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CROATIA ON THE THRESHOLD OF THE EUROPEAN UNION: A CHALLENGE OR A PROBLEM COMPETITIVENESS OR HOW TO BE BETTER

Hrvatska pred ulaskom u Europsku uniju:
izazov ili problem
Konkurentnost ili kako biti bolji

Abstract

For the last decade the Republic of Croatia has been preparing to enter and become a full member of the European Union (EU). The negotiations began in the context of political and social issues (the degree of democratization of society, respect for human freedoms and rights, etc.). Then in the framework of 35 negotiating chapters the focus shifted to economic factors. The freedom of market competition, the example of shipbuilding, stimulus and protection of agriculture production, trade relations and a preferential relationship compared to the neighboring countries outside the EU became the dominant questions in the continued process of negotiation and harmonization.

At the same time, Croatia first began to understand and then the media set out to treat more significantly and consider the question of our (national) competitiveness. In this context and at that time (the past decade) the National Competitiveness Council was established.

In the past decade the Council has played a crucial role in creating public awareness of why *competitiveness* is important in achieving the (ultimate) goal - creation of national prosperity as a permanently sustainable condition. This is a goal that can be achieved only through economic success, within national boundaries, within the EU, and increasingly within a stronger global economy. All of these questions, and the search for (correct) responses, are more strongly present in the conditions of the global economic crisis on one hand, and the impending accession (measured in months) of the Republic of Croatia to full membership in the EU. Following from the above, the research and analytical interest of the work is to see how one transition country can succeed on this path; what it must and must not do; what are the specific conditions and limits; and what are the requirements and limiting values of those successful countries to whom the Croatian economy must draw closer and which is must respect in the long term.

Key words: *transition, national and global competitiveness, EU negotiations, structural reforms, globalization, economic crisis, national prosperity*

Sažetak

Republika Hrvatska proteklo se desetljeće priprema za ulazak i punopravno članstvo u EU. Pregovori su otpočeli u kontekstu političkih i društvenih pitanja (stupanj demokratizacije društva, poštovanje ljudskih sloboda i prava,...), a zatim su u okviru ukupno 35 pregovaračkih poglavlja svoje težnje premjestili na ekonomske odrednice. Sloboda tržišnog natjecanja, primjerice brodogradnja, poticanje i zaštita poljoprivredne proizvodnje,... trgovački odnosi i preferencijalne relacije u odnosu na države okruženja izvan EU, postala su dominantna pitanja daljnjeg procesa pregovaranja i usuglašavanja.

Paralelno, unutar Hrvatske otpočelo se najprije shvaćati, a zatim i (medijski) sve značajnije tretirati i razmatrati pitanje stupnja vlastite (nacionalne) konkurentnosti. U tom kontekstu i u tom vremenu (proteklo desetljeće) osnovano je Nacionalno vijeće za konkurentnost.

Vijeće je u proteklom desetljeću odigralo presudnu ulogu u stvaranju svijesti na nacionalnoj sceni zašto je *konkurentnost* važna u postizanju (konačnog) cilja - stvaranja blagostanja nacije, kao trajno održivo stanje. To je cilj kojeg je moguće ostvariti jedino ekonomskim uspjehom i to unutar vlastitih granica, unutar EU, te sve više i jače globalne ekonomije. Sva ova pitanja odnosno potraga za (pravim) odgovorima još su viša i jače izražena u uvjetima svjetske gospodarske krize na jednoj strani, te skorog ulaska (mjereno mjesecima) Republike Hrvatske u punopravno članstvo u EU. Shodno iskazanom, istraživački i analitički interes rada je vidjeti kako jedna tranzicijska država može na tom putu uspjeti; što mora učiniti i što ne smije učiniti; što su datosti i ograničenja. Koji su to zahtjevi i granične vrijednosti onih uspješnih kojima se nacionalna ekonomija mora približiti i koje mora trajno respektirati.

Ključne riječi: *tranzicija, nacionalna i globalna konkurentnost, EU pregovori, strukturne reforme, globalizacija, ekonomska kriza, blagostanje nacije*

Introduction

The level of competitiveness as an implicit and explicit problem, or a limitation, in the achievement of national development, appeared as a pertinent and important question in the context of the establishment of market economies in all of the countries of Central and Eastern Europe in parallel with the sudden and powerful process of democratization and the creation of a civil society suitable for a European milieu. The degree of success in achieving national results varied in individual groups of countries. The Czech Republic, Slovakia, Estonia, and more recently Poland, have made visible progress, measured by important comparable parameters: the growth of GDP, employment, and exports, and when measured directly, in an improvement in their positions in the rankings of the World Economic Forum from the moment that they were included in that list to the current period.

Until the year 2000 the Republic of Croatia was faced with a *delayed transition*. In the succeeding period (until 2008) it achieved continuous growth in its level of national competitiveness. But confronting the global economic crisis (2008-2012) was delayed. First came the realization of the depth of the crisis and the recognition that it was not just a problem of the US and/or Europe as developed parts of the world – it was also our immediate problem. Then came the creation of a consistent system, a conceptually and practically adequate instrument for operating in crisis circumstances, endogenously and exogenously. In regard to the already high degree of public and foreign debt in the period up to 2008, the possibilities for and the types of government intervention were limited to the areas of fiscal and budget policy. There was a stark contrast in the opportunities for action between the powerful and highly developed economies (the US, parts of Europe, and the Far East), as *trendsetters*, and the small and open economies that included the Republic of Croatia, as a *niche player*.

Such a position is not and cannot simultaneously be an excuse and justification for the absence of an adequate formulation of a domestic development policy, especially *industrial policy*, understood, considered, and implemented in its wider and more complex definition. At the same time, the absence of several possible and necessary measures

to improve the quality of public services, beginning with public administration, education and health and the encouragement of innovation and research, and what is even more important, their application, was an area of obvious deficit that considerably reduced interest (attractiveness) among possible partners for new investment, domestic ones, and even more importantly, foreign ones.

In addition, it will be extremely interesting to verify these claims by analyzing data of the relevant institutions (WEF, IMD), and at the same time through the analysis that M. Porter (2009) conducted for the Republic of Croatia, as a possible *manual* for concrete action. In view of the downward trend of national competitiveness, especially in this period, and also the strengthened effects of the economic crisis, these analyses and suggestions carry additional weight and significance.

Competitiveness and the role of the state

Creation of institutions, creating development strategies and policies

The beginning of the transition period was characterized by a naive belief of governments and societies in this region that the establishment of a democratic system (political parties, regular elections) and the creation of the basic market prerequisites for business, such as partial price liberalization, the gradual removal of state and social ownership, the initial creation of private enterprise, and the beginning of foreign investments, by themselves were sufficient for creating a framework for successful economic development, and accordingly, for the long-term and stable growth of the quality of life as well as a stable and long-term growth of employment. This subject has been extremely well emphasized in the literature: *“Dramatic restructuring occurred in the area of income distribution and consumption. Although critics of the socialist system rightfully complained that a system of material privileges indeed existed, income distribution and consumption occurred primarily in a rather narrow framework. The last ten to fifteen years was enough to reach undeniable growth in the existing level of inequality... On one hand, the previously unknown level of suspect wealth became*

immediately clear, while on the other hand poverty, which earlier was much less obvious, became deeper and much more apparent. Many people with a sense of social justice who were not victims of the restructuring considered it appalling. The serious problems cited above are linked to questions of employment. Open unemployment was not known in the socialist economy; the degree of employment was very high and every worker could feel secure in his job. Indeed, just a reverse inequality prevailed. The socialist economy created chronic shortages, including a chronic shortage of labor – at least in the more industrialized countries of Central and Eastern Europe” [9, pp. 349-350].

A painful new realism was created by the fact that the desired and expected changes did not automatically occur; skepticism toward the political introduction of simple and spontaneous solutions appeared; and combinations of neoliberalism and populism were frequently present. But, at the same time, on the basis of these realistically painful experiences, a turnaround occurred with the understanding that the creation and use of high quality institutions in the longer term ensured attaining the living standard of advanced countries. *“Strategies for stimulating growth must be fulfilled over time by a cumulative process of building institutions to ensure that growth does not remain without any motive force and that the economy remains resistant to shocks. Furthermore, “...high quality institutions are those that demonstrate socially desirable behavior by economic agents...” The last two centuries of the economic history of wealthy countries today can be interpreted as a permanent process of learning how to make capitalism more productive with a greater offer of institutional content in a self-sustaining market economy: meritocracy in state administration, an independent judiciary, central banking, financial supervision, a stabilizing tax policy, the fight against monopolies and regulation, social insurance, and political democracy. Just as it was foolish to look at them as the prerequisites for the economic growth of poor countries, it would be equally foolish not to understand that such institutions with time become necessary to achieve full economic convergence” [16, p. 55].* In other words, awareness of the necessity to respect the importance of institutions slowly but constantly acquires its place in achieving the prerequisites for economic growth with new strategies for growth and development.

And only after creating an awareness that economic growth and development does not happen by itself but is created systematically, complexly and exactly with the passage of time or because of the desire and needs of the political elite and population it is possible to approach an identification of content, or in other words, a definition of the fundamental responsibilities of the state that is understood as the framework but also the navigator of essential changes that every country faces. The statements above take on additional importance in the context of the economic and social transitions that the countries of Central and Eastern Europe are facing. Such a transformation to a social-liberal state is now the new reality [14, p. 184].

- 1) *“Setting more precisely the limits of state action, by reducing its size; privatizing state-owned enterprises; granting autonomy and transferring to the non-profit sector the social and scientific services while keeping its financing within the state; outsourcing non-core or auxiliary activities.*
- 2) *Reducing the extent to which the state regulates the private sector, transforming the state into a promoter of the competitive capacity of the country instead of a protector of the national economy against international competition.*
- 3) *Increasing state governance, i.e. its capacity to make government decisions effective, by means of a fiscal adjustment that refunds financial capacity to the state, and of administrative reform aimed at a managerial public administration (instead of a bureaucratic one).*
- 4) *Increasing governability – i.e. the power to govern – through political institutions that ensure a better intermediation of interests and make governments more legitimate and democratic, thus improving representative democracy and opening spaces for social control or direct democracy.”*

Such a definition of the role and responsibility of the state in shaping the overall development policy of a society and (implicitly/explicitly) creating a *catch-up* strategy to reach the level of developed countries provides another solution to the dilemmas present in the literature, which are even more urgent in the context of current political and social discussions: where are the limits, but where also is

the optimal content of state action; what are the differences between a *responsible and efficient state (strong state)* and a state that acts immediately in the social and economic sphere, whether by an enhanced policy of transfer or with an immediate management role (*big state*). The difference is important and clearly defined. *“The first essential distinction to be made when dealing with state structures and government policies is between a ‘strong state’ and ‘big government’.* The confusion between them is responsible for much of the noise that surrounds discussions on the matter. A ‘strong state’ means the possession of an executive power capable of coordinating and shaping the strategies of big business groups, a bureaucracy with an autonomous core, able to negotiate priorities in the nation’s agenda and having the necessary respectability to be heard, and – last but not least – a sound financial capacity to support both those features. It differs sharply from ‘big government’ in the sense that strong states do not imply state-owned productive enterprises and welfare systems can be quite small” [3, p. 41]. Such a redefined role of the state compared to the *welfare state* that has been present in Europe for more than three decades is primarily the expression not of a lack of desire to abandon a society that at one time and in one milieu was economically productive and also competitively sustainable but an inevitable turn to new paradigms created in new circumstances and with the appearance actors on the global stage who have initiated and developed an accelerated process of globalization based on scientific-research and on the mobility of capital and technology, especially from those developed countries toward emerging countries and markets.

The frameworks for recognizing the new situation and the new relationships have been defined in a text by T. Mickiewicz: *“It seems that a clear-cut difference that runs against the mainstream consensus in Western economics, dominant in the second half of last century, is that the savings rates matter. It is savings that are much higher in Asia. The consensus that still dominates the policy-making in the Western world of high-income economies, and was even amplified during the 2008-2009 crisis is that consumption spending, both public and private is good, and saving has negative macroeconomic implications as it withdraws funds from the circular flow. Over the last 60 years the impact of this idea on the design of economic policies, taxes, welfare provisions*

and pensions has been dominant. While consumption credit expanded real interest rates on savings were both low and the related gains were taxed significantly. So were capital gains and any gains from inheritance, making longer-term capital accumulation strategies of families counter-productive. Saving for pensions and for private health insurance have been discouraged and replaced by (apparently) uniform provision by the government. Thus, both motivation for savings disappeared and gains from saving were eliminated by taxes and by welfare provisions, which in many cases penalized those who save by making access to government services conditional on a lack of savings (including old age provisions and other benefits)” [12, p. 218].

The distortions in the global economy, and in individual parts of it, created by the use and maintenance of an economic and social model from one period that was based on the concept of a relationship of domination (a reduced number) of key protagonists (Europe and the US) has completely changed with the appearance and growth of the BRIC countries. What was possible and sustainable yesterday is no longer possible today. And it will no longer be possible to establish and permanently sustain it (see Figure 1).

Figure 1: EU trade with China

Source: Beattie, A. (2010), “Going Head to Head”, *Financial Times*, London, October 8, 2010, p.9.

- 1 It is not just Western Europe but also the US, with more limited redistribution, that continues to punish its savers and investors via its design of tax policies and welfare benefits. In turn, low domestic saving rates lead to reliance on inflow of funds from abroad, implying that the most developed economies are converging to the similar model of development as some emerging market and transition economies (outside Asia) and are become increasingly sensitive to international financial markets and to the behaviour of their main sponsors [12, p. 218].

There is no question that (in terms of trends, the entire decade) the EU is buying and importing more from China. A new global production base has been created whose power is growing – in range and quality (see Figure 2). All of this is apparent and confirmed by the much above average annual rates of growth in GDP. This growth is based on relations that were built step by step in the last three decades. It picked up pace in the 1990s with the acceleration of the globalization process. This was the same period in which the transition countries were particularly devoted to the construction of a new system, but especially in the political and social arenas.

The shares of China and the US in global industrial production were practically equal in 2010, while the shares of other highly developed countries – Germany, Great Britain, and Japan – are continuously declining. India has also registered gradual relative growth since 2000. The establishment of new relationships in industrial production also means further redistribution in the services sector, especially those that are directly or territorially an integral part of industrial production. Furthermore, this means a new division and allocation of jobs and employment. The current high rate of employment in the EU and (partly) in the US means less tax revenues in national budgets with a simultaneous increase of financial obligations on the basis of social transfers.

Overall, this can be a basis for a decline in the level of national competitiveness. Compensating factors may be found in the increase of productivity based on the introduction of technological innovations and the creation of new products with higher added value.

And this is the exact transition that is occurring in the EU and the US; the battle for jobs, for one's purchasing power, is inseparable from a (lost) competitive capability that maintains and attracts investment. And this represents both sides of the coin: how to maintain existing industries and production and how to attract

new investors and investments that stimulate the need to create newer and newer technologies – the IT sector, nanotechnology, biotechnology, pharmaceuticals, energy, water management as sources of energy, the production of food, and ultimately national security.

The concept of new technologies and new products is part of the phenomenon of *the third industrial revolution*, as the linkage of innovation and production, and it represents

Figure 2: The new economic order in the world

Source: The Economist. (2012), *Special Report: Manufacturing and innovation – Back to making stuff*, April 21, 2012, p. 5.

Figure 3: Slicing the Apple: Distribution of value for 16 GB Wi-Fi iPad, 2010

Slicing the Apple

Distribution of value for 16 GB Wi-Fi iPad*, 2010
Profit/cost breakdown**, \$ (Share of retail value #, %)

*1st generation, Wi-Fi only version
** Numbers do not add to their respective totals because of rounding
*** Non-labour, components only. Assigned to corporate headquarters

Source: The Economist. (2012), "A third industrial revolution", *Special Report: Manufacturing and innovation – The boomerang effect*, April 21, 2012, p.7.

the essential framework for creating an *exit strategy* for the still economically dominant parts of the world. In this context, the example of the company Apple and an analysis of the relationship in the price and value of one of its products provide an excellent illustration (see Figure 3).

The overall material value of all the components of the product is financially roughly equal to the amount per unit that Apple achieves. The third greatest issue is costs of distribution and business. All remaining costs, such as the total labor of sub-contractors in other parts of the world are considerably lower, important and present. This example clearly demonstrates how innovation and research, and what is especially important, their application in the production of newer and newer products is essential for maintaining the leading role of global corporations and also the creation of new products, especially in the US, which is acting considerably faster compared to the same trends in the EU. At the same time, the US is facing a phenomenon that has been present since 2010, and that is *jobless recovery*. The global recession, caused by a decline in real estate and a crisis in the banking system that began in the US and continued in the EU, has created a new framework for events – overcoming the crisis and beginning an economic recovery with an increase in GDP has also been accompanied by strong growth in productivity but with high rates of unemployment. These trends are apparent in the Figure 4.

Figure 4: Long-term trends

Long-term trends are towards a smaller but more productive sector
Manufacturing indices, Q1 2000 = 100

Source: Marsh, P. (2012), "Industry: Nimble, niche and networked", *Financial Times*, London, June 13, 2012, p. 9

In the last decade in addition to stagnant industrial output there has been exceptional growth in the rate of productivity (over 50% overall), and as a consequence of that, a drastic fall in unemployment of almost 40%; the difference has been compensated through the use of new technologies.

National frameworks – Lessons in competitiveness from the world and the region

The events and trends described above, however they seemed, and even more desired (*not in my backyard*), have direct implications on the reality of events in our region. An objectivized picture of events is visible from structural data on national competitiveness that is monitored and analyzed in two globally relevant rankings, by the World Economic (WEF – Washington) and the International Institute for Management Development (IMD – Lausanne). The latest situation is as follows.

For the period 2011-2012 Croatia's overall ranking was 76th out of a total of 133 countries analyzed in the report, which is a significant decline compared to the period before the global crisis (57th place in 2007-2008.). Further analysis of the individual segments of competitiveness brings to light those areas in which Croatia's shortcomings are most evident. Observations about satisfactory results for individual averages – infrastructure (39th), macroeconomic environment (70th), health and elementary education (48th), higher education and training (56th), technical foundations (38th), and the size of the market as an objective category (72nd) – are followed by areas that are exceptionally important for economic growth and development where the gap to the stated averages is (relatively) more drastic: efficiency of markets and market mechanisms (114th), efficiency of the labor market (116th), development of the financial market (87th), innovation and sophisticated factors of development (82nd), innovativeness (76th), and the complexity and development of business structures (88th) [20, pp. 17-20]. Overall, Croatia's relative decline in the rankings compared to its earlier position can be structurally characterized by a greater lag exactly in those areas that are of particular

importance to the establishment of a dynamic model of economic growth and development.

To verify these results it is worth considering indicators of economic success by using for the same time period the analytical tool of the other research institution, IMD of Lausanne, which includes a narrower circle of countries in its rankings. The Republic of Croatia here is ranked 57th out of a total of 59 countries. Individual pillars of competitiveness were analyzed within four important areas: economic performance, government efficiency, business efficiency, and infrastructure. The weight of the indicators is presented in the Figure 5.

The above average rankings for health and the quality of the environment (37th), education (39th), technical infrastructure (37th), the extremely high ranking for price stability (4th) and productivity and efficiency (35th) were roughly the same. Price stability was ensured primarily by exchange rate policy (imports) and the level of productivity and efficiency by a rapid decline in the rate of employment because of the decline in industrial production and economic activity in general. On the other side of the scale is the degree of employment (57th), efficiency of the labor market (59th), management skills (59th), and the overall state of the national economy (57th).

The analyses of both rankings identify almost identical areas of deficit, outside the range (necessary) for restructuring, which nevertheless have influence as limiting factors for the establishment of a matrix

model of economic growth and development. A logical consequence of those limitations and weaknesses is the absolute and relative position of the Republic of Croatia in the degree of its use (engagement) of the national labor pool (see Figure 6).

Croatia's position in the lower part of the table is considerably closer to that of Bulgaria and Albania than to the positions of the Czech Republic, Slovakia, Poland, or Slovenia. The analysis (M. Porter) was prepared for the period up to 2008; the sudden growth of unemployment in the period since 2009 has undoubtedly created additional problems in this situation and made it absolutely and relatively unsatisfactory.

In the literature and in practice attempts to find partial responses to resolve the specific real limitations that have emerged are well-known. For example, Acemoglu and Robinson emphasize an approach that attempts to create prosperity by the targeted removal of individually established bottlenecks. *"The second approach to engineering prosperity is much more in vogue nowadays. It recognizes that there are no easy fixes for lifting a nation from poverty to prosperity overnight or even in the course of a few decades. Instead, it claims, there are many 'micro-market failures' that can be redressed with good advice, and prosperity will result if policy makers take advantage of these opportunities – which, again, can be achieved with the help and vision of economists and others"* [1, p. 448]. The fact remains that such efforts and attempts can

Figure 5: The competitiveness landscape

Source: Institute for Management Development (IMD). (2012), *IMD World Competitiveness Yearbook 2012, Country Profile: Croatia*, Lausanne, IMD, available at <http://www.imd.ch/wcy>.

partially correct and/or mitigate the causes of the crisis, but they cannot permanently or essentially remove them.

Thus, in the case of Croatia, the stated objective indicators (disturbing because they are always present) prompted international monitoring to an open and indisputable warning. Beginning in the first half of 2011 (the pre-election period), and in coordination with other institutions (the World Bank, the EU Commission), strong pressure and demands for undertaking structural change were continuously present. Thus, the IMF stated:

“1. While the worst of the recession is over, Croatia is yet to see the signs of the sustained recovery.

2. Long-standing challenges are weighing down Croatia’s economic outlook. Medium-term growth prospects are weak due to deep-rooted structural rigidities and competitiveness problems. Meanwhile, vulnerabilities are high. Fiscal deficits and public debt have been rising. High external indebtedness is particularly worrisome given the narrow export base. Large balance sheet exposures to foreign currency risks reinforce the authorities’ preference for a stable exchange rate. At the same time, limited policy space is compromising Croatia’s ability to withstand shocks.

3. What needs to be done? Implementation of a consistent set of macroeconomic, structural, and financial sector policies is urgently needed to ensure sustained growth. To address competitiveness problems, priority needs to be given to structural policies and fiscal consolidation.

- *Structural reforms in the areas of labor markets, public administration, and costs of doing business are required to enable a more flexible wage-setting, improve the business environment, and enhance the private sector’s role in the economy. Croatia’s wage levels, which are high relative to both its income and productivity levels, need downward correction to facilitate an internal adjustment given the stable exchange rate regime.*
- *Fiscal policy should prevent a further rise in the deficit in 2011 by identifying additional spending cuts, and, in the medium term, reverse the rise in the public debt and create policy space for macroeconomic management by pursuing an expenditure-based consolidation“ [4, p. 1].*

Furthermore and immediately within the next 60 days, a warning followed:

Figure 6: Labor force utilization

“17. Orderly unwinding of vulnerabilities and a reversal of Croatia’s brittle fundamentals requires a multi-faceted policy response. Given the stable exchange rate policy, a consistent set of structural, fiscal, monetary and prudential policies are needed for sustained growth and reduced vulnerabilities.

- Reducing external indebtedness of the economy requires policies that enhance competitiveness and growth potential, and lower reliance on debt-financed and domestic absorption-driven growth. This, in turn, requires corrective wage and structural policies that would increase tradable sector’s contribution to growth, enhance economy-wide productivity, and allow financing of external current account deficits through higher non-debt creating flows (FDI).*
- Reducing public sector indebtedness requires reduction of public expenditures to achieve a cyclically-adjusted balanced budget in the medium term.*
- Croatia should also continue to build up reserves to enhance its ability to absorb shocks. Large prudential foreign currency buffers should be maintained to safeguard the stability of the highly-euroized financial sector” [6, p. 10].*

The warning was based on a detailed examination of the segments of the structural weaknesses and limitations within the Croatian economy. Shortcomings emerged among other reasons as a consequence of administrative shortcomings (the overall capacity of the state). They were also determined by the fact that it was an election year, when it could be assumed that the focus of the government and the opposition would be directed at the political arena and voter preferences. The warning was almost identical in substance to the one stated in an EU Commission document (October 2011), a part of which speaks about fulfilling economic criteria for Croatia’s full membership in the EU. *“Croatia’s economy has recently shown signs of a mild expansion following three years of recession which has resulted in higher unemployment, public deficits, and debt. Although the current account deficit has fallen sharply, external debt has continued to increase and remains a key vulnerability of the economy.*

Monetary policy has maintained exchange rate and financial stability. Fiscal policy has, to some extent, contained the negative budgetary consequences of the recession. Further efforts are needed as regards structural reforms, including reforms of the labor market and improvements in the business environment” [5, p. 1].

A continuation of this encouragement of changes, but also a caution that time was of the essence and not just a chronological framework for behavior and events was contained in a short-term warning:

...”(2) With unchanged policies, economic prospects in 2012 and the medium term period are weak. According to the projections of members of the Mission, with existing policies GDP would be reduced by about 1 percent in 2012, reflecting the continued weakness of domestic demand because of debt repayments by enterprises and the overindebtedness of households. The recovery of foreign demand will probably be delayed because the euroarea has gone into recession. This projection has not taken into account the recently announced public investment projects because at this time the timing of their start, the import component, and the effect on growth is not known. Above all, the resources to achieve them would primarily have to come from foreign sources to ensure adequate liquidity for the private sector. In the medium term period weak competitiveness will limit growth in the absence of structural reforms. (author’s emphasis). The growth that rested on domestic demand and was stimulated by a large influx of capital in the years before the crisis is no longer a sustainable option because it is likely that foreign financing will remain subdued. A reorientation of the economy to foreign demand is required to return to the path of sustainable growth.” (author’s emphasis)

...10) Croatia’s results related to exports and growth are limited by relatively high salaries and widespread rigidity. Participation of the labor force is low because of the generous system of social benefits. The labor market is one of the least competitive in the region, while salaries are high in comparison to revenues and productivity. Insufficient progress has been made in

the privatization and restructuring of enterprises, which limits the growth of productivity and the development of the private sector. Because of this, the public sector remains large, with numerous regulations and obligatory and burdensome costs for the private sector. These structural weaknesses have limited Croatian exports and their entry into EU markets; in the last decade they have been among the lowest in European countries with emerging markets.

- 11) Implementation of the long-delayed structural reforms is necessary to improve competitiveness and to achieve sustainable growth in the medium term. First, internal devaluation by means of a reduction of prices and salaries to a competitive level is required in light of the stable foreign exchange regime that would be expensive to adapt because of the large net hard currency exposure of the economy. Second, priority must be given to structural reforms aimed at: (a) increasing the flexibility of the labor market by changing the labor law to create a more competitive environment for salaries and by reducing the cost of employment and dismissals, (b) increasing participation of the labor force by reforming the system of social protection, and (c) reducing the number of people employed in the public sector and increasing efficiency" [7, pp. 1-4].

International standards and agreements conditioned by international monitoring (IMF, World Bank, EU) for the purpose of evaluating the current situation, but even more important, a clear definition on one hand of the cause and on the other hand of the formulated necessary actions for changes, contain in two important factors: structural reforms and raising the level of competitiveness are essential prerequisites for change. Identical requirements can be seen by studying assessments of the new circumstances by important partners in managing national economic policy – global rating agencies.² Thus, Standard & Poor's rating agency, stressed: *"Between 2002 and 2009 Croatia's real GDP growth averaged 4.8%, fueled by foreign-currency credit growth averaging 19% per year. This rapid growth*

encouraged a widening of Croatia's current account deficit to nearly 9% of GDP in 2008, and an increase in external liabilities. By 2010, the current account had narrowed substantially – back an estimated 1.6% of GDP – as credit conditions tightened and import demand fell back sharply in 2009 and 2010. Croatia's rigid monetary regime and high euroization rule out exchange rate depreciation as a natural channel to improve competitiveness and retain macroeconomic stability. (author's emphasis) As a consequence, the onus of macroeconomic adjustment rests on fiscal policies and greater wage flexibility, among others. There is a mismatch between high nominal wage levels and productivity in some sectors, particularly the public. Such mismatches are less evident in the private sector [17, p. 2].

The fact is that the Republic of Croatia, and other transition countries in Central and Eastern Europe, are facing the cumulative consequences of the many years of, first, a lack of awareness of and then the absence of political necessary for economic and general reform as a response primarily to the endogenous and also the cumulative global crisis. With the assumption that this moment of transformation is a consequence of the inevitability that had arrived, then the increase of national competitiveness was clearly determined by the necessary structural reforms: implementation of internal devaluation (an alternative to depreciation of the exchange rate), which also means eases the expenditure side of the national, but also the local and regional budgets. The next area of restructuring is public enterprises, whose monopolistic position means the constant payment of additional expenditures, with a concomitant lower efficiency in providing their (monopolistic) services. It is also clear that reforms of the judiciary and all other aspects of security for the citizenry must also mean that there is a sense of security in the business sector that the resolution of disputes will not last so long that they seem endless and that outcome does not seem arbitrary. Resolving the situation in the land registries, as a further critical prerequisite for legal security, but also for economic efficiency (business transactions, credit collateral) is the next important qualitative factor for raising the level of competitiveness. All of this is necessary, but it is not enough because there must be an awareness that *"By itself,*

² The estimate of the Croatian National Bank (HNB) is that if for any reason there is a drop in the credit rating and an increase of one percent in the interest rate it would be an additional financial burden on GDP of 700 million euros.

a strategy is useless without organizational structures that are capable of implementing it. This applies both to countries and to companies. It is really much easier to devise a well-founded strategy than to create an organization that can efficiently carry out a strategy in a timely fashion" [19, p. 10]. In this context, all of the sources of noncompetitiveness are simpler to understand and then to overcome by using a *best practice* list of requirements "so that reforms occur and succeed," which aggregates the timing and scope of basic principles that create the general prerequisites for a continuing national program of reform and its success:

- *"Governments need to have an electoral mandate for reform.*
- *Effective communication by governments is important.*
- *Policy design should be underpinned by solid research and analysis.*
- *Successful structural reforms take considerable time to implement.*
- *Cohesion of the government is important.*
- *Government leadership is essential.*
- *The condition of the policy regime to be reformed matters.*
- *Successful reform requires persistence"* [13, p. 27].

It is important to add the fact that experience (Economic Policy Recovery, Going for Growth) based on research of several reforms carried out in OECD member states shows that a readiness for reforms and their start, frequently and within an electorate that is demanding changes, does not automatically mean unsatisfactory election results. It is more probable to assume that the electorate values the persuasiveness of the offered package of reforms and the degree of success in achieving it as the basis of their (future) electoral preferences.

Conclusion

Most of the countries of Central and Eastern Europe have faced development limitations in different phases of the transition process. This circle of countries did not possess the competitive advantages that according to classical theories ensure growth, especially when it is a question of resources (the amount of raw materials

with a market value) or an exceptional transportation and/or geopolitical position: from transportation routes to military logistics, where one or the other provides payment of location rents.

Thus, there remains only the possibility of selecting a more difficult course: building one's own competitive advantages at the level of the national economy (see: Austria, Switzerland, the Netherlands, Singapore) and/or attracting global corporations that are again appearing and operating in a globally comparable stimulating economic environment. Choosing this path, increasing the degree of national competitiveness (Porter) is an individual choice and a conscious orientation of each country. It is followed by a demanding process of creating one's own model of development suitable to one's own needs, possibilities, and circumstances. But at the same time, it is also based on general principles: an active labor market, quality education and innovation; an orientation to foreign markets, a consistent legal system, and a consistently high quality of comprehensive public services.

Such a commitment ultimately requires the creation of a national awareness that this will be neither easy nor simple, neither short-term nor spectacular in the speed by which noticeable results will be achieved. It is also the only realistic way to: a) first, stimulate economic growth and b) create the conditions and general environment in which that growth will be sustainable in the long term – so that this model is resistant and adaptable to regional and global crises that are inherent to the globalization environment of today's times. Through the interaction of (selected) political elites and (majority) support from the electorate such achievement are possible. The achievements of the Scandinavian countries – the Nordic model – or of other countries like South Korea, Singapore, and Taiwan – the East Asian model – are a testament to this.

A development policy that links (competitive) interests of the business sector with public interests and ultimate social goals must be known, understood, and achieved. The state is not the same as an enterprise; it cannot be led and managed in the same way as a corporation – achieving immediate goals and thus building its competitiveness over its immediate competition. The state has to create a framework in which the business sector can be successful

and competitive because it will then also fulfill in the best possible way the expectations of its citizens (stakeholders) and satisfy their most vital needs: employment, a standard of living, and social and general security.

How to come up with suitable answers to the questions of how to create efficient institutions and political stability; how to keep public debt under control and to direct it at strengthening infrastructure; how to link (medium-term and long-term) growth to growth of GDP, and how to implement a policy of monetary flexibility that corresponds to the needs of economic growth while simultaneously stimulating the export sector (especially small and open economies) are questions for which finding synchronized answers means being able to achieve fundamental development goals of society, relying on stable and sustainable long-term economic growth that is nevertheless determined by an active competitive position compared to geographically close or more distant competitors. This task and this goal cannot be realized without the creation of a (general national) awareness that in addition to efficient and quality public services, an adequate and coordinated monetary and fiscal policy, and a flexible labor market it will be essential to develop and enhance the innovative potential of the economy, which means successful, reputable universities and research institutes, adequate sources of financing, ties to the business sector in the application of achieved research results or the application of those results achieved elsewhere in the world. For all of this it is necessary to have adequate technological and business support and infrastructure.

The responsibility of political elites to devise, coordinate, and achieve these processes and activities in partnership with the business community, trade unions, and the academic community is exceptional, while at the same time their role in general events is irreplaceable. The analysis and the findings of the work clearly show that growth and development did not spontaneously, or with the passage of time, appear anywhere. An intelligent role for a strong state (management) and not for a large state (dominant ownership) is the greatest divide that distinguishes that countries that act as subjects to

events from those that survive as objects and dependent partners in events a narrower (regional) or broader (global) setting with (several) examples of successful ones serving as warning examples to other (current) ones (Greece) by showing that for a successful return to the phase of their own subjectivities and managing present, and even more importantly, future events the time and effort to achieve this are considerably greater and more complex compared to other countries and societies that began to achieve reforms by paying attention to the fact that timing is also an important (active), and in no way neutral, factor.

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