also made progress compared to the early 2000s and compared to other countries of the former Yugoslavia that are still struggling to strengthen the rule of law.

Effective use of support

8

The government mostly acts as a credible and reliable partner, but some international actors still express doubts regarding its reliability. In June 2013, Croatia's parliament adopted a law that constrained the scope of the European Arrest Warrant to crimes committed prior to 2002. Aimed at protecting Josip Perković, an influential communist-era security official suspected of organizing the murder of an exiled Croat dissident in Germany, the law violated EU law Croatia had declared to respect in its accession treaty. This prompted the European Commission to envisage imposing sanctions on Croatia. According to the Commission, Croatia had broken the trust expressed by exempting Croatia from a post-accession monitoring. In January 2014, Croatia's government gave up its initial resistance, revised the law and extradited Perković. This action contributed to improving the cooperation with other EU states in the area of criminal law.

Credibility

8

The political leadership cooperates with many neighboring states and complies with the rules set by regional and international organizations. Croatia's newly elected president pledged to advocate the rights of ethnic Croats in neighboring countries. During the presidential election campaign, she indicated she would propose blocking Serbia's EU accession talks if Serbia did not provide sufficient information about missing persons from the 1990s conflict.

Regional cooperation

9

The relations between Croatia and Serbia deteriorated after the International Criminal Tribunal for the former Yugoslavia had temporarily released the Serbian ultra-nationalist Vojislav Šešelj. Croatia's government criticized that Serbia's government

had not clearly distanced itself from Šešelj's public claims for a Greater Serbia incorporating parts of Croatia.

Croatia and Serbia had also lodged suits against each other before the International Court of Justice, arguing that they had been subject to the crime of genocide committed during the wars 1991-1995. In early 2015, the Court ruled that neither Croatia nor Serbia had provided sufficient evidence to substantiate the accusation of genocide.

In November 2014, Croatia's Minister of Justice threatened to block Serbia's EU accession if Serbia did not prosecute war crimes committed by Yugoslav People's Army generals.

In August 2014, the presidents of Croatia and neighboring states agreed to intensify the search for people still missing from the wars of the 1990s.

Croatia and Montenegro continue to dispute the delineation of their maritime border at the Prevlaka peninsula, an area with potentially rich oil and gas fields. By January 2015, the International Court of Justice, which was involved by both states in 2008 to settle the dispute, had not yet issued its arbitration.

In July 2014, the European Court of Human Rights ruled that Slovenia had to reimburse citizens of other Yugoslav republics for deposits held in Ljubljanska banka, as the government had restructured the bank in 1994. Slovenia's government had refused the reimbursement, arguing that claims should be settled by all successor states of Yugoslavia on the basis of their respective territorial jurisdictions. The ruling concerns about 130,000 former clients in Croatia.

## Strategic Outlook

The Milanović government has faced an uphill struggle in its efforts to overcome the legacy of deep-seated structural economic problems and clientelistic interest group politics left by the preceding governments. The high levels of popular support for the opposition parties observable in opinion surveys are likely to translate into a change of government in the parliamentary elections scheduled for early 2016. Croatia's next government will have to address three challenges to avoid a "Greek" scenario of insolvency, deepening socioeconomic divides and populist economic policy maneuvering with severe long-term damage to the country.

First, any future government will need to devise a strategy to attract foreign investment into economic sectors and industries with the potential to generate high added value and internationally competitive products or services. This strategy should include policies to better use the country's potential as a tourist destination while coping with the wage and price distortions investments in tourism have generated for other sectors. Education and research and development policies should be better oriented to facilitate the emergence of high technology, skill-intensive businesses. Structural reforms of these policies need to be combined with a more effective use of the EU's Structural and Cohesion Funds. Improving the country's absorption capacity will be particularly difficult in view of its inefficient public administration and the constraints on public finances after years of cumulating debt and large fiscal deficits.

Second, a future government will have to reform public administration to improve its efficiency, effectiveness and integrity. This reform should include the management of human resources, aiming at creating a more professional, depoliticized civil service and a civil-service culture opposed to clientelism, nepotism and patronage. Moreover, administrative reform would also involve restructuring the territorial organization of public administration, that is, the relationship between subnational self-government and the state administration and the relationship between local, regional and central government. The aim should be to integrate the deconcentrated territorial units of line ministries and the fragmented units of local self-government, enabling the latter to perform more public tasks on their own.

Third, a future government should demonstrate its commitment against right-wing extremism and neo-fascism. If mainstream political parties and politicians show tolerance of extremist political actors, they undermine the principles of liberal democracy enshrined in Croatia's Constitution, harm Croatia's international reputation and obstruct the leading role Croatia could play in the Balkans. Rather than reinforcing Croatia's divisive history through public gestures, leading mainstream politicians should try to acknowledge the ambivalences of historical events and the legitimacy of alternative perceptions or interpretations.

Center-right and center-left political elites alike should emphasize that Croatia's democracy of today represents a clear break with the fascist state of 1941-45 and that the so-called homeland war of 1991-95 involved unjustifiable crimes committed against non-ethnic Croat civilians. The scale of crimes and violence characterizing these historical periods precludes any glorifying reference to them. Building such a consensus among moderate political elites would indicate the civic, political and cultural maturing of Croatia's new nation-state.