

---

## Economic Interpolation of Croatia into the European Integrational Policy

---

LUKA BRKIĆ

Faculty of Political Science in Zagreb  
Assistant Professor of Contemporary Economies and  
International Economic Relations

### *Summary*

The author analyses various aspects of the co-operation between Croatia and the European Union, showing that the linkage with this group, from the functional integration to the institutional admittance, is the prerequisite for economic restructuring. The author points to the incompetence of the exporting sector as a constant in Croatian economy and the main obstacle for more profitable exports. This is primarily due to the low quality and a meagre competitive edge.

The conclusion is that Croatia is yet to come up with the economic and social interpretation of its position within the European integrational policy, compatible with its new position as an independent and sovereign state.

The strategy of economic relations of Croatia with foreign countries must be given credit to for its political openness towards the outside world. The openness of economy is a concept which, though including both, transcends not only the phenomenon of the so called liberalisation of imports, but the so called export orientation as well. Central to this is the opening of economic subjects and economy in general to the influences of the more effective foreign economic subjects by means of the mechanisms of international competition abroad and at home. The results are an increase in the competitiveness of economic subjects, the creation of new, more efficient economic subjects, and the concurrent shaking off of the incompetent ones through the process of "creative destruction".

It is this very resistance of the structure of Croatian economic subjects to the procedures accompanying the entrance and the exit of the "economically defunct" that is one of the main weaknesses of the transitional countries (including Croatia) that do not sufficiently value the competitive potential of economic subjects as a constituent element of an efficient economy.

At the corporate level, the findings of the analysis (Radošević, 1994) point to the under-development of the strategic approach to management,

the consequence of which is that the latest global and operational trends are not implemented, particularly the changes regarding the emergence of new technologies. Added to this is the fact that Croatia, on gaining independence, inherited the corporate structure atypical for the small countries where an overwhelming majority of companies is small (e.g. Denmark) or in which there is a balance between several big companies and numerous middling and small offshoot firms (e.g. Sweden). Big, domestic-market-oriented companies with a high degree of sluggishness predominate in Croatia, and in that respect this structure is typically socialist (Radošević, 1994, p. 24).

### *Foreign trade competitiveness of Croatia*

Croatia belongs to the group of semi-developed countries whose gross domestic product per capita has reached \$3,000. In 1990, prior to the disintegration of Yugoslavia and the war destruction, Croatia exported abroad and into the other republics of the former Yugoslavia about 80% of its national output. In the structure of its economic trade with foreign countries, a special place belongs to the export of services (tourism and transport) and the transfers from abroad (remittances from workers and emigrants).

Croatia's share in the most important export markets (German and Italian) is meagre (1.05% or 4% of their total exports), but in comparison with other developing countries its position is remarkably better. The average price which Croatian export goods achieve at the German market is 12% lower than the average world price (in the case of Italy it is 15%). These price differences are a reflection of the differences in the non-price factors of competitiveness — marketing, quality of goods, product service content, etc. (Radošević, Cimeša, Lenardić, 1993, p. 695).

The balance of commodity and service trade with the convertible currency market is illustrative of the characteristics of Croatia's trade with the world: the commodity trade deficit is compensated with the service trade surplus. The before-the-war service trade surplus was about 1.5 billion USD, mostly owing to the export of tourist services. The commodity trade, on the other hand, registered a permanent deficit of 750 million USD on the average. Furthermore, the Croatian export structure shows that these are the goods without a significant growth of export demand, i.e. those goods that in the structure of world trade growth represent stagnant types of production or those whose growth does not exceed that of the average growth of world trade. An increase in their exports is possible solely at the expense of the third countries, which means through a competitive struggle. The biggest Croatian net exports are: textiles, ships, wood and lumber and shoes (Radošević, Cimeša, Lenardić, 1993, p. 695).

The biggest employment-generating industries in Croatia are: the manufacture of textile goods and the production of food (10% of industrial workforce), metal-working industry (9%), machine construction (7%) and final products from wood (6%).

The industries with the biggest contribution to the Croatian national product are not those that make up the biggest share of imports. Despite the doubling of imports of equipment from 50 million USD a month in 1990 to 100 million in early 1996, the real value of the investments during that period diminished for almost 90 percent, which is a definite indicator of the decrease of investments in the country, reflected in the technological obsolescence of production capacities and a drop in their competitiveness at the world and even — in the circumstances of the liberalisation of imports and the appreciation of the rate of exchange — at the domestic market. At the same time, this has magnified the adverse effects of the problem of exporting Croatian equipment, whose production is, on the average, 56% lower than in 1990 (in machine construction industry even 73%) and represents the industrial sector with the most pronounced drop in production (the drop for the production of primary materials and manufacturing components is 40%, in the production of consumer goods 41%) (Rohatinski, 1996, p. 456).

The industries with the biggest contribution to the Croatian national product are not those that make up the biggest share of imports with the exception of final textile goods. The production of foodstuffs, with the biggest share in the national output of the Croatian industry and mining, is an industry with a high foreign trade deficit. The manufacture of electrical machines and appliances, metal manufacturing industry and processing of chemical products are the industries that found themselves in dire straits upon losing the clearing-payments market, and are faced with serious problems in exporting to western markets (Radošević, Cimeša, Lenardić, 1993, p. 696).

An analysis of this brief foreign trade statistics leads us to the conclusion that there is a constant incompetence of the exporting sector in Croatian economy since the most important exporting products come from old industries, while in the industries which have no problems with import demands, the main limitations are the high cost of entering the market (the cost of product development and marketing) and the quality of Croatian products. On the other hand, in the industries where we possess certain comparable advantages (textiles, lumber, ships) there is a limited demand and the basic progress can be achieved solely through increasing the market share." (Radošević, Cimeša, Lenardić, 1993, p. 695).

### *Croatian economy and European integrations*

The trade relations between Croatia and the European Union were, until 1992, regulated by the 1980 Agreement on the Co-operation between the European Union and the former Yugoslavia (the so called *sui generis* agreement). It provided for the former state's certain non-reciprocal trade benefits which were more favourable than the benefits which it could have secured through a preferential scheme which the EU grants to developing countries. The application of these preferentials did not exclude the preferentials envisaged by the General preferential scheme but excluded the possibility of accumulating the benefits on both grounds.

This Agreement provides for a general liberalisation of importing manufactured and primary commodities, i.e. without customs duties, quantitative or similar restrictions, with a significant deviation from this principle for the so called "sensitive" products. For agricultural products the Union stipulated the regulations providing strong import protection within the framework of the common agricultural policy. There were exceptions to this restrictive regime for a certain number of special-quality agricultural products for which mechanisms for a gradual lowering of the tariffs together with quantitative reductions were set. The regime of imports for textile goods was based on the principle of self-imposed quotas on the part of the exporting country, within the framework of MFA — Multi-Fibre Agreement.

At the end of 1991, European Union suspended the Agreement with the former Yugoslavia, while in 1992 and 1993 it unilaterally decided to set trade benefits only for the co-operative republics of the former Yugoslavia. These regulations are essentially derived from the mentioned agreement on the co-operation between the EU and Yugoslavia, regarding both the status of preferential commodities and the quota setting.

The imports of Croatian products, which are not subject to the special regimes stipulated by the regulations, is not quantitatively restricted and is exempt from customs duty and similar tariffs. The goods which EU deems "sensitive" are imported duty-free or with lowered customs duties only up to certain quantities (ceilings, quotas, contingents).

The imports to the Union are duty-free up to the annual ceiling, and after that the Union can impose tariffs which are valid for the third countries and introduce a series of restrictions such as: the *a priori* restrictions (customs tickets), the maximum quotas and ceilings, the safeguard clauses which enable the suspension of preferential schemes when the prices or the quantities jeopardise domestic production of the same commodities, the specific exclusion of certain commodities or countries, the convoluted regulations regarding the origin of the product, the voluntary export restriction clause, the surge clause in cases of "sudden and poten-

tially harmful” import increase, the penalty tariff, grey zones, antidumping measures, etc.

Several regimes were envisaged for the import of agricultural products, depending on the segment of the EU agricultural policy. For certain agricultural products there are explicit concessions, while all the unspecified products are saddled with the tariffs valid for the third countries. For some products which are in turn products of processing agricultural produce there are reduced, i.e. preferential tariffs and variables (MOB) (this refers to the products such as: fruit yoghurt, sweet corn, pasta, specified types of chocolate, yeast, ice-cream, etc.). For the other group of agricultural produce, listed in a supplement, the custom duties are gradually reduced to 0% over the course of several years, but the quotas often remain the same.

Structure of Croatian exports into the EU countries according to Commodity Sections SITC in percentages

<b>Sections according to Standard international trade classification (SITC)</b>	<b>1990</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>
Foodstuffs	11.39	7.43	6.73	4.61	3.78	3.37
Drinks and tobacco	0.59	0.55	0.41	0.82	0.47	0.78
Raw materials (except fuel)	10.49	6.84	8.45	7.65	6.33	7.09
Mineral fuel and lubricants	9.01	8.52	5.26	7.64	6.39	5.99
Animal and vegetable oils and fats	0.05	0.03	0.03	0.03	0.11	0.03
Chemical products	9.50	0.96	8.34	12.75	9.71	17.81
Commodities classified according to the materials	27.00	14.78	12.27	12.68	15.02	13.58
Machinery and transport equipment	12.74	10.50	18.94	10.37	16.00	12.01
Miscellaneous finished products	19.02	41.33	34.25	43.32	42.12	39.30
Unclassified	0.21	0.06	0.32	0.13	0.07	0.04
<b>Total</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: Karaman-Aksentijević, Kopal, 1997, p. 428.

Although a significant number of manufactured goods is not quantitatively restricted and is duty-free when imported into the EU, there is still a number of products on the list of sensitive commodities, mostly those

that make up the biggest portion of Croatia's exports to the Union (eg. textile goods, leather clothing, shoes, furniture, cables, ferroalloys, petroleum products, etc.). Moreover, not only is the number of the quota commodities rather high in relation to the production structure, but some of these quotas are very low (for some timber products, leather goods, textiles, etc.). If we add to all this that the structure and the level of the quota systems are based in part on the manufacturing and the import structure of the former state, then it becomes clear that every disturbance in that preferential regime has a very inauspicious impact on Croatian exports into the European Union.

This review of the structure of Croatian exports into the EU countries clearly shows a high share of resource- and labour-intensive products and a low share of knowledge-intensive products. The OECD expert study (De Jong, Zalm, 1992) clearly shows that the transitional countries of central Europe import products of marked differentiation (equipment and technology) as well as those based on scientific advancement, and they export resource- and labour-intensive goods, and some commodities for which volume economy is essential. The analysis of individual commodity groups clearly shows that the Croatian export goods rarely occupy a more significant share in the import matrix of the EU countries; more considerable market shares are occupied by products which are exportingly less important for those countries. Besides, as a rule, the unit price of certain exporting commodity groups is below the level of average prices of these products on those markets. In the commodity structure of Croatian exports there are too many technically and technologically inferior goods and services — the first step towards exclusion from the European integrational processes and, consequently, from the contemporary international developments.

The studies (Nigel, 1982, Davidson, 1982) have showed that prices are a far more significant factor of competitiveness at the lower per capita income markets (the so called "price markets") than at the markets of developed countries. Since premium is placed on product quality, these markets are frequently dubbed "quality markets".

The global competition has emphasised the question of complex efficiency of the entire production system of this economic domain, or even the country as a whole. The international globalization of markets gives more prominence to the issue of capacities and service quality. All this points to the pre-eminence of the cultural dimension of the new technological revolution which will broaden the gap between the developed and the undeveloped world.

The prices of the Croatian commodities offered to the EU buyers are low, but still uncompetitive due to the non-price characteristics of the commodities and supply. The low level of competitiveness of many Croatian commodities, particularly regarding the final stages of product finalisation, are a consequence of slow progress and often of stagnation, even

deterioration, of the total of non-price performances which accompany these products. This lends itself to the conclusion that Croatia increases its exports and participates in the EU markets primarily by means of competitive prices and less by means of improving the technical and technological standards and the quality of commodities and services.

### *From asymmetrical privileges to (associate) EU membership*

The analysis of numerous aspects of the economic relations between Croatia and the European Unions shows that the links with this group of countries, from the functional integration to the institutional admittance are the condition for the realisation of economic reform in Croatia. And finally, all this leads to the conclusion that — despite certain critical connotations in the account of the EU trade regime towards Croatia — the relationship in which the EU is to grant Croatia certain asymmetrical privileges in the trade and customs regime will suit us.

A bilateral agreement on co-operation would probably eliminate certain incongruous solutions which would also mark the commencement of the negotiations about Croatia's associate membership as a stage on the way to eventual full membership in the European Union. There is a more than illustrative example in the form of the Agreement with Slovenia. This Agreement became effective as of September 2, 1993 (together with the Protocol on financial co-operation of EU and Slovenia, while the Agreement on co-operation in traffic and transport became effective on July 29, 1993). This meant that Slovenia's way to a "European agreement" — an agreement on the association with the European Union — was paved.

The EU Council is of the opinion that Slovenia is speedily fulfilling the requirements set for the potential member-countries by the Edinburgh EC Summit of December 1992. The Agreement explicitly promotes the growth of small- and middle-sized enterprises. Slovenia will mostly profit in the area of small business, but also in the general modernisation of industry, transfer of technology and foreign investment. Since Croatia's aim is to join various forms of integrations and finally the European Union itself, Slovenian success is as encouraging as is symptomatic and significant.

The analysis of many aspects of the co-operation of Croatia and the European Union shows that forging links with this group, from the functional integration to the institutional admittance, is a prerequisite of the realization of economic restructuring.

Croatia's main EU partners absorbed in 1985 a quarter of Croatia's exports and delivered a third of its imports. Ten years later, in 1995, the same economies absorbed 55% of the exports and delivered 57% of the imports (Družić, 1997, p. 62).

The imports share from Croatia in the total EU imports is on the increase, but despite this, Croatia's position at the member-countries' market is marginal. Croatia's imports from the EU countries (including OECD countries) grows more slowly than the total exports of these countries so that Croatia's share in these countries' total exports is on the decrease. This does not mean that there has been some structural change in the substitution of the imports with domestic production. This is a consequence of the decline of Croatian economic activity and, consequently, the import demand of Croatian economy.

The analysis of the market shares shows that it is very difficult to find for Croatia a heftier market share in the import matrix of the EU (or OECD) countries. Croatia holds bigger market shares with minor commodities in the total exports of these countries. In the structure of Croatian exports into the EU countries there is a high share of resource- and labour-intensive products. As a rule, the unit prices of certain exporting commodity groups are below the level of the average prices of these products on those markets. The final stage commodities are generally more expensive in Croatia than in the EU countries, a consequence of the system blockade: in Croatia the higher-order production factors (organisation, entrepreneurship, rational state, etc.) as yet do not have appropriate place and importance.

Though the EU import policy has envisaged defensive protective mechanisms, the suggestion that the EU discriminatory policy is the sole determiner of the structure and dynamics of Croatian exports is untenable. The key limitation and obstacle to a more efficient Croatian export is the deteriorated export structure, primarily regarding the low level of quality and competitiveness.

The integrational processes within the EU pose new demands regarding the quality of imported commodities and services. Croatia's economy has not done enough on the microeconomic level to adjust its production to these new demands. At the economic level, the homogenised rules of competition significantly narrow the classical concept of the economic sovereignty of states (nations) by giving precedence to the sovereignty of enterprises and business systems, within the framework of the domination of functional forms of integration internationally, regionally and nationally.

A comparison of Croatian imports, exports and production with those of the European market economies shows that Croatia still employs something that could be conditionally called a non-European model of development policy from the point of view of efficiency, potential for structural adjustments and participation in functional integrations. Namely, some countries, members of the regional integrations, the membership in which Croatia covets, are leading a policy of opening to the world; they have increased the physical volume of exports and imports at a rate higher than the rate of growth of domestic production; their exports have increased at a higher rate than the imports. Without exporting, there is no

economic growth: exporting commodities, transport, infrastructure, tourism. Since we have lost a significant portion of the market which we need for exporting, we have to find a new one. We have CEFTA. In order to enter this market, we must be competitive. Macroeconomic policy must take this into account, i.e. it must be understood as a preparation for the regional integrations, and the CEFTA and the European Union (Zdunić, 1997, p. 416).

Based on the results of the analysis which showed that Croatia is "a price taker" and "a rule taker" and a marginal competitor at the EU markets, we are in favour of the approach which regards export as a development resource. From that angle, "the problems of uncompetitiveness of Croatian exporters do not exclusively stem from the technical unsophistication of Croatian products (i.e. from the problems of the Schumpeterian adjustment) ... This does not require big investments but it does require the quality of the human factor i.e. the so called "invisible investments (non-physical)" which are financed from the current expenditure and which are a bottleneck of development. In short, due to the marginal market position, the demand is not the central problem, so the most favourable middle-term prospects are for the so called Keynesian adjustment (i.e. the adjustments by means of stimulating domestic or meeting the increasing foreign demand)." (Radošević, 1994, p. 53).

The theories of international trade are based on the principles of the theory of comparative advantages; whether the curve of the production potentials is determined by the differences in technologies (Riccardo) or by the supply level of production factors (Heckscher-Ohlin), they do not suffice to explain the realities of international trade. Even Vernon's theory of the foreign policy impulse, which best explains the realities of the role of companies on the market and in the international division of labour, nevertheless keeps companies and their products within the aggregate curve of national economies' supply.

Contemporary development rests on the creative individual since the circumstances require program adaptability, organisational flexibility and resource mobility. In the coming years, those protagonists of development that rely on the principles and mechanisms conducive to rigidity, fragmentation and the stasis of political, social and developmental trends will be eliminated.

All this points to the conclusion that Croatia is yet to come up with a comprehensive plan as to how to adapt both economy and society to the changes brought about by the European integrational processes as well as by its new status of an independent and sovereign state. Croatia has to create an economic and political system compatible with European systems, which will at the same time be the basis for the articulation of internal relations, modelled after the European examples. In order to regain our proper place, we have to restore our European traditions in science and education and develop the European way of thinking.

### References

- Davidson, H. W. (1982), *Global Strategic Management*, A Roland Press Publication, John Wiley and Sons Inc.
- De Jong, A., Zaim, G. (1992), Scaring the Future: A Long Scenario Study of the World Economy 1990—2015, in *Long-term Prospects for the World Economy*, OECD, Paris
- Družić, I. (1997), Hrvatsko gospodarstvo i svjetski trgovinski blokovi, *Ekonomska misao i praksa*, VI, 1
- Karaman-Aksentijević, N., Kopal, M. (1997), Izvozna usmjerenost Hrvatske i Europska unija, *Ekonomski pregled*, 48, 7—8
- Nigel, P., (1982), *Export Strategy: Markets and Competition*, George Allen and Unwin, London
- Nikić, G., (1994) Vanjskoekonomski položaj postsocijalističkih europskih država, *Ekonomski pregled*, 45, 3—4
- Radošević, D., Cimeša, M., Lenardić, M. (1993), Konkurentske sposobnosti hrvatskog gospodarstva, *Ekonomski pregled*, 44, 11—12
- Radošević, S. (1994), *Konkurentski izazov Hrvatske*, Zagreb
- Rohatinski, Ž. (1996), Pet godina poslije, *Ekonomski pregled*, 47, 7—8
- Zdunić, S. (1997), Ekonomski suverenitet i integracijski procesi, *Ekonomski pregled*, 48, 7—8