

# Croatia

<b>Status Index</b> (Democracy: 4.2 / Market Economy: 4.0)		<b>8.2</b>	<b>Management Index</b>		<b>6.6</b>
<b>System of government</b>	Parliamentary Democracy		<b>Population</b>	4.4 Mio.	
<b>Voter turnout</b>	75 %		<b>GDP p. c. (\$, PPP)</b>	9,170	
<b>Women in Parliament</b>	21.8 %		<b>Unemployment rate</b>	20.4 %	
<b>Population growth</b>	0.2		<b>HDI</b>	0.818	
<b>Largest ethnic minority</b>	12 %		<b>UN-Education Index</b>	0.88	
			<b>Gini-Index</b>	29.0	
<small>Figures for 2001 – if not indicated otherwise. <sup>a)</sup> Annual growth between 1975 and 2001. Sources: UNDP: Human Development Report 2003.</small>					

## 1. Introduction

After declaring its independence in the summer of 1991, Croatia suffered a serious transformation crisis that was aggravated further by armed conflicts throughout the region. Failures at the political level, the authoritarian leadership style of the first president, Franjo Tudjman, and a lack of willingness to cooperate with international organizations increasingly isolated the country politically and economically in the latter half of the 1990s. As a consequence, Croatia remained one of the few transformation countries in Central and Eastern Europe not participating in NATO's Partnership for Peace and without an association agreement with the EU by the end of 1999.

The parliamentary and presidential elections of January 2000 finally gave new direction to Croatian transformation politics, putting a new government in power and ending the reign of the Croatian Democratic Union (HDZ), which had held power since independence. The country has since been engaged in a remarkable process of catch-up. This report on the status of democratic and market transformation during the last five years concludes that, despite the difficult start, enormous progress has been made in the area of democratic transformation, particularly since 2000. Croatia's contribution to stability and peaceful development in the Western Balkans, and the willingness of the Racan government to cooperate regionally have opened Croatia's path to potential EU membership. Progress in market transformation has been more modest, in particular in the area of restructuring the business sector and increasing competitiveness.

## **2. History and characteristics of transformation**

Until its independence, the Republic of Croatia was a constituent republic within the Socialist Federated Republic of Yugoslavia. The path toward democracy and a market economy had already been opened for the constituent republic on December 13, 1989. At a special party conference, the Federation of Croatian Communists, the SKH (Savez Komunista Hrvatske), decided to open upcoming elections to non-socialist parties for the first time. The Croatian Democratic Union, the HDZ (Hrvatska Demokratska Zajednica), a kind of catch-all for nationalist factions, captured a majority of votes in elections held in May 1990. Franjo Tudjman, chairman of the party and a former general and nationalist dissident under Tito, became the first president of Croatia. Along with its declared intention to lead the constituent republic of Croatia to independence, the newly constituted government had expressed support for democracy and a market economy. Thus, political and economic transformation was accompanied simultaneously by the task of establishing a new state.

While the Tudjman era witnessed the adoption of a new democratic constitution (December 22, 1990), the democratization of the country advanced only cautiously. The political system of the 1990s was tailored to a large extent to the person of Tudjman and characterized by little transparency, marked patronage and limited freedom of the press and speech. Consolidation of democratic structures was prevented in no small part by war, as the new state was under constant threat. At times, up to 30 % of its territory was occupied by rebellious Serbs and units of the Yugoslav Army. As a result, important connections between the capital of Zagreb and Slavonia, in northeast Croatia, and sections of the Dalmatian coast were seriously disrupted or even severed completely.

In the area of market transformation, the reform policy of the 1990s attained some success, despite difficult structural conditions. From 1991 to 1993, industrial production dropped by 50 % and unemployment increased rapidly. The passage of the new economic program that established a private property regime and the macro-economic stabilization program in the autumn of 1993 formed the foundation for a market-based economic regime. With the help of restrictive loan, finance and income policies, inflation was brought under control. Inflation rates have since hovered between 4 % and 6 %, stabilizing the kuna, the Croatian currency introduced in 1994. On the micro-economic level, especially in the development and strengthening of the private sector, the reform policy achieved less. Privatization proceeded under an inconsistent stop-and-go policy against the backdrop of political power struggles. Minimal transparency in ownership conversions and preference for insiders discouraged foreign capital and resulted in insufficient restructuring and

modernization in the business sector. This, in turn, led to low competitiveness of the Croatian export economy and rising trade deficits.

A number of factors eroded Croatia's relations with the EU. These included the military reconquest of occupied territories in the early summer of 1995 (West Slavonia and Krajina); the expulsion of large numbers of the Serb minority; an unclear policy toward Bosnia-Herzegovina; and Tudjman's subsequent refusal to cooperate with efforts by the International Criminal Tribunal for the former Yugoslavia in The Hague to investigate war crimes. As a result, Croatia had to manage its democratic and market transformation process without EU support programs (e.g., the PHARE program and financial and technical support as part of an accession strategy), in contrast to other Central and Eastern European countries. The government's attitude of non-cooperation also complicated Croatia's access to international financial markets. Loans previously approved by the IMF to rebuild infrastructure were frozen.

After Tudjman's death, the governing HDZ suffered a devastating loss in the parliamentary elections of January 2000. A broad center-left coalition of six parties under the leadership of the social democrats (SDP) won a majority and elected the premier, Ivica Račan. This change in political direction was accompanied by a reorientation of Croatian transformation, evident in more democracy, an opening to the West and renewed international relations after years of isolation.

### **3. Examination of criteria for democracy and a market economy**

#### **3.1 Democracy**

During the period, especially the last three years, Croatia has made great progress in transforming its political regime in the direction of democracy. The EU confirmed this accomplishment with the resumption of previously frozen relationships, signing a Stabilization and Association Agreement (SAA) and opening up the prospect of EU accession. Deficiencies continued in the areas of administrative structure and judicial administration (courts' work capacity).

##### **3.1.1 Political regime**

*(1) Stateness:* Since the peaceful reintegration in 1998 of occupied territories in East Slavonia, Croatia has extended the state's monopoly on the use of force over the entire national territory. All citizens have the same civic rights. The majority

recognizes the Constitution in principle. While the Catholic Church enjoys great stature and social weight in Croatia, state and religion are largely separate, and the political process has been secularized. Public safety and order are ensured. The state has been established with a basic administrative structure, while execution and enforcement of political decisions still require partial improvement.

(2) *Political participation:* The population determines the head of government through free and fair elections; there are no restrictions placed by governmental structures. The smooth change of power after the last parliamentary and presidential elections at the beginning of 2000 illustrated this. The elected government has the power to govern; there are no actors holding veto power, nor are there political enclaves in the hands of the military. There is freedom of association and assembly within the framework of a democratic fundamental order. Limitations that existed at times during the 1990s have been lifted. The work of independent trade unions is not disrupted. Despite wide-ranging improvements in the areas of freedom of speech and the press, in particular for the print media, there remain opportunities for sporadic political influence on the state media. A law is currently under preparation that should ensure the autonomy of the Croatian state television and radio channel, HRT.

(3) *Rule of law:* In principle there are no limitations on the basic functioning of the separation of powers in Croatia. The judiciary operates relatively independently. Leeway for unconstitutional interference is shrinking due to the constitutional changes of November 2000 and March 2001. Based on insufficient functional penetration and equipment, the functioning of the judiciary is partially limited. During the 1990s, a large proportion of judges was given early retirement partially due to political reasons, leaving a negative mark. Available judicial capacity has reached its limits. Improvements in rationalization of procedures and the administration of justice are needed. The Racan government has declared war on corruption; abuse of authority is increasingly punished politically and legally. Still, corrupt elected officials can find procedural loopholes. So, there remains room for improvement. The population is highly sensitive to corrupt practices on the part of officials, in particular to those instances connected with privatization of cooperative and state enterprises. For that reason the Racan government appointed a special commission shortly after coming to power to review and, when necessary, revise previous ownership conversions. However, the measures could not meet the expectations so that electoral promises were not fulfilled in this context. Civil liberties are generally respected and where they are partially violated, suit can be filed to enforce them. In particular, redress for human rights violations committed under the previous regime can be pursued through the courts. Because the courts are so over-burdened, however, litigation may be protracted over many years.

### 3.1.2 Political patterns of behavior and attitudes

(1) *Institutional stability*: Democratic institutions are stable. They work in accordance with their designated functions but there are inefficiencies in the interplay among institutions. This could be observed at the start of the legislative period in the differing opinions on the division of jurisdiction between the new government and the president, Stipe Mesic. Overall, there has been a displacement of power during this electoral period in favor of the government and parliament compared to the previous term. The constitutional amendments of November 2000 introduced a parliamentary system of government, ending the system of a dual executive and of the president's superior power position. Since then political decisions have been prepared, made and implemented by the responsible offices. Democratic institutions are accepted and viewed as legitimate by the relevant social and political actors.

(2) *Political and social integration*: The core of a consolidated party system exists in Croatia, but it is subject to fluctuations. The system is characterized by a high degree of fragmentation, a moderate level of voter volatility and a moderate degree of polarization. While the political landscape was dominated by the HDZ during the 1990s, new parties were established during the period, in some cases as split-offs from existing parties. Since 2000 a polarized pluralist party system has been emerging. Only a few parties, such as the HSS (Hrvatska seljačka stranka, Croatian Farmers Party) have a long tradition and are anchored in society. Limited program capability and weak social integration can often be observed. In addition some parties are one-sidedly oriented toward their regional constituencies.

The network of interest groups is beginning to fill in but is still dominated by a few interest blocs (employers' association HUP and trade unions). Willingness to cooperate and mediate between society and the political system exists in embryonic form. The difficult situation at the start of transformation, with an enormous economic collapse and increase in unemployment, left the trade unions with a low level of organization during the 1990s. Their significance and autonomy grew during the period; approximately 64 % of all workers are now members of unions. The population's approval of democracy is medium to high; political protests are aimed at those currently in power and do not throw the institutional framework into question. Voter turnout was about 75 % during the most recent parliamentary elections.

A robust mesh of autonomous grassroots groups and organizations was in the process of developing during the past years. A major contribution to this trend was the law passed in 2001 by the Račan government that considerably simplifies the licensing and functioning of organizations and associations compared to previous practice. Trust among the population must still be ranked as generally low. The new

government's approach towards ethnic minorities and its efforts to simplify the return of the expelled Serbian population contribute to integration and reconciliation.

## **3.2 Market economy**

Croatia has made some progress in transforming its economic regime during the reporting period, in particular in privatization and on the macro-economic level. Transformation deficits continue at the micro-economic level, in the areas of restructuring the business sector and enhancing competitiveness.

### **3.2.1 Level of socioeconomic development**

Social exclusion is quantitatively and qualitatively little evident and, in part, not structurally anchored either. Gender-specific discrimination is not apparent; the moderate social disparities of the 1990s increased slightly during the period. The income of lower income groups deteriorated, while the poverty rate increased. Already existent developmental imbalances among regions did not decrease. Developments in Krajina, Lika and on the thinly populated Dalmatian islands are particularly negative.

### **3.2.2 Market structures and competition**

The fundamentals of market competition—such as independent price determination, freedom of trade and free use and transfer of profits—are guaranteed, but uniform rules do not exist for all market participants. When privatizing the business sector, the government sometimes invalidates the general rules (e.g. Suncani Hvar). Treatment of foreign investors and the transparency of individual processes could be improved. Privatization strategy and legislation during the 1990s led to a wide distribution of business shares and left behind insufficient corporate governance. The approach of the privatization fund, HFP, slightly improved during the reporting period; the search for strategic investors for pending privatization projects has been given unambiguous priority. While there is antitrust legislation and a supervisory body, the formation of monopolies and oligopolies is only incidentally and inconsistently regulated. Foreign trade has been extensively liberalized. Special rules exist for certain branches of industry but are being eliminated step by step within the framework of negotiations with the EU and the WTO. The Croatian banking industry has significantly stabilized in the wake of the 1998–99 crisis. Inflow of foreign capital in the form of equity

investments and the establishment of foreign banks, primarily from Western Europe, were responsible for that to no small extent.

More than 80 % of banking assets are now in foreign hands; today, the banking sector can be described as well differentiated, competitive and oriented to international standards in principle. Still it is not free from susceptibilities to fluctuations due to high external dependency and a partial lack of supervision, as the example of Riječka Bank shows. The capital market remains underdeveloped with low market capitalization. Croatia has treated itself to the luxury of two stock markets; in addition to the main stock exchange in Zagreb, shares are also traded in Varazdin.

### **3.2.3 Stability of currency and prices**

The previous government scored victories in the fight against inflation. The stabilization program introduced in 1993 succeeded in ending a long tradition of hyperinflation in Croatia. This consistent inflation policy and appropriate exchange rate policy were continued by the new government, at times in opposition to massive demands by export-oriented businesses to devalue the Croatian kuna. This policy ensures reliability of expectation for all actors. The independence of the national bank was strengthened. Foreign currency reserves have recovered, while at the same time external debt grew to more than \$14 billion. The government agreed with the IMF, however, to bring down high external debt. To what extent this will succeed during the new term of government—parliamentary elections were held at the end of 2003—remains to be seen.

### **3.2.4 Private property**

Sufficient framework conditions exist for a functioning private sector. Property rights and regulation of property acquisition are well defined in principle in regard to purchase, use, appropriation and sale. Partial problems of legal implementation exist, however. Privatization of state enterprises accelerated during the reporting period (e.g. Hrvatske Telekomunikacije). The private sector's share of gross domestic product, at 60 %, remains lower than that in successful transition states such as Hungary and Poland.

Therefore, the state enterprise sector must be consistently reduced, and large enterprises such as INA, HEP and Croatia Osiguranje must be privatized. Fortunately, the new government has revised the approach to privatization so that strategic investors receive more attention. Some reservations toward foreign investors in larger

privatization projects remain and may hinder greater inflows to FDI. The government continues to tolerate concentrations of power in a few industries.

### **3.2.5 Welfare regime**

Traditionally, the workplace component of the social insurance system played a large role in Croatia. With the collapse of the social system and the demise of cooperative enterprises, it lost its importance at the start of the 1990s. Simultaneously, efforts were made to build up social insurance systems in the realms of health, elderly and unemployment services. Today, social safety nets have been built in part but do not cover all risks facing all strata of the population. Risks associated with poverty remain for some sections of the population. The large number of unemployed, which exceeded 390,000 in 2001, represents a burden on social insurance systems. Croatian society is, in some respects, heterogeneous; there are institutions to counteract crass social disparities. Women have substantial access to higher education and public office. The share of women in parliament is currently about 22 %.

### **3.2.6 Strength of the economy**

Croatia has enjoyed a phase of economic growth since 1995, in part based on the strong climb in domestic demand and accompanied by relatively positive macro-economic data. This solid economic growth showed just one drop, in 1999, but overall presented a positive picture during the reporting period. Apart from fortunate developments in the area of price stability, there are a number of unfavorable indicators to be noted, such as the unsatisfactory level of employment that has persisted for years, the tendency to indebtedness, problems with budgetary balance and a negative balance of trade. The extent and impact of the high budget deficit was reduced in recent years by successful tourism results boosting the current account balance.

Pacification and stabilization throughout the region promises continued development for Croatian tourism in the future, as well. The growth potential of the Croatian national economy can be classified as favorable, particularly because of better access to the EU market in the wake of the SAA and the expected positive trade effect of integration with European and international organizations (WTO, CEFTA). To realize these effects, however, the private sector must be strengthened and the business sector must be more broadly restructured and modernized.



### 3.2.7 Sustainability

In the past, there was little environmental consciousness in Croatia, particularly during the socialist period. In recent years, however, both the public and legislators have become sensitized to pollution. This is clearly reflected in the various environmental groups and organizations that have been formed. The need for ecologically sound development is now taken into account in some segments of the economy but remains in many respects subordinate to the push for growth. A positive exception to this is the tourism industry, which is attempting to build upon existing advantages over competing tourist destinations by highlighting ecologically sound growth. In the course of approximating EU standards, the future will probably see an increase in environmentally sound economic development. Croatia possesses solid state-run primary and secondary educational institutions. The performance, however, of the university system, while varying according to the particular department, is generally limited; it is highly centralized and undergoing transition. The goal is to adjust the curricula to the Western European system. Expenditures for education in 2000 were about 5.3 % of GDP. Shortcomings can be seen in the area of research and development, both quantitative and qualitative. Private institutions and investments in R&D are gaining importance, such as the research center recently built by PLIVA, a pharmaceuticals company.

## 4. Trend

(1) *Democracy*: Prior to the reporting period, certain criteria such as statehood, the rule of law and the independence of the judiciary were not assured in Croatia. The same applies to performance indicators such as elections and freedom of speech and the press. During the reporting period and particularly since the change of government at the beginning of 2000, a progressive trend has been observed. The degree of democratic consolidation has clearly improved overall and in certain respects even greatly. The improvement in jurisdictional demarcation among the executive, parliament and judiciary deserves particular emphasis. Progressive tendencies are also apparent in regard to social organizations' freedom of action and freedom of speech, and in the media. In the latter instance, there remains room for improvement, as is the case with administrative efficiency. In contrast, the country's socioeconomic level of development has improved only slightly. Corruption remains widespread.

(2) *Market economy*: The institutional framework conditions for market activity continued to improve during the reporting period. In particular, alignment with the EU and acceptance in the WTO represent positive, long-term directions, not to

mention their positive influence on the inflow of foreign capital to Croatia. The establishment and investment of foreign banks advanced the recovery of the Croatia banking industry. In comparison to the democratic transformation, however, the pace of reform in the market transformation is weaker. Fundamental indicators show only a slight improvement during the reporting period. Unemployment remains high. Restructuring and modernization of the business sector, strengthening of the private sector and increasing the competitiveness of Croatian products remain priorities for long-lasting economic recovery.

**Table 2: Development of socioeconomic indicators of modernization**

	HDI	GDI	GDP Index	Gini Index	UN Education Index	Political Representation of Women <sup>a</sup>	GDP per capita (\$, PPP)
1998	0.795	0.790	0.7	29.0	0.88	Not available	6,865
2000	0.809	0.806	0.73	29.0	0.88	21.8	7,960

<sup>a</sup> Share of female representatives in parliament as a percentage following the parliamentary elections in 2000.  
Sources: UNDP, Human Development Report, 2000, 2002.

**Table 3: Development of macroeconomic fundamentals (1998–2002)**

	1998	1999	2000	2001	2002 <sup>a</sup>
Growth of GDP as a %	2.5	-0.9	2.9	3.8	4.0
Export growth as a %	10.4	-0.5	18.9	8.1	4.0
Import growth as a %	-7.2	-2.0	16.8	17.4	9.0
Inflation as a % (CPI)	5.7	4.1	6.2	4.9	2.4
Unemployment as a %	18.1	20.4	22.3	23.1	22.5
Budget deficit as a % of GDP	0.1	-8.2	-6.5	-6.8	-6.2
Current account balance as % of GDP	n.a.	-7.0	-2.4	-3.8	-3.6

<sup>a</sup> Projected for 2002.

Sources: Croatian National Bank, WIIW, IMF 2002,2003.

## **5. Transformation management**

### **5.1 Level of difficulty**

Shortcomings in implementing democratic reforms aimed at establishing the rule of law, limitations on freedoms of speech and the media, inadequate administrative structures and the country's political and economic isolation all represented unfavorable conditions for continuing transformation at the beginning of the reporting period. Based on the transformation management over the last three years, however, important steps toward democracy have been taken. Particularly in the realm of the rule of law and institutional stability, missed opportunities of the 1990s have been recouped. Starting from minimal civic traditions, an increase in civic involvement and NGOs was noted during the reporting period. With solid economic growth since 1994–95, Croatia's developmental potential must be classified as favorable, with moderate incomes and a relatively high educational level. Ethnic conflicts were ameliorated during the reporting period by strengthening minority rights and pursuing a prudent policy.

### **5.2 Reliable pursuit of goals**

The first two years of the period were characterized by the HDZ's attempts to maintain the *status quo* and hold on to power through loose credit and dramatic wage increases for state enterprises. The following years were marked by efforts to create credibility, domestically and internationally, and to implement reforms promised during the election campaign. For the first time, the previous government's neglect of democratic reforms could be openly discussed and addressed. The Racan government exhibited enormous reform energy immediately after assuming power, reduced drastically increased government expenditures and, while politically managing current problems, also pursued long-term goals such as successful overtures to European and international organizations and institutions.

Over time, this reform energy flagged, particularly in relation to market transformation. Important decisions on reducing subsidies, strengthening competitive framework conditions and increasing flexibility in the labor market were often postponed. Electoral promises such as the reduction of high unemployment, the revision of privatization and more resolute action against corruption have been implemented insufficiently. Political tensions within the coalition were to blame, exacerbated by extradition requests from the Hague tribunal (Norac, Bobetko) and the procedure involved in some privatization projects, which finally led to the withdrawal and collapse of some smaller coalition partners.

The coalition's dwindling majority and the approaching parliamentary elections more and more threaten to give priority to short-term political expediency over consistent domestic policies designed for lasting impact. Pending EU candidature remains a high priority, as does meeting accession criteria. Croatia hopes to qualify for the second round of EU enlargement in 2007, together with Bulgaria and Romania.

### **5.3 Effective use of resources**

Despite improvements, the government is not completely efficient in its use of available economic, cultural and human resources. Personnel expenditures continue to be relatively high. Budget deficits and state indebtedness are persistently in relation to GDP. Administration is not clearly structured, and administrative organization requires more effective leadership, based on rational professional criteria. Recruitment procedures are not always devoid of political influence, although improvements over the previous government's practice can be observed. Overall, decentralization is still insufficient, although local organs of self-administration are being granted more legal and financial autonomy (Law on local and regional self-government from April 2001). The administrative division of the country into individual counties (Zupanije) is problematic in terms of its efficiency.

The government is able to implement only portions of its announced reform plans due to tensions within the coalition. Micro-economic adjustments, in particular, remain behind plan targets. In contrast, activities by the political control system aimed at quantitative structural changes in the political system were generally successful. Public services provided by the government facilitate progress in transformation but still need improvement.

Increased efforts are needed, especially in providing infrastructure (rail and roads) and in developing human resources. The health care system is in serious need of reform. Integration mechanisms are only partially effective. Additional steps must be taken toward effective criminal prosecution of corruption and independence for the media. Government efforts to establish nonexistent integration mechanisms are apparent, however. The government is attempting to make use of European identity for its policy of approximating European structures in order to win the population's support for the painful measures that will be required.

#### **5.4 Governance capability**

While during the first two years of the period, Tudjman-era political actors seeking to retain power clung to misguided policies with increasingly damaging effects, the first half of the Racan government's legislative period was marked by reform energy. Political actors proved their ability to learn by adapting with changes after false starts and political mistakes. Although the coalition emerged from the parliamentary elections with sufficient political authority, tensions arose within the coalition over time that distracted from real problems and hobbled the government. This became clear in opinion polls, as well, which at times showed a clear loss of prestige for the SDP. The government paid attention to the allocative effects of its policies but applied too little effort overall to increasing the efficiency of markets. With its reduced basis of legitimacy and continuing tensions within the coalition, primarily between the SDP and the HSS, the Racan government's maneuvering room is shrinking. This threatens to slow down the pace of transformation, particularly since the opposition, and even some within the government, are calling ever more stridently for early parliamentary elections.

#### **5.5 Consensus-building**

While there are differences of opinion regarding the correct path and tempo of reforms, the major political actors all agree the country must build democracy and a market economy. This consensus includes both the current and potential new elites. Anti-democratic actors with veto power no longer play any essential role in Croatia. The danger of a reversal of the reform course is low, particularly since all important parties have expressed support for membership in the European Union and are prepared to introduce the required steps at the political, legal and economic levels.

The growing intermittent strength of isolated extreme positions, in particular in connection with the Hague Tribunal's extradition requests, has been successfully neutralized by the Racan government. The government has prevented any escalation of structurally significant conflicts and, in some cases, successfully reduced conflict polarity. Government efforts have encouraged expressions of social solidarity, which has not been marked. A willingness to deal with historical acts of injustice has also been apparent. These certainly include an attitude of reconciliation and gestures for wrongs committed after World War II, but also the attitude of reconciliation by the new government toward ethnic minorities and the call for more tolerance in society.

## 5.6 International cooperation

While the first phase of the period under review (1998–99) was characterized by only slight willingness to cooperate on the part of the Tudjman government—resulting in the country’s political and economic isolation—the situation changed immediately after the change of government at the start of 2000. The new political actors are now using international programs and projects to support their reform efforts, in particular to expand infrastructure. Improvements in the balance of democratic transformation are closely connected with increased cooperation with external actors (EU, WTO, CEFTA, IMF). In general, international bodies and foreign governments view the Racan government reliable and predictable. The thoroughly positive signals from Western Europe in regard to Croatia’s possible membership in the EU demonstrate that.

The attitude of the US government toward Croatia’s rapid admission to NATO can also be judged as positive. Croatia joined NATO’s Partnership for Peace program already in May 2000. The willingness to cooperate with international organizations (e.g. the Hague Tribunal) was the primary contributor to this, as well as the new direction of Croatian policies towards its neighbors, Bosnia and Herzegovina, and Serbia and Montenegro. Since then, Croatian politics has played a stabilizing role for peaceful development in the entire West Balkan region. The only flies in the ointment remain the unresolved border disputes on land and at sea with Slovenia and the two open disputes over the Krsko nuclear power plant and Ljubljanska Banka.

## 6. Overall evaluation

In regard to originating conditions, status and evolution, and political performance of the actors (management), this report comes to the following conclusions:

(1) *Originating conditions:* The originating conditions for transformation must be evaluated as difficult. The lack of traditions of the rule of law, civic society and democracy was significant. The war and occupation of about 30 % of Croatia’s territory resulted in the postponing of democratization. To this day, ethnic conflicts have left deep scars in sections of society. After the reconquest of Krajina the country was overwhelmingly politically isolated, which was reflected in its economic capacity as well. By the end of the 1990s the population’s standard of living had not yet reached the level of the period prior to transformation, despite a phase of economic growth since 1995.

(2) *Status and evolution:* The evolutionary path of *democratic transformation* is remarkably long. Political decision makers have succeeded since the start of 2000 in qualitatively broadening the democratic transformation, particularly in the realm of political representation and integration, the institutional efficiency of the system of government, the rule of law and in the population's support for the democratic system. Internal threats to democracy within Croatia are unlikely, including in the event of another transfer of power.

The evolutionary path of *market transformation* has been shorter. Political decision makers did succeed in further improving the economic framework conditions and stabilizing macro-economic development, which had been relatively good prior to the reporting period. The groundwork was laid, as well, for the recovery of the banking system. Nonetheless, the economic transformation to an efficient, socially responsible market economy has not been completed. Very high unemployment continues to be a strain. Although some indicators point toward successful crisis management, important structural reforms, such as restructuring and modernizing the business sector, strengthening the competitiveness of Croatian businesses and developing an effective anti-monopoly and competition policy are all unfinished. The process of transformation continues.

(3) *Management:* The conclusion on the relative organizational performance by the actors is overwhelmingly positive. Without a doubt, in comparison to the prior period, the political process of transformation during the period gained in resolve, in speed and in prospects of success. Successful management strategies regarding Croatia's integration with international structures (WTO), collaboration with external actors (EU, NATO), signing of important agreements (SAA), reorganization of regional relations (especially relations with Bosnia and Herzegovina, and Serbia and Montenegro) contrast with weaker and increasingly slower organizational performance in the realm of economic policy reforms.

## **7. Outlook**

The key strategic tasks for democratic reforms that must be solved in the short- to medium-term are in the areas of administrative structure and judicial administration, particularly shortening the duration of litigation and improving the media law. Measures initiated to fight corruption must be continued and strengthened. Existing market and competition regimes must be strengthened, especially through privatization and a credible fight against the formation of monopolies and oligopolies. Reducing high unemployment is extremely important for the country's development and stability. This can be accomplished by strengthening the private economy,

supporting small and medium-sized business and, especially, by strengthening the export economy.

Admission to the WTO and CEFTA, as well as agreeing to the SAA, have opened opportunities for expanding trade while simultaneously subjecting domestic industry to increased competitive pressure. Reform measures should do more to support restructuring and modernization of the business sector and provide incentives for the required adjustment of Croatian foreign trade to West European markets. How these tasks and other electoral promises are fulfilled will decide over the next government: either a continuation of the current coalition or the formation of a center-right coalition led by a strengthened HDZ. Whatever the outcome of the next parliamentary elections, Croatia will continue on the path toward democracy and a market economy. There is wide-ranging consensus on the strategically important steps toward membership in the EU and NATO. Accession to the EU, in particular, is supported by a majority of the population. Strengthening cooperation with the Hague tribunal and a rapid resolution of border disputes with Slovenia are prerequisites for EU integration and NATO membership, however.