PRODUCT MARKET REGULATION:
A POLICY INSTRUMENT FOR SUSTAINABLE GROWTH
IN SOUTH EASTERN EUROPE

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Abstract

The conference paper is a comparative analysis of the economic and administrative regulation performance and product market regulation in the countries of Southeast Europe with a focus on the Croatian market. The approach that has been used relies on a methodology developed by the OECD and the associated data, which are available for all the countries examined. The objective is to use conceptual basis to research and compare the roles of economic and administrative regulation in market economies in the region and identify parts of market regulation that need further convergence towards the European Union. Regulation of economic structure and administrative regulation are part of the system of fundamental policies acting as the economic dimension of sustainable growth and development.

The paper is organized as follows. The contribution of research of the effects of economic regulation is first considered in the theoretical section and the explanation is given concerning the importance of measuring the effects of market reforms. The second part of the paper consists of the analysis of the structure of economy-wide Product Market Regulation (PMR) indicator explaining the starting point of summary and aggregated indicators that form the basis of the analysis in the empirical phase of research. The primary and secondary PMR data are the backbone of the empirical examination presented using graphical method. Changes in the regulatory framework that have taken place in Croatia in the period from 2007 to 2012 show that certain parts of market regulation have taken a good course and are converging towards EU market policies, but there are segments in which existing restrictions need to be further extenuated.

Keywords: economic regulation, sustainability, product market regulation, indicators, South Eastern Europe

1. INTRODUCTION

European transition economies face a number of challenges as they emerge from the crisis. They need to put their economies and trading activities back on the path to sustainable growth. Efficient regulation in terms of product market regulation may be a powerful support in the effort to accomplish these challenging goals. Further liberalization of the product and services market is expected, however, at the same time, there is some uncertainty in terms of the ability of such more attractive and more liberal market environment to support sustainable growth and development policies because of a weaker Government influence and control.
In addition to common geographic characteristics, countries of Southeast Europe also share some common social and economic characteristics which is why they are often viewed in the context of a single economic region. There are several reasons why the course of economic development and changes in these countries has become interesting topics of recent research. The recent reshaping of state-planned into market economy has led to radical changes with various ramifications of the growth and development of these countries. Slovenia, Hungary, Slovakia, Bulgaria and Romania completed the accession process and became the members of the European Union. Several countries of the region have gone through the process of becoming independent states and because of that endured wars with disastrous consequences. The majority of the remaining countries in the region have pursued the membership in the European Union, however the processes of transition and preparation depend on the extent to which the countries are ready to implement appropriate reforms to strengthen competitiveness and achieve higher employment levels. However, sound legal systems and institutions as requisite components of an emerging country’s market economy in transition, have been among the slowest ones to develop.

The transition into a different economic system has occurred primarily as a result of changed national regulatory frameworks that govern the market and activities of market entities. The market regulation applicable at the time was aligned with the socialist social-economy system in which business entities were represented by associated labour organizations, there was no freedom of movement of goods and capital and private ownership of operating assets was banned. Notwithstanding the great change, one may still encounter relatively restrictive measures in the producer-customer chain, which bring benefits to one side but create costs to the other, hinder business operating or cause other types of economic damage, which may cause grave detriment to sustainable growth and development. The distributive trade is a very interesting indicator of market regulation since it is accompanied by legislative and administrative barriers, restrictions of the entry of new businesses on the market, competitiveness etc. Market regulatory policy, in addition to monetary and fiscal regulatory policy, is one of the fundamental powers of the state.

Regulatory policy has already made a significant contribution to economic development and societal well-being. Economic growth and development have been promoted through regulatory policy’s contribution to structural reforms, liberalization of product markets, international market openness, and a less constricted business environment for innovation and entrepreneurship. Any modern economy with price regulation and entrance restrictions is certain to face signs of market inefficiency. The objective is to apply inductive approach to demonstrate that countries in the region are converging in terms of economic and administrative regulation of product markets, but also that they need further reforms for market liberalization in order to support the policies of sustainable economic growth and development.

National executive and local (federal) administrative bodies have a wide range of available interventionist measures concerning business enterprises and business operations, market prices and channels, introducing permits and other types of restrictions in order to shape market relationships. The relationships that are required for a market economy to operate efficiently and effectively can exist only if there is an existing well-developed legal and regulatory framework. The assumption is that the product market regulation has a significant role in market convergence and in achieving the expected sustainable growth and productivity in the transition and emerging countries of Southeast Europe. The status in Croatia shows an
earnest intention to remove barriers and liberalize trading environment. The purpose of the paper is to expand perspectives for sustainable development of economy-wide market regulation in the countries of Southeast Europe with a special focus on the Croatian economy in order to be able to identify distributive trade development factors.

The theoretical starting point of the paper is the economic regulation measurement determining also the relevant theoretical background. The appropriate structural model will be used in the empirical part of the study for assessment of the status of market regulation based on the statistical method of factor analysis developed by the Organization for Economic Cooperation and Development – OECD. The role of the model is to quantify the variability of the economic regulatory framework in the national economy or industry so that the results enable monitoring in the range between liberal ("0") and restrictive ("6") forms of market. Based on the achieved progress, the paper will give an estimate on how Croatia ranks today relative to competitors. Various data gathering options, on-line services and advanced statistical methods are the instruments that enable the shaping of complex metadata indicators as "Product Market Regulation Indicator - PMR", which should show repercussions of various regulation changes. The PMR indicator is a useful structural model of behaviour and performance that allows the development of regulatory effect estimates. The results of research may be applied not just to the development of distributive trade but also to the analysis of broader economic conditions in which traders operate.

2. THEORETICAL ASPECTS OF MARKET REGULATION MEASUREMENT

Explaining the interventionist role of the Government on the market – frequently called also "economic regulation" – is a great challenge. The effects of either economic regulation or social regulation, i.e. of regulation in general, are likely to depend on a variety of factors: motivation for regulation, nature of regulatory instruments and structure of the regulatory process, an industry's economic characteristics, legal and political environment in which regulation takes place (Joskow and Rose, 1989:1451). Because of the diversity of these factors one may expect that after a while effects of regulation will be altered, but it is highly probable that effects of regulation will be also differently reflected across industries. Trading and other economic activities require the spending of material, capital, physical and other resources, in order to create additional profit and additional margin, however, the issue is how to direct parties involved in such activities to act according to the principles of sustainable development that will not put at risk the performance and functions of such activities in future. According to Springett (2005) and Bell and Morse (2008) the power of market regulation as economic dimension within sustainable development is such that it may assist considerably political and social factors facing ever growing challenges of sustainable development.

The available evidence suggests that regulation can impact, positively or negatively, productivity, growth and competitiveness (Conway et al, 2006; Crafts, 2006; Timmer et al, 2011). Positively, for example, by supporting competitive markets and protecting intellectual property, or negatively by diverting resources away from more productive uses, raising barriers to entry into industries and producing disincentives to investment and innovation. Crafts (2006) discusses the increasing evidence that restrictive product market regulations, in particular those limiting new entry, hinder technology transfer and have a negative impact on productivity.
Joskow and Noll (1981) explain that theoretical contribution in the field of economics of government regulation may be divided into two opposites, normative theoretical research advocating the timing of the introduction of regulation and the optimal form of regulation, and positive regulatory research starting from the objective analysis, from the actual situation, and analysing the ways in which economic, political, legal and administrative powers are supposed to influence regulatory agencies as a class of governmental institutions. Normative aspects focus on "market failures" and on whatever may be effective, looking for a solution for created product surplus or shortage depending on demand, trying to alleviate or prevent monopoly etc. Posner (1974:351) emphasizes that positive theories of regulation have matured. Since 1970s the economists have started to reject the simplistic model of normative regulation in favour of richer positive theories of regulatory objectives. The embracement of such paradigm shows that government regulation and regulatory processes may be a response to complex interrelations among interest groups that may benefit or lose due to various types of government interventions. Therefore, the starting point of positive theories may be used as the basis for the analysis of modern economic regulation on the market on which one interest group, for example, domestic retailers, is subject to different treatment than the other interest group, foreign retailers. If a different model of theory is chosen, it will lead to different predictions about the nature and magnitude of effects. In terms of the existence of effects of economic regulation in the economy, Joskow and Noll (1981:3) and Joskow and Rose (1989:1458) have cited the following division:

- price controls and market entry,
- costs of production,
- innovation and productivity growth,
- environmental, health, occupational safety and product quality,
- distribution.

There are several ways of how price control and market entry might affect incentives to innovate. Price regulations change the pattern of expected returns on innovation. The shift away from price towards non-price competition may strengthen incentives for rapid adoption of product and service innovations. Entry restrictions and the imposing of new product and service licences may extend the period of introduction and slow down the diffusion of product, service and process innovations by raising costs and reducing revenues. Lately, there has been a growing research interest in investigating the impact of regulation on the distribution of effects among producer, agent/intermediary and consumer interest groups, and to identify winners and losers. Posner (1974:339) has mentioned four types of regulatory effects concerning distribution: transfers to owners of regulated firms (profit); transfers to factors of production such as workers or roads or municipalities; transfers among consumer groups (different delivery terms offered to households and major producers) and transfers among producers or intermediaries.

There is always scepticism about the credibility of regulatory policy, i.e., whether it will be a confident solution for an issue, therefore, it is necessary to analyse its effect on prices, economic benefit and the market structure. If business entities operate on a market which has been regulated to a certain extent, their position will probably be reflected in prices of their products or services, which in turn has an increasingly broader impact on other economic factors such as profit, tax, number of entities etc.

The convergence of economic regulation depends on the implementation of reforms that may be lower or higher in intensity. Regulatory reform and, for example, labour market reform, financial or fiscal system reforms, are always viewed as the second level of a wider structural
reform that helps reorganize an economic system in order to strengthen its sectors. Reforms consist of improvements made to institutional frameworks, regulation and government policy so that barriers are minimised to improve economic performance and advance economic integration of a region. In terms of reforms the state may have a role of public service provider (for example health, education) or a role of interventionist (for example competition, labour market) or a combination of both roles. Buis et al (2012) shows that effects of product market reforms reduce employment and increase unemployment under weak job protection. The empirical analysis of Buis et al (2012) suggests that product market deregulation boosts private investment and total investment, but that this effect vanishes after a few years. The regulation index similar in size to that achieved in the average OECD country in the period from 1998 to 2008 is associated with an increase in total investment by about 0.4 percentage points of GDP in the year following the reform of product market regulation. This reform is also associated with short-term increases in consumption growth. However, they are also found to reduce investment and GDP growth (Kerdrain, Koske and Wanner et al, 2010). This might reflect capital spending cuts by incumbent firms in the wake of privatizations that have accompanied a number of past reforms in the countries of Southeastern Europe. In turn, reducing economy-wide barriers to firm entry might bring relatively quick employment gains, especially when reforms make it easier to create a firm and recruit workers. The stringency of product market regulation is identified with the size of sunk entry costs paid to access the market. Moreover, such reforms require investment (entry of new firms) that needs to be financed by reducing consumption. Indeed, the existence of short-run costs associated with structural reforms is, along with their uneven distribution across individuals and firms, one of the motivations behind political resistance to the reform process.

Crucial for the empirical assessment of economic regulation on the market is measuring or the attempt of quantification of actual effects of regulatory measures, which requires precise benchmarks against which regulatory effects are measured. Current economic conditions and regulation regimes in industries are not that much different from country to country, especially in individual regions, such that a distinct variation between observed "regulated" and "unregulated" environments simply may not exist. The empirical research of economic regulation should provide new useful data that will allow a clear explanation of achieved effects. Sustainable economic growth and development have been promoted through regulatory policy’s contribution to structural reforms, liberalisation of product market, international market openness, and a less constricted business environment for innovation and entrepreneurship. Timmer et al (2011) say that regulatory efforts must be such to recognize and protect rights of all market participants, such that later in the process one is able to make unrestricted judgement as to value or price that may be achieved on a market product or service. Laws, administrative rules and licences are to serve to create a meaningful regulatory market mechanism that should be used by and useful to all registered market entities.

3. COMBINING THEORY AND PRACTICE OF PRODUCT MARKET REGULATION

There are international institutions that produce macro-economic indicators of individual countries’ performance relating to regulation. These are constructed using a number of different methods, including self-assessment and surveys of opinions. The performance may vary between indicators due to different composition, sample sizes and objectives of each assessment:
OECD product market regulation indicators\(^1\);
the World Bank report ranks in terms of ease of doing business;
World Economic Forum (WEF) produces overall assessments of competitiveness (Global Competitiveness Index). This composite indicator includes measures of better regulation.

Since regulation is one of the most pervasive forms of state intervention in economic activity, the focus had to be set on a limited number of regulatory domains and industries. Benchmarking product market regulation has proved to be a useful tool for monitoring the performance of policies and institutions in OECD countries and for identifying specific policy gaps, thus offering the opportunity to benefit from the experience of other member states (Conway et al, 2006; De Rosa et al, 2009). Country scores can be related to specific underlying policies, for example general policies encompassing areas such as public ownership and competition issues, regulatory process and public administration opacity or administrative requirements for business start-ups. As a result of application of factor analysis the economy-wide OECD PMR indicator may be decomposed to a few sub-domains considered as administrative and economic regulation (Figure 1) that affect product markets, but ignore other important regulatory areas (such as environmental, health and safety regulations) that could be more helpful in the exploration of environmental and social dimensions of sustainable development, in addition to the economic dimension.

Economic regulation includes a wide range of constraints and incentive mechanisms concerning market access, the use of inputs, output choices, pricing and international trade and investment and could be interpreted as (i) the regulation of firm behavior, (ii) the regulation of economic structure, and iii) the regulation of competition (Nicoletti, Scarpetta and Boylaud, 2000).

The regulation of economic behaviour indicates the level of direct control over business enterprises measuring general constraints on the sale of state-owned equity stakes, the extent to which legislative bodies control strategic choices of public enterprises and to what extent government special voting rights in privately-owned firms can be exercised (based on 24 business sectors). Another domain it reflects is the use of command and control regulation which indicates the extent to which government uses coercive (as opposed to incentive-based) regulation in general and in specific service sectors such as road freight, retail distribution, air travel and railways. A higher result of the indicator nearer to “6” can be interpreted as market conditions where economic behaviour is the result of experiencing unequal rights in key market aspects and in favour of government power.

The regulation of economic structure includes the scope of public ownership and legal barriers. It measures the pervasiveness of state ownership across business sectors as the proportion of sectors in which the state (government or its agencies) controls at least one firm (based on 24 business sectors). The important determinant of economic structure is the scope of explicit legal limitations on the number of competitors allowed in a wide range of business sectors such as manufacturing of tobacco, manufacturing of metal products, water distribution

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\(^1\) The OECD’s PMR indicators are based on self assessment questionnaires that are filled in by national administrations in each country. Responses are ranked between "0" and "6" and aggregated so that assessments can be benchmarked to enable comparisons. They consist of the overall indicator, summary indicators, high- and low-level indicators and regulatory input data. In the product market the aggregation procedure yielded the pyramid of indicators as shown in Figure 1 and each level of the pyramid aggregate the lower level (more detailed) indicator using weights estimated by factor analysis dimensional reduction (principal component analysis).
and operation of water infrastructure, urban passenger transport, restaurants and hotels, wholesale trade, financial institutions, etc. The incline to "0" indicates market conditions free of restrictions on ownership and the number or concentration of business entities in economy-wide sectors.

The regulation of competition examines antitrust exemptions and price controls. It measures the scope of duly granted exemptions from general competition rules in the case of vertical or horizontal integration or merging of publicly-controlled undertakings as opposed to privately-owned firms. It reflects the extent of price controls in the following competitive sectors: air travel, retail trade, road freight, professional services, and mobile communications. Despite extensive privatization and recent regulatory reforms, state-controlled enterprises are still present and recourse to “command and control” regulations and price controls in competitive industries is frequent relative to other countries.

Economic regulations that restrict competition are generally matched with burdensome administrative environments and public ownership appears to be associated often with legal limitations to the number of competitors (Conway et al, 2006). Administrative regulation, i.e., the interface between government agencies and economic agents includes means for communicating regulatory requirements to the public as well as compliance procedures (Nicoletti, Scarpetta and Boylaud, 2000; Conway et al (2006); Wölfli et al 2009). According to Figure 1 it reflects:

- the use of "one-stop shops" and "silence is consent" rules for getting information on issuing licenses and permits;
- the extent of administrative burdens on the creation of corporations and sole proprietor firms using data such as number of mandatory procedures, number of bodies to contact, days to register and total cost of registering;
- aspects of government's communication strategy and efforts to reduce and simplify the administrative burden of national licensing and permitting system;
- the level of sector-specific administrative burdens in road transport and retail distribution sector such as registration in a commercial register, financial and technical fitness, licences are needed to engage in economic activity relating and/or not relating to outlet sitting.

The purpose of administrative regulation indicator is to recognize the restrictions existing in reporting, information and application procedures and the burdens on business start-ups, implied by both economy-wide and sector-level requirements.

Market-oriented economic and administrative regulatory environment is only a necessary condition for enhancing product market competition because in many markets competition could be affected and stifled by anti-competitive behaviour of private businesses. Timmer et al (2011) claim that strong competition regime is fundamental to growth in the European countries, to thrive investment and innovation and productivity and ensure that consumers get the best deal possible. Restrictions such as: introduction of licences for the development and use of urban planning spaces for the performance of commercial activities are associated with the environmental dimension of sustainable development. Similar connections may be found also among some other elements of the PMR indicator, such as sector-specific administrative burdens and government involvement in network sectors serving governments to regulate mechanisms of influence and implement actions in compliance with their sustainable development policies. Crafts (2006) argues that the main impact of regulation may stem from its effect on incentives for companies to invest and innovate.
There is evidence in the survey data (Coyne and Hausemer, 2008) that, at general level, uncertainty as to how regulations will be enforced impacts business and strategic decisions of companies. Without certainty about government economic regulation policies, business decision makers are unable to assess risk and opportunity and make trade-offs necessary for investment in new technologies. Restrictive product market regulations, in particular those limiting new entry, hinder technology transfer and have a negative impact on productivity (Aghion et al, 2001). This is especially important for retailers who draw great benefits from investments in new technologies in terms of growth of productivity and attracting customers. On the other hand, stronger trading sector in the SEE countries brings about the increased demand for the supply of energy, with a higher volume of packaging waste, while the intensified supply and customer transport activities cause higher environmental pollution; with a higher demand for non-renewable material resources such as metal, wood, glass. Because of all this, one may easily argue that the economically stronger distributional trade should be carefully regulated in future. In addition, one must emphasize the mutuality of economic and social dimensions. It has become increasingly clear that the social and economic outcomes of effective product market regulation reinforce each other (OECD, 2010). Economic growth depends on a stable setting, formalised and enforced through an effective regulatory framework. Conversely, a sound and growing economy is fundamental to quality of life. Poverty and social conditions which degrade the dignity of people undermine respect for the law and encourage illegal activity outside the formal economy.
4. THE RESULT OF EMPIRICAL EXAMINATION

The empirical research covers countries in the region with determined PMR as well as Austria as one of the neighbouring and, along with Greece, the EU-15 country. The data in the research are compared also with the average shown by OECD-34 and EU-15 countries. The PMR methodology was first introduced and applied in 2000 and since then several research studies have been done in the countries of Southeast Europe. De Rosa et (2009) investigated the condition in Croatia and Albania for the year 2007, Fay, De Rosa and Pauna (2007) analysed the condition in Romania, while Fay, DeRosa and Illeva (2007) did the same in Bulgaria.

The productivity slowdown in the countries of Southeast Europe is evident (Graph 1). The analysis of BDP per capita trends shows stunted productivity of the countries of Southeast Europe based on the BDP per capita indicator compared with the developed European countries, i.e., EU-15 countries’ average.

Graph 1: GDP per capita in some European countries in 2003 comparing to 2011.

Note: South Eastern European Countries with existing data together with Austria were examined. “EU-15” includes: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom.

Source: Author's calculation; OECD.StatExtracts, [available at: stat.oecd.org, 10.08.2012]; The World Bank Indicators [available at: data.worldbank.org, 10.08.2012].

Table 1 includes the comparison of summary and overall PMR indicators across the region's countries. There is no major variation in the PMR regulation index (from 1.2 to, as the maximum, 2.3). The task of the region's countries is to achieve the EU-15 average. The overall PMR of Croatia was somewhat lower in 2007 than the one shown by Greece that has had the most stringent product market regulation in the region (Graph 2). The market reforms implemented in Hungary have led, as a result, to the significant market liberalization which according to the index is within the EU-15 average.
Table 1: Summary and overall PMR indicators in 2008.

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<tr>
<th>Summary indicators</th>
<th>PMR overall indicator*</th>
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<td></td>
<td>State control</td>
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<td>Hungary</td>
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<td>EU-15</td>
<td>2.14</td>
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<td>Albania</td>
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<td>OECD-34</td>
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<td>Slovenia</td>
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<td>Austria</td>
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<td>Slovak Rep.</td>
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<td>Romania (2006)</td>
<td>3.20</td>
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<td>Bulgaria (2006)</td>
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<td>Croatia (2007)</td>
<td>3.50</td>
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<td>Greece</td>
<td>3.85</td>
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* Sum of each summary indicator weighted by 0.33 according to Wölfel et al (2009), pp. 10.

Note: Index scale of 0-6 from least to most restrictive. Data for Croatia and Albania related to 2007, and for Romania and Bulgaria to 2006.


The empirical research conducted by De Rosa et al (2009) has shown substantial convergence of product market policies across OECD countries in 2003, compared to 1998, with substantial improvements achieved by countries that originally exhibited relatively restrictive product market regulations, such as Poland, Turkey, Czech Republic, Greece, Italy, France, Hungary, and Spain. Substantial improvements in easing product market policies have also been achieved among EU-15 countries where the average PMR score fell from 2.1 in 1998 to 1.4 in 2003. While this reflects the increasing harmonization of EU common market rules, the PMR benchmarking may have been instrumental in fostering this improvement.

Graph 2: PMR overall indicator in 2008 – country comparison.

Source: Table 1.

The 'state control' domain shows a strong involvement in publicly-owned enterprises as a result of use of 'command and control regulation', and it is still the biggest burden of economic regulation (Graph 3). The 'barriers to entrepreneurship' domain that includes mostly
The aggregated administrative regulation indicator, however, shows a different index distribution compared to the overall PMR index (Graph 4). Countries marked by a weak interventionist policy of governments, are confronted on the other hand with the burden of administrative regulation. According to the analysis conducted by De Rosa et al (2009) using the 2007 regulatory data, Croatia is in a relatively good position compared to the other analysed countries. In Hungary and Slovakia there are administrative burdens for setting up enterprises. In Greece, there is a large number of sectors in which entry is restricted by law. Croatia reflects a very burdensome licensing and permits system captured by PMR. On the other hand, in terms of economic regulation indicators (Graph 4), Croatia’s performance was the first next to the worst in the sample. One may conclude based on these results that market regulation in Croatia has sought convergence with the other countries of the region. Little progress has been made in the areas of regulatory environment that directly affect the incentives of economic agents, namely corporate governance and, more generally, the degree of competition in product markets.

Government formalities are important tools to support public policies, and can help businesses by setting a level playing field for commercial activity. But they may also represent an administrative burden as well as an irritation factor for business and citizens, and one which tends to grow over time. Difficult areas include employment regulations, market regulation, environmental standards, tax regulations, and budgeting regulations. Permits and licenses can also be a major potential burden on businesses, especially SMEs.
Graph 4: Administrative and economic regulation indicators in 2008 – country comparison.

Note: Scope of low level indicators according to Figure 1.


The relationship between productivity and PMR index, as shown, helps identify the convergence of the countries of Southeast Europe towards the EU-15 and OECD developed countries’ average (Graph 5). Loosened regulation or aspiration towards market liberalization must be oriented towards the increase of productivity (the shaded area in Graph 5). Given the general tendency of convergence in the broad features of product market regulation, differences in the regulatory regimes of examined countries may potentially have as an important consequence the product market competition becoming more subtle. In addition, convergence towards lower barriers to product market competition has to be stronger than the existing one, with stronger convergence in 'state control', 'regulation of economic behaviour' and 'regulation of economic structure' and, to a lesser extent, 'barriers to entrepreneurship' and 'regulation of competition'. The achievement of this relatively important objective towards convergence has been motivated in the first place by efforts to implement the single market programme.

Benchmarking process and analysis of regulation convergence are necessary not just for making necessary adjustments, but also to demonstrate the practical effectiveness of
regulatory framework, and identifying where resources should be allocated to sustain effectiveness and development of industry sectors. Countries with more marked administrative or economic structure regulation, may expect less problems and divergences in the implementation of economic policies - owing to the "command and control" principle - and thereby also in the implementation of sustainable growth and development policies.

Graph 5: Relationship of PMR overall indicator to GDP per capita in 2008 – country comparison.

Note: data for Croatia and Albania related to 2007, Romania and Bulgaria to 2006.

The shift in the Croatian regulatory policy in the five-year period, i.e., in 2012 compared to 2007, indicated in the overall PMR index, shows that regulation has weakened by only 0.2 (Graph 6).

Graph 6: Aggregated and overall PMR indicators survey for Croatia in 2012 comparing to 2007.
In addition to reforms that have had an effect of marginal liberalization of overall PMR indicators, one must mention segments of market regulation system that are within 'state-control' and 'barriers to trade' domains. Positive shifts are a result of Croatia's preparations for the EU market: government power and control decreased in some sectors and there are new entrants due to weaker legal barriers in national and local regulations. Efforts made towards the reduction of administrative regulation in the analysed period have not been successful, but have been kept at the level of the EU-15 average. The national programme for simplification of the procedure of incorporation of new companies through 'one-stop shop' has been set-up in the meantime, but this has not created the environment that allows creation of companies at one location. Some "e-" initiatives have been launched, however, time limits for the incorporation of companies have not been sufficiently reduced and administrative procedures have not been objectively simplified, although reforms in that area were announced in 2006 and 2007. The number of mandatory procedures required to register sole-proprietorships has fallen to less than 12 but the number of public and private bodies to contact for registration has remained the same. Similar changes have been made in the area of establishment of corporations.

The control of companies by the Government as their owner and/or holder of (controlling) interest has been insignificantly reduced, which has affected the liberalization of economic regulation or of 'regulation of economic behaviour' indicators. Also, some limitations in the model of sale of government interests in companies have been removed, which has allowed a practice of greater management influence on strategic decisions. There are chances that in the future, the economic regulatory policy of Croatia will be managed in compliance with the best practice of EU countries and in this respect it is essential to monitor continuously the status and changes in the regulation and adopt timely measures.

Dunković, Jurić and Cvetković [2012] have analysed cross-country differences in the regulatory conditions in the OECD area's retail distribution industry including the focused examination of Croatia's regulatory conditions, comparing the situation in 1998, 2003, 2008 and 2011. The results have shown that 60% of the European OECD members aspire towards liberalization while the status of 30% of the countries has been identified as restrictive. Regulation affects three areas of development in the retail sector: i) the internationalisation of the sector; ii) market structure, including concentration rates and technology; iii) the growing market share of retailers' private labels. According to the overall retail distribution indicator, Croatia has been positioned in the group of moderately restrictive countries, however, the sub-domain indicator relating to licences and permits reflects a restrictive administrative regulation environment. The visible progress has been proved by comparing the status and shifts in the retail distribution regulatory framework in 2008 and 2011 respectively, starting from 2.29 down to 1.36. Requirements and/or special requirements, depending on the size of a store, imposed on the start-up of retail activities stifle the vitality of distribution activities weakening the competitive pressure on the market, which may lead to the employment growth slow-down and higher prices for end customers. Regulation has a major impact on the main areas of development of the food and non-food products retail sector, such as sector internationalization, market structure, concentration rates, retail information technology and private labels.
Changes that have been made until 2012 are beneficial for the development of product distribution sector. The impact of price control on tobacco products, petroleum products, drugs, some foods etc. for the purpose of increase of public revenues has been found in the majority of EU countries and no significant changes are expected in that area. Administrative barriers, which have not been reduced in Croatia, hold sway over the competitiveness and growth in the distributive trade sector, but it is evident that this type of restriction hampers trade in other countries of the region as well.

5. CONCLUSION

Market regulation, productivity, competitiveness, investment and innovation are interconnected. They are all key factors and indicators of success of the economic policy. Product market regulatory reforms mainly involving deregulation through the removal of regulatory barriers have been an important component of structural reforms over the last decades. The development of market regulation must be sustainable and oriented towards the preservation of economic and capital resources. Also, such shaping of a regulatory framework must support a sustainable growth of trade and its associated activities. This may be achieved through reinforced convergence among countries of the region because that would be the sign that the countries pursue balanced management of economic and administrative barriers on the market. Efficient regulation must act as support to sustainable growth.

Government interests in the ownership of business entities, price control, communication with market entities, administrative barriers etc. regulate to a certain extent and influence actions of all market participants, affecting production costs and product quality. A better institutional architecture of a government may improve oversight and coordination of reforms pertaining to product market liberalization. Regulatory uncertainty destroys value by diverting management resources from value-enhancing to compliance-related activities. Therefore, regulatory activity affects investment and innovation and it can confidently be likewise expected that it will affect productivity growth, on a roughly similar scale.

There are no major deviations in the status of economic regulation in the countries of Southeast Europe. However, although there are differences in aggregate indicators, they are evidently not just the result of the fact that several countries of the region have joined the EU. Areas of regulation have been identified in the empirical research in which reforms are necessary in order to remove administrative barriers and loosen state control over business entities, sectors and retail prices. There is evidence that some countries of the region, including Croatia, must conduct further liberalization in all areas of economic and administrative regulation towards higher convergence and the achievement of market regulation modelled based on the example of developed European countries. For example, further reducing of administrative burdens, overall and sector-specific may lead to stronger competitiveness, introduction of new technologies as benchmarks of competitiveness and may lead to more convenient prices for end customers. As a result of correction of the regulatory frame, Hungary and Slovenia are good examples of liberal regulation and their field of convergence is the closest to the developed EU countries. Better regulation does not mean more or less regulation but rather, the adoption of a policy and processes aimed at ensuring that all regulations are of high quality and sustainable. Higher productivity based on the PMR – GDP per capita ratio, may bring about better results in terms of sustainable growth.
The process of convergence in Croatia has been slow and existing only in a segment of the PMR system. Market policy has lately been more oriented towards the loosening of economic regulation but no progress has been made in the area of administrative regulation. The access to the EU market will enhance competition on the domestic market across all sectors, even those currently controlled by the state. Such anticipated trends will lead to weaker barriers for new competitors to access the market, thereby introducing new technologies in the retail sector with a more diversified supply of products and services. In general, the development of a regulatory framework in Croatia should be oriented towards weaker traditional barriers for the performance of trading activities, as a result of convergence, while higher competitiveness may be achieved through simplified administrative procedures, promotion of competition among domestic business entities and, in parallel, liberalization of new entries.

6. REFERENCES


