

## **BUSINESS EFFICIENCY – RANKING THE REPUBLIC OF CROATIA AS A DESTINATION IN A REGIONAL, EUROPEAN AND GLOBAL ENVIRONMENT**

Mladen Vedriš, PhD\*  
Ružica Šimić, MA\*\*

### **Summary**

Since the beginning of this decade, which corresponds to the processes of an accelerated political, social and economic opening to the European and global environment, the Republic of Croatia has become aware of the need for deep reforms to enable the creation of permanently sustained success of its national economy. In this context, the creation of conditions for efficiency in existing business entities, and the shaping of new and effective institutions, is becoming the central question for all of the necessary changes. It is also the same from the aspect of success in achieving individual reforms and their synergistic power and value.

Besides subjective value judgments and a feeling about the degree of change that has been achieved, objective parameters of success are measured and observed in individual value scales that have become generally accepted regional, European and global standards. Since 1979, one standard has been the ranking of the World Economic Forum (WEF), in which Croatia has been included 2002. Croatia has been included in the rankings of the IMD rankings, which began in 1989, since 2006. At the same time, Croatia's position has begun to be evaluated in other important rankings that measure the effectiveness of individual countries, such as Doing Business (the World Bank), the Index of Economic Freedom (the Heritage Foundation), the Bertelsmann Transformation Index (Bertelsmann Foundation), the Corruption Perceptions Index (Transparency International), the Global Entrepreneurship Monitor (London Business School and Babson College), which are the leading and most recognized in a social and economic context.

*Key words:* economic growth, business efficiency, structural reforms, institutional framework, competitiveness, international environment of the European Union.

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\* Dr. Mladen Vedriš, is assistant professor in the Department of Economic Policy at the Faculty of Law in Zagreb and a member of the National Competitiveness Council.

\*\* Ms. Ružica Šimić, is a research and teaching assistant in the Department of Economic Policy at the Faculty of Law in Zagreb.

The purpose of this paper is twofold. First, it will show the current situation and the level of business efficiency that has been achieved in Croatia. Second, it will analyze under the circumstances of daily life and work, Croatia's position in comparison to other countries in the region, and to members of the EU, and – globally. However, the key goal, on the basis of scientific and reasoned analysis, is to establish what solutions and what actions are necessary in individual sectors – from an institutional framework to macroeconomic policy – in order to raise in absolute terms the level of Croatia's attractiveness as a business destination, but more importantly, to raise it within an environment that has already been suggested by the title of this paper – regionally, within Europe and globally.

The first section will analyze the existing situation through the evaluation and position achieved in specific rankings of business efficiency. The absolute and relative position of Croatia in individual sectors will be established and what transpired in specific time periods will be analyzed. Also the reasons that conditioned, either objectively or subjectively, specific acts, or immobilizing actions, in the implementation of reforms necessary for a partial or overall climb in individual rankings will be analyzed.

The second section will evaluate the causes that led to fundamental limitations. These began with the *lost decade* within the former Yugoslavia, but they also continued in the newly independent Republic of Croatia, primarily as a consequence of aggression and war, and then because of the selection of an inadequate framework for institutional change and macroeconomic and overall policy.

The third section will analyze the possibilities for overcoming the current situation. It will also emphasize the high degree of consistency that it is necessary to achieve in reforms at the national level, with the demands for adaptation on the road to full EU membership.

In the conclusion the authors point to partners whom it will be necessary to find at the national level, and the consultation process that will have to be achieved with *stakeholders* in order to achieve individual reforms. The synchronization of reforms, meaning their structural and temporal harmonization, however, is the basis not for a perceived but an actual raising of the level of business efficiency as an essential precondition for a higher rate of investment by foreign and domestic partners, which ultimately is the only path available for lasting and sustainable economic development.

## INTRODUCTION

The Republic of Croatia has gradually achieved its political and economic independence. The break-up of Yugoslavia and international recognition of Croatian independence in 1992 was an essential, formal act that established a new reality.

But, the process of creating a comprehensive concept for the national economy that would at the same time operate interactively in its environment (regional, European, and global), was, and still is, in structural terms, a more complex and longer term process. For more than a decade, parameters were measured almost exclusively as an internal comparison in various time periods, and only partly as a regional (or transitional) one. Only since 2002, when Croatia was included in the international rankings of the World Economic Forum, has Croatia begun an evaluation of its business efficiency within a global framework.

### ANALYSIS OF THE EXISTING SITUATION

In the leading global rankings of business efficiency (WEF) the leading countries of the world, where it has been established that size or location are not decisive factors for determining a ranking, it is important to observe the results achieved by the group of transition countries that in the meantime also became members of the EU (2004). Their positions in the rankings of global economies were (primarily) between 35th and 50th place, which has made them reforming and potentially successful business destinations. This is an evaluation that links them to the countries in the first group -- from the top of the list to 50th position. Croatia is gradually but with difficulty approaching this first group of countries, and in this context, has achieved a more successful ranking than two transition countries (Bulgaria and Romania) which in the meantime (1 January 2007) have become EU members. With the exception of Slovenia, Croatia is also ranked considerably higher than other countries that arose after the break-up of the former Yugoslavia (1990 - 1992).

Table 1.

#### *Global Competitiveness Index 2007 – 2008*

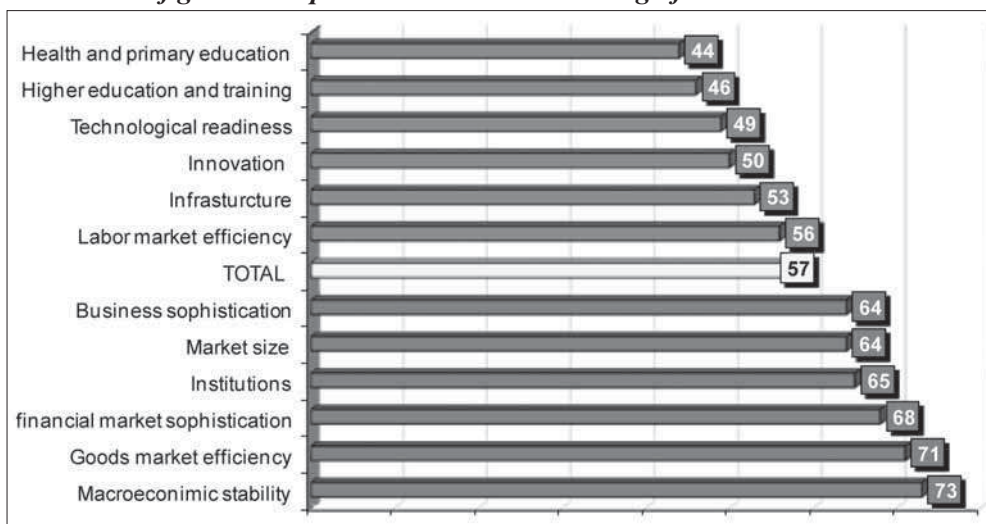
USA	1.	Estonia	27.
Switzerland	2.	Czech Republic	33.
Denmark	3.	Slovenia	39.
Sweden	4.	Slovakia	41.
Germany	5.	Hungary	47.
Finland	6.	Poland	51.
Singapore	7.	Turkey	53.
Japan	8.	Croatia	57.
UK	9.	Romania	74.
Netherlands	10.	Bulgaria	79.
Korea	11.	Macedonia	94.
Hong Kong	12.	Serbia	91.
Canada	13.	BiH	106.
Taiwan	14.	Chad	131
Austria	15.		

Source: Global Competitiveness Report 2007-2008, WEF, 2007

In 2007, Croatia maintained its relative position, which was accompanied in real terms by a moderate positive shift by which it has drawn closer to the new member states of the EU, and away from the countries of the former Yugoslavia. To estimate the future prospects for advancement in the scale depicted above, a more detailed analysis of achieving the pillars of global competitiveness (12 pillars), and the ranking of Croatia in each of them individually, may be of crucial interest.

Graph 1.

***Pillars of global competitiveness and the ranking of Croatia***



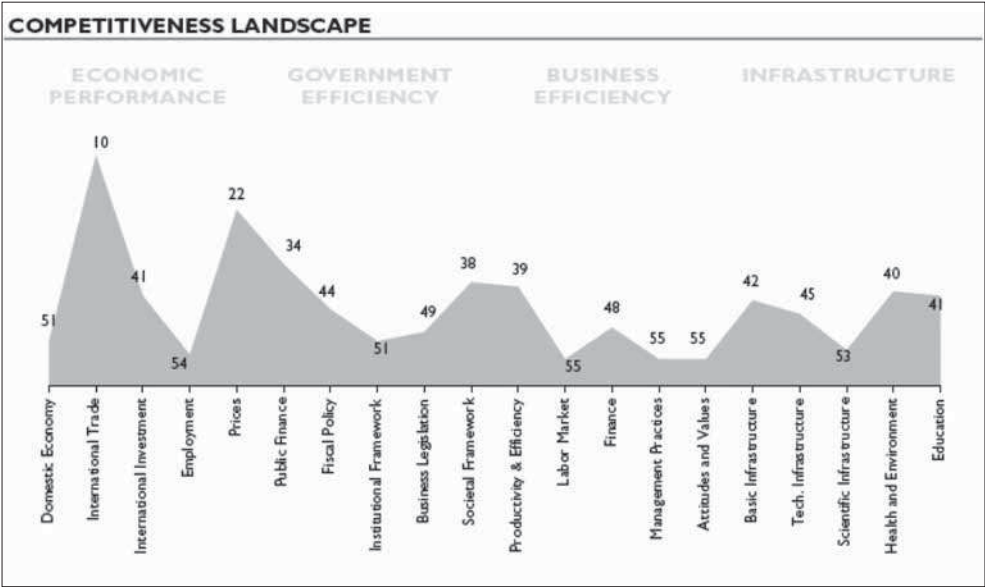
Source: National Competitiveness Council, based on World Economic Forum, Global Competitiveness Report, 2007-2008.

It should be observed in the graph above that the ranking of Croatia in several areas -- *health and elementary education, higher education and professional training, technology and innovativeness* -- is already in the group of the top 50 countries. A rising, positive trend is also apparent in the categories of *improving the quality of infrastructure*, and changes that are taking place in the *segment of the labor market*. Sectors in which reform efforts have to be made more intensively and more rapidly are: *business sophistication, the quality of the operations of institutions and financial institutions, increasing freedom*, but also *market dispersion* linked to the flow of goods. The *macroeconomy* is depicted as a sector that in particular requires adaptation. Only by a substantial effort to change in these last described areas can Croatia raise its level of quality and efficiency as a business destination of the first rank, which means entering into the circle of the pro-actively reforming countries.

It is undoubtedly necessary to evaluate and analyze the depicted ranking using the research results of other organizations. The goal is to weigh subjectivism and

one-sidedness in the analysis against the degree of reality in the findings. For that purpose, the research results obtained from other (complementary) rankings (IMD, Lausanne, 2007) might prove to be exceptionally useful. <sup>1</sup>

Graph 2.  
*Ranking of Croatia by Individual Sectors*



Source: World Competitiveness Yearbook 2007, IMD 2007

Of the total number of countries included in the rankings (55), Croatia’s ranking (53rd) represents a double challenge. The first is to analyze the reasons that determined this rank, while the second is what to do to improve this ranking. Croatia is evaluated as above average in the ranking category *international trade*, which primarily is due to its high foreign exchange earnings (absolute and relative) generated by the tourist industry. More satisfactory than the average ranking are: *price stability, the quality of public finance and business legislations*. Also evaluated affirmatively are: *societal framework and health and education*. The areas where the

<sup>1</sup> The IMD World Competitiveness Yearbook currently includes 55 countries from around the world, primarily those with the highest degree of economic development. The countries are ranked on the basis of 323 criteria divided into four key areas with several sub-areas: Economic Performance (domestic economy, international trade, international investment, employment, prices), Government Efficiency (public finance, fiscal policy, institutional framework, business legislation, societal framework), Business Efficiency (productivity, labor market, finance, management practices, attitudes and values), Infrastructure (basic infrastructure, technological infrastructure, scientific infrastructure, health and environment, education).

acquired data, comparatively observed for Croatia, indicate the need for urgent action and reform are: *employment and the labor market, institutional framework, management, quality, scientific infrastructure, and attitudes and values*. The rank of these latter categories in general match the evaluation (EU 2007) on the need for greater mobilization of the general public in the direction of: a) understanding the need for change; and b) support for the necessary changes and reforms that must be achieved as a necessary (pro)active reflex to current global events.

The cited research (IMD, 2007) basically is structured on four important areas: *Economic performance, Efficiency of the government and public services, Efficiency of the business sector, and Quality of infrastructure*. Within these four areas, Croatia is ranked lowest in *Business Efficiency* (55), and highest in *Infrastructure* (43). *Economic performance* (50) and *Government efficiency* (50) are areas where Croatia was evaluated somewhat higher than its overall ranking (53). However, it is a cause of concern that in both cases there has been a downward trend (from a ranking of 48 to 50).

For a more relevant and complex evaluation of Croatia's position within this given research topic, it is necessary to consider its ranking by the World Bank's report *Doing Business*.<sup>2</sup> A positive signal and active position of Croatia related to the findings of this research can be recognized and observed in which Croatia is located among the leading reform countries, with the goal of removing *bottlenecks*.

Table 2.

***Number of Reforms in Doing Business 2008***

Leading reformers:

Egypt	5
<b>CROATIA</b>	<b>4</b>
Ghana	5
Macedonia	3
Colombia	3
Georgia	6
Saudi Arabia	3
Kenya	4
China	3
Bulgaria	3

Note: Economies are ranked on the number and impact of reforms, *Doing Business* selects the economies that reformed in 3 or more of the *Doing Business* topics. Second, it ranks these economies on the

<sup>2</sup> The *Doing Business* project provides objective measures of business regulations and their enforcement across 178 countries and selected cities at the subnational and regional level. This report covers following areas: Starting a business, Dealing with licenses, Employing workers, Registering property, Getting credit, Protecting investors, Paying taxes, Trading across borders, Enforcing contracts, Closing a business.

increase in rank in Ease of Doing Business from the previous year. The larger the improvement, the higher the ranking as a reformer.

Source: Doing Business 2008 Croatia, World Bank.

With four areas in which it is achieving reforms, Croatia, along with Egypt (5), Georgia (6), Ghana (5) and Kenya (4), is among the top countries that are carrying out reforms in areas that are essentially limiting its business efficiency as a national destination. Such an evaluation and such a process is also essential from the aspect of the awareness and the fact that such a powerful, urgent reform capacity is being achieved primarily in economically highly developed countries. It might therefore be of interest to consider Croatia's position in this ranking.

Table 3.

***Doing Business – 2008***

Economy	Ease of Doing Business Rank	Economy	Ease of Doing Business Rank
Singapore	1	Slovakia	32
New Zealand	2	Hungary	45
United States	3	Bulgaria	46
Hong Kong, China	4	Romania	48
Denmark	5	Slovenia	55
United Kingdom	6	Czech Republic	56
Canada	7	Turkey	57
Ireland	8	Poland	74
Australia	9	Macedonia, FYR	75
Iceland	10	Montenegro	81
Norway	11	Serbia	86
Japan	12	Croatia	97
Finland	13	Bosnia and Herzegovina	105
Sweden	14	Congo, Dem. Rep.	178
Thailand	15		
Estonia	17		

Source: Doing Business 2008, World Bank.

Although at first glance Croatia's ranking (97) out of the total number of countries (178) does not seem to be a preferred one, it is important to put this ranking into a more dynamic context, which means comparing it to the rank that it achieved in 2006 (134 out of 175) and in 2007 (124 out of 175). With a continuation of the reform process described, it can be assumed that there will be a further rise in this



ranking, and that Croatia will take over position in its upper half, which would represent a substantial improvement.<sup>3</sup>

A further *upgrading* of Croatia's position in the context of its business efficiency, parameters essential for domestic and foreign investors, can be achieved by greater legislative efforts, investor protection, and a continuation of active steps in the area of labor legislation. This latter area will require a clear and open but also well-reasoned dialogue between the business community and the labor unions in order to reach that threshold of understanding about how to raise the ranking of *employability* of workers on the labor market, instead of efforts to protect the *status quo*, which means jobs or sectors whose position whose position is increasingly more difficult (economically evaluated) to defend.

More concrete data on the two areas of potential reform are apparent in the following comparative overview.

Graph 3.

***Protecting Investors – Global Rank***



Source: Doing Business 2008 Croatia, World Bank.

<sup>3</sup> **Croatia** reformed in four of the 10 areas studied by Doing Business. Two years ago, registering property in Croatia took 956 days. Now it takes 174. Company start-up also became faster, with procedures consolidated at a “one-stop shop” and pension and health services registration now online. Credit became easier to access: a new credit bureau was launched, and a unified registry now records charges against movable property in one place. In its first two months, €1.4 billion in credit was registered. In addition, amendments to the country's insolvency law introduced professional requirements for bankruptcy trustees and shorter timelines. (Doing Business 2008, WB, p. 3)

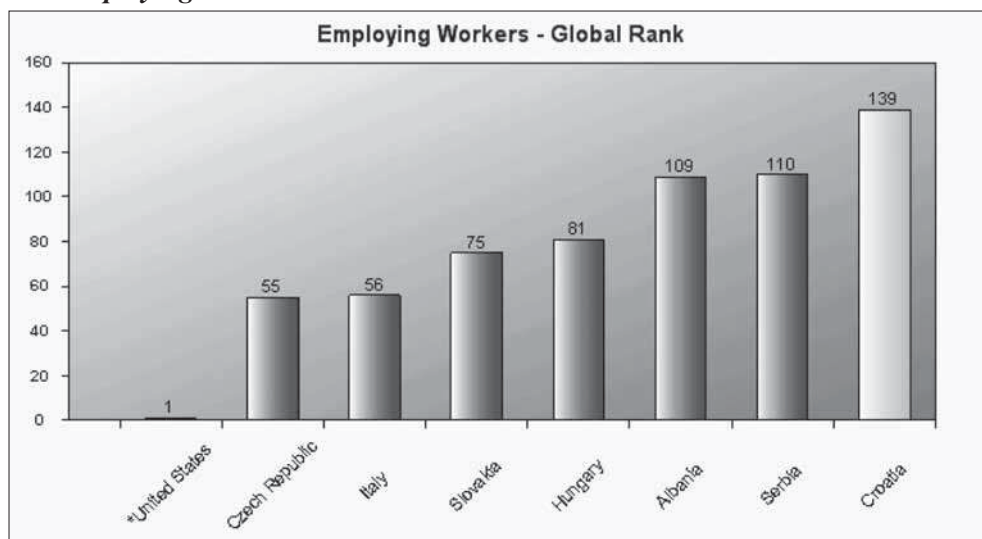


It is apparent that this legislative effort first in its iteration, and then by the public administration for its successful implementation has been achieved more or less successfully by a group of transition countries: the Czech Republic (83), Slovakia (98), Hungary (107), and most surprisingly Serbia (64). The leading counties in this area of the rankings are: New Zealand, Singapore, Hong Kong, Malaysia, the United States, Canada, Ireland, Israel, and the United Kingdom. It is also important to correlate this situation with the fact that for half of the decade of the from the 1990s until today Croatia attracted more than two-thirds *brown field* investments, in contrast to the majority of other transition countries, where *green field* investments predominated. Investments of this type, when initiated *ab ovo* with other (market) parameters require greater security for and protection of investors. The consequences of such a situation are multiple: the great proportion of *green field* investment, by definition, created and strengthened export capacity and the potential of the national economy. Regarding the impact on the upgrading of technology, it stimulates production and the creation of products with a higher degree of new value. At the same time, it creates employment corresponding to the average of a more qualified and better paid profile of workers.

However, in the other area, labor legislation and greater elasticity of the labor market, it is apparent that there is room for important positive steps. In comparison to the results of other comparable national economies, there is considerable room free to achieving structural reform.

Graph 4.

***Employing Workers – Global Rank***



Source: Doing Business 2008, Croatia, World Bank.

In the context of this indicator the highest rankings were achieved, for example, by Singapore (1), Australia (8), Denmark (10), the United Kingdom (21) the United States (55), the Czech Republic (56), Slovakia (75), Hungary (81), and Serbia (110), which are all ranked above Croatia. In regard to the fact that countries from other areas and with other value systems for achieving their concept of social cohesion (the Far East, South America, etc.) cannot be deemed appropriate for *benchmarking* for Croatia, the rankings of the Czech Republic, Slovakia and Hungary demonstrate that with the appropriate efforts at reform it is possible to achieve a position in the top half of this ranking.

A ranking whose indicators and results have analytical value of (global) significance, but which also provide certain indications for the direction of further reform, is Croatia's position on the Index of Economic Freedom.<sup>4</sup>

Table 4.

***The Index of Economic Freedom 2008***

1. Hong Kong	26. Lithuania
2. Singapore	...
3. Ireland	35. Slovak Republic
4. Australia	37. Czech Republic
5. USA	38. Latvia
6. New Zealand	...
7. Canada	68. Romania
8. Chile	71. Macedonia
9. Switzerland	75. Slovenia
10. UK	83. Poland
11. Danska	....
12. Estonija	<b>113. Croatia</b>
13. Nizozemska	...
14. Island	121. Bosnia and Herzegovina
15. Luksemburg	157. Sjeverna Koreja

Source: The Index of Economic Freedom, The Heritage Foundation, 2008.

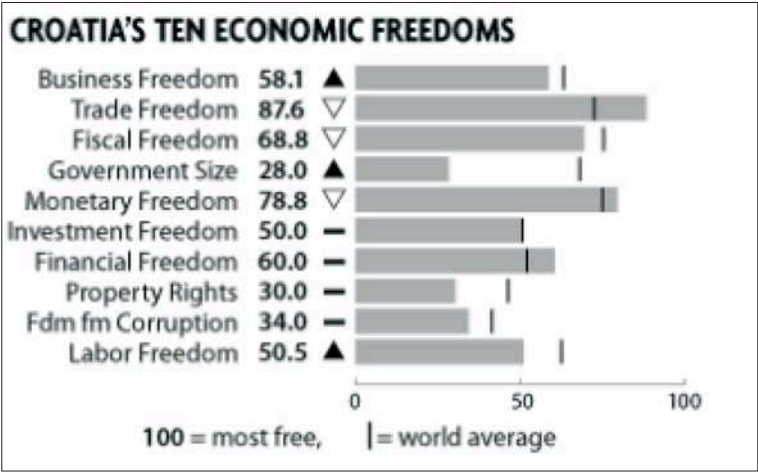
Croatia's overall position in this ranking is determined by the extremely unsatisfactory situation in several areas, such as *government size*, *protection of property rights*, *corruption*, etc. Improvement in these several areas, together with an objec-

<sup>4</sup> The 2008 *Index of Economic Freedom*, Heritage Foundation, covers 162 countries across 10 specific freedoms such as trade freedom, business freedom, investment freedom, and property rights.

tive evaluation of the methodology applied in the data gathering process and the presence in other areas, such as *fiscal freedom*, *trade freedom*, *monetary freedom*, *business freedom*, should result in important shifts in this ranking. The points results for Croatia, viewed structurally, are as follows:

Graph 5.

*Croatia's Ten Economic Freedoms*



Source: The Index of Economic Freedom, The Heritage Foundation, 2008.

In general, the result is that the Croatian economy has 54.6% freedom compared to a global average 60.3%, and a European average of 66.8%.

In regard to the stated important limitations on overall business efficiency, it is interesting to observe the position of Croatia in the rankings of Transparency International.<sup>5</sup>

<sup>5</sup>The annual *Corruption Perceptions Index (CPI)* was first released in 1995 by Transparency International. It has been widely credited with putting TI and the issue of corruption on the international policy agenda. The CPI ranks 180 countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys (from various credible sources around the world).

Table 5.  
*Corruption Perceptions Index 2007*

1	Denmark	39	Hungary
1	Finland	41	Czech Republik
1	New Zealand	49	Slovakia
4	Singapore	51	Latvia
4	Sweden	51	Lithuania
6	Iceland	61	Poland
7	Netherlands	64	Bulgaria
7	Switzerland	64	Croatia
9	Canada	64	Turkey
9	Norway	79	Serbia
11	Australia	84	Bosnia and Herzegovina
12	Luxembourg	84	FYR Macedonia
12	United Kingdom	84	Montenegro
27	Slovenia	105	Albania
28	Estonia	179	Somalia

Source: Corruption Perceptions Index 2007, Transparency International.

Croatia's position in 64th place (out of a total of 179 countries ranked), and in comparison to the earlier ranking period, reveals a slight improvement: in 2006 it was 69th out of 163 countries; in 2005, it was 70th out of 158 countries; and in 2004, it was 67th out of 145 countries. At the same time, it demonstrates how much can and must be done in this area. The fact is that the rankings of Romania (70th) or Serbia (79th) are not substantially different than Croatia's because Bulgaria (63), Slovakia (49), the Czech Republic (41), and Slovenia (27), let alone Singapore (4), Finland (3), and Denmark (2) show that neighboring (transition) countries, or those other countries at which Croatia is aiming, are achieving considerably better results, both in regard to general social values, and more specifically, in strengthening their rankings in their business capability through an ethical, highly professional way of doing business.

## 2. EVALUATION OF THE CAUSES OF FUNDAMENTAL LIMITATIONS

Croatia today is faced with the consequences of a model realized in the framework of *delayed transition*. This delay results in two degrees of which the second, factually and perceptually, is more apparent and connected to two sub-periods. The first sub-period was characterized by aggression and wartime events, and by political independence and international recognition, roughly the period from 1990 to 1995. The second sub-period, 1996 – 2004, when Croatia continuously achieved its

concept of economic policy (ideal and normative, conceptual and implemented) that began at the end of 1993 with the adoption of the so-called Stabilization Program, whose general goals were as follows: <sup>6</sup>

- a) Stabilization and strengthening of the Croatian economy;
- b) Creation of a market climate and appropriate ownership structures with a reduction of government investment in the economy;
- c) Protection of the poorest people from the destructive power of re-distribution under conditions of hyperinflation; and
- d) Creation of the pre-conditions for stable development and growth.

It was planned that the goals would be achieved in three phases, where the first phase represented a short-term anti-inflation program to provide support to the radical interventions and reforms of the economic system that were intended to remove the main generators of inflation. The second phase (to June 1994) had to encompass accelerated privatization and de-monopolization, a final balancing of the state budget, and the beginning of a long-term process of bank recovery.

This concept of economic policy, so formulated and accepted, was achieved regardless of parliamentary changes or changes in executive power. The results that were achieved, viewed comparatively, can be observed from an analysis of the Vienna Institute for International Economic Studies.

Table 6.

***European countries in transition – comparative economic indicators GDP (real change against previous year/during selected time period - in %)***

	1990-99	2002	2006	2007	2008 forecast	2009 forecast	2010 forecast
Czech Rep.	-5.3	2.0	6.4	6.6	4.5	5	5
Hungary	-0.8	3.5	3.9	1.3	3.0	4.1	4.3
Slovakia.	0.5	4.0	8.5	9	8	7	6
Slovenia	9.2	2.2	5.7	6	4.7	4.5	4.8
EU-27	...	...	3.2	3.1	2.2	.	.
Croatia	-22.2*	5.2	4.8	6	4.8	4.5	5

\* Croatia – an important difference in the following timeframes: large drop in GDP 1990-92: -35.3, followed by growth 1993-99: 20.2

Source: WIIW 2001, p. 21; WIIW 2004, p. 3; WIIW 2008, p. 3.

<sup>6</sup> Source: Anušić, Z., Rohatinski Ž., Šonje, V.: The Road to Lower Inflation: Croatia 1993-1994 (*Put u nisku inflaciju, Croatia 1993. – 1994.*), Government of the Republic of Croatia, 1995.

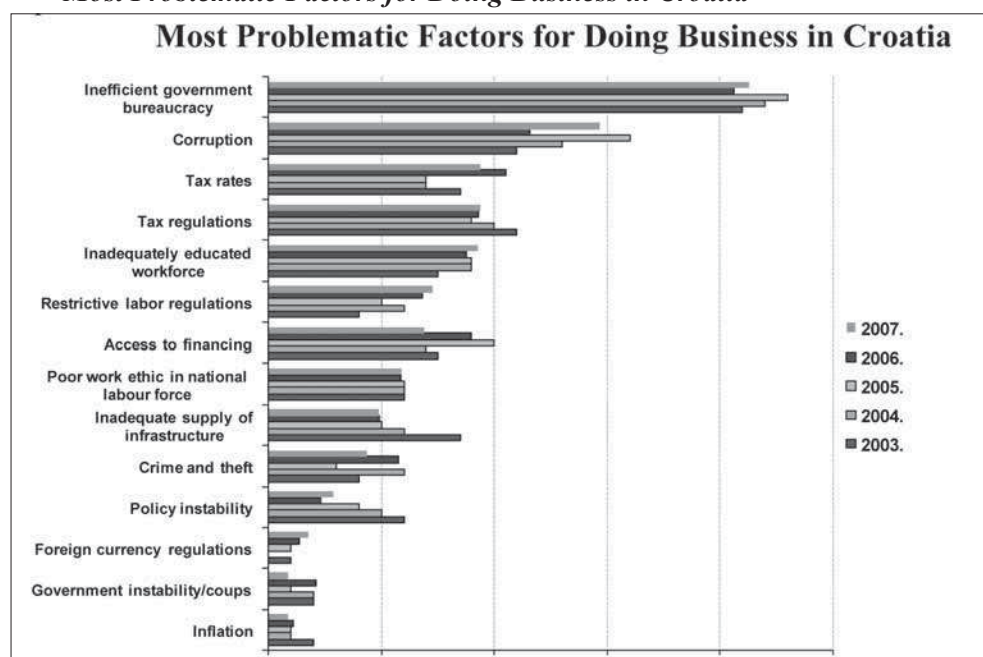
Croatia achieved considerably weaker results than similar transition countries, such as the Czech Republic, Hungary, Slovakia, and Slovenia. A possible cause of this situation may be found in the following evaluation: *“If we were to look for the primary culprit for the negative movement in the Croatian economy, especially after 1994, then it would mostly be the overall macroeconomic policy which had as its basic goal price and exchange rate stability and not development ... Such an exchange rate policy drastically changed the structure of the Croatian economy, in which a commercial sector based on exports became increasingly dominant, and which led to an increase in the balance of trade deficit, a current accounts deficit, a balance of payments deficit and the degree of indebtedness... Negative current account in the balance of payments were covered by foreign indebtedness, so that foreign debt grew 2.6 billion US dollars 1993 to 30.2 billion US dollars in 2004.”* (Družić, 2005)

Along with the stated consequences of this particular concept of carrying out exchange rate policy, at the level of subjective reasons for the current ranking, we can point to the failures of the selected model of privatization and transformation. On the side of objective (synergistic negative) factors are the consequences of war and wartime destruction, the high costs of reconstruction, and the delay in the formation of a national economy capable of regional and global competitiveness after the break-up of the once unified economy of the former Yugoslavia.

But, the erosion of economic potential in Croatia had already begun in the last decade of the former Yugoslavia, which represents the first phase of *delayed transition*. It was the direct consequence of: a) the loss of the country's global competitive capability at a time of accelerating globalization processes, and b) the beginning and unavoidable break-up of Yugoslavia due to unresolved inter-national, and consequently, mutual economic relationships. Quantitative and qualitative parameters are seen in the fact that the volume of industrial production in the period 1980 – 1990 grew by (only) 12.9%. Stagnating trends were also present in other areas: construction, tourism, and the services sector in general. Overall, Croatian GDP in 1980 amounted to 58% of the EU average, but in 1990 it was only 46%. In comparison to the global average in 1980 that indicator was 169.7, but in 1990 it was only 142.5%. (Stipetić, 2005.)

It is reasonable to evaluate this trend from the first phase (1980 – 1990.) of *delayed transition*, and to link it contextually with the second phase of events from the two designated sub-periods, and it is extremely important for a realistic view of the causes for the situation that arose in the area of national business efficiency. In summary, the current limitation on existing business efficiency in this environment can be observed by statistically weighting and considering the time dimension, and also using and analyzing the following data:

Graph 6.

***Most Problematic Factors for Doing Business in Croatia***

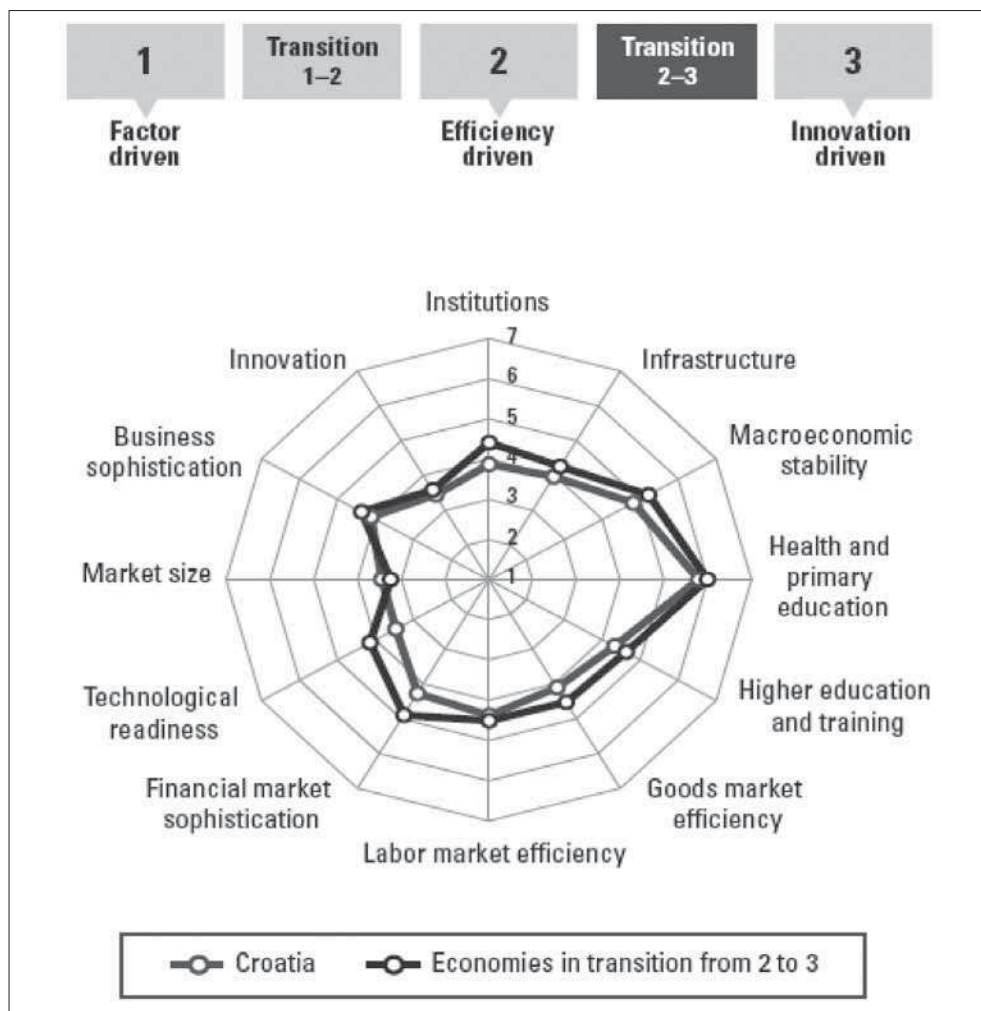
Source: National Competitiveness Council, based on the Global Competitiveness Reports, World Economic Forum, 2002-2007.

The order of the stated priorities (problems) in main determinants is constant and is present in 5 – 6 limitations: *Low effectiveness of administration, Corruption, Tax rate, Tax regulations, Inappropriately educated work force, and Restrictive labor legislation.*<sup>7</sup> The stated limitations and obstacles summarize several areas noted in other research already cited, i.e. rankings in the framework of which they are presented. Viewed comparatively, it is possible to observe the current position of national performance in business efficiency from a model that measures individual ranks and the synergistic effects of complex factors that influence the quality, sustainability and tempo of economic development of individual countries.

<sup>7</sup> It is highly probable that in 2008 inflation will be a parameter with a significant change. This is due to local and global events.



Graph 7. Croatia and the stages of competitiveness



Global Competitiveness Report 2007-2008, World Economic Forum, 2007.

It is interesting to observe how the fundamental limitations reflect the quality and tempo of the negotiations with the EU, keeping in mind the responsibility, role and interest of the EU to evaluate the capability of each new potential member to fulfill the economic portion of the Copenhagen Criteria. In accordance with this, the Commission stated in November 2007, "However, economic policy coordination between various parts of the government was sometimes insufficient. The economic rationale of reforms has not always been communicated effectively to the general public. At times, the limited impact of existing economic expertise in government

decision making reduced the scope and pace of structural reform, in particular prior to the 2007 general elections. Overall, consensus on the fundamentals of a market economy has been maintained, but the government has not taken full advantage of its economic expertise.”

The stated facts, and the accompanying evaluation, precisely show the areas in which it is necessary to act in order to achieve a positive turnaround. More complex is the question by which measures and instruments and under which policy, in the given circumstances this will be possible to achieve.


3. OVERCOMING EXISTING LIMITATIONS

Awareness of the need for reform and the strengthening of institutional capacity, while taking into consideration all of the limitations that are present on that road, arise from the simple fact that “the building of a state is the creation of new institutions and the strengthening of already existing ones.” (Fukuyama, 2005.) In this sense, both analytically and operationally, the responsibility of the state in its modern context is an important statement.

Table 7.

*The scope of state functions*

Minimal functions	Intermediate functions	Activist functions
Providing pure public goods - Defense, law, and order - Property rights -Macroeconomic management - Public health Improving equity - Protecting the poor	Addressing externalities Education, environment Regulating monopoly Overcoming imperfect education Insurance, financial regulation Social insurance	Industrial policy Wealth redistribution



Source: Fukuyama (2004), p. 11.

It is the responsibility of every state to determine what functions it will recognize as indispensable and important, how it will ensure their interaction and synergy, and depending on this, what is most important -- the ultimate result in the quality of its business environment, which primarily determines and creates the prosperity of the nation. Structural reforms are an essential element for achieving these changes. In Fukuyama’s analysis on **x-osi** is located within *Activist functions*, as part of the point of *Industrial policy*, and as such they become a *general site* that determines the overall process of change.

In its way this has been confirmed in the most recent document from the IMF (March 2008), which states the following formulation: *“Faster structural reforms will be needed for Croatia to realize its goals of sustainably raising living standards and successfully concluding EU accession negotiations. The mission’s discussions, with representatives of the public and private sector alike, continued to underscore the urgency of improving the business environment and addressing corruption, including the improving the efficiency and transparency of all levels of public administration.*

*This is critical to enhance Croatia’s attractiveness as a destination for “green-field” foreign direct investment, rightly recognized in the authorities Strategic Plan for the Economic Development of Croatia as key to sustainably increasing total factor productivity and thereby Croatia’s growth potential. In this context, judicial reform becomes doubly essential, both to underpin the rule of law needed for a better business environment, and as part of the EU accession process. Absent reforms, it is doubtful that Croatia can substantially boost export growth, thereby lessen external vulnerabilities, and raise economic growth on a sustainable basis».*

It is evident that there exists domestic and foreign expertise, both in evaluating the situation and in clear views on the types changes and reforms that are necessary. The next expected and necessary step is activism in their operational implementation. An earlier evaluation of the National Competitiveness Council is therefore both valuable and valid that today Croatia *“is faced with a competitiveness challenge in which economic development and competitive advancement depend on investment efficiency. The main sources of the present competitive advantages lie in macro-economic stability, large investments in infrastructure, and products and services that are sophisticated but largely based on imported technology, development and design. Problems with efficiency are being encountered in the areas of market efficiency, higher education and technological preparedness, i.e. the ability to absorb new technologies.”* (National Competitiveness Council, 2006, page 14)

## CONCLUSION

The Republic of Croatia in the last four-year period (since 2004) has intensively achieved reforms that are (generally) linked to fulfilling the Copenhagen Criteria of the designated negotiating framework within the negotiating process with the European Commission. The stated structural reforms, in parallel with the fulfillment of normative frameworks (the adoption of legal requirements of the EU), represent the basic conditions for full membership. At the same time, that effort is leading in the direction of raising the level of quality of business activities in the country.

As it was stated in this paper, *delayed transition* in Croatia, was in particular a consequence of wartime events, the selection of a concept of macroeconomic policy in the early postwar years, and also the selection of a model of transformation of social, or state, ownership. But, at the same time, it was part of the response to the question of later established awareness on the validity of an efficient business environment for economic development arising from the lost decade, or the last ten years of the former Yugoslavia, burdened by conflicts in the political, social and economic spheres, which completely blinded all of the participants to critical external events.

In the last four-year period the observed institutional, normative, macroeconomic and other shortcomings have motivated the social elite, meaning the executive power, the employers association, non-governmental organizations, the media, but also the general public to intensify efforts for positive changes. The upward trend in important rankings, where the same categories are measured and weighed in various ways, and this means the referenced business efficiency of a national environment, or the competitive position of an individual country, shows that the awareness created is accompanied by corresponding practical efforts and effects.

The current support (demands) of domestic (National Competitiveness Council, the Employers' Association) and foreign (especially the IMF, the World Bank and the EU Commission) organizations is gradually growing in the creation of national capacity of new institutions, and the *upgrading* of existing ones in the direction of a specific and individual contribution in particular concrete areas: land registration, the opening and registration of new companies, the protection of intellectual property, the protection of creditors, raising the overall educational level of the population, investment in physical infrastructure, etc.

To accelerate the process that has been started to create a successful *catch-up* strategy, and to make a connection to those who have already created an attractive business environment, it is important to establish suitable alliances and partnerships. In this context, it is the special responsibility and role of the central government, respecting the criteria of a social dialogue, to make a considerable effort to expand the awareness of *stakeholders* on the need to accept joint platforms and common denominators, all for the purpose of creating common and fundamental development goals.

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