International Journal of Emerging and Transition Economies
Vol.3, No. 1, 2010, 71-78

ECONOMIC CRITERIA OF CROATIA ACCESSION TO THE EUROPEAN UNION

Anna Erdmańska*

ABSTRACT

The paper focuses on the economic criteria for the EU enlargement and Croatia's present economic situation stated in The Croatia 2009 Progress Report. Additionally, it defines reasons for Croatia delay in becoming the EU member state.

Keywords: *Regional Economic Integration, the European Union Enlargement, Croatia*

ECONOMIC CRITERIA OF CROATIA ACCESSION TO THE EUROPEAN UNION

The latest round of the European Union enlargement took place at the beginning of 2007, when Bulgaria and Romania became the twenty-sixth and twenty-seventh member states. Currently there are three candidate countries: Croatia, The former Yugoslav Republic of Macedonia and Turkey. There are five Balkan countries with potential candidate status: Albania, Bosnia and Herzegovina, Montenegro, Serbia and Kosovo. This paper focuses on the economic criteria for the EU enlargement and Croatia's present economic situation stated in The Croatia 2009 Progress Report, which was published in October 2009 by the Commission of The European Communities. It also aims to define reasons for Croatia delay in becoming the EU member state.

In the past, up to 1990s, Croatia was a part of the former Yugoslav federation which consisted of the following republics: Croatia, Slovenia, Bosnia and Herzegovina, Serbia and Macedonia. None of these countries had a typical socialist economy. The first two represented most developed part. At the beginning of 1990s, when the Yugoslav system collapsed, all of the five republics faced transitional processes.

Croatia was one of the best positioned out of five countries. Its economy represented relatively high income per capita, economic broad-mindedness as well as well qualified labour force. Additionally, Croatia's

---

* University of Gdansk, Sopot, Poland, E-mail: slawistka5@wp.pl

markets for goods and services were fairly advanced. Hence they were subject only to minor intervention. All of the above mentioned facts contribute to an implication that Croatia had favourable conditions for smooth transition to a fully market-oriented economy. Nonetheless, the country's complimentary situation was destroyed by the subsequent political events, mainly war operations. It is significant to highlight that not only majority of initiated processes, such as privatization, were postponed but also a number of new issues arose due to serious damages of infrastructure and accommodation facilities (Lejour, 2008).

Croatian aspiration to join the EU was postponed for relatively long period due to political criteria and issues with the International Criminal Tribunal for the former Yugoslavia (ICTY) in The Hague. In 2001 there was the first official document signed between the country and the EU. This was The Stabilisation and Association Agreement prepared for South-Eastern European states (Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Serbia and Montenegro). In June 2004 Croatia was granted the status of candidate country. During the period between 1990 and 2004 the country substantially proceeded with numbers of Macroeconomic and Structural Reforms such as economic freedom, size of government, freedom to trade. The only field of reforms with a negative change in 2004 was legal system and property rights (Figure 1).

In February 2005 The Stabilisation and Accession Agreement entered into force. Accession negotiations were opened in October, the same year. According to a roadmap proposed in 2005 by the Commission for accession strategy, provided fulfilling all the necessary conditions, Croatia should have become a member of the EU by the end of 2009. Although it is commonly known that the initial plan has already not been achieved, the most recent Croatia 2009 Progress Report assesses Croatian progress against the roadmap in a very affirmative way. Main reason for Croatia still holding a candidate status is of political nature. It is the border issue between Slovenia and Croatia that held back the accession negotiations so strongly that a substantial number of chapters could not be finalised until October 2009[1].

The Commission examines economic development in Croatia on the bases of The European Council in Copenhagen conclusions from June 1993. They state that a candidate country may become the EU member if it has existing market economy and if it is able to cope with competitive pressure and market forces within the Union.

---

[1] The most problematic areas that have not progressed in line with the roadmap are: *the judiciary and fundamental rights and competition* - have not been opened yet; transport – has not been closed yet.

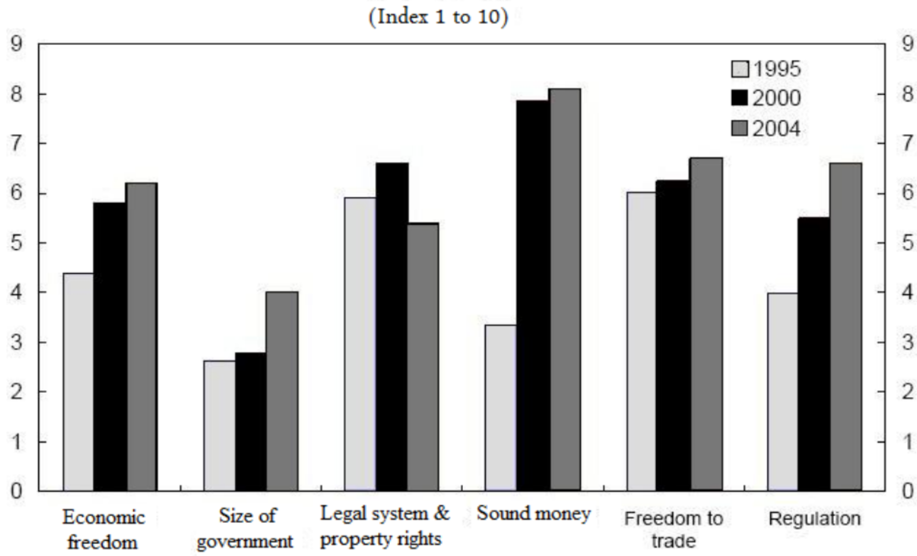

Figure 1: Croatia's Macroeconomic and Structural Reforms
Source: Moore & Vamvakidis, 2007

As far as macroeconomic stability is concerned, Croatian situation has significantly changed due to the global financial and economic crisis. It started to affect the Croatian economy at the end of 2008. In the last quarter of this year GDP growth substantially decreased to 0.2% year-on-year. Moreover, for the whole 2008 year, GDP growth dropped to 2.4% from 5.5% in 2007 (Table 1).

Table 1: Basic Macroeconomic Indicators for the Croatian Economy in 2007-2009

	2007	2008	2008	2009		
			q4	q1	q2	q3
GDP, current prices (mil. HRK)	314 223	342 159	82 753	77 867	84 627	-
GDP, real growth rates	5.5	2.4	0.2	-6.7	-6.3	-
Total volume of industrial production, growth rate as %	4.9	1.2	-1.7	-10.9	-9.4	-9.0

Source: Koršlović, 2009

In order to give an appropriate view of Croatia main economy indicator, it is worth to compare real GDP growth rate of the country to other countries with candidate status (Former Yugoslav Republic of Macedonia, Turkey) as well as new European Union members (Romania, Bulgaria) (Table 2).

In comparison to Former Yugoslav Republic of Macedonia Croatia GDP decreased significantly more. In Macedonia real GDP growth rate decreased from 5.9% in 2007 to 4.9% in 2008. However, another candidate country, Turkey had considerably worse GDP result than Croatia. Turkish GDP dropped from 4.7% in 2007 to 0.9% in 2008.

Table 2: Real GDP Growth Rate in 2006-2008 for Croatia, New EU Members and Candidate Countries

	2006	2007	2008
Bulgaria	6.3	6.2	6.0
Romania	7.9	6.3	7.3
Croatia	4.7	5.5	2.4
Former Yugoslav Republic of Macedonia	4.0	5.9	4.9
Turkey	6.9	4.7	0.9
European Union (27 countries)	3.2	2.9	0.8

Source: Eurostat

When comparing Croatia's real GDP growth rate to the one of the EU new members' different trend can be seen. Described economic indicator increased for Romania (from 6.3% to 7.3% in 2008). Simultaneously it dropped for Bulgaria (from 6.2 to 6.0 in 2008), however the difference is much lower than for Croatian GDP.

The same, decreasing trend indicates Croatian private and public consumption growth as well as the growth of exports (it declined from 4.3% in 2007 to 1.7% in 2008) and imports (it dropped from 6.5% in 2007 to 3.6% in 2008). Economic situation continued to suffer in 2009 (real GDP decreased by 6.5% year-on-year). A positive syndrome represents average per-capita income, which rose in 2008 to 63% of the EU-27 average, from 61.1% in 2007. Due to lower domestic demand the current account deficit has been declining in 2009 (Croatia 2009 Progress Report). Net capital flow was unstable during 2008. There was an increase in the inflows during the first three quarters in the year. Whereas in the last quarter the trend changed. In general, with the result 11.6% of GDP, net capital flows were still higher than 2007 figure.

Net FDI, despite of a significant decrease from 8.7% of GDP in the first half of 2008 to 3.9% of GDP in the first half of 2009, remained main source of foreign financing. It covered about 33% of the current account deficit in comparison to 45% in 2008.

Unemployment rate in Croatia significantly increased in 2009 in comparison to 2008. At the end of 2008 there were 13.5% citizens unemployed, whereas at the end of third quarter in 2009 the percentage increased to 14.7% (Table 3). According to the Commission, Croatian labour market performance deteriorated as a result of the crisis and there are still major structural weaknesses.

Table 3: Unemployment in Croatia in 2007-2009

	2007	**2008**	**2008**	**2009**		
			q4	q1	Q2	q3
Unemployed persons, end of period	254 484	240 455	240 455	267 244	247 147	259 193
Unemployment rate, end of period	14.4	13.5	13.5	15.0	14.0	14.7

Source: Kršlović, 2009

As far as monetary and foreign exchange system is concerned, the central bank intervened twice in 2009 by selling euros for a total amount of around EUR513 million. To mitigate appreciation pressures the central bank bought euros back in a third intervention. Official foreign reserves started to decline in the second half of 2008. The average daily EUR/HRK exchange rate fluctuated between 7.11 and 7.49 kuna per euro. It decreased by 3.1% between October 2008 and mid-September 2009. The Commission assessed Croatia monetary policy as successful in relieving external financing pressures and contributing to preserving stability.

Domestic credits to private sector decreased from around 15% in 2007 to 4.3% in July 2009. Because of lower and more costly access to foreign capital, Croatian companies became more interested in domestic sources of financing. The structure of outstanding credit has changed significantly as a result of a substantial incline in government borrowing since December 2008.

Describing main indices of Croatian economy, it is important to analyse average annual inflation. It inclined to 6.2% in 2008 from 2.9% in 2007. According to the Commission the main reasons for this significant change are increases in oil and food prices in the first seven months of 2008 as well as large carry-over effects from 2007.

At the end of 2008 annual inflation amounted to 2.8%. During the first quarter of 2009 inflation increased to 3.8%, mainly due to adjustments in regulated gas prices, an incline in excise duties on tobacco and a seasonal increase in vegetable prices. In August, the inflation dropped to 1.4%.

In 2008 the general government deficit was maintained at 1.4% of GDP level. Nonetheless in May, 2009 government was forced to incline domestic borrowing by issuing EUR750 million government Eurobonds. A worsening economic situation and deteriorating fiscal trends implicated numerous budget revisions. In April government froze wages for civil servants and public employees. In July spending was significantly cut, a special tax on income was introduced; VAT was increased by one percentage point. Despite all the above mentioned steps taken, in 2009 the revised planned general government deficit increased to 3.3% of GDP. Overall, the government efforts to re-balance the budget came to late and the fiscal deficit increased substantially.

Limited progress in public spending is the only one from economic criteria highlighted by the Commission as a negative factor. As the key Accession Partnership priority, it should have been more successful. According to the Commission no significant reforms have been undertaken in order to improve social support. Social spending still consists mainly of categorical benefits. The mandatory pension system has not been improved so far. The only positive facts about public spending are numerous reforms of initial health care.

As far as market forces are concerned, the privatization process did not progressed significantly. The Commission mentions only one major transaction which was the sale of additional assets of the national oil company to a foreign investor. Since June 2009, around 103 companies' shares have been published or liquidated. Only 4 firms were sold. Potential investors were not interested in other companies. Moreover, some offers were based on rather unrealistic sale conditions. Currently there are 835 companies in which the State remains major shareholder. 70% of people employed works in the public sector. The private sector contributes to around 70-80% of GDP.

Croatia government managed to improve company registration procedures. There was on-line registration introduced for limited liability companies. However, in 2008 there were less newly registered companies than in 2007. The conditions for entrepreneurs are still unfavourable due to difficulties in obtaining necessary licenses, other authorizations such as building permits as well as due to relatively high taxes. Croatia still experiences problems with corruption[2].

Financial sector in Croatia is dominated by private and foreign-owned banks. According to the Commission it remained resilient to shocks. However, it is still vulnerable because of largely un-hedged balances of the non-financial private sector. Share and bond markets suffered from outbreak of the crisis. The stock market index decreased by 70% in 2008. What is more, market capitalization on the Zagreb stock exchange dropped from 128% to 42% of GDP. For bonds market the situation worsened more significantly. In 2008, it registered the lowest turnover since 2003. Bonds market capitalization decreased from 15% to 10% of GDP. The situation of financial sector in Croatia is typical for other European countries. This fact is highlighted by European Commission in the Croatia 2009 Progress Report.

In general, the Commission assesses most recent Croatian macroeconomic policy as an appropriate to address the global economic and financial crisis domestic syndromes. Monetary policy was successful in maintaining financial stability. However, more immediate and comprehensive fiscal response would be more beneficial for the economy. A key challenge for Croatian government remains creating more responsive fiscal strategy and more efficient public spending.

The Commission highlights the fact that Croatia is an open economy with 92% of GDP represented by total trade in goods and services. Tourism created 20% of GDP in 2008 and represented the biggest source of export revenue. The trade and investment integration with the EU represented high level. The EU, by sharing 61% of Croatian export and 64% of import, is the largest trading partner for the former Yugoslav republic. In 2009 this proportion slightly declined as trade with other countries decreased more slowly than the trade with the EU. As far as foreign direct investment structure is concerned, 93% of it was contributed by the EU Member States.

During Croatia accession process the EU additionally provides financial assistance under the new Instrument for Pre-accession Assistance (IPA). IPA programmes amounted to EUR151 million in 2009 and they focused on democratization, human rights, refugee return, cross border cooperation as well as intervention against financial crisis.

Overall, Croatia has made good progress on its way to the EU so far. Additionally, the political and economic dialogue between the EU and the candidate country has continued by meetings held in Luxembourg and Brussels in 2009. As significant steps made, the Commission mentions:

---

[2] In the year 2009 Croatia has improved in the Transparency International corruption perceptions index by reaching 4.1 level (in comparison to 4.4 in 2008). It took 66th place among 180 countries.

improvements in shipbuilding sector, the elimination of the discriminatory taxation of cigarettes as well as entitlement for EU nationals to real estate ownership under the same conditions as Croatian nationals (The World Bank, 2008). As far as economic criteria are concerned, the candidate country must focus on pension system reform, more responsive monetary policy as well as privatization process.

REFERENCES

Berlett, W. (2002). The EU-Croatia Stabilisation and Association Agreement: A Stepping Stone to Membership or Semi-Permanent Satellisation?, Marne-la-Valle University.

Commission of the European Communities. (2009, October 14). Croatia 2009 Progress Report. Enlargement Strategy and Main Challenges, p. 1-6, 18-27. Retrieved November 16, 2009 from the World Wide Web: http://ec.europa.eu/enlargement/pdf/key_documents/2009/hr_rapport_2009_en.pdf.

Eurostat. Tables, graphs and maps. Retrieved February 10, 2010 from the World Wide Web: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab= table&init=1&plugin=1&language=en&pcode=tsieb020.

Hrvatska gospodarska komora. (2006) Kretanja u hrvatskom gospodarstvu u 2006. Zagreb

Kršlović, S. (Ed.). (2009). Ministry of Finance Monthly Statistical Review – Number 167. Retrieved December 11, 2009 from the World Wide Web: http://www.mfin.hr/adminmax/docs/Statistika_engleski_167.pdf.

Lejour, A., Mervar, A., & Verwelj, G. (2008, 3 March). The Economic Effects of Croatia's Accession to the EU. Economics Discussion Papers, 3-5, 7, 10-17. Retrieved November 16, 2009 from the World Wide Web: http://www.eizg.hr/AdminLite/FCKeditor/UserFiles/File/radni%20 materijali%20EIZ-a%20-%20working%20papers%20-%200705.pdf.

Moore, D., & Vamvakidis, A. (2007). Economic Growth in Croatia: Potential and Constraints. IMF Working Paper, Retrieved November 16, 2009 from the World Wide Web:http://imf.org/external/pubs/ft/wp/2007/ wp07198.pdf.

The World Bank. (2008, October). EU10 Regular Economic Report. Croatia Suplement. Retrieved October 10, 2009 from the World Wide Web: http://siteresources.worldbank.org/INTECA/Resources/257896-1213784527782/EU10_Main_Report_19_Feb-FINAL.pdf.