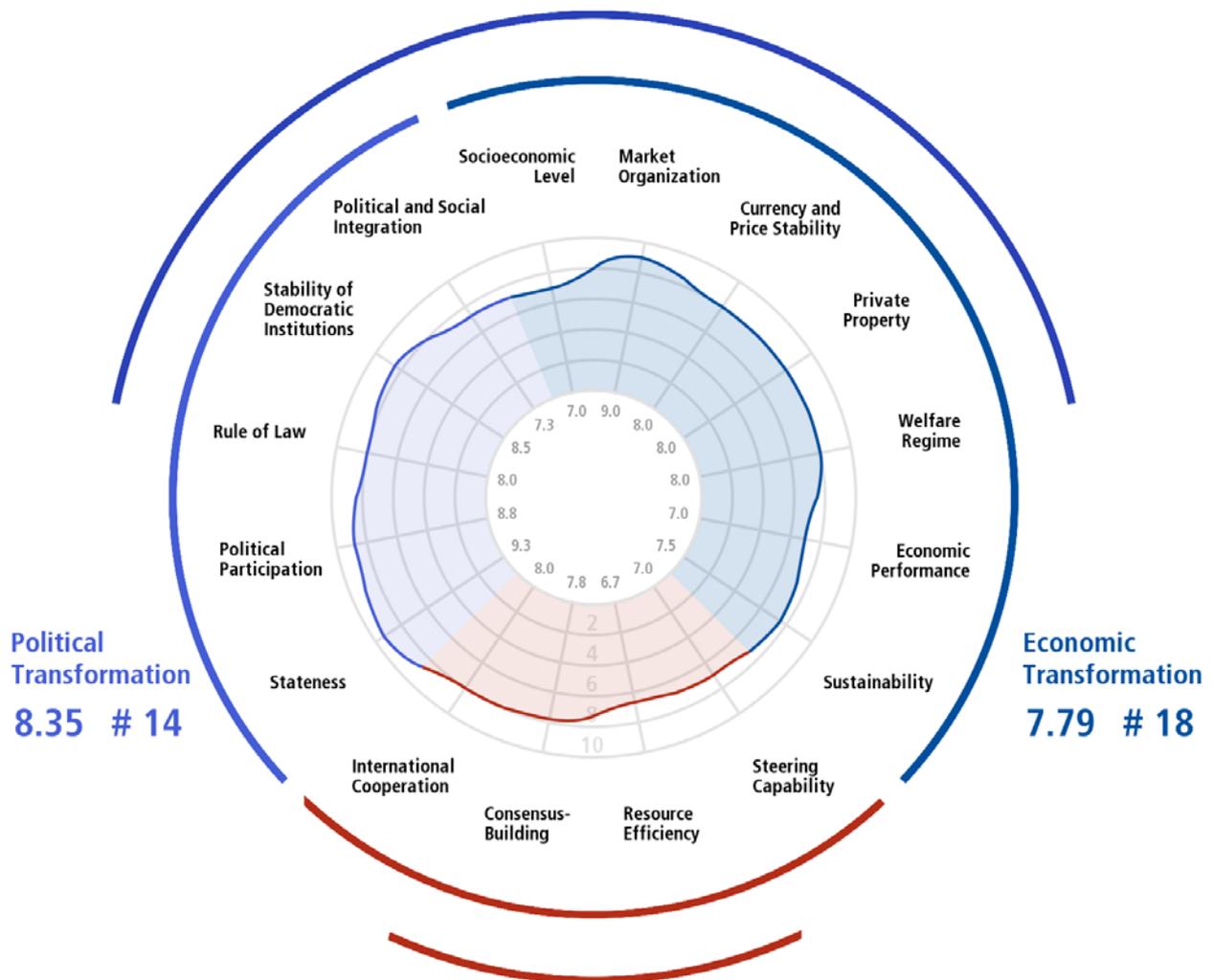


Croatia

Status Index

8.07 # 14

on 1-10 scale out of 129



Political Transformation
8.35 # 14

Economic Transformation
7.79 # 18

Governance Index

6.07 # 21

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	4.2	HDI	0.827	GDP p.c., PPP \$	23596
Pop. growth ¹	% p.a.	-0.8	HDI rank of 188	45	Gini Index	32.2
Life expectancy	years	77.3	UN Education Index	0.820	Poverty ³	% 1.9
Urban population	%	59.3	Gender inequality ²	0.141	Aid per capita \$	-

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

The period between January 2015 and January 2017 in Croatia was characterized by political turbulence. The country saw a succession of three governments led by Zoran Milanović, Tihomir Orešković and Andrej Plenković. Two parliamentary elections took place during this period, in November 2015 and September 2016. In the first election, the HDZ and SDP won an equal number of constituency seats (56 each), while the HDZ won an additional three seats reserved for Croatian diaspora (largely based on the votes from Bosnia and Herzegovina Croats). A major surprise was that MOST (a coalition of independent slates) placed third. In January 2016, following negotiations between the three parties, a HDZ-MOST government was formed with Tihomir Orešković as a non-party prime minister. Orešković was a businessman from Canada, unknown to the public, who had not participated in the election. However, the government was inefficient and incapable of organizing any relevant legislative activity. In June 2016, MOST demanded the resignation of HDZ party president Tomislav Karamarko on the grounds of a conflict of interest, subsequently a no-confidence motion against the Orešković government was accepted. Both HDZ and opposition members of parliament voted for the no-confidence motion. Shortly afterwards, Karamarko resigned as party president and was replaced by Andrej Plenković who, until then, had been a member of the European Parliament. In July 2016, the Croatian president called a new parliamentary election for September 2016. The HDZ placed first, winning 62 seats, but failed to win the required 76 votes to form a majority government. Consequently, they formed a second coalition with MOST, which had won 13 seats. In October 2016, a new government was formed, with HDZ president Andrej Plenković as prime minister.

In 2015, the last year of the SDP government's mandate, the Milanović government managed to accomplish economic growth (approximately 1.6%), helping Croatia out of an almost six-year economic recession that had begun in 2009 with the HDZ governments of Ivo Sanader and (in mid-2009) Jadranka Kosor. The most important decision of Milanović's center-left government concerned the Swiss franc loan conversion law, passed in September 2015 immediately before the 2015 parliamentary election. Under the law, banks were encumbered with the entire cost of the

conversion of Croatian loans from Swiss francs into Croatian kunas. The aim was to protect tens of thousands of Croatian citizens who had found themselves in a very difficult financial situation, having to repay their Swiss franc loan dues. Naturally, the decision provoked a reaction from commercial banks (almost all of them foreign-owned) and several banks pursued legal action through the European courts.

In January 2016, the center-right HDZ-MOST coalition government came to power, headed by Tihomir Orešković as a non-party prime minister. With the exception of the 2016 budget, the government almost completely failed to implement any relevant decision during its half year in power. However, as the government was relatively cautious about incurring any further debts, the growth in public debt was stopped in 2016. After June 2016, the government functioned as a resigned government, dealing only with technical issues. Nevertheless, the economy continued to grow during its mandate, with the growth rate increasing by more than 1%. The expected growth rate for 2016 is approximately 2.8%.

In October 2016, a new HDZ-MOST government came to power, with Andrej Plenković, the president of the HDZ, as prime minister. Several ministers in the former government, including finance minister Zdravko Marić, retained their posts in the new government. At the end of 2016, Marić initiated a coherent tax reform program, which was later adopted by the Croatian parliament. This is the most important reform step carried out by the Plenković government so far.

History and Characteristics of Transformation

Croatia's transition toward democracy and a market economy has coincided with the disintegration of Yugoslavia and the armed conflicts arising from Yugoslavia's disintegration. As early as 1989, Croatia saw the beginning of an intensive process of political liberalization and forming of the first non-communist political parties. The dissolution of the League of Communists of Yugoslavia in January 1990 strengthened the mobilizing potential of the non-communist parties. The Croatian Democratic Union (HDZ), led by charismatic leader Franjo Tuđman, blazed the trail. HDZ scored a convincing victory at the first multiparty election in Croatia in May 1990. The constitution of the Republic of Croatia was adopted at the end of 1990 and the referendum on independence was held in May 1991, with 93% of the Croatian population supporting Croatia's sovereignty and the possibility of joining a confederation of former Yugoslav republics on the basis of the Croatian and Slovenian proposal for overcoming the Yugoslav crisis. Following Serbian leader Slobodan Milošević's policy that all Serbs should live in Yugoslavia, the Serbs from the parts of Croatia where they constituted a majority or a dominant population rebelled against the Zagreb government. In mid-1991, the conflict escalated into open warfare. As the Yugoslav People's Army sided with the rebel Serbs, approximately one third of Croatia's territory was occupied by the end of the first phase of the war in late 1991. The occupied territory stretched along a large part of the border with the neighboring Bosnia-Herzegovina and along the entire border with Serbia. The situation persisted until mid-1995, when Croatian troops liberated the occupied territories in the central and southern parts of the country. Most of the Serb population living in

those parts left Croatia together with Serbian forces. As for the remaining occupied territories in Eastern Slavonia and Baranja along the border with Serbia, their peaceful reintegration into Croatia was successfully negotiated by the end of 1997.

In addition to thousands of deaths, massive migration and widespread destruction, the war substantially slowed down the democratic transition and the development of democratic institutions. Although a democratic multiparty system was in place throughout the 1990s, in reality it was a semi-authoritarian form of political rule with President Franjo Tuđman and the ruling HDZ party dominating the politics on the national level. The opposition parties held power only at the local level, largely in the more developed western parts of the country and in some major cities. Popular opposition toward this political order started to grow in the late 1990s. After Tuđman's death, the center-left parties led by Social Democratic Party (SDP) and Croatian Social Liberal Party (HSLHS) won a large majority in the parliamentary election in early 2000.

The ensuing political development started acquiring the fundamental characteristics of a democratic political rule, accompanied by a relatively intensive development of civil society organizations. Unfortunately, it was also accompanied by a very high corruption rate reaching the highest levels of government. Nevertheless, Croatia experienced very strong economic growth between 2000 and 2008. The HDZ won the parliamentary elections in 2003 and then 2007, but this time with very pro-European leanings. In the mid-2009, prime minister and HDZ president Ivo Sanader (later charged with corruption) suddenly resigned, handing his mandate over to his deputy, Jadranka Kosor, who successfully completed the negotiations on Croatia's accession to the European Union. However, in the same the year, Croatia was hit hard by an economic crisis. For six years, neither the Kosor (HDZ) government nor the Milanović center-left coalition government led by SDP managed to pull the country out of the crisis. Despite Croatia's full membership in NATO in 2009 and accession to the European Union on 1 July 2013, the crisis persisted, accompanied by a growing emigration to other European countries. This negative migration trend has continued through 2016. Even the return to positive GDP growth in 2015 (the last year of the Milanović government) did not stop the trend. Though positive economic growth has continued through 2016, during both HDZ-MOST governments. During its transition period, Croatia experienced not only a massive loss of population, but also considerable economic stagnation. In the early 1980s, as the western part of the socialist Yugoslavia, Croatia's GDP growth rate ranked among the highest of any former socialist country, second only to Slovenia. Today, Croatia's GDP growth rate trails behind the former socialist countries from Central and Eastern Europe, which are now EU member states.

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

Transformation Status

I. Political Transformation

1 | Stateness

The state has no rivals to its control over the country's territory. The police provides security for citizens and property across the entire territory of the state, and is administered by the central government, not by local or regional self-governments. This arrangement has been in place since 1995, when a Croatian army operation terminated the existence of the Republic of Serb Krajina (established in 1991), incorporating the entire territory hitherto controlled by the Republic of Serb Krajina into the constitutional and legal order of the Republic of Croatia.

According to the fundamental provisions of its constitution, the Republic of Croatia is defined as a nation-state of the Croatian people and the country's national minorities. The constitution specifies 22 minorities, including Serbs (the largest minority), Czechs, Slovaks, Italians and Hungarians. In Croatian society today, there are no relevant groups that would strongly contest the way citizenship and the internal organization of the nation-state are regulated. However, the concept of citizenship and acceptance of Croatia as a legitimate nation-state were strongly challenged in the early 1990s, when the Serb community refused to accept their inclusion in the Republic of Croatia, defined by its December 1990 constitution (adopted after the first multiparty election in April and May 1990). The Serbs' armed rebellion ensued, supported by the Yugoslav army and volunteers from other parts of the former Yugoslavia, the Serbian forces occupied approximately one third of Croatia's territory and established the Republic of Serb Krajina. In a series of operations, Croatian armed forces gradually liberated the occupied territories, with the final operation taking place in August 1995. This led to a mass exodus of the Serb population. The easternmost occupied territories, along the border with Serbia, were then peacefully reintegrated into Croatia. This process resulted in a drastic reduction in the Serb population living in Croatia from 581,663 (12.16% of the total population, according to the 1991 census) to 186,633 (4.36%, according to the latest census in 2011).

Question
Score

Monopoly on the
use of force

10



State identity

9



In the period under review, Croatian Serbs became increasingly dissatisfied with their social and political status. Milorad Pupovac, a longtime member of parliament and the leader of Croatian Serbs, asserted as recently as 2010 that the Serbs “again wield a political influence in Croatia”, referring to their participation in the then coalition government. In 2016, Pupovac pointed out that “Serb returnees in the rural areas are stricken by poverty and urban Serbs are stricken by fear.” A series of developments in 2015 and 2016 indicated a growth in radical right-wing political activities, and political messages marked by Croatian nationalist and Catholic ideas.

The constitution defines Croatia as a secular state in which all religious communities are treated equally. In reality, however, the Catholic Church has the status of a key religion, and exerts a very strong influence on Croatia’s social and political life. The Catholic Church has increasingly promoted and backed civil society initiatives advocating conservative, anti-liberal values and ideas. Catholic bishops have also openly supported HDZ and the veterans’ organizations.

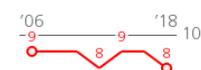
The influence of other religious communities is very limited, and the Orthodox Church has experienced significant problems and strong negative attitudes from a large portion of the population as a direct aftermath of the war.

Religious beliefs are widespread in Croatia, 85% of the population declare themselves religious. In late 2016, having analyzed ten parameters of religiosity, Croatian sociologists of religion pointed out that Croatia ranked fifth in Europe by the religiosity rate. Though the sociologists underlined that approximately one third of the believers did not accept the guidelines of the Church and instead behaved as “do-it-yourself” believers.

The state has at its disposal the administrative structures that cover the entire territory of the country. At the moment, the state administration consists of 20 ministries, five government offices, seven state administrative organizations and 20 state administration offices in the counties. A total of 1,279 local units of the central state administration bodies and local offices have been established for conducting central state administration affairs in counties, cities and communes. Also, a total of 91 local offices and 302 registrar’s offices have been established in communes and cities for conducting county state administration affairs. In addition, there are numerous bodies with public authorities (agencies, institutes), an extended structure of 555 local self-government units (127 cities and 428 communes) and a regional self-government structure consisting of 20 counties. According to the World Bank, 97% of the population had access to improved sanitation facilities and 100% had access to an improved water source in 2015.

No interference of religious dogmas

8



1

Basic administration

10



1

2 | Political Participation

Croatian elections for the national parliament (Hrvatski sabor), local and regional self-government units, and presidency can be rated as free and fair. The 2015 parliamentary elections were positively assessed by the Organisation for Security and Cooperation in Europe (OSCE). Though the OSCE noted that individual constituencies differed by more than 10% from the national average, and that defamation and insult continued to be criminal offenses, enabling the intimidation of journalists. No international observers were invited to monitor the 2016 elections.

There have been some problems with electoral registers, with the addresses of some registered voters having been found to be fictitious (particularly of Bosnian-Herzegovinian citizens living in Croatia), while the electoral registers for the so-called diaspora have not been fully updated. Generally, the legal framework of political-party and electoral-campaign financing is well-structured, but the enforcement of legal provisions and effective legal sanctioning of violations of law is weak due to the rather low capacities of the State Electoral Commission as the central body in charge of monitoring political financing.

Croatian parliamentary elections are based on proportional representation and seats are distributed according to the D'Hondt system. From 2015, parliamentary elections voters can vote for a party list or for a specific candidate. The personalized element of voting was introduced as a result of a campaign by some small groups and parties to introduce voting for a candidate and not for a party list. The majority system was not accepted by the ruling coalition and instead preferential voting was introduced using a PR electoral system. Croatia has 10 electoral districts, each electing 14 members of parliament. The eight remaining members of parliament are elected by national minorities (with three seats reserved for the Serb minority). Three additional members of parliament are elected by Croatian citizens with no permanent residence in Croatia (the diaspora).

The democratically elected representatives possess an effective power to govern. While some interest groups have some influence, the veto power wielded by various interest groups cannot limit the power to govern. As the social partnership system in place in Croatia is only partially efficient, strong groups such as the most powerful entrepreneurs (who usually have a direct influence on government decisions, not through the social partnership), war veterans and representatives of the Catholic Church exercise influence over many important political decisions behind the scenes. For example, in November 2014, the war veterans raised a large tent in downtown Zagreb in open political defiance to the then center-left government represented by Prime Minister Milanović and President Josipović. The tent was removed only in April 2016, after the new center-right HDZ-MOST coalition had come to power on all levels.

Free and fair elections

9



1

Effective power to govern

9



1

Croatian citizens face no limitations when organizing themselves into political or civil initiatives. There is a rather strong network of civil society organizations in Croatia. The period of the Milanović government (2011-2015) saw a noticeable growth in conservative civil society organizations, such as the NGO U ime obitelji (In the Name of the Family). Previously, it was primarily the NGOs advocating liberal-left values that were active on the public scene. Various war veterans' organizations featured prominently among those who advocated national values.

Freedom of expression is constitutionally guaranteed, but occasionally subject to interference. Although no drastic cases of censorship or interference in mass media have been recorded in Croatia, the editorial policy of Croatian Radiotelevision is dependent on the political parties in power. As a result, Croatian Radiotelevision not only functions as a public broadcasting company, but also promotes the political issues convenient to the incumbent government. This was evident in 2016 when, after the center-right parties had won the parliamentary elections, the influence of conservative-right political commentators grew substantially. In March 2016 the Orešković government replaced the head of Croatian Radiotelevision with an advisor to HDZ President Tomislav Karamarko who subsequently dismissed about 70 TV directors, editors, journalists and staff members.

However, the most prominent example of the violation of freedom of expression involved the Croatian Audiovisual Center (HAVC). Since influential associations of veterans criticized HAVC for supporting a documentary that examined the killing of disabled Serbian civilians at the end of the 1995 war, the Orešković government and its right-wing extremist minister of culture launched an investigation into HAVC. Eventually, in early 2017, the director of HAVC was accused of authorizing illegal financial transactions and replaced, despite the support of the majority of leading filmmakers in Croatia.

In March 2016, the government also sought to replace members of the board of the licensing and supervisory Agency for Electronic Media due to alleged irregularities, following a protest of veterans' organizations in January 2016. The protest of approximately 5,000 people, which was attended by a deputy speaker of parliament, was accompanied by the usual right-wing iconography and rhetoric. The protest had been triggered by the agency's decision to suspend the license of the local TV station Z1 for three days due to hate speech. The director of the station had warned citizens not to walk near to the Serbian Orthodox Cathedral in Zagreb because their children could become victims of Chetnik (nationalist Serb WW2 fighters) violence. Leaders of the protest gave Chetnik and communist partisan caps to Mirjana Rakić, the agency's director (and a self-declared ethnic Serbian journalist from Croatia) who later decided to resign in March 2016.

Association /
assembly rights

10



1

Freedom of
expression

7



1

Financial difficulties threatened the existence of private media outlets and increased their dependence on individual economic interest groups, which increased direct and indirect pressure on journalists to subordinate their reporting to owners' interests.

3 | Rule of Law

Croatia has a parliamentary system of government with a rather stable division of legislative, executive and judicial functions. Though the parliament (the Sabor) is unable to adequately evaluate the quality of policies proposed to it by the government. The monitoring and supervisory function of parliament is not well developed because party leaders dominate their respective parliamentary parties and many members of parliament are not interested in tightly scrutinizing government policies. The president of the republic is a relatively weak institution which cannot influence the policy-making process or the work of government. Since 2000, the prime minister has been the most powerful political function in the political system and the head of the executive branch. In 2014, President Josipović proposed a strengthening of the constitutional powers of the president, but this was not accepted by the political elite or the new president, Grabar Kitarovic.

Another problem is the quality of the judiciary. It often happens that the Constitutional Court (an institution authorized to interpret and enforce the constitution) reverses court verdicts. The most significant examples include the annulment of the County and Supreme Court verdicts against the former Prime Minister Ivo Sanader in the HYPO and MOL cases in 2015, and the Supreme Court's verdict in the Swiss franc loans case due to the number of omissions in the proceedings. The Constitutional Court performed its constitutional law function, without assuming the competence of regular courts.

Although the judiciary in Croatia is basically independent from the political structures, there is a public perception that the judiciary is still under some political influence from the political authorities. Another problem relates to corruption in the judiciary, although judicial circles deny that there is a significant level of corruption in their sector.

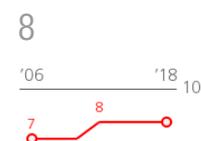
In 2015, the court network in Croatia underwent substantial changes, including a significant reduction in the number of basic municipal courts. As a result of the reform, Croatia now has the Supreme Court, 15 county courts and 24 municipal courts. It also has the High Misdemeanor Court and 22 misdemeanor courts, the High Commercial Court and eight commercial courts, the High Administrative Court and four administrative courts, the State Attorney's Office of the Republic of Croatia (DORH), as well as 15 offices at county and 22 at municipal level. There is also one special, separate body, the Office for the Suppression of Corruption and Organized Crime (USKOK). In total, there are 116 judicial bodies in Croatia.

Separation of powers



1

Independent judiciary



1

Croatia has a very large number of judges compared to other European countries. Croatia has 41 judges per 100,000 people, the second highest rate in Europe. Similarly, Croatia has 162 court staff per 100,000 inhabitants, again the second highest rate in Europe. In late 2015, there were 10,208 employees in the judiciary bodies: 8,527 in courts and 1,681 in state attorney's offices. The large number of judges in Croatian judiciary system has not resulted in greater efficiency, because the judiciary is still underequipped when it comes to IT and e-communication, judicial procedures are very complicated, laws are frequently amended and the number of cases brought before judges far exceeds the European average.

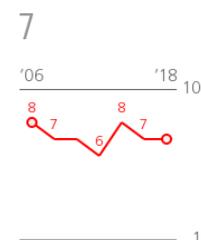
Croatia is somewhere in the middle of all EU member states according to the time required for first instance rulings to be handed down in civil, commercial and administrative cases. It took 134 days on average for the Croatian justice system to hand down verdicts in 2014, while in the two highest ranked European countries it required only 19 and 33 days respectively.

Public officials are regularly prosecuted for corruption. The central body for processing such offenses is USKOK (Office for the Suppression of Corruption and Organized Crime). USKOK is a specialized body operating as part of the State Attorney's Office of the Republic of Croatia (DORH). So far, USKOK's investigations have resulted in the trials of a former prime minister, a deputy prime minister, Zagreb's mayor, several highly-positioned government officials, local officials, sports officials and others. The drawback here is that not many of the verdicts are enforced. There were also cases when the Supreme Court confirmed a court verdict and the Constitutional Court later reversed the verdict on the grounds of protection of some fundamental constitutional provisions. For example, on July 27, 2015, and October 1, 2015, the Constitutional Court repealed the verdicts against the former Prime Minister Ivo Sanader because of procedural mistakes. Sanader had been convicted in 2012, prior to Croatia's EU accession, in order to demonstrate the credibility of Croatia's anti-corruption activities.

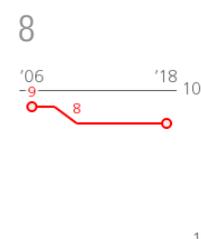
In June 2016, the HDZ President and Vice Prime Minister Tomislav Karamarko had to resign, because it was revealed that his wife's company had provided consulting services for the company of a former manager of Croatia's oil company INA who was involved in one of Sanader's corruption affairs.

Protection of civil rights in Croatia is characterized by a relatively well-institutionalized system in which the basic institutions include the Ombudsperson of Croatia, Disability Ombudsperson, Ombudsperson for Children and Ombudsperson for Gender Equality. According to the latest report prepared by Amnesty International on Croatia, there are currently several problematic areas affecting citizens' rights. Civil rights related to refugees and asylum-seekers are characterized by generally adequate reception conditions, but there was no coherent long-term social integration policy. In Croatia, there are frequent examples of open discrimination against ethnic minorities, and in particular toward the Roma population. Discrimination is

Prosecution of
office abuse



Civil rights



particularly expressed in hate speech that stigmatizes specific groups, in particular ethnic Serbs, refugees and migrants. In January 2016, a protest march was organized against Mirjana Rakić, chair of the Electronic Media Council, and prominent Croatian journalist and TV commentator, after the Electronic Media Council had penalized a local TV station for hate speech used by one of its journalists. The council's decision had provoked radical nationalist demonstrators to organize a protest march to the council's premises. The march was accompanied by the usual iconography and rhetoric of right-wing radicals in Croatia. The highest number of cases opened by the Office of the Ombudsperson in 2015 involved justice (359), civil service and employment relations (316), and discrimination in various areas (284), while cases relating to the issue of persons deprived of their liberty was the eighth most common type of case (165). Analyzed by discrimination, 25% of complaints cited discrimination on the basis of race, ethnicity, skin color or national origin, followed by age (9.9%), health condition (8.1%), education (7.4%), political or other belief (5.6%) and religion (4.2%).

4 | Stability of Democratic Institutions

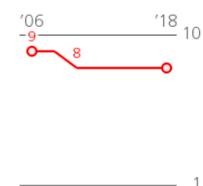
The fundamental democratic institutions are relatively stable and, essentially, face no problems in performing their basic tasks. There are fundamental mechanisms controlling the decisions made by the central, regional and local governments. Most of the usual forms of transfers of power are complied with.

The activities of independent control agencies contribute to the stability of democratic institutions by increasing public accountability. These agencies include the Commission for Conflict of Interest, set up in 2011 under a special law, and the Commissioner for Information, established in 2013. The Commissioner for Information is an independent body for the protection of the citizens' right of access to information. The commissioner's office has developed several channels to make information publicly available.

The stability of democratic institutions has been threatened by two parallel processes. First, there is a growing influence of populist movements organizing public campaigns and referendums. Such movements not only partake in such actions, they also challenge the democratically elected government and demand the resignation of ministers who oppose their views. For example, war veterans protested against a minister of the Milanović government who was in charge of the Ministry of War Veterans. The protests had begun in 2014 with pitching a tent in front of the Ministry of War Veterans. The tent was not removed until April 2016, after both the center-left president Ivo Josipović and the center-left coalition government led by SDP had lost power. The stability of democratic institutions is also affected by the lack of public trust in the fundamental political institutions, which is reflected in very low voter turnout at parliamentary, presidential and local elections. Turnout for the last

Performance of democratic institutions

8



three parliamentary elections never exceed 70% and fell below 60% for the last parliamentary election in June 2016. It is a very strong downward trend in comparison to the 2000 parliamentary elections when turnout was 76.5%. Turnout at local elections is usually even lower, seldom reaching 50%.

A large majority of relevant political actors (e.g., central and local government bodies, political parties, business associations, trade unions and civil society organizations) accept the fundamental democratic institutions of the Republic of Croatia. An exception to this are some minor and marginal extreme-right political parties which glorify the Ustasha's fascist Independent State of Croatia, which existed from 1941 to 1945. Their influence on the political electoral process is almost negligible, but their activities do present a problem. Many right-wing politicians and a part of the society have covertly glorified the Independent State of Croatia at public events. It is expressed in radical nationalist speeches and by using Ustasha's iconography. Although the Ustasha ideology is officially condemned, a part of society and the political elite, including some members of the governing party HDZ, have not accepted all liberal democratic values.

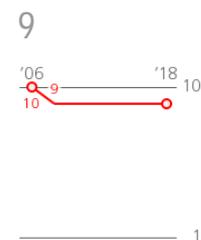
5 | Political and Social Integration

Croatia is characterized by a moderate pluralist party system that has emerged since 2000 when a coalition of center-left parties, led by the social democrats (SDP), won against the Croatian Democratic Union (HDZ, Hrvatska demokratska zajednica), a center-right party that had dominated the 1990s. In the following five elections cycles from 2003 to 2016 the HDZ and the SDP became major political parties in Croatia.

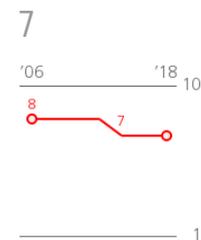
In the 2015 parliamentary elections, the Bridge of Independent Lists (MOST nezavisnih lista) entered parliament for the first time as the third strongest party (19 seats). At the last election, in September 2016, HDZ attained 59 seats (plus three seats won among Croat diaspora voters), the SDP and its allies obtained 54 seats, while the list of parties outside the group of two leading political parties included not only MOST (13 seats) but also Živi zid and a group of populist political groups (8 seats). Other traditional political parties are rarely able to overcome the 5% threshold unless they are involved in a coalition with one of the two main parties. The exception is the regional Istrian Democratic Assembly (IDS), which consistently wins seats in the constituency covering the Istrian peninsula.

Voters who typically vote for the two principal political parties do not differ substantially according to preferences in basic social and economic policies. The political cleavages influencing Croatian voters are more strongly determined by factors related to historical identity (the division of the Croatian nation during Second World War) and the ideological and cultural cleavages (the relationship of the church and state, and the relationship between religious and secular statements). Citizens whose origins are not related to the political forces that won the Second World War

Commitment to democratic institutions



Party system



and who are strongly attached to the church typically vote for the HDZ and right-wing parties. The SDP and liberal parties are largely supported by citizens whose origins are more strongly related to the political forces that won the Second World War and who are secular or loosely related to the church.

Electoral volatility is higher among left-wing than right-wing voters. Clientelist linkages between voters and politicians contribute to stabilize voter alignments.

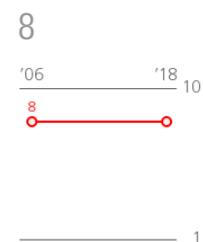
In Croatia, there is a completely institutionalized system supporting the involvement of interest groups in the policy-making process. There is also a completely formalized system of social partnership which consists of governments, employers' associations and trade union organizations. In 2009, parliament enacted a Code of Practice on Consultation with the interested public in the process of adopting laws, other regulations and policies, which opened additional space for interest groups to be involved in policy-making process.

However, government has retained authoritative decision-making powers. But that does not mean that the power of interest groups is generally small and significant differences in the degree of influence on politics between various interest groups do not exist. There are relatively strong bipartite arrangements between government and various business associations. These arrangements include regular contact between representatives of employers' associations, representatives of banks and members of government, as well as a series of hidden influences, mostly non-transparent and out of sight of the public. This is especially true of the largest entrepreneurs in Croatia. Compared with the power of entrepreneurs, the power of trade unions is much lower. The number of trade union members was drastically reduced since independence in 1991. The influence of trade unions is stronger in the public than in the private sector.

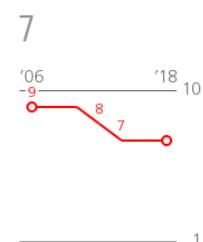
Beside this, there are very strong arrangements with individual advocacy groups, which are often marked by some form of clientelism. This is especially true in the case of war veterans and policies that apply to them. Various professional associations have an extremely large impact on governance, such as associations of doctors, lawyers or similar professions. They are often able to block important government policies.

According Eurobarometer in autumn 2016, 61% of EU citizens replied that the word democratic describes the European Union as a political community well, while only 32% responded that the word describes the European Union poorly. The percentage of Croatian citizens who believe that the word democratic describes the European Union well was higher than average at 73%. When it comes to democracy in their own countries, 53% of the EU citizens on average are satisfied with its functioning, while 44% are dissatisfied. In Croatia, the situation is reversed, with 62% of respondents dissatisfied and only 37% satisfied. According to this criterion, Croatia ranked 23 and 24 out of 28 EU member states, respectively.

Interest groups



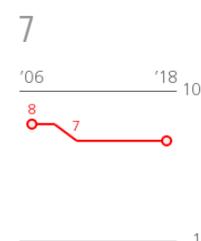
Approval of democracy



According to a representative survey conducted on behalf of the European Bank for Reconstruction and Development (EBRD) in 2016, 46% of the citizens preferred democracy over any other form of political system. This share of “convinced democrats” was higher than in Serbia (33%) but lower than in Slovenia (51%), and it had decreased by five percentage points in comparison with a previous EBRD survey from 2010. Dissatisfaction with the state of democracy is expressed in two ways: the protest vote (e.g. supporting the populist-oriented political parties and individuals) and voter abstention. Parliamentary elections in 2015 and 2016 showed that the share of votes for populist parties increased significantly.

According to research by CIVICUS’s Civil Society Index (CSI) in countries around the world, bonding social capital is still relatively strong in Croatia. Bonding social capital, as opposed to bridging social capital, holds together the people who share fundamental socio-cultural characteristics, while bridging social capital connects people who are dissimilar. The severe economic crisis, which hit Croatia in 2009 and caused a six-year recession, will continue to strengthen bonding forms of social capital and restrict new civil initiatives. The results of the study showed that civil society has only a limited impact on the strengthening of social capital, since it did not show significant differences in the level of social trust and commitment to the public good between members of the organization and other citizens. The problem of relatively low levels of all forms of social trust, particularly political trust, remains a major obstacle for strengthening the impact of civil society on social capital in Croatia. According to a representative survey conducted on behalf of the European Bank for Reconstruction and Development (EBRD) in 2016, 22% of the citizens stated they were members of at least one civil society organization. This was the third highest share in East-Central and Southeast Europe.

Social capital



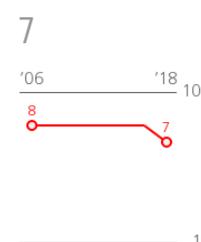
II. Economic Transformation

6 | Level of Socioeconomic Development

Using the income-based method, the at-risk-of-poverty rate in Croatia in 2015 was estimated to be 20%. The level of the Gini coefficient is between 30.0 and 31.0. The poverty in Croatia is characterized by an uneven distribution, primarily by regions, but also to a significant extent by age. While in the continental part of the country, one in five people are poor, in the coastal region, only one in eight people are poor. The poverty rate is the lowest in the urban areas of the northwestern and western parts of the country. In Zagreb (the capital), 9.8% of the population are poor, with a similar situation in the other western regions. On the other hand, the poverty rate in eastern parts of the country is very high. In three out of five counties in Slavonia (i.e., the

Question
Score

Socioeconomic
barriers



Pannonian part of the country bordering Hungary in the north, Bosnia-Herzegovina in the south and Serbia in the east), the poverty rate exceeds 30%, with the poverty rate in the poorest county reaching 35.9%. As regards poverty by age, the highest poverty rate in 2015 was in the over-65 age group, reaching 26.3%. Besides the indicators based on the number of persons in the absolute-poverty zone, another very important indicator illustrating the real socioeconomic barriers in Croatia is the material deprivation rate. The material deprivation rate shows the percentage of persons from the households that cannot afford at least three out of nine basic items like paying rent, paying bills, running a washing machine, running a car or heating in the coldest months. In Croatia, the material deprivation rate was 32.8% in 2015. It should also be added that the severe material deprivation rate (i.e., the percentage of people who cannot afford at least four out of nine basic items) was 13.7%. Though a slight improvement in this area has been recorded recently as the severe material deprivation rate has decreased.

Croatia's Human Development Index was 0.827 in 2015, equal to Argentina and ranked ninth rank within East-Central and Southeast Europe. The Gender Inequality Index was 0.141 in 2015, which was the sixth lowest level in the region with regard to inequality between women and men.

Economic indicators		2013	2014	2015	2016
GDP	\$ M	57769.9	57080.4	48676.3	50425.3
GDP growth	%	-1.1	-0.5	1.6	2.9
Inflation (CPI)	%	2.2	-0.2	-0.5	-1.1
Unemployment	%	17.3	17.3	16.3	13.5
Foreign direct investment	% of GDP	1.6	6.9	0.3	3.7
Export growth	%	3.1	7.6	10.0	6.7
Import growth	%	3.1	4.5	9.4	7.3
Current account balance	\$ M	566.9	448.1	2491.6	-
Public debt	% of GDP	82.2	86.6	86.3	83.8
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-

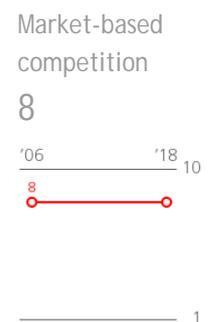
Economic indicators		2013	2014	2015	2016
Net lending/borrowing	% of GDP	-5.5	-4.0	-	-
Tax revenue	% of GDP	19.1	19.3	-	-
Government consumption	% of GDP	20.1	20.1	19.7	19.6
Public education spending	% of GDP	4.6	-	-	-
Public health spending	% of GDP	6.4	6.4	-	-
R&D expenditure	% of GDP	0.8	0.8	0.9	-
Military expenditure	% of GDP	1.7	1.6	1.5	1.4

Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

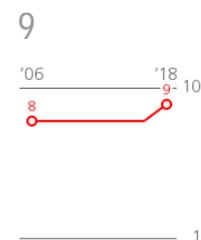
Croatia has a rather stable market-based competition system meeting the basic requirements of the EU single market and competition policy. All market prices are determined freely, excluding power and gas prices which are partly regulated. Power production is a market activity, and transmission and distribution are regulated activities. The regulated activities are supervised with prices determined by the Croatian Energy Regulatory Agency (HERA). The government also appoints a gas supplier in the wholesale market. This supplier sells gas to end users at a regulated price. The Croatian Energy Market Operator (HROTE) has the key role in organizing Croatia's energy market. Operating as a (limited liability) company, it primarily organizes the power and gas market as a public service.

In Croatia, the limitations affecting investment possibilities are primarily caused by the public sector's slowness in providing infrastructural services, the public administration's sluggishness in issuing permits and widespread corruption. According to the World Bank's Doing Business Report, Croatia ranked 43 out of 190 countries. However, it is only ranked 95 in terms of starting a business, 68 in terms of the time required to obtain a power hook-up (getting electricity), 62 in terms of the time required for registering property (registering property) and only 128 in terms of the time required to obtain a building permit (dealing with construction permits). In all these categories, Croatia lags behind the other countries in the region, a fundamental reason for the rather low investment rate. However, these shortcomings are (to a large extent) compensated for by the benefits the country enjoys as an EU member state, like in terms of the trading across borders. Similarly, Croatia ranked very high in terms of enforcing contracts (rank 7). The informal sector was estimated to account for 25% of GDP.



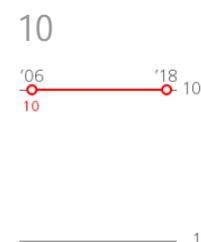
The anti-monopoly legislation in Croatia is rather efficiently enforced, with the Croatian Competition Agency (AZTN) playing a key role. With Croatia's accession to the EU, the AZTN became an implementing body of the European Commission and has since had an advisory function. The AZTN has so far resolved over 600 competition-related cases, including prohibited agreements between entrepreneurs (cartels) and other forms of market competition violations. In the mid-2014, the agency stopped dealing with state aids as a form of EU competition policy violation because the issue came within the jurisdictions of the Ministry of Finance and European Commission.

Anti-monopoly policy



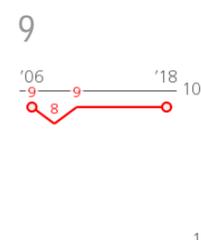
Croatia has a fully liberalized foreign trade system, characterized by the absence of any barriers to the import of products from EU member states. As regards the imports from other countries, Croatia follows the common customs policy of the European Union. Indeed, Croatia is one of very few countries that does not have in place any form of legal limitations for unfair trading practices in food supply chains. As a result, 2016 saw a great number of cases showing that a substantial quantity of low-quality foodstuffs were sold in Croatian markets at dumping prices. It turned out that the inspection was much more rigorous for domestic food producers than for imports of foreign foodstuffs. The public usually interprets this situation by claiming there is a very dominant “importers’ lobby” at work. The evidence of a radical decrease in foodstuff production and an increase in foodstuff import recorded after Croatia's accession to the EU could substantiate this claim.

Liberalization of foreign trade



Croatia has a relatively stable banking system regulatory policy, but its banks are largely foreign-owned. In early 2017, 16 out of 31 credit institutions operating in Croatia were foreign-owned. However, the market share of the foreign-owned banks was 90.3% with the 12 Croatian-owned banks accounting for the remaining 9.7%. Still, Croatian banking system is relatively stable. In 2016, the capital adequacy ratio of the banks in Croatia was 20.5%. However, the governor of the Croatian National Bank repeatedly pointed out in 2015 and 2016 that there was a possibility of reducing the capital adequacy ratio of the banks in Croatia, although Croatia's system still boasts an exceptional resistance to shocks and even to significant losses.

Banking system



One such loss is a result of the Swiss Franc loans legislation enforced by Zoran Milanović's government in September 2015, at the very end of its mandate. The legislation aimed at helping tens of thousands of Croatian citizens who had taken loans in Swiss francs and ended up on the verge of bankruptcy due to a rapid depreciation of the Croatian kuna against the Swiss franc. Under the provisions of the bill proposed by the center-left government and adopted by the parliament, the banks would cover the cost of the loan conversion, totaling approximately HRK 8 billion (more than €1 billion). The banks resisted the legislation and decided to take a legal action against the government. UniCredit was the first bank to file a lawsuit. The Croatian government was notified of the lawsuit in September 2016.

According to the World Bank, the share of non-performing loans in total loans was 14% in 2016, down from 17% in 2014. The bank capital to assets ratio was 14% in 2016 and has remained stable since 2009.

8 | Currency and Price Stability

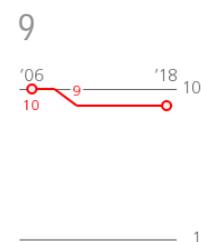
Inflation and foreign exchange policies are aligned with other economic policy goals and are institutionalized in a largely independent central bank. In 2015, in the wake of the six-year recession, the Croatian National Bank (HNB) still persisted in pursuing a rather restrictive monetary policy. As a result, Croatia recorded deflation in two consecutive years, -0.2% in 2014 and -0.5% in 2015. Faced with such trends, the governor of the HNB decided in late 2015 to turn toward a slightly expansive monetary policy. The governor announced the introduction of so-called REPO operations with new kunas printed and lent to banks for a period of four years. Previously, the Croatian National Bank would use this instrument only exceptionally and for short periods of time (e.g., a week). In the governor's opinion, such an operation would encourage commercial banks to increase credit financing in kunas, lower the national currency debt and develop the domestic market for government securities. The governor also promised that the policy would not cause inflation (which would not exceed 1%) or the kuna-to-euro exchange rate to drop.

In 2016, the HNB kept pursuing an expansive monetary policy, while maintaining the stability of kuna-to-euro exchange rate. HNB's gross international reserves kept growing throughout the period under review. In the late November, gross international reserves reached €14 billion, exceeding the amount at the end of the previous year (2015) by €300 million (1.9%).

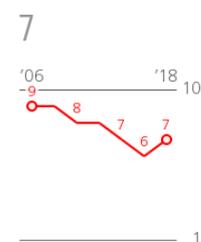
These operations did not result in any relevant price growth as the consumer price index in December 2016 was only a little higher than in December 2015. In other words, deflation continued for a third year in a row.

During the period under review, state budgets were prepared and implemented by three consecutive governments. The 2015 budget was prepared by Zoran Milanović's center-left government and the 2016 budget was prepared by Tihomir Orešković's center-right HDZ-MOST government. In December 2016, the 2017 budget was proposed by the same coalition government, but led by Andrej Plenković. The nominal 2015 budget deficit was HRK 8.8 billion. Though it eventually turned out to be lower than planned and more importantly it was much lower than the previous year's deficit that had amounted to HRK 12.8 billion. In 2015, the state budget deficit was for the first time lower than 3% of GDP at approximately 2.6% of GDP. The budget revenue anticipated for 2016 was HRK 116.3 billion and is anticipated to be HRK 121.7 billion for 2017, with an even lower deficit anticipated for 2017. The 2017 budget, with an anticipated revenue of HRK 121.6 billion and expenditure of

Anti-inflation /
forex policy



Macrostability



HRK 128.4 billion, resulted in a HRK 6.8 billion deficit. In other words, for the first time, the budget deficit would not exceed €1 billion, which is 1.9% of GDP.

Such trends have reflected on the public debt level, too. Croatia's public debt has grown drastically since the outbreak of the economic crisis in 2009. While it was somewhat below 40% of GDP in the years before the crisis, during the six-year recession it grew to 58.3% of GDP in 2010, 65.2% in 2011, 70.7% in 2012 and 82.2% in 2013. Its growth continued in 2014, when it reached 86.6%. In the first post-recession year it grew insignificantly to 86.7% of GDP. In 2016, the fiscal consolidation measures finally managed to reduce the public debt growth to 84.9%. The domestic debt accounts of 60% of the overall structure of the national public debt and the external debt accounts for 40%.

9 | Private Property

Property rights and regulations on acquisition, benefits, use and sale of property are well defined. The right to ownership of private property is established in the Croatian constitution and in several laws and regulations. During the negotiation process for EU membership, Croatia agreed to a seven-year transition period during which nationals from other EU member states would not be entitled to purchase agricultural land in Croatia.

The protection of property rights is practically the best evaluated element of competitiveness to the Doing Business Report of the World Bank in 2016.

One of the most important cases related to the regulation of property rights in Croatia is a dispute between the government of Croatia and the Hungarian oil and gas company MOL regarding the ownership of the oil company INA, the largest Croatian company. According to the Croatian government, the contract was secured by bribing a former Croatian prime minister, Ivo Sanader. As a direct consequence of the contract, the Croatian government pointed out, Croatian state (as the owner of 45 % of INA) was deprived of influence in all key managerial decisions. In December 2016, the public was informed that the decision was made in proceedings initiated against the Hungarian oil and gas company MOL before the arbitral tribunal of the United Nations Commission on International Trade Law in Geneva. The arbitration court decided that the offered evidence was insufficient to prove that the 2009 contracts were secured by corruption. Therefore, the court refused to cancel the contracts. The arbitration court argued that Croatian courts had yet to reach a final verdict that could support the Croatian government.

Property rights

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Private companies are fully permitted and protected, and the privatization process began in the late 1980s, when Croatia was part of Yugoslavia and the federal prime minister was Ante Marković. Previously, all companies were within the system of social ownership. Privatization continued after 1992 when the Croatian Privatization Fund was founded, which managed the conversion of social enterprises into the state and private companies through the sale and transfer of shares and rights in the former socialist enterprises. Various methods of privatization were experimented, including privatization through worker's and manager's shareholding, through coupon privatization and selling through public offerings. Currently, the privatization of the remaining majority and minority state-owned shares in companies are conducted by public tendering and sales on the Zagreb stock exchange (auction sales of company shares). The share of state-owned or local government-owned companies is still relatively large. Of the 73 companies that in 2015 generated revenues of more than HRK 1 billion, 16 were majority or minority state-owned. During Tihomir Orešković's term in office in 2016, the government announced a relatively large privatization package, labeling the package as one of the priorities of government policy. Though the government's share in only one company, Končar electric industry, has since been successfully sold through a bid on the Zagreb Stock Exchange. The Croatian government did not propose concrete future steps for privatization of these companies.

Private enterprise

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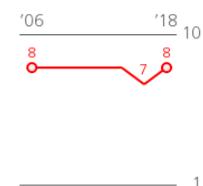


10 | Welfare Regime

Unemployed persons in Croatia can receive unemployment insurance, which includes financial compensation, pension insurance, financial assistance and compensation for expenses incurred during training, one-time financial assistance, reimbursement of travel and relocation expenses. The right to financial compensation can be granted to unemployed persons if at the time of termination were employment at least nine months out of the last 24 months. The right to financial compensation can be granted if an unemployed person registers within 30 days of termination of employment, termination of sick leave or maternity leave. Unemployed people do have a right to compensation in Croatia if their employment terminated because they quit (except in the case of an extraordinary notice of resignation caused by the employer's conduct), reached a written agreement on termination of employment or because they did not meet the requirements during probation or during their training or internship. In addition to passive measures of employment policy, the Croatian Employment Service developed a series of relatively comprehensive active employment policy measures.

Social safety nets

8



According to the Croatian Bureau of Statistics, the percentage of people at-risk-of-poverty or social exclusion was about 29% and the share of severely materially deprived people was 13.7% in 2015.

Assistance to socially vulnerable groups, which is not related to the employment policies, is implemented by the Ministry of Demography, Family, Youth and Social Policy. The ministry in 2016 added the name “demography” to its official title due to extremely poor long-term demographic trends in Croatia, which were exacerbated by Croatia’s accession to the EU and the opening of several EU member state’s labor markets to Croatian citizens. During 2016, the ministry implemented several social programs that extended social assistance programs and direct compensation to support the social empowerment of young people, families and children (the largest expenditure increase aimed to strengthen compensation for maternity leave).

Among the range of issues which are important for the existence of equality of opportunity is equal access to education. In that category, Croatia ranks among the group of northern European countries, which are the best in Europe. However, the quality of education is a little worse, as Croatia’s PISA results typically rank among the lower middle category of European countries. When it comes to employment, especially in public services, the Serbian minority is in a non-privileged position. The most severe discrimination in employment is experienced by the Roma minority.

On the other hand, war veterans are in a much better socioeconomic position compared to other vulnerable groups.

The literacy rate was 99%, the ratio of female to male enrollment was 1.4 and the gross enrollment ratio in tertiary education was 70 (World Development Indicators 2016), indicating relatively high levels of gender equality and inclusiveness in the education system.

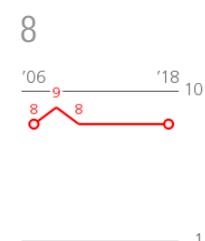
11 | Economic Performance

The Croatian economy continued with a strong recovery during 2016 and the trend of economic growth appeared in 2015. The Croatian economy was in constant recession from 2009 to 2014, showing in the last quarter of 2014 a slight increase of 0.2%. Though this increase was not sufficient to reverse the national economy’s negative GDP growth rate. During 2015, GDP increased in each quarter, with an overall 1.6% rate of growth for 2015. In 2016, GDP growth further increased in each quarter, with an average 2.9% rate of growth for 2016.

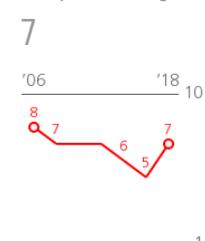
GDP growth was strongly influenced primarily export growth (6.1%), gross fixed capital formation (4.1%) and private consumption (2.8%). Imports, however, grew at an even higher rate (6.5%), so that the negative balance of foreign trade increased from HRK -52.9 billion to HRK -55.0 billion, so that the export-import ratio remained at around 62%.

It is significant, however, that for the second year in a row employment rates have increased, which had been negative since the economic crisis began in 2009. (In 2008,

Equal opportunity



Output strength

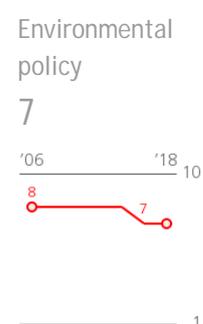


the increase in employment was 2.3%). All these economic trends further reduced the administrative unemployment rate, from 17% in 2015 to around 15% in 2016. These economic processes, characterized by economic growth and reducing unemployment, have not resulted in the growth of the general price level. The country's gross external debt has also continued to decline. During 2016, for the first time since 2008, gross external debt fell below 100% of GDP to 93.8%, and is expected to further decline in 2017 below 90% of the GDP.

12 | Sustainability

Regulation of the policy environment in Croatia is only partially effective in reducing the challenges related to the requirements of the European Union, which Croatia agreed during the accession negotiations. Environmental regulation and incentives are in place, but their enforcement at times is deficient. The environmental awareness of citizens has increased over the last decade. The basic Environmental Strategy was adopted in 2002, but has not yet been fully implemented. The Waste Management Strategy was adopted in 2005 and followed by a series of environmental protection documents. Probably the most important development was the Strategic Plan of the Ministry of Environment and Nature for 2014 to 2016, which was adopted in 2013. However, after the departure from power of Zoran Milanović, the new minister of environment, who has retained the portfolio despite the change in prime minister from Tihomir Orešković to Andrej Plenković, launched the Waste Management Plan of the Republic of Croatia for 2016 to 2022. In July 2016, the European Commission asked the Croatian government to bring its national law into full conformity with EU rules on waste management. The European Commission requested that Croatia prepare no later than the end of 2016 a new program. The program was adopted only in the early January 2017. Many stakeholders have strongly criticized the new program, particularly the representatives of the Croatian Employers' Association (CEA). The CEA have warned the government that the waste management plan for 2017 to 2022 does not comply with the commitments undertaken by Croatia when joining the European Union nor the operational program through which Croatia secured EU funds. The CEA pointed out that it will not be possible to withdraw these funds if the government adopted the plan. The CEA also warned that the plan for the proposed waste management system is based on facilities for primary selection, which currently not specified in the existing planning documents.

Education policy in Croatia should be seen at different levels. In terms of the access to education and the coverage of young people, the education system in Croatia ranks highly among EU member states. However, the quality of education is problematic, which is evidenced by Croatia's PISA results published in 2015. In the field of scientific literacy Croatia achieved 475 points, and ranked below average at 37 out of 70 countries. In reading literacy, Croatia scored a little better (487 points), but again ranked modestly at 31 out of 70 countries. Because of this, at the beginning of

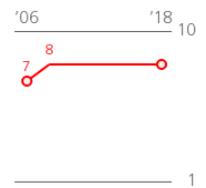


Education policy / R&D

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2015, the Milanović government established a working group for implementation of a comprehensive curriculum reform for early and pre-school, primary and secondary education. The working group was led by Dr. Boris Jokić and started work in February 2015. Jokić's working group has gathered more than a hundred high-quality teachers from across Croatia, who were committed to a deep, systematic transformation of the education system. However, Jokić's working group was abruptly interrupted by the departure from power of Milanović. In response to this interruption, at the beginning of June 2016, an estimated 50,000 Croatians gathered in the main square of Zagreb and in other towns across the country to advocate the continuation of long-needed education reforms.

The level of investment in research and development in Croatia is far from the level required by the European Commission. With investment equaling 0.8% of GDP, Croatia ranks among the lowest group of EU member states for investment in R&D, investing less than 1% of GDP. In the framework of the European semester, the European Commission has requested that Croatia raise the level of investment at least to 1.5% of GDP, but so far there are no signs that this will happen.



Governance

I. Level of Difficulty

The structural difficulties of governance are relatively low. Although around one fifth of the population live below the poverty threshold and the Gini coefficient (30.6) is much higher than in neighboring Slovenia, this criterion nevertheless puts Croatia somewhere in the middle among EU member states. The Croatian labor force is comparatively well educated, but the fact that a large portion of the labor force (medical and IT-related professions in particular) are leaving to work in other European countries presents a setback. A large number of other, not so qualified people are also moving abroad, generally for service sector and construction jobs. As a result, Croatia already has problems with hiring sufficient number of workers in certain industries, including construction and service sector.

Croatia boasts a very developed network of motorways which, given the country's geographical shape, is a very important factor for the smooth flow of traffic. Investments in railway lines over more than 25 years since the disintegration of Yugoslavia have not been sufficient. The country's railway network is very obsolete. Its systematic reconstruction, financed by EU funds, has started only very recently. For a country with a very indented coastline and numerous islands, Croatia has a relatively well-developed network of shipping lines.

In respect of the natural hazards, the greatest risk Croatia faces is flooding. Flooding occurs periodically, particularly in the Sava River Basin (the Sava springs in Slovenia and flows into the Danube in Belgrade, Serbia).

Despite the massive drain of medical professionals to other European countries, Croatia has a well-developed basic health care system. HIV/AIDS patients are relatively few and so are other pandemic patients. According to the latest available reports (2014), life expectancy for women is 80.5 and for men 74.6 years.

The development of civil society in Croatia has strong roots dating back to the socialist period when the country was part of Yugoslavia, as a relatively liberal state within the countries of communist world. In the mid-1980s, the first independent groups advocating new environmental policy, gender issues and human rights appeared. The war that broke out in Croatia in 1991 significantly reduced the further development of civil society institutions, promoting instead ethno-nationalistic

Structural
constraints

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Civil society
traditions

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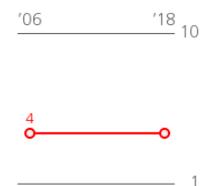
homogenization of society and strong identification with the national state. When the war ended in 1995, it was a turning-point for civil society and the second half of the 1990s led to a very dynamic development in civil society, followed by the establishment of a series of non-governmental organizations, stronger activities of trade unions and all other forms of associations.

In comparison with developed European democracies, civil society in Croatia is especially weak in the area of policy-making impact. Croatia performs considerably better on the criterion of organization and structure of civil society, which was strongly enabled by the establishment of the Government Office for Cooperation with NGOs.

There are some indications that things are starting to improve also with regard to civil society's impact. Over the last couple of years, several civil society organizations have developed their own capacities to set agendas and to propose policy in particular fields. However, public participation in civil society is still low, and there has been a failure to establish sustainable cooperation between civil society organizations, and government and business associations. Among civil society organizations, there is also a lack of transparency, little networking between organizations, and a heavy dependence on foreign and domestic public funding.

There are no social, ethnic or religious conflicts of any relevant intensity in Croatia today. The social conflicts are negligible: the socioeconomic differences (which are of moderate intensity) arise primarily from regional differences. Stricken by economic hardships, devastated industry and poor status of agriculture, the eastern region (Slavonia) has been facing an extremely high rate of labor drain to other European countries, a phenomenon suppressing potential conflicts of social nature.

Croatia is ethnically very homogeneous today, with Croats accounting for 90.42% of the population. Serbs rank second (4.36%), while no other ethnic group exceeds 1%. The country's national structure underwent a radical change after the war that had followed the disintegration of Yugoslavia (1991-1995). According to the 1991 census, Croatia's population was 4.8 million, with Croats accounting for 78.10%, Serbs 12.16%, and Serbs and Yugoslavs 2.21%, while none of the remaining ethnic groups exceeded 1%. After the bitter conflict between Croats and Serbs in the early 1990s (with Serbs gaining control over one third of Croatia's territory with the help of the Yugoslav army and Serbia for several years, not just of the predominantly Serb-populated areas), the intensity of the conflict gradually subsided after the mid-1990s. The peaceful reintegration of the country's easternmost parts (the Danube Region) into the constitutional order of the Republic of Croatia marked the beginning of a new perspective for Croat-Serb relations. After that, the two communities kept coexisting peacefully in this part of Croatia, but only as separate social systems. Children even attend separate schools.



There are no significant religious conflicts in Croatia today. While more than four fifths of the population declare themselves Roman Catholics, there was a period when both the president (Josipović) and the prime minister (Milanović) were non-believers, illustrating a relatively high level of tolerance in the society. The situation changed in the past few years. The influence of the Catholic Church has clearly grown and all key government officials are members of the Catholic Church. Another distinguishing feature of Croatia is its marked tolerance of the Islamic community. Islamic leaders often point out that the position of their religion in Croatia could be a role model for other European countries.

II. Governance Performance

14 | Steering Capability

Prioritizing strategic public policy goals has traditionally been an extremely problematic issue in Croatia. Policy management is dominated by a legalistic approach. Proposed regulations or private-public partnerships are assessed, but these assessments have been of a poor quality and do not consider all aspects of implementation. Mending these problems would also require systematic education programs for civil servants and policymakers, which are nonexistent or partially existent in Croatia.

Another large problem is the fact that an increasing number of strategic documents are piling up in Croatia - various sectoral strategies which are never coordinated. These documents are supposed to demonstrate that something has actually been done and that some specific policy sector has been developed. However, this is usually not so. The strategies are written for the sake of appearance and often end up shelved.

In order for these strategies to be functional, a much more efficient monitoring system should be established. And such a system is very often missing and public funding worth tens of millions of kuna has disappeared. Besides the inefficiency of policy-making, the incoherency of public policies is also a large problem. For example, since the national government does not have a central body that would signal to ministries and agencies how to formulate individual policies, every government agency does as it pleases. Furthermore, inter-ministerial coordination is very poor, and the vertical coordination between the political and different administrative levels - the government's inner cabinet, state administration offices on the regional level (in counties) and local self-government units - is weak. Additionally, in all types of coordination, deadlines are extremely short, there is no comprehensive policy planning, everything is done hastily and important stakeholders are often not consulted. Decisions which are then made are very often wrong, and everything must be redone and corrections have to be made after only a few months. Laws are adopted without having drafted the regulations required for their implementation beforehand.

Question

Score

Prioritization

7



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Croatian governments are regularly faced with relatively low level of effectiveness in implementing policies. For example, during the review period, the Orešković government tried to revise the comprehensive curriculum reform for primary and secondary schools, which had been initiated by the previous government in consultation with the HDZ party. When the education minister changed the composition of the reform team, its head resigned and the implementation of the reform was halted, causing mass protests of teachers and parents in June 2016.

The problem is primarily related to the failure to set clear and measurable policy goals, while central government and other levels of governments are relatively ineffective in reaching most of the policy goals formulated in strategies, programs and multi-year frameworks. The reason for the ineffectiveness of policy implementation stems both from ministerial non-compliance and low monitoring capacities. Public policy monitoring capacities in Croatia are truly inadequate. Very often there are no efficient mechanisms for policy monitoring, evaluation and assessment. Elementary cost-benefit analyses of policy proposals are only partially carried out.

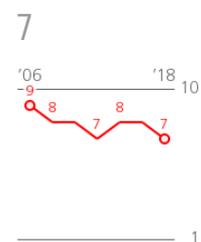
The government has not demonstrated an adequate level of innovation and flexibility in policy-learning. In regular EU reports, which relate to the coordination of economic policies of EU member states within the framework of the European semester, Croatia has been regularly criticized for the slow implementation of crucial public policy reforms and for the failure to fulfill requirements for policy innovation. The European Commission regularly criticized the involvement of small horizontal policy stakeholders in the formulation of public policies, and the low capacity of policy monitoring and evaluation of effective public policies to be implemented. The European Commission also regularly pointed to the under-involvement of experts in the development of key policies.

15 | Resource Efficiency

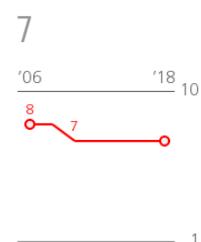
When the Orešković government in March 2016 proposed the 2016 state budget, the total projected deficit was 2.7% of GDP, the lowest budget deficit level since the start of the economic recession in 2008. The subsequent Plenković government proposed a 2017 state budget with even lower deficit, limiting the budget deficit to 1.9% of GDP. In 2016, a reliable fiscal framework was finally established, which contributed to a relatively balanced budget and prevented any further increases in the public debt.

Control over spending public money carried out by the National Audit Office has also become much stronger and more systematic compared to previous periods. In July 2015, the law on internal control systems in the public sector was enacted, which stipulates the functioning of the internal control system and requires all budget

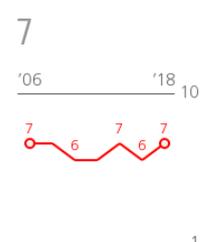
Implementation



Policy learning



Efficient use of assets



implementers to declare a statement on fiscal responsibility. This has strengthened the mechanisms for limiting the deviation of planned budget expenditures.

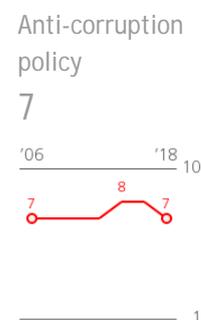
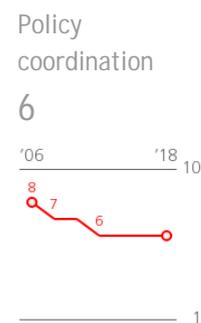
According to a European Commission report from 2017, the Plenković government in December 2016 delayed the implementation of an ambitious action plan that aimed to improve the efficiency of public administration, depoliticize human resource management and digitalize public services.

The Croatian political and administrative system suffers from inefficiencies when it comes to transforming conflicting objectives into a coherent policy in a particular policy field. The policy-making process generally suffers from a lack of coherency. Together with the low quality of strategic planning and the limited usage of evidence-based policy-making techniques, this is the crucial shortcoming of the Croatian system of governance.

In the Croatian public governance system, the coordination of policy agendas between ministerial and prime minister's cabinet is particularly problematic. The crucial missing tools include the capacity of prime minister's cabinet to stop line ministries' proposals on the grounds of an applied policy analysis and not only on the basis of formal technical (legalistic) grounds. Such institutional arrangements diminish the quality of conflict management, as well as the quality of strategic management in the Croatian governance system.

Anti-corruption policy was an important element of the conditions set by the European Commission as part of Croatia's EU membership negotiations. The Europeanization process was a key factor in addressing widespread corruption and a relatively low rating for Croatia across all relevant international measurements of corruption. The first systematic document on anti-corruption policy was published in 2006 during Ivo Sanader's government and entitled the National Programme of Suppression of Corruption. Also in 2006, a specialized body of the Croatian parliament was formed, called National Council for Monitoring the Implementation of the National Anti-Corruption Program, which was headed by a representative of the opposition parties. A comprehensive Strategy of the Suppression of Corruption was published in 2008, which was accompanied by corresponding action plans, adopted every two years. The latest document in this area, the Strategy of the Suppression of Corruption from 2015 to 2020, was adopted in mid-2015, and its provisions now form the key policy framework for combating corruption.

In an effort to raise public awareness of the devastating effects of corruption, governmental institutions addressed a number of priority areas. Among these areas are conflicts of interest in the performance of public tasks and duties, the right of access to information, public procurement procedures, the audit of recipients of public funding, and political party financing.



Special importance was focused on the processing of allegations of corruption. After 2010, the number of indictments involving senior officials increased, including former Prime Minister Ivo Sanader.

Nevertheless, some improvements in a broad framework of anti-corruption policy were relatively successful. State Audit Office of the Republic of Croatia started to prepare after 2010 financial reports on the usage of public money by public institutions, including political parties. Furthermore, in 2011, Croatia adopted a relatively systematic law on financing political parties and electoral campaigns. In 2013, parliament appointed the first information commissioner. Subsequently, the commissioner successfully developed effective electronic platforms for strengthening public access to information. Also in 2013, the Committee for the Prevention of Conflict of Interest was elected, consisting of five members. So far, investigations have been conducted into a president of the republic, prime ministers, ministers, the president of the Croatian parliament, several members of parliament and senior public officials. And finally, in 2013, a better system of the control of public procurement was established, which enabled the creation of the State Commission for Supervision of Public Procurement Procedures.

Nevertheless, the perception of corruption in Croatia has remained high and the country is still considered a relatively corrupt country. Beside the institutional innovations described above, there still exist hidden arrangements in a series of public activities in which the anti-corruption institutions have failed to penetrate. Not because these institutions would not have wanted to, but because they do not have sufficient capacity to do so. The commissioner for information has repeatedly publicly stressed that there are not enough street-level inspectors able to increase public access to information where it is currently not possible to access information. The State Electoral Commission does not have the capacity to adequately monitor money which is spent during election campaigns. The Croatian Health Insurance Fund has only five inspectors who check costs in the health care system. These examples show that the capacity of anti-corruption institutions are limited and represent the weakest chain in monitoring real financial flows. Additionally, the persistence of high levels of corruption in Croatia is due to the inefficiency of the judiciary and an extremely small number of final verdicts in corruption cases.

16 | Consensus-Building

In Croatia, there is a consensus on the importance of democratic institutions and threat posed by hate speech to democracy. But problems arise when defining exactly what constitutes hate speech and strong differences appear, which reflect the key historical cleavages that marked Croatia in the 20th century. The fundamental problem in these disputes relates to different understandings of the function of the state. Achieving consensus on key development objectives enhances the state's

Consensus on goals

9

capacity to formulate and implement public policy. However, this type of consensus in Croatia is a major challenge. So far, political consensus has only successfully been achieved in determining whether Croatia should join the European Union.

In Croatian society there is a relatively clear commitment of key stakeholders (e.g., politicians in power, leading political parties, business associations, trade unions and non-governmental organizations) to the development of Croatia as a democratic country with a social market economy. Problems arise when determining long-term policy goals and the principal policies that will lead to the accomplishment of these goals. A good example is the concept of the social market economy. This is in some ways a general goal that is followed by both major political parties (the HDZ and the SDP). However, the HDZ and SDP have markedly different visions for reform of the labor market, education system and pension system, which will be necessary for the development of a social market economy. This problem is evident in almost all policy areas, including issues of demographic renewal, sustainable environmental management, reform of the local government, development of agriculture and rural areas.

Anti-democratic political actors in Croatia are mainly related to right-wing parties and non-governmental organizations that use extremely conservative, nationalist rhetoric and generally perceive opponents of Croatian nationalism in all institutions that should be politically eliminated whenever possible. Such parties have been given a certain impetus since the elections in November 2015, when the HDZ gathered a wide range of parties, which included some parties that strongly advocated nationalist rhetoric. In the September 2016 parliamentary elections, these right-wing parties failed to enter the Croatian parliament, but the HDZ included several politicians among its parliamentary deputies whose rhetoric is strongly linked to all forms of ethnic exclusiveness. While the moderate conservatives within the HDZ succeeded in appointing Andrej Plenković as prime minister and HDZ president, and marginalizing the radicals, the moderate center-right politicians nevertheless failed to clearly distance themselves from right-wing extremists and their ideology.

In addition, there is a whole range of non-governmental organizations that strongly advocate radical conservative ideas, oppose gender equality and advocate a ban on abortion rights. Among the anti-democratic groups there are a couple of non-parliamentary political parties, which have little political influence, but occasionally organize political rallies whose origins could be traced to the tenets of the Independent State of Croatia (a puppet fascist state from 1941 to 1945). In the army or within the powerful economic groups, there are no significant anti-democratic veto-actors.



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Anti-democratic actors

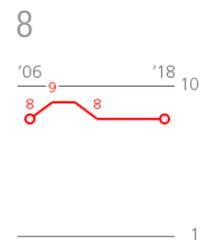
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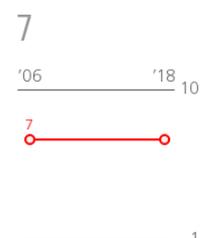
The key political actors agree that both a democratic political system and a market economy represents the basic institutional framework for further development in Croatia. In the political arena, there are actors who promote a strong populist attitude that question several standard mechanisms of the market economy, but such views do not yet represent a comprehensive platform that would challenge the institutional framework of a market economy. Political groups that openly question the basic mechanisms of a democratic political order are quite marginal. The basic cleavage that exists in Croatian society primarily concerns the extent to which the idea of the Croatian nation and the institutional role of the Catholic Church should be the primary source of political action, and the development of state and society. Those cleavage-based conflict that do exist are rooted in the country's fascist period (1941-1945) or period of one-party socialist rule (1945-1990). Citizens who believe that the idea of the nation and the Catholic Church should have an important place in Croatian politics strongly support the right-center political parties, while citizens who feel that the role of these factors should not be overstated support the left-centrist parties. Class polarization is in fact almost completely irrelevant, but where it does exist it has a regional dimension. In the east, south, and in areas along the border with Bosnia and Herzegovina, there is a significantly greater attachment to the idea of the Croatian nation and the role of the Catholic Church, than in the more developed western and northwestern parts of the country.

Cleavage /
conflict
management



Civil society in Croatia shares many of the shortcomings that have existed in other post-communist countries and especially in the western Balkans. Civil society's key weaknesses include the low level of public participation; the lack of meaningful and sustainable cooperation between civil society organizations, and government and business associations; the general lack of transparency; the limited networking between civil-society organizations; and the reliance of civil-society organizations on foreign and domestic public funding. However, the involvement of civil society in public policy-making processes has improved due to the systematic monitoring of implementation of the Code of Practice on Consultations with the Interested Public in Procedures of Adopting Laws, Other Regulations and Acts. The code strongly supports the involvement of civil society actors in all phases of policy-making, particularly in policy formulation and implementation. The European Commission also strongly supports the more active involvement of civil society in the policy-making process.

Civil society
participation



When Croatia and many other post-communist countries, particularly from the southeastern Europe, are compared with the more mature democracies of western and northern Europe, it is evident citizens in post-communist countries rarely participate in civil society activities because they lack trust in others, and prefer to engage with family members and close friends. That is probably the crucial reason why post-communist countries are predominantly based on informal relations, where informal practice represents a kind of social norm, strongly shaping people's behavior.

During the time of the Orešković government, the minister of culture, the right-wing historian Zlatko Hasanbegović, reduced state financing for parts of the non-profit media and NGOs. Observers viewed this measure as an attack on left-wing and liberal organizations and publishing houses.

Relatively strong divisions still persist related to the events of 1941 and 1945, during the existence of the Independent State of Croatia (NDH). Dealing with the past in Croatia remains an extremely fractious and painful process, which results in completely opposing interpretations of the tragic events during and immediately after World War II. Croatia's divisive history has recently become more important factor for political mobilization and framing. While right-wing extremists within the HDZ do not deny their admiration for the fascist NDH regime, the social democrats are framed as neglecting the crimes committed by the communist regime. The social democratic Prime Minister Zoran Milanović struggled to prevent the extradition of two communist-era secret-service agents who organized the killing of a Croatian nationalist emigrant in Germany in 1983. During the 2016 electoral campaign, Milanović proudly declared that his grandfather had been an Ustasha, in an attempt to attract votes from right-wing Croats.

Consequently, Prime Minister Plenković announced that he will form a committee to deal with the past and address the difficult conflicts that exist on these issues in Croatian society. The task of the committee, which is yet to be established, will not be to determine what happened (i.e., the truth), because it is a matter of serious historiographical research. Instead, the task of the committee will be to achieve a minimum consensus on the past and enable Croatian society to cope with the past.

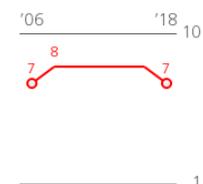
Contradictory memories of the Croatian military operation to liberate the so-called Serbian Krajina from Serbian insurgents in 1995 prevent a reconciliation between Croatia and Serbia. Whereas Serbia commemorates the conflict as the expulsion of Croatia's ethnic Serb community, Croatia celebrates it as a great military victory and nationalist groups even link it to NDH symbols in mass public events, such as the Čavoglave concerts.

17 | International Cooperation

Croatia has made some progress in the planning of political and economic development, which is also the result of Europeanization. EU membership for Croatia, as one of the least developed member states, is of great importance and the Croatian authorities are trying, by aligning their actions with the European Commission, to improve the country's development. The European Commission has repeatedly stated that the alignment of policies should be done faster, as Corina Cretu, European Commissioner for Regional Policy, stated when visiting Croatia at the

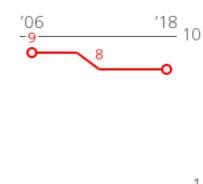
Reconciliation

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Effective use of support

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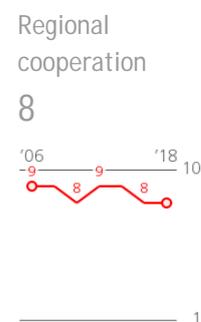
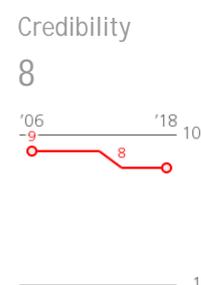
beginning of 2017. Cretu said that Croatia must accelerate the implementation of EU funded programs.

Since 2013, when the Milanović government refused to apply the European Arrest Warrant for Perković (an influential communist-era security official suspected of organizing the murder of an exiled dissident in Germany), Croatian authorities have not had any major disputes with the European Commission. However, Croatia has still not achieved a satisfactory level of effectiveness in the use of EU development mechanisms (especially in cohesion policy, and agriculture and rural development) to promote domestic development. The European Commission has regularly warned Croatia about the country's shortcoming within the procedures of the European Semester.

The government mostly acts a credible and reliable partner in its relations with the international community. This applies equally to relationships with multilateral and intergovernmental organizations, as well as in relations with the governments of other countries and some international non-governmental organizations. Cooperation with the International Criminal Court for the Former Yugoslavia was a pre-condition for the start of negotiations on Croatian membership in the European Union. The Perković case (the controversial extradition of a communist-era secret-service agent charged with killing a Croat emigrant) was resolved in early 2014 with his extradition to Germany. The Orešković government declared its readiness to host a share of refugees as agreed by EU interior ministers in 2015. Cooperation with the international community, multilateral organizations and international organizations in the field of environmental protection is very productive. The problems of credibility in relations with the international community largely affect foreign investments. The dispute bureaucracy and complicated legal system significantly undermines foreign investor confidence, which could significantly contribute to the growth potential of the Croatian economy.

Political cooperation between Croatia and other countries in the region is not at the level as economic cooperation between Croatia and other countries of the former Yugoslavian single market. Political cooperation with Serbia is particularly problematic, especially after the International Criminal Tribunal for the Former Yugoslavia had temporarily released the Serbian ultra-nationalist Vojislav Šešelj. Relations were further exacerbated by the refugee crisis in 2015, and exchanges of hostile public statements between the Croatian and Serbian prime ministers.

In 2016, Croatia blocked the opening of two EU accession negotiation chapters with Serbia for several months in order to force Serbia to repeal a law that had authorized its courts to prosecute war crimes committed throughout the former Yugoslavia. Croatian war veterans' organizations feared a wave of European arrest warrants after Serbia's accession to the European Union.



Cooperation with Slovenia is burdened by the unresolved issue of the Piran Bay border. In July 2015, Croatia withdrew from arbitration after alleged breaches of arbitration rules by Slovenia that involved the unacceptable connections of one of the judges with the Slovenian representatives. The arbitration tribunal decided that Slovenia violated the Arbitration Agreement about setting boundaries, but decided to continue the process, and stressed that the court would decide on the border between Croatian and Slovenia.

Relations with Bosnia and Herzegovina are basically good, though still burdened by the issue of crimes committed during the war in Bosnia and Herzegovina between 1992 and 1995. Relations with Montenegro are very good and without significant burden.

In contrast to relations between political leaderships in the former Yugoslavia, economic cooperation is much better, although it could be stronger. The economic legacy of the former Yugoslav single market, where the former Yugoslav republics, now independent states, realized the largest proportion of GDP has been used only partially. The disappearance of the single market coincided with the relative economic decline in comparison with other post-communist countries, especially the countries of central Europe.

Strategic Outlook

Croatia has been an EU member state for several years now. Nevertheless, Croatia faces several challenges that jeopardize the development of a market economy and democratic political order. The country's low economic growth rate is the fundamental economic challenge facing Croatia today. The GDP growth rate exceeded 1% in 2015 and 2016, but it is unlikely to continue over the medium term without further reforms. Therefore, the priority of the incumbent Andrej Plenković government and future governments should be to implement structural policies that increase the economic growth rate. The key factors contributing to the low economic growth rate are low factor productivity and low utilization of human capital. Across practically all economic sectors (except the power industry), Croatia's productivity rate is significantly lower than that of comparable central and eastern European countries. However, in the long run, the low (even declining) utilization of human capital could pose an even larger problem. Croatia will face the long-term challenge of a negative natural population growth rate, an aging population and a high emigration rate to other European countries.

In order to create a basis for high long-term economic growth, the government should shape and implement (much more efficiently than so far) public policies in several spheres.

First, in the area of public finance, in addition to introducing policies that aim to reduce public debt, the structure of public expenditure should be substantially changed, primarily in order to reduce the share of expenditure on payroll and intermediate goods (e.g., material and energy costs). This could enable greater public investment in productive areas, such as R&D, education and social programs.

Second, reform of the institutional framework for economic investments should be strengthened. The most critical reforms include establishing a more efficient public procurement system, implementing more stimulating competitiveness policies and regulatory framework for investments (including direct foreign investments), and developing the infrastructure to support the digital and telecommunications economy (average internet speeds in Croatia significantly lag average internet speeds in other EU member states). However, the biggest challenge is likely to involve increasing the efficiency of the judiciary system which, despite a number of employees that far exceeds the European average, is still rather slow, inefficient and prone to corruption.

Third, Croatia badly needs targeted policies to attract and retain labor. Although the employment rate today is much lower than in the crisis years, this reduction is largely due to the labor force participation effect with a significant number of people leaving the labor market (either emigrating or having stopped working).

Fourth, Croatia needs to introduce reforms across a wide range of social policy areas, including pension, health care, education and social welfare. Particularly important for further pension policy development will be penalizing early retirement and stimulating labor market participation.

The health care system will require a long-term stability program that addresses the periodic losses that are repeatedly covered using additional public expenditure. The required reforms for the education system include the continuation of the current curriculum reform program and the improvement of the quality of the entire system.

However, essential to the development of all these policies will be the further development of democracy in Croatia. Jeopardizing further democratization is the growth in populist tendencies that often acquire a radical-conservative form. Therefore, current political leaders have a historic responsibility to - while facing the past - preserve the fundamental values considered a standard for advanced democracies, such as the protection of ethnic and gender minorities, and women's right to abortion.