

## Chapter 1

# **CROATIA AND THE EUROPEAN UNION: ACCESSION AS TRANSFORMATION**

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## **ABSTRACT**

This chapter summarizes the findings of the three year long project of monitoring Croatia's preparations for EU accession, if and when it comes, performed by a group of Croatian researchers. The first hypothesis is that a kind of real integration of Croatia in the European space already exists and that it should be further deepened through improvements of the relevant institutions and harmonisation with European standards and requirements. The second is that despite the professed dedication of Croatia's government to joining the EU and encouraging signals from the EU, hesitations in structural and institutional reforms may hamper not only the success of future negotiations and delay Croatia's accession, but also the transformation to a modern and efficient state. The first part of the chapter analyses the changes in the last couple of years in Croatia regarding the administrative and judicial structure, economic sustainability and democracy, human rights and fundamental freedoms; the second part emphasizes the effects of the latest EU enlargement, competitive pressures and market forces, the free movement of workers, knowledge and innovations, social issues, the real estate market and spatial planning, and regional policy. The chapter ends with conclusions and recommendations. We would lay stress on the necessity of structural reforms in legislation, the judiciary and the public administration, the restructuring of agriculture and ship-building, the privatization of public utilities and tourism; patient and

shrewd negotiations with the EU, and the possibility of bearing in mind some kind of virtual membership that could help us deepen *de facto* integration even without *de jure* membership status. Croatia's future will depend on capabilities of the government to implement and enforce the reforms and on the readiness of citizens to endure necessary adjustments even when they are painful, making certain sacrifices in the present for the sake of benefit in the future.

**Key words:**

European Union, Croatia, accession, transformation

## INTRODUCTION

The first hypothesis of this chapter is that a kind of *de facto* integration of Croatia in the European space already exists and that it should be further deepened and developed through the building of the relevant institutions and via harmonisation with European standards and requirements.<sup>1</sup> The second is that despite the ostensible dedication of Croatia's government to join the EU as soon as possible and despite encouraging signals from the EU, hesitations in structural and institutional reforms may hamper the success of future negotiations and delay not only the actual date of Croatia's EU accession, but also the conclusion of the transformation of the country into a modern and efficient state. This leads us to two conclusions. First, the citizens of Croatia should use the accession process as an incentive for constant improvements of the economic and institutional preconditions for stable economic growth, development and democratization, regardless of formal integration. Second, the government has to do its best to speed up these processes, moving from rhetorical declarations to concrete policy actions and measures.

Trying to raise the awareness of citizens and awaken the government from its over-satisfied state of mind, we have to ask ourselves at which stage of the *de facto* integration Croatia really is, what the problems are, what the possible solutions for those problems are, if our efforts to solve the problems are fast enough and if they are on the right track, as well as what can be expected in the immediate and long-term future.

For that purpose, we are dealing with the issues we deem to be the most relevant at this moment, having in mind not to repeat the issues we already dealt with in our previous two books.

The first book (Ott, 2003) emphasized economic and legal challenges. Having dealt with issues like macroeconomics, banking and finance, taxation, state aid, trade policy, energy, agriculture, employment, the legal system, civil society and gender equality, we realized that it is not enough to familiarise ourselves with the EU framework and requirements, to compare Croatia with other countries and enumerate Croatia's advantages and weaknesses. We concluded then that the most important factor in the process of the accession – and we were not even speaking at that time about accession, rather using the less-presumptuous word association – would be the role of Croatian citizens in achieving economic development, efficient institutions and a society that respects laws and individual rights.

In all the fields we were dealing with we emphasized problems of education (not just the basic educational needs of population, but also specific education about the EU, e.g. the *acquis* and Common Agricultural Policy), quality of public administration and independent agencies, normative vs. real conformity with EU rules, regulations and requirements, decisions about adjustments being made at once or later and of course sensitive issues of attitude towards regional initiatives. The particular problems we discovered were related to civil-society-building and the protection of individual rights.

That led us to the second book (Ott, 2004) emphasizing institutional challenges. Institutions are not only fashionable, but also important for both the economy and society as they can influence the level of GDP growth and stronger democratization. In this context we analysed the macroeconomic and fiscal system, poverty, inequality and social exclusion, the rule of law and the judicial system, governance and public administration, consumer, environment and minority group protection, education and science, and finally social values. Going deeper into the enumerated fields we realized that, unfortunately, adjustments are often just normative, the bureaucracy is flourishing, the laws are often poorly harmonised and equally as often deficient, causing problems in the courts, and that we have to be aware of the problems that will arise with the accession of neighbouring countries. We realized that the key issues with or without the EU accession will be: a firm will and dedication to reforms within the country, better application of existing and faster establishment of new rules and institutions, quality and depoliticisation of public administration and particularly the judiciary, and of course the quality and preparedness of institutions for the deregulation and liberalization of markets.

Aware of the uncertainty of the possible date of any future Croatian accession to the EU, which could depend on our own preparedness or the lack of it, the preparedness or the lack of it of Bulgaria and/or Romania, attitudes within the EU towards Turkey, and the probable fatigue of the EU with the last enlargement and changes and problems derived from it, in this third book we are, as emphasized at the beginning, concentrating on the accession process as the key to the transformation of Croatia. We want to emphasize the international context, the eventual consequences of the latest EU enlargement, our “competitive stance” with Bulgaria and Romania, and the aspects of the *acquis* we did not deal with in previous books, or which if we did deal with, we now find particularly important in some different viewpoint, in this book we are concentrating on the meaning of the enlarged EU for Croatia, Croatia’s trade integration, freedom of movement of workers, preparedness for the knowledge-based society, Croatia’s innovation capability, social policy, social inclusion and social dialogue, free movement of capital, the real estate market and tourism, urban (spatial) planning, and finally regional policy.

The following part of the chapter will first analyse the changes in the last couple of years regarding the administrative and judicial structure, economic sustainability and democracy, human rights and fundamental freedoms. The second part will give a brief overview of the main topics of this book. The text ends with overall conclusions and recommendations.

## **CHANGES IN CROATIA IN THE LAST COUPLE OF YEARS**

Regarding the EU framework for accession negotiations with Croatia, our progress will greatly depend on the fulfilment of the Copenhagen criteria; sustainability of political reforms, regional and ICTY cooperation; respect of the liberty, democracy, human rights, fundamental freedoms and the rule of law; administrative and judicial structures; commitments to the Stabilisation and Association Agreement (SAA) and *acquis* requirements (Enlargement Weekly, 2004). These are all the issues fitting nicely within the context of all our three books. If we in that context look at the changes regarding the issues we were dealing with in last couple of years, government seems to be well aware of

problems and priorities, promising a lot, but not delivering enough. Reform of the judiciary for example seems a high government priority, and the budget of the relevant ministry is constantly growing, but the number of unsolved cases that is one of the biggest problems of our judiciary is still rising. So, let us try to group some of the main issues.<sup>ii</sup>

## **Administrative and judicial structure**

The Government is ostensibly dedicated to the reform of the *public administration* emphasizing anti-corruption, land registers, the cadastre and a code of behaviour for public employees. The public administration has been undergoing constant reforms, but changes are often made without previous analyses of needs or subsequent evaluations of effects and it is difficult to foresee the results. The best example is the overnight reorganization of government, i.e. the decrease of the number of ministries and establishment of government offices in 2004. There is no long-term strategy and often no necessary coordination. For example, Ministry of European Integration is in charge of public administration changes for EU purposes and the Government Office for Public Administration for domestic purposes. In addition, this Office is often overburdened with pressing short-term issues (like preparations for the elections) and is thus unable to pursue the more important long term strategy of public administration.

Similar conclusions could be drawn regarding *governance*: superficial reforms without real contents and new laws and amendments of existing ones without attention to their implementation. The rule of law – there have been certain new laws passed, but there are still a huge number of unsolved cases and poor criteria for electing judges; de-politicization – and yet the number of politically appointed people in the public administration (deputy and vice ministers, government secretaries) increasing; openness to citizens – a new law, but still there are complaints of journalists, placing Croatia 84<sup>th</sup> behind all the other Central and Eastern European countries (CEEC) except Romania in the global free press ranking (Freedom House, 2004); anti-corruption – new laws but the immediate amendments and poor results make Croatia share 67<sup>th</sup> place with Poland, while all the other CEEC are far in front and only Romania lags behind (Transparency International, 2004).

The problems with the reform of the public administration and quality of governance can be nicely shown in the case of the *energy*

*sector*. As a result of stagnation in public administration reform in Croatia, but also of the new requirements within the *acquis*, the level of harmonization with EU requirements in that sector is unfortunately decreasing. Regarding the capability of the Croatian energy sector to confront the competition in the EU, we lack harmonization with the new *acquis*, the relevant rules and regulations have not been passed, and efficient control and adequate penalties have not been established. A strong lobby within the sector is an additional obstacle to successful reform. Another issue – successful regional cooperation – will also require substantial legal adaptations, but again they will not be sufficient without efficient enforcement. Real adjustments of the Croatian energy sector should not be a problem, but restructuring is facing great resistance and it could hamper competitiveness not only at the regional and EU levels, but within the country too. Here we could mention that unfortunately overall competitiveness in the country has deteriorated, placing us 61<sup>st</sup> in 2004 in comparison to 53<sup>rd</sup> in 2003 in the world behind all CEEC except Romania (World Economic Forum, 2004).

The *legal system* is still struggling with the conflict of normative vs. real conformity, but the relationship with the EU is improving constantly. If we compare its reports from 2002 and 2004 it seems that the European Commission has no more objections to the election laws (status of diasporas and minorities); human rights and minority group status, and regional cooperation. The problems still exist in the judiciary reform – particularly the inefficiency and long duration of procedures, inadequate selection and education of judges and protection of citizens' constitutional rights; regulation of Croatian public radio and television – non-transparent selection of members of the governing council that does not enable political independence and plurality and poor participation of non-government representatives; slow return of property to refugees – caused by lack of housing, inefficient local governments and a slow judiciary, and finally, cooperation with the ICTY regarding one single person, which is keeping the whole country in a stalemate position (European Commission, 2002; 2004). Unfortunately, persisting problems of redefinition of the SAA in the Croatian constitutional and legal system and the change of the legal culture regarding first of all credible interpretation of laws by the Parliament have not been dealt with yet, emphasizing the necessity to take a new course on the way to the values of a pluralistic democracy. The relevant ministry announced a complete reform package in 2004 but improvements are for the time being visible only in faster procedures in land registers, but not yet in

other fields. The Ministry is optimistic, but it seems that real projections and objective indicators are still missing.

## Economic sustainability

At the beginning of our project we were probably most concerned with *macroeconomic* issues relevant for EU accession, but it seems now that from year to year sheer macroeconomic indicators are the least worrying.

- Economic growth is slowing (5.2% GDP in 2002, 4.3% in 2003 and 3.6% in 2004/IIIQ), but it is still at decent levels in comparison with the majority of new and particularly the old members of EU.
- Inflation rate is stable under 2% per year.
- The external current account deficit, although still very high, is improving from 8.5% in 2002 to 7.3% in 2003, and is expected to amount to around 6% in 2004.
- Foreign debt is increasing from 67.5% GDP in 2002 to 81.9% GDP in 2003, but there are some encouraging signs that the growth has been stabilized during 2004.
- General government budget deficit is, as usual, higher than expected but is steadily decreasing and expected to be 4.5% in 2004 and 3.7% in 2005.
- Favourable economic growth has led to a slight increase in employment and a slight but steady decrease of the unemployment rate (from 14.9% in 2002 to 14.3% in 2003 and 13.8% in I-VI/2004).

Among good signs we could also mention that Standard & Poor's raised Croatia's sovereign credit rating for long-term bonds in foreign currency (from BBB - to BBB), while the ratings for short-term debt (A-3) and debt in domestic currency (BBB+/A-2) have stayed the same. The new Country Assistance Strategy of the World Bank doubled the amount of loans for which Croatia would become eligible to 1.5 billion dollars. The main purpose of these loans will be to facilitate Croatia's integration with the EU over 2005-08. Of course, it is now up to us to use the possible funding from these sources for solid structural reforms or to squander them without positive results.

In line with the EU trends the *tax* burden in Croatia is decreasing and coming closer to EU averages. Tax revenue as a proportion of

GDP in 2002 in Croatia was 41.4% (it dropped to 41.0% in 2003), in the EU-15 (40.5%) and in the EU-25 (38.5%), but in new member states (NMS) 34.5%. The tax structure in Croatia is similar to that in NMS with lower income and higher consumption taxation, which could enhance economy. The overall tax burden still has to be lower, but that will of course depend on success in cutting expenditures and cannot happen without serious structural changes. Luckily it seems that in one of the segment of expenditure – *state aid* – there are visible improvements. The government agency became better equipped and is now expected to be capable of granting and monitoring state aid, programs for harmonization with SAA criteria and the EU system have been produced, registers and procedures improved.

The Government intends to stabilize foreign debt under 80% of GDP and lower the general government budget deficit to 3.7% of GDP in 2005. Unfortunately, it seems to be focusing more on how to raise additional revenue than on reducing the expenditure side of the budget. Privatization in key industries such as tourism, insurance and mobile telecoms has in particular been slow. Serious public administration reform has also yet to start. The slow pace of fiscal consolidation and institutional reforms could adversely affect the development of the private sector and put at risk potential growth of the economy as a whole. Croatia will also need to implement deep structural reforms in the fields of legislation, judiciary, agriculture and shipbuilding, and privatize public utilities and many enterprises in the tourism sector. Judging by the experience of many countries, these reforms and privatizations would have positive effects on both the pace and the extent of fiscal consolidation.

Because Croatia became an official EU candidate, meaning that it could start using the pre-accession funds, because the Ministry of Finance changed its fiscal projections for 2005-07, and because following the experiences of NMS Croatia's GDP has to be adjusted for the unregistered part of the economy, we could expect lower *costs of the possible 2007 accession for the budget* than previously calculated – amounting to 0.65% of the 2007 GDP. Unfortunately, the budgetary deficit is expected to be higher, amounting to 3.55% of the 2007 GDP (more about the calculations Cuculić, Faulend and Šošić, 2004). Although the fiscal discipline has been deteriorating in many EU member states and we could probably expect some changes in the Stability and Growth Pact by the time Croatia becomes a member, it does not mean that we could loosen the fiscal discipline. Croatia's budgetary



deficit is still at much higher levels than the proscribed limit. What can we conclude? External factors like the status of candidate have improved the fiscal projections while internal factors like fiscal discipline have worsened them. Again, the EU behaves encouragingly.

## **Democracy, human rights and fundamental freedoms**

Looking first at the *non-governmental sector* we could say that various good initiatives like the National Forum on Europe, the National Foundation for the Development of Civil Society, the Program of Information and Education on the EU for NGOs have been started. They are all good new initiatives and let us hope they will – particularly having in mind the dilatoriness of the government – improve the weak status of NGOs vis-à-vis the government in Croatia and provide them greater influence in society.

One of the issues that are constantly under the magnifying glass of the EU is certainly the *protection of minorities*. We are witnessing various legal improvements regarding minorities, language, education, return of refugees and reintegration, but also problems in practice. Problems are not due only to the various obstructions, but also arise from poor housing, the still turbulent economic conditions in regions of special concern that are being addressed with state aid to those regions. There are also institutional improvements like councils of national minorities (230 councils are registered) but there is little interest in participating in them. Despite many positive steps, further harmonization with European laws and European positive practices is necessary, and particularly education both of the majority and of the minority population.

Antidiscrimination laws were passed regarding *equality of men and women*, protection against violence in the family, and there has been legislation regulating same-sex communities. A government office for equality was established and public legal officer appointed. Normative adjustments seem perfect, but practice is lagging behind. Laws offer solutions on paper that are not enforced in practice because the new concepts are often not understood, some provisions are incomplete or unenforceable, citizens do not report and the police are often not sensitized enough.

When it comes to *consumer protection* there have been some improvements regarding the formation of institutions responsible for the implementation of consumer protection. However, the relevant law is

not considered to be precise enough, and is deemed lacking in coverage and to contain loopholes. Consumers' complaints are numerous, amendments and changes of the law are already in preparations, and the national program is lagging behind. Reasons lie in the reorganization of the relevant ministry as well as in poor information of citizens (only 20% of them are aware of their rights arising from the law) and of the traders. There are also funding problems – funds from CARDS are not used yet and there are fears that they might not be used at all – and problems in communication and co-ordination among the relevant actors.

There are also no spectacular improvements in *environmental protection*, but certain improvements are visible in regulations on the access to information and preparations for CARDS project regarding improvements in environmental legislation. Encouraging enough seems that public is – despite the controversies within the government – extremely engaged in some environmental issues like for example Družba Adria pipeline.

We can here conclude that government is aware of the necessary moves and although delivering too slowly – mostly in form of new or improved laws, regulations and institutions – at least prerequisites for further changes are being established. Changes in administrative and judicial structure are certainly the most worrying, economic situation seems promising and changes in the level of democracy, human rights and fundamental freedoms probably the most encouraging.

## **FACING THE CHALLENGES OF NEGOTIATIONS: HOW WELL IS CROATIA PREPARED?**

### **Effects of the latest enlargement**

Looking at the possible effects of the latest enlargement, *Ana-Maria Boromisa* concludes that integration into the EU is, due to its size, level of development, geographical position and already established economic links economically the best option for Croatia. The decision should be made: is there anything more strategic than the EU (like fisheries and oil in Norway) and how much are we ready to pay for EU membership without knowing its timeframe?

Reforms are transition-related and their result should enable sustainable growth. These reforms would still have been needed even if the

EU had not enlarged, and if Croatia had not signed the SAA. Enlargement and establishment of free trade zone hence highlight the need for reforms, might speed them up and can be regarded as beneficial for Croatia in spite of the fact that they create adjustment costs. In that context Boromisa recommends examining how fast is the integration possible, identifying alternative options for integration in the meantime, defining additional strategies of interests, and sequencing the reforms considering the possible timeframe for membership. It is particularly important to raise public awareness that some of the EU-related reforms are also transition-related and necessary anyway and that by entering the EU reforms and related costs do not stop.

Looking at various possible scenarios Boromisa states that the progression scenario is possible if Croatia does its part, but that this denotes the fastest possible, although not necessarily fast membership. She also warns that reforms, including unpopular ones, are often labeled “European” raising the perception that Croatia is doing its best, but that EU is not accepting us. In spite of the formal consensus around greater Europeanization such a perception might slow down reform implementation meaning that domestic policy will be crucial in the integration process.

Labelling unpopular reforms “European”, which is not always the truth, and simultaneously announcing EU membership as “strategic goal” sends confusing signals. It seems that no one is ready to say that Croatia needs reforms anyway, including unpopular ones. Still, it should be estimated how much membership might cost, and what sequencing of reforms is needed. Croatia should know its negotiating position – if membership is our strategic goal, is there really anything to negotiate?

Also, there should be a clear definition of what prices we are ready to pay for full membership (which could be distant). Although full membership is according to the analysis available so far economically the best option, Croatia should be open to “virtual membership” possibilities, such as political or economic integration and decision-shaping without full membership. There are various options and combinations of them for participating in the EU. The benefits of virtual membership include various ways of sequencing reforms. However, this implies that sufficient analyses exist for the best option to be chosen. For a small country, virtual membership could decrease costs, especially in limited human capital.

Raising public awareness that there is a life outside the EU and that reforms are needed anyway for successful transition and not be-

cause of the EU might help in keeping the pace of reforms and enable meeting membership criteria. Meeting the criteria should be regarded as Europeanisation and hence a goal and not a condition.

## **Coping with competitive pressures and market forces**

Economic criteria for EU membership require the country to be a functioning market economy capable of coping with competitive pressures and market forces within the Union. The latest opinion of the European Commission (2004) states that Croatia is a functioning market economy, but that it is unable to cope with competitive pressures and market forces within the Union. It could of course become able to satisfy the second criterion provided that it continues implementing reforms to remove remaining weaknesses.

*Vedran Šošić and Boris Vujčić* state that before the break-up of Yugoslavia Croatia was a very open economy, but while other CEEC during transition became more, Croatia became less open. Deterioration of Croatia's trade-openness ratio during the 1990s was a consequence of reduced trade with the former Yugoslav republics and the stagnation of trade with other countries. Here we have to emphasize that this approach deals only with trade in goods, without trade in services meaning that the results of trade openness would be quite different if the authors were speaking about overall trade, because of the particular importance of tourism for Croatia.

Croatia became a member of the WTO in 2000 and by the end of 2003 had signed preferential agreements with 31 countries including both old and new members of the EU. The SAA provided Croatia a favourable position, removing barriers to the exports of many sensitive products, but the SAA in comparison to the Europe Agreements, did not admit Croatia into the Pan-European Diagonal Cumulation of Origin which is a serious obstacle to the international trade.

Although the European Commission favourably assessed the Croatian ability to pursue further economic integration into the EU, Croatian trade still exhibits a strong bias towards the former Yugoslav republics, particularly Bosnia and Herzegovina and Macedonia. These biases evolved from inherited trade patterns that were supported by early conclusions of preferential trade agreements with some of those countries and by losing ground in the EU market on account of those competitors from CEEC that advanced faster in trade integration. Lost ground cannot be made good in the short run, but trade integration with

the EU should be accelerated in order to reduce existing biases and long-term costs of trade restructuring. The CEEC, probably Croatia's most serious competitors on that market, are at the same time full EU members after a decade of participation in the Pan-European Diagonal Cumulation of Origin. The existing system of bilateral trade relations actually means that a large portion of trade between Croatia and the EU is not carried out within the free trade regime, which inhibits manufacturing foreign direct investment and hinders Croatian integration into European production chains.

In order to facilitate trade integration with the EU, Šošić and Vujčić claim that it would be desirable for Croatia to join the EU as quickly as possible. Efforts to integrate more deeply with South and Eastern European countries would only provide a temporary shelter in the markets of countries that are even less open than Croatia. This strategy would increase the long-term costs of trade restructuring so it should in no case be a policy priority. This does not mean decreasing trade with the former Yugoslav republics and with some CEEC, but rather increasing trade with the EU and other countries of the world.

## **Free movement of workers, knowledge and innovations**

Despite the fears of the possible effects of opening up our borders to the wider labor markets often encountered in our media, *Mirta Kapural* states that integration already exists thanks to the provisions of the SAA, relevant Croatian legislation and bilateral agreements with several EU countries. There are already more than 2,000 registered foreign workers in Croatia, mostly in shipbuilding and construction, the majority of them from Bosnia and Herzegovina. Their number corresponds with the increased need for seasonal workers in Croatia. The majority of workers from Croatia concentrate in Slovenia, Italy, Austria and Germany. After the accession, Slovenia had to impose some limitations on workers from non-EU countries. Consequently a smaller number of workers from Croatia will be able to work in Slovenia. The experience of the NMS shows that we could expect the number of foreigners working in Croatia to increase and the number of Croatian citizens working abroad to decrease.

On our way to the EU we will be confronted with the need for further harmonization of our legislation and with a transitional arrange-

ment for the free movement of workers ranging from two to seven years.<sup>iii</sup> Croatia will have to improve legislation regarding the mutual recognition of qualifications and non-discrimination based on nationality, assure implementation of national strategies and plans, improve education and training of workers, mobilize resources by the private and public sectors and use available pre-accession EU funds. Government and media will regularly have to inform the public about the state of negotiations and try to consult professional associations and keep them informed about the rules that will apply to them.

At the moment considerable numbers of workers from Croatia are interested in seasonal work in Germany, Austria and Italy, but downward trends can be observed. Still a number of workers are interested in working in Slovenia, but possibilities could be reduced due to the transitional arrangements of the NMS. On the other hand, progress in negotiations could reduce the need of workers from Croatia to migrate. Furthermore, economic growth, lower unemployment and closer perspective of EU accession might attract more migration to Croatia, particularly from the region.

Kapural recommends preparing negotiating teams that will, using experiences of NMS and closely monitoring the negotiations of Romania and Bulgaria, try to negotiate a transitional agreement of five years, with gradual increase of freedom of worker mobility, including a standstill clause, Community preference rule and equal restrictions. The goal is to enable free movement of workers while avoiding the best young and highly skilled labour to leave Croatia and becoming overburdened with low-skilled workers from other regions.

Improvement of education and training of workers will be necessary for better placement of Croatian workers on the enlarged European labour market. *Predrag Bejaković* in his chapter fears that Croatia is poorly prepared for a knowledge-based society and that it could be a huge impediment for joining the EU market. This is a market that intends by the end of this decade to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion. That impediment could be particularly important, bearing in mind existing fears regarding Croatia's capabilities to cope with competitive pressures and market forces within the Union (European Commission, 2004).

Bejaković claims that the labour force in Croatia does not have the knowledge and skills required for a modern competitive economy, and

that the education and training systems have not yet taken the adequate steps to remedy this situation. He stresses general problems like the lack of emphasis on developing analytical and problem-solving abilities<sup>iv</sup> and weak links between education and the professional world. Particularly visible are problems of tertiary education: enrolments are relatively low, the average duration of study is long, a relatively low share of students major in the natural and technical sciences, and inadequate knowledge and skills of graduates in some social sciences. Adult and life-long education is almost completely neglected (only 0.2% of the population over 35 is participating, in comparison with EU average of 7%).

Bejaković offers numerous recommendations for improving Croatian education, but we could here stress just some of the most important: a change from a supply – to a demand-driven system, more flexibility and efficiency in the system including decentralization and privatization, and aiming for more responsibility, initiative and executive thinking in the students.

Unfortunately, numerous education strategies have been proposed, but they were neither put into operation nor fully implemented, nor were any major reforms implemented at any level.

Using the European Innovation Scoreboard *Zoran Aralica and Katarina Bačić* conclude that Croatia ranks well by European standards in comparison to other CEEC, in particular Bulgaria and Romania, but has not made a significant progress in its innovation potential and policy with respect to the EU. In *human resources indicators* Croatia is close to the EU average in science and engineering graduates, population with tertiary education and employment in high-tech services, but far below the EU average in participation in life-long learning. Croatia ranks unfavourably in all of the *indicators of knowledge creation* – lagging behind the EU average slightly in public R&D indicator, but seriously in business expenditure on R&D and catastrophically in patent applications. When it comes to the *transmission and application of new knowledge indicators*, Croatia ranks fairly well relative to both the EU average and the CEEC values – exceeding EU average in SMEs involved in innovation cooperation and SMEs innovating in-house, but lagging behind in innovation expenditure.

The Government has stipulated establishing a modern innovation system among microeconomic and structural priorities, an innovation technology development program exists, the National Competitiveness Council placed innovations among top priorities, but no national industrial strategy incorporating an innovation policy has yet been passed.

The results of international comparison of indicators and current institutional settings in the country mean that Croatia needs: a modern national innovation system, changes in the scientific and higher education policies to integrate them into the European Research Area, inclusion of the principles of life-long learning, particularly among the unemployed, plus stronger efforts in innovation policy implementation, but also in coordination with other areas of economic policy, in particular science and technology, SMEs and industrial policy. Among the recommendations Aralica and Bačić stress: setting explicit goals and targets of innovation policy, better implementation of programs, removing the obstacles to financial instruments, setting a statistical base for innovation policy measures and instruments enabling assessment, monitoring and evaluation.

Obviously, substantial improvements are needed. In theory, innovative policy is a topic, but in reality improvements can not be made overnight or by the government only. Improvements will depend on changed attitudes of the population and the business sector and changes in the business environment. The Government should bear in mind that the situation will not be improved by the greater allocations of funds but through reform of educational system and science, setting qualitative standards, principles of monitoring, evaluation and rewards for standards of quality.<sup>v</sup>

## **Within the extended social Europe**

Dealing with the Croatian position in the extended social Europe, *Paul Stubbs and Siniša Zrinščak* elaborate how social policy and social inclusion are today much higher on the agenda of the EU than before, but still social policy improvements depend on the individual countries and not much help can be expected from the EU. Luckily EU opinions regarding social policy in Croatia are sparse and generally favourable. In terms of social protection the last report calls the Croatian system generous when compared to the size of the economy (European Commission, 2004).

With limited formal influence from the EU but influenced by a mix of international actors the Government has been undertaking various social policy reform activities: the 2001 decentralization promoted social dialogue; the 2002 program for combating poverty and social exclusion addressed also the role and tasks of different government



agencies, unfortunately going no further than paper statements; the 2002 social welfare reform project regarding social services, social assistance, labour market policies, monitoring and measuring poverty leading to data on poverty which included some of the Leaken indicators being produced in 2004; relevant agreements with social partners were signed and the office for social partnership was established; Croatia ratified the European Social Charter with its three additional protocols. Despite a lot of efforts on the part of Croatia and good evaluations from the EU, various problems still exist.

EU financial support to Croatia in the social policy field has been limited and mostly oriented towards refugee return and the war-affected regions. Croatia produces minimalist reports which are rarely part of any wider process of awareness-raising and of consultation with stakeholders. The lack of strategic direction in social policy, the failure to resolve key issues such as the role of the state centers for social welfare and the role of non-state actors, both in civil society and in the private sector, and the absence of decentralized, meaningful social planning mechanisms. There appears to be little or no discussion of the importance of community-based provision over and above institutional care. No short, medium or longer term outcome indicators for future social protection. The co-ordination of different policies, including the recently developed family policy, is also not well developed.

Stubbs and Zrinščak suggest greater efforts be invested in the elaboration of the core principles of social dialogue and of social policy, in the strengthening of social dialogue and the promotion of social inclusion, and in measures for implementing social dialogue and strengthening social protection systems. Progress is needed in improvements of statistics and data, introduction of internationally comparable qualitative and quantitative indicators of social exclusion and poverty as well as methods for their calculation; in the alignment of legislation with the social *acquis* and in effective implementation of the provisions over the medium term: preparation for communication processes at the EU level on employment, social inclusion and pensions. There should be a process of consultation with all the stakeholders not only at the national but also at the local, sectoral and firm levels. Greater public awareness of social inclusion and social dialogue needs to be fostered.

Social protection and social dialogue are not priority areas in the relation of the EU with Croatia, because other issues like regional and local development, particularly of the war affected areas, refugee return, minority rights and the legal system are seen as more pressing problems.

Besides, Croatia appears to resemble countries of Central Europe more than Bulgaria and Romania in terms of the scale of social problems. Still, we will have to align legislation and effectively implement it.

With the exception of Bulgaria and Romania, social policy has not thus far been an important element of the pre-accession process for aspiring new members. However, because of the latest development of the European social model it may well be that Croatia will encounter more demands during the pre-accession phase. Membership – if and when it comes – will certainly create higher social tensions and make the socially excluded even more vulnerable if we do not prepare in advance. Stubbs and Zrinščak conclude that without thorough changes, we could risk being unprepared for the social dimensions of EU membership, both in the short and in the medium term.

## **Real estate market, tourism and spatial planning**

In accordance with the SAA, Croatia already has an obligation to liberalize most capital transactions and in particular open up the regime for real estate sales to non-residents after 2009, i.e., four years after the SAA enters into force. *Dubravko Mihaljek* argues that the current regime for property sales to non-residents, which will remain in force until 2009, is relatively liberal in some respects (e.g., non-residents who establish a company in Croatia can acquire real estate without restriction), but relatively restrictive, non-transparent and cumbersome in others – private individual non-residents have to wait up to one year to get permission to buy a vacation home in Croatia. This differential treatment is unwelcome for Croatia's investment profile and provides fertile ground for corruption. An unfortunate consequence of this and other forms of red tape is poor ranking of Croatia in various surveys of business climate. For instance, the Heritage Foundation (2005) ranks Croatia as 74<sup>th</sup> in the world in terms of economic freedom, in the same group as Senegal and Uganda. By comparison, Estonia is ranked as the 4<sup>th</sup> freest economy in the world.

The development of real estate and tourism industries in Croatia is also hampered by the lack of enforcement of environmental and spatial planning regulations, weak and often irresponsible local governments, and poor local infrastructure (including waste disposal facilities, sewage and local transportation). In addition, Croatian legislation provides almost no protection against property speculation. While this is

not obvious at the moment because the lack of capital largely prevents Croatian citizens from engaging in speculation, once the property market is opened up to non-residents, this weakness of the legislation could manifest itself very quickly, resulting in the meantime in potentially large disruptions in local property markets.

Unfortunately, because of the lack of information and expert analysis, these hot topics are often discussed by politicians and the general public without solid empirical, economic and legal arguments. The sides in the debate often depend mainly on ideology, lobbying interests or misperceptions. The paper by Mihaljek is perhaps the first serious attempt to understand how the opening up of the real estate market to non-residents might affect local property markets, tourism and the national economy.

Mihaljek recommends a measured approach to the opening of the real estate market to non-residents. He says that although Croatia stands to benefit in the long term from foreign investment in the property sector, in the short run a more gradual liberalization can be justified on a number of grounds. These include potential spillovers of price increases from the market for secondary residences onto the local housing market (of which there is already some evidence); costs of the adjustment in the housing market and construction industry to a sudden large increase in demand for secondary residences; loss of competitiveness in the tourism industry if there should be violations of building regulations and the resulting overdevelopment of coastal areas; and macroeconomic pressures arising from large and sudden capital inflows.

He suggests that a well articulated public discussion might help in formulating arguments that Croatia's accession negotiators could use in their attempts to extend the transitional period for property sales to non-residents. He also recommends transparent and efficient application of existing regulations on property sales to non-residents; determined implementation of building regulations, in particular in public coastal areas; improvements in the legislative framework and administrative procedures regarding property transactions; and the development of instruments and institutions of housing finance.

As the existing regime for property sales to non-residents is perceived as relatively liberal, the author's recommendation for a more gradual approach will probably be well accepted by the domestic audience. The author recognizes, however, that the negotiating process will leave Croatian officials very little room to obtain substantial concessions in this field.

However, one could also argue that Croatia needs faster and more complete liberalization and deregulation to speed up the adjustment process, not only in the real estate sector where the economy stands to profit from the inflow of capital (provided, of course there are simultaneous improvements in legislation on capital flows, speculative activities, etc.), but also in industries such as shipbuilding, where government protection, state aids, and political interference present formidable obstacles for economic restructuring. A priori, one would expect restructuring to be less costly if done sooner rather than later.

Maintaining restrictions, as is well known, leads to various informal and illegal activities. Interested buyers will always find ways. We see this already now, in that many non-residents find it less complicated and costly to register a company and buy real estate, than to wait for a “clean” procedure to purchase as private individuals. Mihaljek himself recognizes that increased foreign demand for vacation homes in Croatia might increase incentives for local governments and developers to bypass the recently introduced building regulations and cash in on the interest of foreign buyers as quickly as possible. He suggests that policy makers and the society at large will need to consider carefully the balance between restrictions on property ownership on the one hand, and regulations pertaining to the environment, urban planning, property speculation, and enforcement of building regulations on the other. I would certainly opt for the latter, as all kinds of negative behaviour could be displayed equally by foreign and by domestic owners, meaning that enforcement of regulations is crucial irrespective of the residence status of the owners.

*Jasenka Kranjčević* states that we could expect the area of Croatia to be exposed to powerful and long-term changes thanks to the preparations for accession and thanks to the fact that it is already bordering with new EU members. This means that Croatia should be better acquainted with and more involved in all the activities related to spatial development at the EU level.

War damage, the introduction of parliamentary democracy, strengthening of private property, the transition, new territorial organization, globalization and integration processes have led to a value-system crisis and the neglect of common and long-term interests in the space. The new local authorities were not prepared to take over the tasks of planning their own space; property title came to be understood as the absolute right over property without respect for the protection of public interests, there has been poor harmonization among various lev-

els of the government, poor horizontal and vertical coordination. As a consequence, local plans remain at the level of determining building zones, ill-adapted to contemporary requirements. We are also witnessing the spreading of building zones without the necessary infrastructure, poor care for waste disposal, poor data bases, unclear titles, outdated geodetic plans and poor participation in international projects.

In the area of physical planning there is no direct obligation with respect to individual chapters of the *acquis*. EU requirements relate primarily to the obligations of candidate countries to harmonize their policies and aims with the European objectives and to incorporate certain mechanisms to harmonize interests of the Union and other member states into the national legislation, to base the preparation, drawing up and acceptance of documents on principles of law and order, the welfare state, financial justifiability and a democratic society, to respect international recommendations, directives, contracts and conventions. In our accession efforts the first task will be to assess the state of affairs, determine our own objectives and policy and to harmonize them with the interests of the EU. We will have to enforce public participation, harmonize legislation, back physical planning with appropriate financial analysis, achieve better management and more effective supervision of legislation and finally ensure harmonized planning of the spatial, economic and social objectives of development.

## Using European Union regional policy funds

In her chapter, *Ines Kersan-Škabić* explains that with a GDP level lower than 75% of the EU average and facing structural problems Croatia could expect when it becomes a member to benefit from the structural and cohesion funds of the EU.

For the time being – in accordance with the SAA and like all other countries of the Western Balkans – Croatia can participate in CARDS program intended to support reforms and build the institutions necessary to implement the SAA. Regional development is a high priority, aiming to reduce development imbalances and to strengthen local authorities.

During the 1990s the majority of funds coming from the EU to Croatia were directed towards humanitarian purposes and the amounts were relatively small in comparison to the other CEEC. EU assistance in 2002-04 focused on democratic stabilization, economic and social development, justice and home affairs, public administration, implementation of the SAA, environment and natural resources.

A large number of projects are available to develop the necessary institutional and economic framework in accordance with EU standards directly through PHARE, ISPA and SAPARD. Indirectly, through the cooperation of regions from Croatia with regions from the EU members, Croatia could also access funds from Interreg III. As with all other programs, funds are limited, but Croatia's absorption capabilities are probably even more so. Istria is one of the most developed regions in Croatia and one with traditional connections with several regions of the EU. It is already participating in cross-border, trans-national and interregional cooperation benefiting probably not so much financially, but more in getting acquainted with international projects and joining other EU funding possibilities. The example of Istria shows that indirect participation in EU regional funding is possible even now, but certain prerequisites should be satisfied and it depends first of all on us, not on the EU.

The problems that are constraining Croatia's possibilities for using EU regional policy funds are threefold: first, there is no single legislative act addressing problems of regional development for the entire country and the existing regional policy is oriented towards the less developed and war-affected regions; second, the Regional Development Fund is for the time being active through the budget only and is not following participation of regions in the EU projects; third, regional and national authorities are not sufficiently coordinated and harmonized in their activities with respect to foreign regions in participation in particular projects.

For improving Croatia's possibilities to access and use EU regional policy funds, it will first be necessary to establish certain development documents like a national development plan necessary for negotiating funds from the structural and cohesion funds once Croatia becomes a member, and a national strategy of regional development referring to all regions, not only those that are lagging behind. Secondly, we will have to establish and reorganize some institutions like regional development agencies at the level of the counties that will get acquainted with EU funding possibilities and methods. Thirdly, we must improve cooperation with EU regions developing inter-regional cooperation, partnerships and mutual projects at the county level and getting acquainted with developments in the neighbourhood.

EU accession could bring Croatia multiple possibilities of using EU regional policy funds. Various possibilities exist even now when Croatia is only a candidate. But, to be able to use even parts of these funds, great efforts will have to be made to avoid the situation that happened in the CEEC countries, which, thanks to low absorption capabil-

ities, used only about a half of the committed resources. Because of the great differences among Croatian regions, poor harmonization and lack of coordination, success will greatly depend on the efforts and capabilities of local governments to engage in projects on their own, irrespective of the support from the national level.

## CONCLUSIONS AND RECOMMENDATIONS

What can we conclude after closely monitoring Croatia's transformations and preparations for EU accession? Croatia has gone a long way from the first insecure days of establishing a country, fighting the war and stepping out on the path of transition from socialist to market economy. Unfortunately, that did all happen simultaneously and this constrained our prospects for joining the group of the best achievers among the CEEC. Now, to catch up, Croatia badly needs serious dedication to structural reforms in almost all aspects of its life, particularly administrative and judicial reform, restructuring of some of the most troubled industries and privatization of the public utilities. These reforms are needed with or without aspirations to EU accession.

The Government is on paper at least dedicated to reforms, but changes are often made without previous analyses of needs, evaluations of effects, and it is difficult to foresee the results. We are witnessing superficial reforms without real contents and new laws and amendments without proper care for their implementation and enforcement. There is no long-term strategy and often no necessary coordination. Government often allows itself to be overburdened with pressing short-term issues instead of addressing more important long term strategies. Rather poor rankings in various indicators like freedom of the press, perception of corruption, competitiveness and economic freedom are the consequence of such circumstances. Despite all these shortcomings, the relationship with the EU is improving constantly.

Bearing in mind all the problems with administrative and judicial capabilities, the economy is coping rather well. We could mention decent levels of economic growth and inflation rate, improvements of the current balance of payments deficit and the general government budgetary deficit (although both at rather high levels), a slight decrease in the unemployment rate, improved credit ratings and a decreasing tax burden. This all means that the Croatian economy is capable of even better achievements once the institutional setting improves. Unfortunately, foreign debt is too high and fiscal adjustments are too slow.

The Government is more concentrated on the changes in the revenue than on the expenditure side of the budget and privatization has been too slow particularly in most problem-ridden industries. Structural reforms in the fields of legislation, the judiciary and public administration, the restructuring of agriculture and shipbuilding, the privatization of public utilities and tourism are needed. These changes could lead to better fiscal consolidation and positively affect economic growth.

Evaluating democracy, human rights and fundamental freedoms we can see various legal and institutional improvements, but enforcement and practice are lagging behind. This is obvious in issues like minorities, gender, consumer or environment protection. Luckily, there are various good initiatives regarding building up the non-governmental sector, encouraging expectations for it to have a greater influence in society once the prerequisites for the functioning of NGOs have been made.

The majority of the experts agree that having in mind our current knowledge, the size of Croatia, the vicinity of the EU, accession might be the best solution for Croatia. Looking at the experiences and effects of the latest enlargement, competitive pressures and market forces, the effects of the free movement of workers, the standing of education, science and innovations, the free movement of capital, the real estate market and tourism, social policy or regional policy, it is obvious that accession to the EU in the long run could bring benefits to Croatia. But, without serious reforms, restructuring and enforcement, the accession could also have adverse effects on competitiveness, stability and the wellbeing of the society, influencing our possibilities for development and growth.

Optimism is present on the side of the EU that granted Croatia candidate status and set the date for starting negotiations, on the side of the Croatian government that finally found a relevant goal that could serve as the cohesion element in society, and finally on the side of citizens of Croatia that are despite the slight fear of changes expecting wonders from the EU accession. There are grounds for optimism in the EU having granted the country candidate status and having set a date for negotiations to start; in the Croatian Government having finally found a relevant goal to serve as a cohesive element in society; and finally in Croatian citizens, despite their qualms, expecting wonders from EU accession. But we should all be aware that disappointments might occur – if the accession does not happen soon enough or if the accession does not deliver the expected wonders. What could we suggest are the most important strategies for success?



- *Structural reforms, structural reforms and structural reforms.* Croatia badly needs structural reforms in the fields of legislation, the judiciary and public administration, the restructuring of agriculture and shipbuilding, the privatization of public utilities and tourism. A successful end to these reforms will mark the successful end of the transformation. If it corresponds with the EU accession, wonderful, but Croatia will gain even if it does not. This and our previous two books give an abundance of suggestions and recommendations for the necessary reforms.
- *Patient and clever negotiations* with the EU, bearing in mind that there is not much room for negotiation. Various concessions and transitional arrangements can possibly be obtained, but permanent exceptions are almost unheard of. As several of the authors in this book state, it means that we have to know our priorities, know what we want, what the price we are willing to pay is and try to get as much as possible through the negotiations. Of course, we have to know how to negotiate. We should not waste time, energy and scarce negotiating capabilities in seeking preferential treatments in many fields, but concentrate on the most pressing ones.
- As the timeframe for our eventual accession is still unclear – despite the encouraging signals from the EU – we could also keep in mind the *possibility of some kind of virtual membership*, which could help us deepen de facto integration without de jure membership status. Virtual membership does not have to be the end of the world for Croatia, but could probably mean lower costs of adjustments and lower bureaucratization, which is desirable anyway, particularly for a country with such scarce human resources.

In the end, there is no guarantee for success. Societies use their resources in various ways – the best of them to prosper, the worst of them to collapse.<sup>vi</sup> There is a wide range of possibilities in between. Croatia's future will depend on the capabilities of the government to implement and enforce the reforms it is so vocal in speaking about and on the readiness of citizens to endure the necessary and often unpleasant reforms, sacrificing something now to be able to benefit in the future.

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i *Interesting views upon de facto vs. de jure integration could be found in Gligorov (2004).*

ii *I would like to thank colleagues who closely monitor their fields of interest and produce the updates for the project on which relays this part of my text: Marijana Badun, Alida Ban, Predrag Bejaković, Ana-Maria Boromisa, Judita Cuculić,*

*Michael Faulend, Ramona Franić, Marina Kesner-Škreb, Danijela Kuliš, Aida Liha, Dubravko Mihaljek, Siniša Rodin, Vedran Šošić, Alan Uzelac, Snježana Vasiljević and Igor Vidačak.*

- iii *All old members except United Kingdom and Ireland introduced various transitional arrangements for free movement of workers from new member states ranging from two to seven years.*
- iv *As a sign of change we could stress that a group of professors managed to introduce the game bridge as non-obligatory course at the Electronics Faculty in Zagreb.*
- v *More about the related problems of the financing of science and higher education can be found in Bajo (2003).*
- vi *Interesting approaches to first of all environmental, but also other relevant factors why some societies succeed or fail could be found in Diamond, J. *Guns, Germs, and Steel: The Fates of Human Societies*. London: W. W. Norton & Company (1999) and Diamond, J. *How Societies Choose to Fail or Survive*. New York: Viking Books (2004).*

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