THE CRISIS, NEW EU POLICIES, AND THE REPUBLIC OF CROATIA

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Abstract

The period from 2007 until today has been characterized by two extreme events: a) an economic crisis of global extent and reach; and b) rapid and powerful reactions by individual countries and regions of the world in response to those disturbances, keeping in mind the consequences of the dilatory reactions to the Great Depression of 1929-1933. In this context, and after a certain time, the EU began a series of systematic changes and coordination within its institutional framework and undertook concrete measures with the goal of correcting national economic policies, and at the same time it also established the coordination, supervision, and implementation of (non)binding recommendations for individual member countries. The measures were applied to public finance, to reducing deficits in national budgets at the level of the Maastricht criteria and to encouraging structural reforms, proportionately to each particular member state. Since 2010, the overall program of these coordinating activities and their regular monitoring has taken place within the framework of the *European Semester*.

On the basis of its full membership in the EU (since 1 July 2013) the Republic of Croatia in 2014 has been completely included in the regulations and obligations that arise from that program: from procedures to reduce excessive deficits over the next three years (2014-2016) to a series of structural changes within a special national program in the framework of the European Semester. What to do to fulfill the formal conditions and criteria, and moreover to raise the performance level of the national economy not only within the EU but globally, is the fundamental question and challenge that the Republic of Croatia is facing in the new economic framework of the EU.

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1. INTRODUCTION

The economic, development, social and regulatory position of the EU from the period before the outbreak of the global crisis (2008) and that of today's times shows a deep conceptual difference. Accordingly, a series of new organizational and regulatory solutions appeared that until that time and in regard to those changes – seemed simply impossible. After the euphoria of creating a common currency – the euro – it seemed that it was an impossible mission to also take further unifying steps: coordinating and harmonizing the economic policies of individual member countries, let alone the establishment of any joint projections, or evaluations of what had been achieved and the issuing (of increasingly binding) recommendations. The changes arose in part as a reflex and response to the crisis, and partly, somewhat less noticeably, as an awareness that the process of globalization and enhanced competitive pressures made past behavior, or any attempt to maintain the status quo, simply unsustainable.

In this context, this work will devote special attention to two types of changes:

a) the new regulatory configuration of the EU that has arisen for creating and implementing the economic policies of individual countries, and

b) a new development paradigm that conceptually and then operationally (measures, instruments, stimuli) draws on a (rediscovered) development model through the use of the tools of industrial policy – as a tool for overall development policy. And within this framework, as a special effort and a segment of activity – the renewal of industrial production on new foundations but with the same fundamental goals: the creation of a platform for the development of other (to a considerable extent service) sectors, and the introduction of innovation and the use of human development capital. All of this is a necessary response to its own shortcomings in this area and to the rapid growth in other countries – the BRIC countries and the US, which have quickly created new economic space, and to a considerable extent have also taken over that which existed until then.

In addition to these EU trends and mega-changes, a special interest of this work is to see to what extent the Republic of Croatia, after its formal (political, normative) inclusion in the EU as a full member, has also succeeded in beginning, behaving, and acting in accordance with these new realities: what are the existing deficits, what are the directions of activity, and what are the possible paths, meaning reforms and mechanisms in achieving these required changes.

2. EU: THE NEW ECONOMIC REGULATORY FRAMEWORK

The powerful shock of the economic crisis on the economic position of the EU has been present since 2008 as a continuation of the events that began a year earlier in the United States. After the first period, a year of surprises, and unilateral actions within individual member countries on how to struggle with the fall in GDP and a decline in industrial production – and following from that employment and exports – it seemed that the EU and Brussels were just joint formal institutions left over from some better and more prosperous times. An organized resistance to the crisis was present, especially in regard to the measures and actions undertaken by individual member countries. It frequently depended on the financial capabilities of a country, whether in the framework of the allocation of current revenues and expenditures, and credit capabilities (the availability and cost of capital) to shore up programs that benefited individual segments of the national economy by external indebtedness, or measures of financial participation that ensured coverage of a part of the labor costs in industry, especially those that created a higher degree of added value and had a significant share of exports.

What happened in individual countries or groups of countries within the EU (EU28, EU 27, and EU 17) can be seen from the data in Table 1 that separates the movement of GDP in a period from before the crisis (2006) until the current situation.

Table 1. Movement of GDP within the EU, referent countries and groups of countries (2006-2013)

GEO/TIME	2006	2007	2008	2009	2010	2011	2012	2013
European Union (28 countries)	3,4	3,2	0,4	-4,5	2,0	1,7	-0,4	0,1
European Union (27 countries)	3,4	3,2	0,4	-4,5	2,0	1,7	-0,4	0,1
Euro area (17 countries)	3,3	3,0	0,4	-4,4	2,0	1,6	-0,7	-0,5
Belgium	2,7	2,9	1,0	-2,8	2,3	1,8	-0,1	0,2
Bulgaria	6,5	6,4	6,2	-5,5	0,4	1,8	0,8	:
Czech Republic	7,0	5,7	3,1	-4,5	2,5	1,8	-1,0	:
Denmark	3,4	1,6	-0,8	-5,7	1,4	1,1	-0,4	0,4
Germany (until 1990 former FRG)	3,7	3,3	1,1	-5,1	4,0	3,3	0,7	0,4
Estonia	10,1	7,5	-4,2	-14,1	2,6	9,6	3,9	:
Ireland	5,5	5,0	-2,2	-6,4	-1,1	2,2	0,2	:
Greece	5,5	3,5	-0,2	-3,1	-4,9	-7,1	-6,4	:
Spain	4,1	3,5	0,9	-3,8	-0,2	0,1	-1,6	:
France	2,5	2,3	-0,1	-3,1	1,7	2,0	0,0	:
Croatia	4,9	5,1	2,1	-6,9	-2,3	-0,2	-1,9	:
Italy	2,2	1,7	-1,2	-5,5	1,7	0,5	-2,5	:
Cyprus	4,1	5,1	3,6	-1,9	1,3	0,4	-2,4	:
Latvia	11,0	10,0	-2,8	-17,7	-1,3	5,3	5,2	:
Lithuania	7,8	9,8	2,9	-14,8	1,6	6,0	3,7	3,3
Luxembourg	4,9	6,6	-0,7	-5,6	3,1	1,9	-0,2	:
Hungary	3,9	0,1	0,9	-6,8	1,1	1,6	-1,7	1,1
Malta	2,6	4,1	3,9	-2,8	3,3	1,7	0,9	:
Netherlands	3,4	3,9	1,8	-3,7	1,5	0,9	-1,2	:
Austria	3,7	3,7	1,4	-3,8	1,8	2,8	0,9	:
Poland	6,2	6,8	5,1	1,6	3,9	4,5	1,9	:
Portugal	1,4	2,4	0,0	-2,9	1,9	-1,3	-3,2	:
Romania	7,9	6,3	7,3	-6,6	-1,1	2,2	0,7	:
Slovenia	5,8	7,0	3,4	-7,9	1,3	0,7	-2,5	-1,1
Slovakia	8,3	10,5	5,8	-4,9	4,4	3,0	1,8	:
Finland	4,4	5,3	0,3	-8,5	3,4	2,8	-1,0	-1,4
Sweden	4,3	3,3	-0,6	-5,0	6,6	2,9	0,9	1,5
United Kingdom	2,8	3,4	-0,8	-5,2	1,7	1,1	0,3	1,9
Iceland	4,7	6,0	1,2	-6,6	-4,1	2,7	1,4	:
Norway	2,3	2,7	0,1	-1,6	0,5	1,3	2,9	0,6
Switzerland	3,8	3,8	2,2	-1,9	3,0	1,8	1,0	2,0

Montenegro	8,6	10,7	6,9	-5,7	2,5	3,2	-2,5	:
Serbia	3,6	5,4	3,8	-3,5	1,0	1,6	-1,5	:
United States	2,7	1,8	-0,3	-2,8	2,5	1,8	2,8	1,9
Japan	1,7	2,2	-1,0	-5,5	4,7	-0,5	1,4	1,6

Source: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&plugin=0&language=en&pcode=tec00114, 5 March 2014.

Prosperity and a high conjuncture are apparent (2006, 2007), then a decline and sinking into negative rates of growth (2008-2012), and followed by the beginning of a recovery in 2013.

But at the height of the crisis in 2010, there appeared an organized concept for the coordination of the economic policies of member countries, which began to be applied with a clearly formulated and mandatory framework of behavior and the degree of freedom in managing economic policies within the national economic of the member countries. This means that in 2010 the active use of a new economic framework for behavior, called the European Semester, began. "Launched in 2010, the European Semester is the cornerstone of the EU's strengthened framework for integrated coordination and supervision of the economic and budgetary policies of member countries. This strengthened framework builds on the Stability and Growth Pact provisions, as well as on the new EU tools to prevent and correct macro-economic imbalances and covers the implementation of the Europe 2020 strategy for smart, sustainable and inclusive growth.

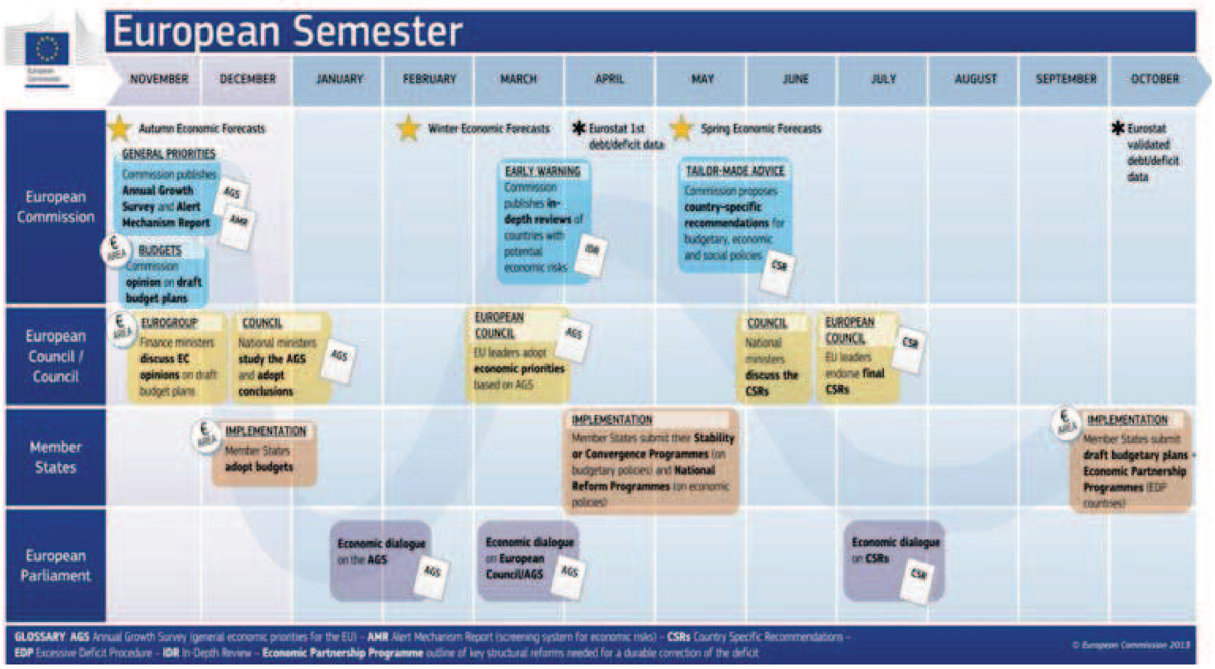
This framework has started to deliver results. A close partnership is being built between the Member States and the EU institutions, national procedures and timetables have been adjusted to enable EU level policy co-ordination to take place in a predictable framework. As a result, Member States have embarked on important reforms, putting in place the right conditions for a return to growth. Further detail on the implementation of country-specific recommendations is provided in annex.

Substantial progress has been made on fiscal consolidation. National fiscal frameworks have been significantly strengthened through e.g. the establishment of independent fiscal bodies and the setting of numerical fiscal rules and important fiscal reforms have been implemented in a difficult economic environment. This has helped to stabilize the increase in debt levels and improved financial markets' perception of the sustainability of public finances, thus lowering sovereign bond spreads. This has also contributed to preserving the integrity of the common currency and stabilizing the financial system." [1]

It is evident that awareness that the economic crisis will not disappear by itself (automatic operation of laws of the marketplace) and of the need to create real conditions for overcoming with an intelligent role of the government has accelerated the creation of just such a new, consistent system of economic management. At the end of the year, the European Semester will begin publication of its *Annual Growth Survey,* in which the Commission will announce the main economic priorities for the upcoming year. EU leaders will consider the report in March and reach agreement on joint guidelines for fiscal and structural policy. They are also analyzing the situation on the financial markets. In April, member countries will report to the Commission on the specific measures within the concept of national economic policy with which they intend to stimulate economic growth and employment and prevent macroeconomic incompatibilities and instability. This will also include measures that have been undertaken within the national area to ensure achievement of the EU fiscal rules. On the basis of these documents the Commission will analyze the situation in each individual member country and draft specific recommendations for each of them. Discussion of these recommendations will take place in June and the programs will be definitively accepted by the European Council in July. The accepted programs have to be achieved by the national governments within the framework of their national economic programs and budgets by the end of the year, when a new cycle of evaluations will begin. The table below shows the dynamic of overall events with the participants, obligations, and deadlines.

[1] Source: Communication from the Commission – Annual Growth Survey 2014, European Commission; COM(2013) 800 final, Brussels, 13.11.2013., p. 4.

Table 2. European Semester 2014



Source: European Semester 2014: Strengthening the recovery, European Commission, Brussels, 13 November 2013; available at: http://europa.eu/rapid/press-release_IP-13-1064_en.htm .

3. EU: INDUSTRIAL POLICY AND REINDUSTRIALIZATION

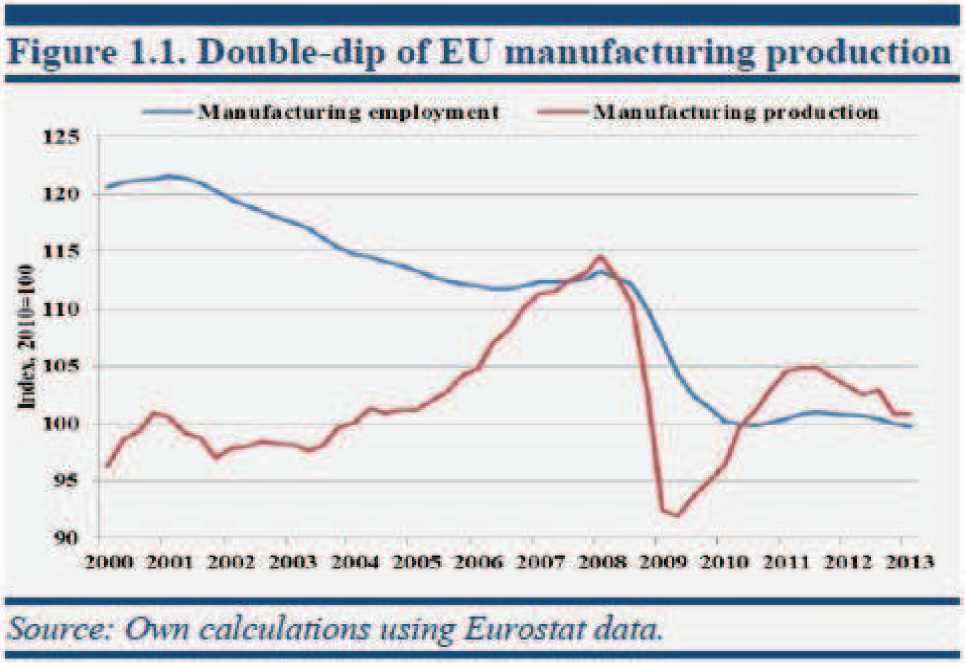
Moved by a new realism arising on the foundation of the deep crisis from 2008, the EU has opened a new path for creative thinking framed in the document *Europa 2020. A strategy for smart, sustainable and inclusive growth* is based on three strong development priorities.

- **Smart growth**: developing an economy based on knowledge and innovation.
- **Sustainable growth:** promoting a more resource-efficient, greener and more competitive economy.
- **Inclusive growth:** fostering a high-employment economy delivering social and territorial cohesion. [2]

The reasons for encouraging a new realism are evident in the next figure:

[2] Europe 2020 – A strategy for smart, sustainable and inclusive growth, Communication from the Commission, European Commisssion, Brusels, 3.3.2010., p. 3.

Figure 1. Double-dip of EU manufacturing production



Source: *European Competitiveness Report 2013 – Towards Knowledge-Driven Reindustrialization,* European Commission, Commission Staff Working Document, SWD (2013)347 final, Brussels, November 2013, p. 15.

In 2013, the success of industrial production was equal to that in 2003 (a decade of development), but the rate of employment in the industrial sector in that same year was one-fifth lower that in the year 2000.

Therefore, for the required priorities to be realized and succeed, several areas were established, the most relevant of which for the purposes of this work, is the *Flagship Initiative: An Industrial Policy for the Globalization Era.* It estimates that industry, and especially SMEs, have been hit hard by the economic crisis and that all sectors are facing the challenges of globalization and adjusting their production processes and products to a low-carbon economy. The impact of these challenges will differ from sector to sector. Some sectors might have to "reinvent" themselves but for others these challenges will present new business opportunities. The Commission will work closely with stakeholders in different sectors (business, trade unions, academics, NGOs, consumer organizations) and will draw up a framework for a modern industrial policy to support entrepreneurship, to guide and help industry to become fit to meet these challenges, to promote the competitiveness of Europe's primary, manufacturing and service industries and to help them seize the opportunities of globalization and of a green economy. The framework will address all elements of the increasingly international value chain from access to raw materials to after-sales service. [3] How that will in fact be achieved can be seen in the following overview (Box 1).

Box 1. Flagship Initiative: "An industrial policy for the globalization era"[4]

To achieve such an ambitious goal, the Commission recommended the following activities:

- To ensure that transport and logistics networks enable industry throughout the Union to have effective access to the Single Market and the international market beyond;
- To develop an effective space policy to provide the tools to address some of the key global challenges and in particular to deliver Galileo and GMES;
- To enhance the competitiveness of the European tourism sector;
- To review regulations to support the transition of service and manufacturing sectors to greater resource efficiency, including more effective recycling; to improve the way in which European standard setting works to leverage European and international standards for the long-term competitiveness of European industry. This will include promoting the commercialization and take-up of key enabling technologies;
- To renew the EU strategy to promote Corporate Social Responsibility as a key element in ensuring long term employee and consumer trust.
- At national level, Member States will need: To establish an industrial policy creating the best environment to maintain and develop a strong, competitive and diversified industrial base in Europe as well as supporting the transition of manufacturing sectors to greater energy and resource efficiency;
- To develop a horizontal approach to industrial policy combining different policy instruments (e.g. "smart" regulation, modernized public procurement, competition rules and standard setting);
- To improve the business environment, especially for SMEs, including through reducing the transaction costs of doing business in Europe, the promotion of clusters and improving affordable access to finance;

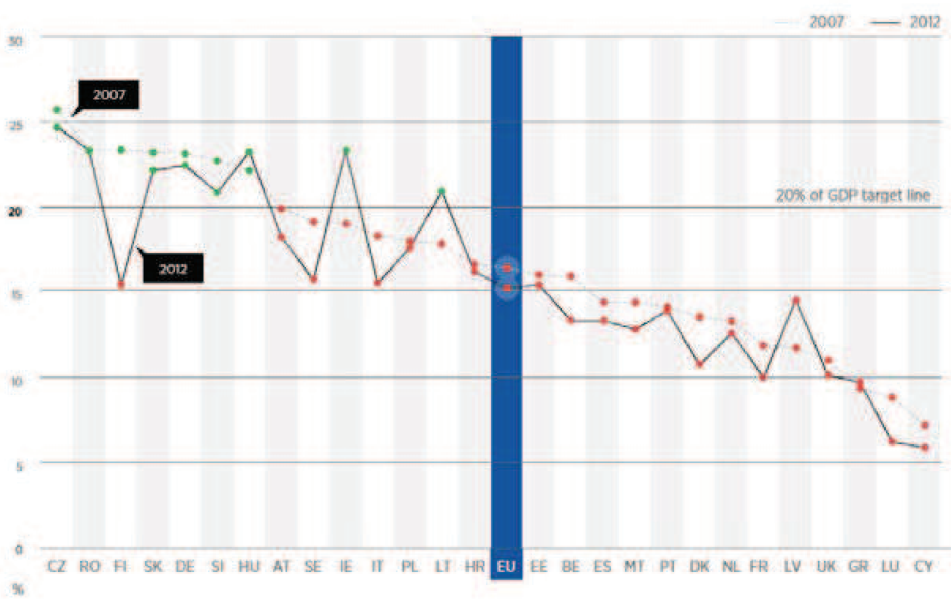
[3] Ibidem, p. 15.

[4] Ibidem, p. 15.

- To promote the restructuring of sectors in difficulty towards future oriented activities, including through quick redeployment of skills to emerging high growth sectors and markets and support from the EU's state aids regime and/or the Globalization Adjustment Fund;
- To promote technologies and production methods that reduce natural resource use, and increase investment in the EU's existing natural assets;
- To promote the internationalization of SMEs;
- To improve the business environment especially for innovative SMEs, including through public sector procurement to support innovation incentives;
- To improve the conditions for enforcing intellectual property;
- To reduce administrative burden on companies, and improve the quality of business legislation;

A turnaround is evident, but so is the pressing consequence of the two-decade trend of de-industrialization in the EU, with all of the accompanying consequences on employment, innovation capacity and exports. The following figure clearly depicts this trend:

Figure 2. EU industrial production

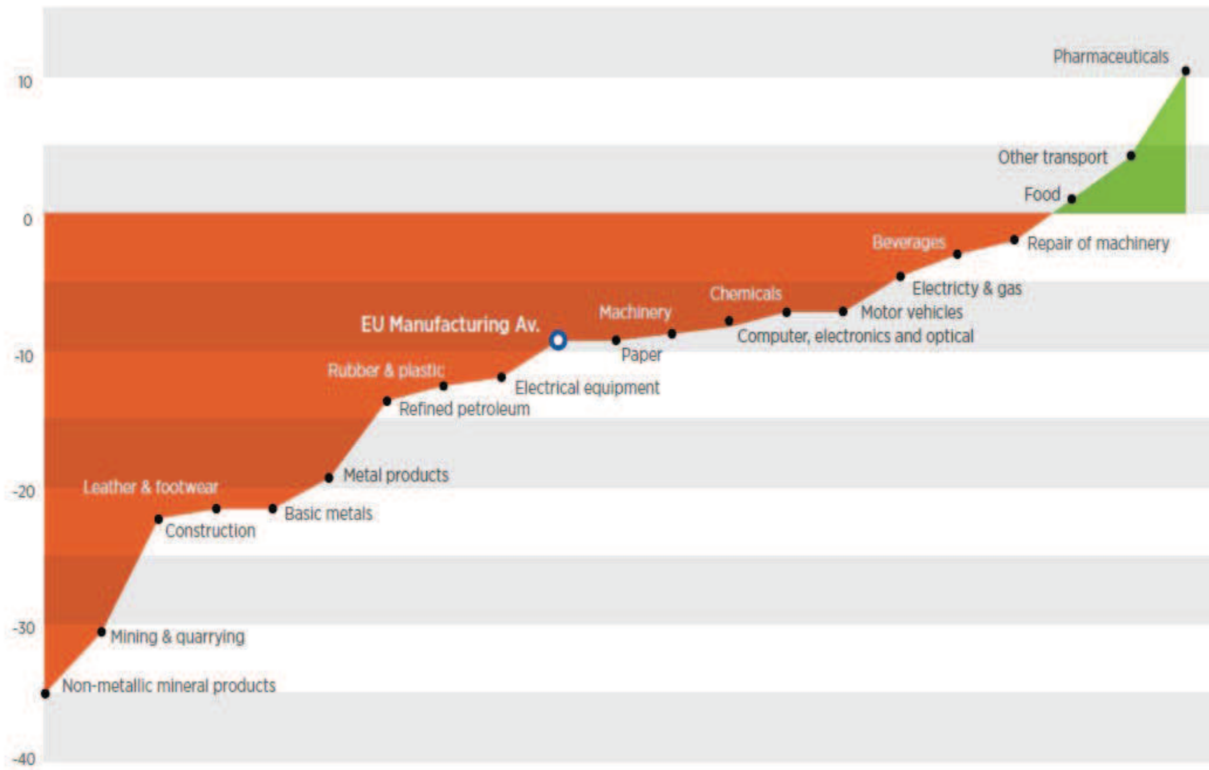


Source: ERT Benchmarking Report 2013, European Round Table of Industrialists, Brussels, updated 12/13, p. 9.

In general, the trend of industrial production at the EU level has been in a constant and drastic decline. The rate of that decline to a considerable also correlates to the depth of the overall economic crisis in individual EU countries (Greece, Spain, and Portugal). From today's approximately 15% share of industrial production in GDP, it is expected that with the introduction of a new EU industrial strategy (*European Competitiveness Report 2013 – Towards Knowledge-Driven Reindustrialization*) can be raised by a high, but not easily achievable, five percentage points to an average of a 20% share of GDP for the EU as a whole.

The dimensions of this trend in the period of the economic crisis are also expressed in the significant decline and oscillations of industrial production in the majority of the analyzed sectors.

Figure 3. EU manufacturing recovery by industry sector

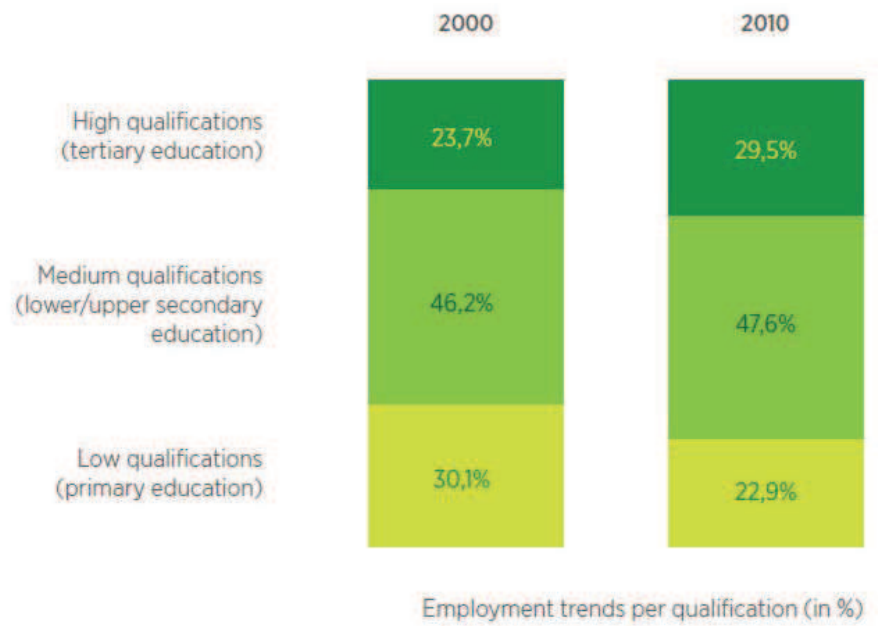


Source: ERT Benchmarking Report 2013, European Round Table of Industrialists, Brussels, updated 12/13, p. 10.

In addition to the especially hard hit sectors of construction and the metal industry, a marked decline was recorded by the chemical and auto industries and in the electronics and energy sectors. The only exceptions were a part of the food processing, the production of transport resources and especially the pharmaceutical industry. It is obvious that the demographics in the EU and the growing purchasing power in other parts of the world comprise a basis for this positive turnaround.

Such an overall decline also continues to be reflected in the general education system from the aspect of the employability of individual profiles in professional education – primary, secondary, and tertiary Overall, the threshold of the demand for higher and specialized education and knowledge has risen, at the expense of less demanding employment in industry, the construction sector, and the services sector.

Figure 4. Trends in EU job skills requirements



Source: ERT Benchmarking Report 2013, European Round Table of Industrialists, Brussels, updated 12/13, p. 25.

All of these trends were the basis for achieving the conceptual turnaround contained in the strategic guidelines of the document *Europa 2020*. A further essential step in evaluating the situation, but also in proposing concrete forms of action, is analytically shown in the previously mentioned document *Towards Knowledge-Driven Reindustrialization – European Competitiveness Report*.[5] This document is

[5] Source: *European Competitiveness Report 2013 – Towards Knowledge-Driven Reindustrialisation,* European Commission, Commission Staff Working Document, SWD(2013)347 final, Brussels, November 2013.

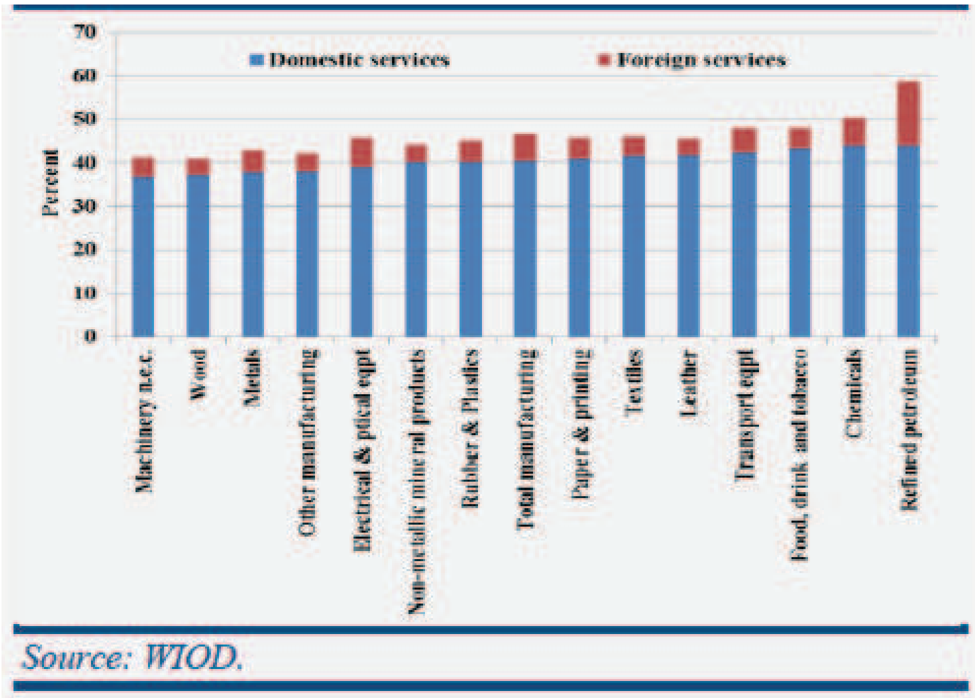
also a call for the establishment of clear and undeniable industrial policy that would raise the level of competitiveness of EU industries. It also cites three imperatives for why it is necessary to preserve the critical size of its industrial production base.

- Manufacturing still accounts for a major part of the innovation effort in advanced economies and this translates into above-average contributions to overall productivity growth and thus to real income growth.
- There are very important 'backward linkages' from manufacturing to services which provide important inputs for manufacturing (in particular business services).
- Manufacturing has a 'carrier function' for services which might otherwise be considered to have limited tradability. This operates through international competitive pressure and has an added stimulus effect for innovation and qualitative upgrading for service activities. Another linkage is increased 'product bundling' of production and service activities in advanced manufacturing activities.
- Lastly, and related to the first argument, is the higher productivity growth in manufacturing which is important because the sector of origin of productivity growth may not be the sector which benefits most from the productivity growth.[6]

The document continually explains that there is no essential dilemma about what is more important – the real sector or the services sector; the degree of their complementariness is high; in a modern economy it is difficult to imagine that they function either separately or exclusively. The following figure depicts this situation.

[6] Ibidem, p. 10.

Figure 6. Services value added in EU manufacturing gross exports 2009



Source: *European Competitiveness Report 2013 – Towards Knowledge-Driven Reindustrialization,* European Commission, Commission Staff Working Document, SWD (2013)347 final, Brussels, November 2013, p. 31.

To a great extent, the existence of the services sector and its creation of new value are linked to individual branches of the manufacturing industries and the creation of economies *of scale* and an export economy. The increasing contribution of the service industry, at the expense of manufacturing, can also be partly explained by an increasing service content of manufacturing final output. This content reflects the total value of the services required for the development, production and marketing of a modern manufacturing product. The service content of manufacturing has been growing in the EU and elsewhere in the world. Currently about a third of the price of a manufacturing product in the EU is associated with integral services. Whilst manufacturing products too are used for producing services, the manufacturing content of services produced in the EU is only around 10 per cent. The gradual rise in services and reduction in the manufacturing share of valued added do not mean that manufacturing can be ignored. It is still seen as a pivotal, though heterogeneous, sector with important production and demand linkages that play a significant role in the process of economic development.[7]

[7] Ibidem, p.

In addition to their conceptual and general value, these explanations have special importance for the national economy and society, where a forced dilemma is frequently observed: is Croatian economy being directed at (or condemned to?!) primarily the services sector only because of the existence of its tourist sector and a rapid development of commerce with a time-limited construction boom (highways, apartment construction), as a permanent substitute for the existence of manufacturing industries with all that they create: centers of competence and innovation, new employment, and a dominant role in exports, which means the presence of an *economy of scale.*

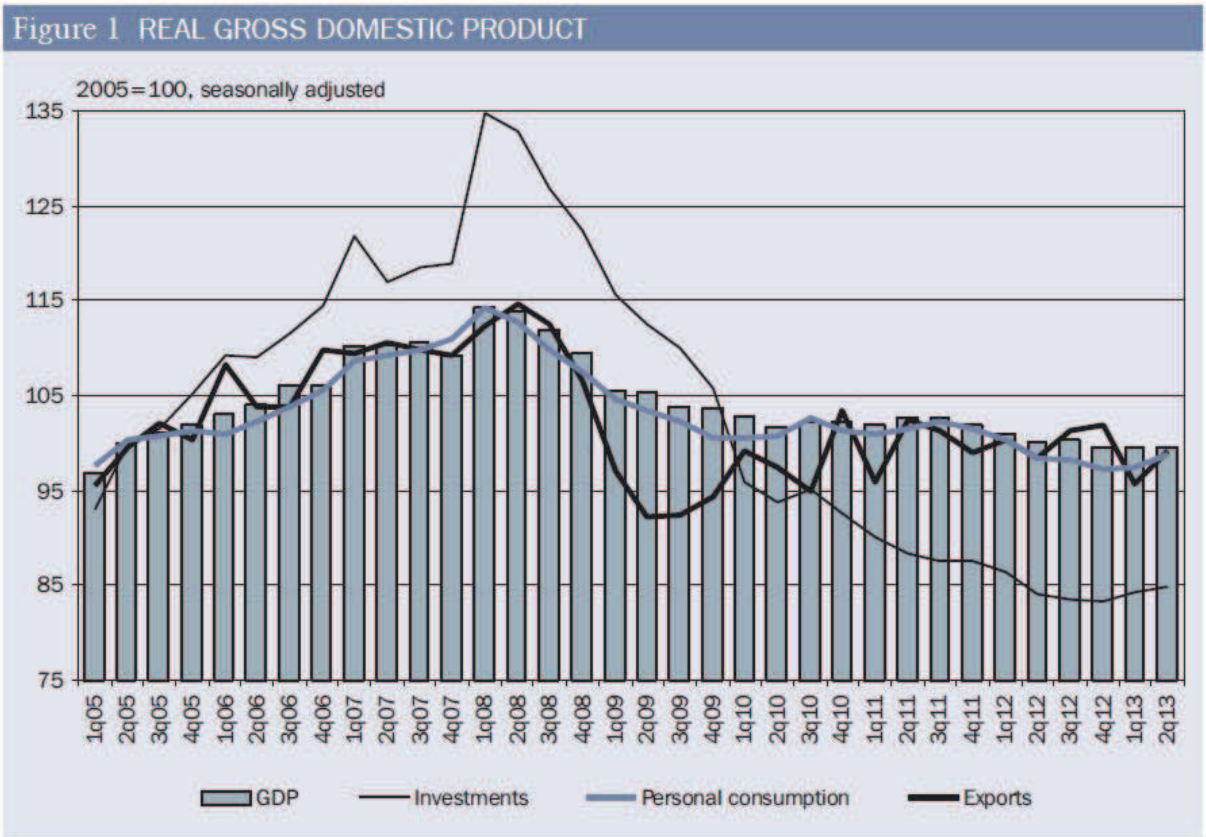
4. THE REPUBLIC OF CROATIA: THE CURRENT SITUATION AND THE NEW EU ECONOMIC REGULATORY ENVIRONMENT

In the Republic of Croatia the process of preparing for full membership in the EU took almost a decade – from the moment of the beginning of that preparation and the chapter-by-chapter negotiations under the *Acquis communautaire.* During that period, the process was slowed even more because of events with a political character, as a consequence of the war and aggression during the creation of the new country in the area of the former Yugoslavia. Although this is more an explanation than a justification, it is apparent that the full attention of the Croatian political elite and several governments was aimed at resolving open political questions, and in parallel a strong normative process of harmonizing legal acts with EU regulations.

At the very beginning, the implementation of the required structural reforms as part of a process to raise the efficiency of public administration and the judiciary and also the level of the competitiveness of the national economy, which was also affected by the inability to undertake reforms, was pushed into the background. Accordingly, the onset of the global, and soon also the European, economic crisis (2007-2008) was not perceived as an important challenge, and in such a situation there was consequently an absence of a corresponding, timely reaction, both in the consistency of the proposed measures and in their implementation.

The following figure, which covers the period from the beginning of 1995 to 2013, is an extremely important documentary foundation for understanding these statements.

Figure 7. Real gross domestic product



Note: Seasonally adjusted by X11ARIMA (Statistics Canada).
Source for original data: *Croatian Bureau of Statistics.*

Source: Croatian Economic Outlook, Ekonomski institut Zagreb, No. 56, October 2013, p. 1.

On the wave of global prosperity GDP, and also the value of investments, grew from the beginning of 2005 to the middle of 2008 in the Republic of Croatia.[8] There was also strong growth in domestic spending (credit activities of banks) and exports, especially non-commodity ones – primarily in the tourist industry. The turning point, with its negative consequences, appeared in the second half of 2008. And it has lasted continuously until now. All of the accompanying values have been in a continual decline: the level of GDP at the end of 2013 is below that of 2005. In an absolute amount it is nearly 14% lower than the level reached in the first half of 2008.

[8] For the Republic of Croatia,a special consideration in the time under consideration is the structure of investment: the relationship between brown field and green field investments and their distribution by sector: primarily commerce and construction – highway and apartment construction. But this is a question for detailed analysis and evaluation on theme outside the focus of the this work.

The level of investment has experienced a drastic decline. Compared to 2005, the level was almost 10% lower in 2013. Personal spending at the end of 2013 was at the same level as in 2005. What is especially hindering the recovery from the aspect of a small and open economy is the fact that it is now (2013) identical to the economy of eight years ago. In view of the limited purchasing power of the internal market, it becomes clearer that, first, economic recovery, and then restored growth, can only be achieved by moving beyond national borders. In principle, it is supported by the full membership in the EU, which occurred in the meantime and which would potentially provide easier access to new markets. The stated economic trends have had an important influence on the overall financial position of the country and on the status of public finances, which is apparent in the following table.

Table 3. Croatia: Government deficit and debt according to the ESA95 concept

Table B2 CROATIA: GOVERNMENT DEFICIT AND DEBT ACCORDING TO ESA95 CONCEPT

	2009	2010	2011	2012
Government revenue (in % of GDP)	40.8	40.5	40.1	40.6
Government expenditure (in % of GDP)	46.1	46.9	47.9	45.5
Deficit/surplus (in % of GDP)	-5.3	-6.4	-7.8	-5.0
Debt (in % of GDP)	36.6	44.9	51.6	55.5
Deficit/surplus (in HRK billion)	-17.4	-20.6	-25.7	-16.3
Debt (in HRK billion)	120.4	145.3	170.5	183.3

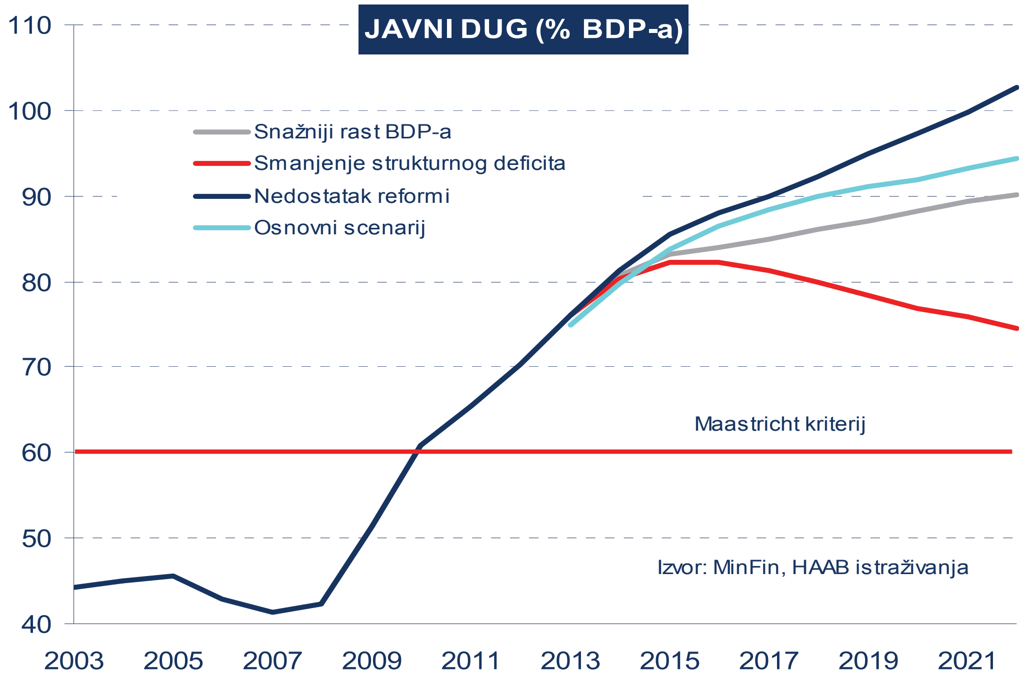
Source: Croatian Bureau of Statistics.

Source: Croatian Economic Outlook, Ekonomski institut Zagreb, No. 56, October 2013, p. 8.

In addition to the clearly stable (continued) share of public revenues and expenditures in GDP during the entire period of the crisis (2009-2013), a high rate of deficit in GDP can be seen (above 5%) and high public amounts of deficit in budget expenditure, which are covered by taking on additional indebtedness. The final consequence is that in this period public debt grew by one-third and now amounts to about 66% of GDP.

Besides the trends from the period of the economic crisis, it is of macroeconomic as well as scientific research interest to examine events from the past period in the context of trends in the upcoming period. From the aspect of public debt the projections are as follows:

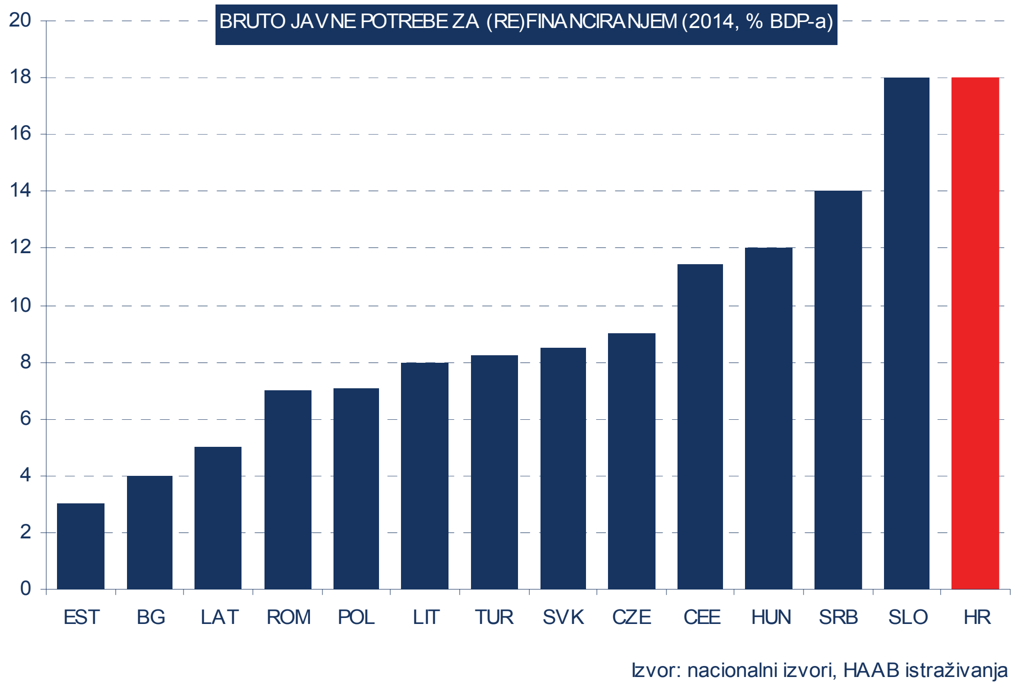
Figure 8. Public debt as % of GDP



Source: *Ekonomski izgledi 2014.-2015. – Recesija popušta, kreću li reforme?,* H. Stojić, Director Ekonomskih istraživanja, Hypo Alpe Adria, Zagreb, 1.10.2013, p. 24.

The absence of reforms, otherwise demanded by the procedure for overcoming the excessive deficit, would lead to a level of public debt for the next three years at a level of 90% of GDP and would make its refinancing a mission impossible. All of this is the link in the relationship that has been established: Croatian economic policy and the new EU economic configuration. The high degree of need for constructing a new economic policy is shown in the following data.

Figure 9. Gross public need for (re)financing (2014, % of GDP)



Source: *Ekonomski izgledi 2014.-2015. – Recesija popušta, kreću li reforme?,* H. Stojić, Director Ekonmskih istraživanja, Hypo Alpe Adria, Zagreb, 1.10.2013, p. 24.

In 2014, the Republic of Croatia needs to ensure almost 20% of the value of national GDP for financing in the current year the expected new deficit in the national budget and for refinancing the payment of annuities that are coming due, but area linked to the indebtedness from the previous period. Stated more precisely, it is necessary to ensure an amount of 8.4 billion euros, but new, additional indebtedness is planned in the amount of 1.5 billion euros.

One and the other position is part of an analysis and overall evaluation by the EU for creating a Croatian program for overcoming the excessive deficit and its reducing to acceptable frameworks in a period of the next three years. In this context, it is possible also to cite a recent evaluation of this part of the economic development, stated by the IMF Mission, according to which the risks in making the prognosis are considerable and mostly negative. It is also estimated that fiscal adjustment could cause a greater than expected reduction in private spending. Furthermore, fiscal adjustment could trigger a larger private demand compression than projected. Conversely, insufficient fiscal consolidation could trigger concerns about sustainability of the public finances and undermine investor confidence. Private sector deleveraging could remain a drag on demand for longer than projected.

Finally, tighter global liquidity conditions and a re-pricing of risk could complicate external financing, affecting especially Croatian sovereign debt. On the upside, foreign direct investment could pick up more rapidly than foreseen, reflecting in part recent policy initiatives to facilitate investments.[9]

Therefore, the IMF Mission in its final report strongly recommends sustainable fiscal consolidation, stating "While very difficult to implement in an environment of economic contraction, sustained and predictable fiscal consolidation is critical to strengthen confidence in macro-economic management, boost sentiment, and retain the economy's access to financing at acceptable conditions. A structural reduction in the general government deficit of about three percent of GDP is needed to ensure the return to a sustainable fiscal stance. To avoid an excessive fiscal contraction in the short term, IMF staff recommends stretching adjustment over three years in roughly equal annual portions. Adjustment should be supported by high-quality measures, with an emphasis on the revenue side in 2014—given the still weak economy—and a gradual switch to expenditure consolidation in 2015 and 2016. To maximize the positive impact on confidence, adjustment would best follow a comprehensive three-year plan whose main parameters are known in advance. As regards the medium term, structural balance should be restored gradually, with a view to achieving a sustained reduction in public sector debt and regain flexibility to react to economic shocks." [10]

These analyses and assessments indicate the high degree of coordination in monitoring Croatian economic policy by the IMF, in conjunction with the World Bank, especially in assessing overall national competitiveness. In parallel, the EU Commission is giving special attention to the sustainability of the financial position and the implementation of the required structural reforms. Thus, the EU Commission states that after a period of conjuncture and expansive growth up to 2009, in which the imbalances accumulated, Croatia is now passing through a phase of additional, deep, and long-lasting economic decline in which external and internal risks have strengthened. The long period of postponing the restructuring of the manufacturing sector has contributed to an inability to establish the relevant export industries as a complement to the tourist sector. Such a situation has limited Croatia's participation in the integration into a regional development of commerce

[9] Source: IMF, Republic of Croatia: Concluding Statement of the 2014 Article IV Consultation Mission Zagreb, March 3, 2014, p.1.

[10] Ibidem, p. 2.

and international exchanges, including during the years of prosperity. The ultimate consequence was that Croatia has remained a small country, a member of the EU, but with one of its most economies and at the same time a country with a relatively low level of GDP, incomes and revenues measured on any basis.

The Commission further stated: A widening current account deficit was largely funded by the foreign parents of Croatian banks and by Foreign Direct Investment (FDI) into inward-oriented sectors of the Croatian economy. As the global financial crisis unfolded, capital inflows suddenly stopped in 2009. The impact on Croatia was severe: domestic demand rapidly contracted and the ensuing recession led to soaring unemployment. The country entered a long-drawn recession from which it has not yet recovered. Despite the reversal in the current account, vulnerabilities such as high external liabilities, uncompetitive exports, a corporate debt overhang and growing public sector indebtedness persist. Structural weaknesses have contributed to these imbalances, including a poor business environment and a malfunctioning labor market. State-owned enterprises still play a dominant role and are often highly indebted and weakly profitable. These factors also combine to lower potential growth, which hinders private sector balance sheet repair and increases the required fiscal consolidation effort.[11]

Regarding possible exit strategies, the analytical assessment of the EU Commission are clear. "**Croatia's low competitiveness was eroding export market shares even before the crisis.** Croatia has been and remains a comparatively expensive production location. After 2004, Croatia's export market shares started falling from their already low level. These losses have accelerated since the crisis, indicating the persistence of a substantial competitiveness gap. Export market share losses have been concentrated in goods exports, where labor cost levels stand out in regional comparison, while overall labor costs have grown moderately since 2009 in comparison to competitors. These high costs combine with a wide range of non-cost-competitiveness deficiencies. One-off factors, including the restructuring of the shipbuilding and chemical industries, have interacted with low overall competitiveness to generate a decline in goods exports in 2013."[12]

An analytical evaluation of economic trends by the ECB is analytically less present, in view of the fact that the Republic of Croatia is not (and will not become for

[11] European Economy – Macroeconomic Imbalances Croatia 2014, European Commission, Occasional Papers 179, Brussels, March 2014, p. 9.

[12] Ibidem, p. 9.

the foreseeable future) a member of the Eurozone. However, a powerful influence on overall events and the position of the real sector can be achieved through the direct cooperation and coordination of the HNB and the ECB and strict observance of the rules of behavior dictated by the ECB, especially from the aspect of the riskiness of the regulatory framework and the operations of business banks. This influence will be additionally strengthened by the fact that more than four-fifths of the overall banking potential in the Republic of Croatia is with banks resident in the country, although the majority or sole owners are banks in Austria or Italy, or to institution that to a lesser or greater degree are subject to the competence and responsibility of the ECB.

All of this points to the fact that in addition to the realities and facts on the public scene, transmitted to the general, and frequently also the professional, public, the degree of autonomy in conducting a national economic policy is essentially limited and narrow, and not only on the basis of the openness of globalization processes and the level of current (non)competitiveness, but increasingly on the rules of the game that are made, and are now being carried out at the EU level. The dominant question in such conditions is what the Republic of Croatia, with in its current position and situation, can and must do, and how to try to take advantage of the new EU regulatory environment and the established institutional framework as a factor of support on that road, and thus strengthen its position both in the analyses of the international rating agencies and, consequently, the EU and the global financial markets.

In the context of the expected reforms, their direction, and depth, it is of interest to consider and cite the joint assessment of the troika (EU, ECB and IMF) related to *The Economic Adjustment Program for Portugal*: "**The economic recovery is strengthening.** Led by investment and exports, economic growth is somewhat ahead of projections, employment is increasing, and the unemployment rate is continuing to decline from very high levels. GDP is now expected to rise by 1.2 percent in 2014—an upward revision of 0.4 percentage points—while unemployment is projected to decline to 15.7 percent — a downward revision of 1.1 percentage points. The current account balance, which moved into surplus in 2013, is expected to improve further, although at a more moderate pace than before."[13]

[13] Source:European Economy – The Economic Adjustment Programme for Portugal, Eight and Ninth Review, Occassional Papers 164, Brussels, November 2013, p. 1, available at: http://www.imf.org/external/np/sec/pr/2014/pr1480.htm .

Furthermore, related to future planned activities is the following priority should be stressed, which is also stated in an assessment of the achievements of the program to date: "**A deepening of the structural reforms agenda is needed to continue the switch to an export-led growth model.** A wide array of structural reforms has already been adopted, and these reforms are expected to have a positive impact on growth and job creation over the coming years. But there are still important bottlenecks that hinder Portuguese companies in competing with their foreign competitors on a level playing field; these include remaining excessive rents in the non-tradable sector and rigidities in the labor market, while public administration needs to become more business-friendly. A strong commitment to continue and expand the process of structural reform into the medium term will be essential in attracting more foreign direct investment to the tradable sectors."[14]

In view of the similarity of the economic structure of Portugal and the Republic of Croatia (tourism, agriculture, construction, transport), and the loss of competitiveness that is essential for the performance of the manufacturing industry and exports, the literature what the Republic of Croatia has to accept as its reality as quickly as possible.

5. CONCLUSION

The global economic crisis initially arose in the United States. Its appearance and intensity has further accelerated the process of the globalization of economic and general social events from the 1980s until today. These changes were stimulated by the introduction of new IT technologies, the ever greater penetration of international financial structures, and in the political field the fall of the Berlin Wall and the disappearance of the US-Soviet bipolar political and military system, with the domination at that moment of a single global power, meaning the United States. But, new powers soon grew and strengthened China and the Far East as a whole. All of these events and more rapid chances inexorably appeared, but they also found the politically, economically, and socially unprepared countries of the EU. The first reflex reaction was the creation of unilateral programs to protect against the accelerating economic implosion, especially the decline of GDP and employment. At the end of 2009, a proactive program began for the creation of a new administrative and regulatory infrastructure that began to place demands on all member countries to: a) consistently formulate national economic policies;

[14] Ibidem, p.1.

and b) to coordinate individual components of those policies to a greater extent. For that purpose a general framework for EU action was created under the name European Semester. The position of the European Commission is that having to compete mainly on price may not be an attractive growth model for EU manufacturers in the long run. Given its considerable knowledge production and the high technology content of EU products, a gradual shift away from the current portfolio of predominantly mature products – where firms compete more on price than quality – to more innovative and complex products could be an avenue to pursue.

As part of the new EU monitoring, the Republic of Croatia has entered in to the circle of countries that are included in the program for reducing and excessive fiscal deficit, which is expected to be achieved in 2014-2016. The achievement of this program is ultimately expressed in the reduction of the fiscal deficit, which is planned to be 2.3% in 2014, 1% in 2015, and 1 % in 2016. To achieve this result it will be important to provide those prerequisites that stimulate economic growth. It is clear that just the introduction of financial order and discipline (which has mostly been done already) and an increased in revenues through the introduction of new tax obligations are not enough to achieve a positive growth rate. And without such growth and on the basis of increased tax revenues, and the level of production and employment, it will not be possible to achieve a turnaround and a permanently sustainable reduction of the fiscal deficit.

The initial experiences in achieving a program in individual countries that exclusively or predominantly relied on increasing revenues and reducing (public) spending, were unsuccessful (Greece, Spain, and Portugal) and served as a guide in the second phase, and in other countries that a policy for achieving economic growth and financial consolidation has to be considerably more complex and balanced.

What the Republic of Croatia can do to turn its membership in the EU, and its new obligations in coordinating its economic policy with that which is created and implemented at the EU level, to its advantage is the essential question: a) the ability and expertise of the political elite; b) the ability of the executive government to begin that process as soon as possible without (pre)election delays and without expectations that the economic recovery will just be a derivative of a new economic upswing and the economic situation in the EU and/or globally in which the Republic of Croatia, based on the logic of traveling in a convoy (its newly acquired membership in the EU), will automatically join.

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