ABSTRACT Research has shown that foreign direct investments benefit the economic development of a host country. However, numerous examples of an inadequate investment structure point to the possible damages for an economic, as well as socio-political development of a country. The purpose of this paper is to looks into the structure of total foreign direct investments realised in the Republic of Croatia and, by using scientific methods, analyse the importance and the effect of foreign direct investments on the Croatian economy. Through following world’s the best practice, the paper offers a comparative analysis of the Republic of Croatia and the countries of the region, with the purpose of identifying the institutional obstacles for investment and producing a detailed SWOT analysis of the Republic of Croatia as an investment destination. Despite numerous existing conventions and protocols, a desired degree of adjustment to international conventions has not yet been achieved, which hinders investment. The Government should create a protection mechanism in order to keep the investors in the times of crisis, as well as policy of attracting the strategically oriented investments that will facilitate long-term economic growth. The first method through which it is possible to define a strategy of attracting strategically oriented investments into the economy, is the qualitative identification of the Republic of Croatia as an investment destination through SWOT analysis.

KEYWORDS: unfavourable investment structure, SWOT analysis of Croatia, competitiveness of Croatian economy, economic growth, strategy for attracting investments.

1. INTRODUCTION

Developing countries achieve faster economic growth by generating and stimulating foreign direct investments (FDI) into the economy. Economic experts have proven that precisely FDIs are the most useful form of saving, as they represent: transfer of knowledge and technology, increase in productivity, and fresh forms of capital flows that are more stable than all the other forms. According to data provided by the Croatian National Bank, in the period between 1993 to 2009, there has been an inflow of 24 billion € of foreign direct investments, which places Croatia in the top five transition countries of the “New” Europe (including twelve new EU member states), based on the amount of “per capita” investments. However, as Croatia does not have a defined strategy for attracting foreign investments, the structure of realised investment has been unbalanced, hence the least amount of foreign direct invest-
ments has gone into “Greenfield Investments”, and these are the ones that stimulate employment and generate higher economic growth.\(^1\) Furthermore, many expert and scientific studies document various scientific benefits of foreign direct investments, such as: opening of new job positions, increased integration through connecting into the multinational foreign owner system, increased competition (which causes pressure to make the economy more effective), exploiting the comparative advantages of the local economy through the economies of scale, creating profit on behalf of the multinational companies that end up being taxed by the host country, improving the balance of payment, etc. Research of economic development and growth from the 1980s and the 1990s show that quick growth has, among other things, been connected to: high amount of savings and investments into the human resources and physical potentials, highly educated workforce, and through it the possibility to bridge the technological gap towards the countries that have been more advanced in that respect. Foreign direct investments do not only represent the mere international transfer of capital, but can also include transfer of modern technology and other intangible assets. In that way foreign companies can significantly affect the growth of productivity and long term economic growth in the host countries.\(^2\) Based on everything said, and also proven by the research, the question is whether Croatia has identified its comparative advantages as an investment destination, and therefore developed a concept of attracting those FDIs that are of strategic importance for the economy. Based on the upcoming convergence of the Republic of Croatia into the EU, and its systematic promotion as a desired investment destination, this paper aims to identify all the comparative advantages and disadvantages of the country as an investment destination, from the experts’ point of view, in order to increase the trend of strategically oriented investments into the economy. Also, it seeks to analyse the obstacles, in order to stop the trend of negative investment structure and its implications.

The paper is consisted of six chapters. Followed by the introduction, the second chapter shows the movements of FDIs in the Republic of Croatia. The third chapter analyses the following: price, development of transport infrastructure and overview of fiscal incentives in the Republic of Croatia with the countries of the region. The fourth chapter is dedicated to identifying the institutional obstacles for investments. The fifth chapter analyses Croatia as an investment destination through qualitative research method, using four different factors: advantages/disadvantages and opportunities/threats. The sixth chapter is consisted of the conclusion and proposals for future research.

2. FOREIGN DIRECT INVESTMENTS IN THE REPUBLIC OF CROATIA

2.1. Overview of Foreign Direct Investment Movements in the Observed Period between 1993-2008

Based on the data provided by the Croatian National Bank, the inflow of foreign direct investments has been recorded since 1993. After the war, in the first half of the 1990s,

\(^1\) op.cit: Pavlović: Foreign Direct Investments in the International Trade, Zagreb, 2008, p 143

\(^2\) op.cit.: UNCTAD (2003), JBIC (2002).
the inflow of foreign direct investments totalled 250 million euros. At the end of 1999, the total influx of FDIs was 3, 3 billion euros. However, if we look at the structure of the realised investments, because of the privatisation of the Croatian Telecom (HT d.d.), the realised investments totalled 1, 2 billion USD in the first round of privatisation. Also, the negative investment structure continued in 2006, when the influx of FDIs doubled to 2, 8 billion euros compared to 2005, because of the realised privatisation of the Croatian pharmaceutical company Pliva PLC. 2007 was the record year for the inflow of foreign direct investments in the total amount of 3, 6 billion euros, followed by the decreased inflow in 2008 in the total amount of 2, 9 billion euros.

**Chart No. 1: Movement of foreign direct investments in Croatia from 1993 – 2008**

**2.2. List of Source Countries of Foreign Direct Investments in Croatia in the Observed Period between 1993- 2008**

In the observed period between 1993 and 2008, the greatest influx of FDIs comes from fifteen largest EU member states. There has also been an increase of investment coming from the new EU members in the period between 2006 and 2008, with the greatest emphasis on an investment influx coming from Hungary, in a total of 1, 2 billion euros.

In the observed period, 94% of total FDIs in Croatia originated from the EU members states, while merely 6% of total investments was realised from the other countries. Looking at the investment structure according to business types, the greatest growth was reported in the financial sector, postal and telecommunication services, and in the sectors producing coke, oil products and nuclear fuel (which was a result of privatisation of INA PLC, the Croatian oil producing company). There has been a domination of equity investments, with the greatest part of investments being
those realised through privatisation of local companies, or subsequent acquisitions of already privatised companies.

**Chart No. 2: Overview of realised investments in Croatia according to source country between 1993 and 2008**

![Chart showing investment sources: EU-15, EU members since 2004, Other developed countries, International financial institutions, European developing countries, Other developing countries.]

*Source: Croatian National Bank*

### 3. COMPARATIVE ANALYSIS OF CROATIA AND COUNTRIES OF THE REGION

State incentives for foreign investors to realise FDIs in Croatia have been defined by the legal framework of the Investment Promotion Act. According to provisions of this Act, the initial investment is considered to be an investment in the long-term assets made ownership of the incentives holder, in the minimal amount of 300,000 euros, and it refers to: the establishment of a new company, expansion of the existing one, or launching an activity that marks a significant change in the product or the production process of the existing company. A replacement investment is excluded, and is not calculated into the initial investment sum.

Regional state incentives, according to the legal provisions, cannot be granted to companies in difficulties, or to companies in the steel industry and the industry of syntethic fibres. Those entitled of being holders of incentive measures are companies registered on the territory of the Republic of Croatia using the incentive measures, or companies that have been granted incentives for the initial investments. A company intending to use the incentive for the initial investment should file an application to the Ministry of the Economy before the beginning of an investment project. Incentive measures regulated by this Act and the Directive are related to the investment projects in:

3. Investment Promotion Act (Official Gazette, No 138/6)
a) the manufacturing sector activities,
b) technological development and innovation centers,
c) strategic business support activities,

which at the same time insure environmentally friendly economic activities and pursue one or more of the following goals:

- introduction of new equipment and modern technologies,
- introduction of new production processes and products,
- increase in employment and a higher level of training of employees,
- modernisation and improvement of business activities,
- Development of production processes involving more value added products
- increase in international economic activities,
- increase in economic activities in the parts of the Republic of Croatia where the economic growth and employment rate fall behind the state’s average and in compliance with the regional aid map,
- development in respect of the provision of new services,
- energy saving
- enhancement of IT activities
- co-operation with foreign financial institutions
- adjustment of the Croatian economy to the European standards.4

It is important to stress that incentive measures under the mentioned Act include: tax and tariff benefits, state aid to cover eligible costs of the job creation linked to an investment, aid to cover eligible costs of training linked to an investment, incentive measures for the establishment and development of technology and innovation centres and strategic business support services, and incentive measures for large investment projects of significant economic interest.

3.1. Comparative Analysis of Price, Development of Transport Infrastructure and Fiscal Incentives of Croatia and the Region

Before making the final decision to invest, foreign investors engage in the preparation of a strategic overview of the location they wish to invest in, in order to prepare for the market uncertainties as quickly as possible. Political stability, market access, quality of workforce, stimulating tax system and quality of life are some of the key parameters the investors take in consideration when making the investment decision.5 Fiscal incentives can also be of crucial importance when making the investment decision. The observed sample includes the following countries of the region: Slovak Republic, Czech Republic, Republic

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4 cfr: Directive on the Implementation of the Investment Promotion Act (Official Gazette, No 64/07)
5 op.cit.: Ernst & Young: „European Attractiveness Survey“, 2009
of Poland, Republic of Hungary, Republic of Romania, Republic of Bulgaria and Republic of Serbia. The reference period for the countries of the region is until the end of 2010.

For Croatia the reference period also includes the period after 1 March 2012 when the new package of tax laws came into force. Based on the primary research conducted concerning prices, development of transport infrastructure and fiscal incentives of the Republic of Croatia (in the narrow sense), compared to the countries of the region, it is possible to conclude the following:

- compared to the observed countries of the region, Croatia has the highest rate of income tax (20%)
  - the countries with the lowest rate of income tax are Serbia and Bulgaria (10%)
- Along with Hungary and Serbia, Croatia’s tax provisions determine income tax rates that vary according to the tax base, while the other observed countries in the region have a unified rate of income tax.
- Croatia and Hungary have the highest reported rate of standard value added tax (25%), while Serbia has the lowest rate of 18%.
- Compared to the observed countries, Croatia has the most developed highway system (1.79 km per 10 000 residents), while Romania has the lowest (0.1 km per 10 000 residents). Czech Republic has the most developed railway system (9.18 km per 10 000 residents), while Serbia has the lowest (4.58 km per 10 000 residents).

### Table 1: Overview of Transport Infrastructure Development by Country

<table>
<thead>
<tr>
<th>Countries</th>
<th>Highway density km/1000 km²</th>
<th>Km of highway /10000 residents</th>
<th>Density of railway tracks km/1000 km²</th>
<th>Km railway tracks /10000 residents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Croatia</td>
<td>14,01</td>
<td>1,79</td>
<td>48,21</td>
<td>6,15</td>
</tr>
<tr>
<td>Slovakia</td>
<td>6,70</td>
<td>0,61</td>
<td>74,89</td>
<td>6,76</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>7,16</td>
<td>0,54</td>
<td>121,90</td>
<td>9,18</td>
</tr>
<tr>
<td>Poland</td>
<td>1,77</td>
<td>0,14</td>
<td>64,77</td>
<td>5,31</td>
</tr>
<tr>
<td>Hungary</td>
<td>6,84</td>
<td>0,63</td>
<td>82,61</td>
<td>7,66</td>
</tr>
<tr>
<td>Romania</td>
<td>0,96</td>
<td>0,11</td>
<td>46,10</td>
<td>5,09</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>2,98</td>
<td>0,44</td>
<td>37,45</td>
<td>5,46</td>
</tr>
<tr>
<td>Serbia</td>
<td>0,00</td>
<td>0,00</td>
<td>43,61</td>
<td>4,58</td>
</tr>
</tbody>
</table>

Source: EUROSTAT

- When it comes to natural gas prices (no tax included), in 2007 Croatia was in the middle, compared to countries in the region (6.6 EUR/GJ), while Hungary had the highest reported price (8.1 EUR/GJ), and Bulgaria had the lowest (4.5 EUR/GJ). In the same year, Croatia had the lowest price of electricity for the large industrial consumers (0.039 EUR/kWH, no tax included), with the largest reported

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price in Slovakia (0.085 EUR/kWh). Poland had the lowest reported export rate of high-tech products (3.11% of total exports), compared to Hungary, which had the highest reported rate (20.32% of total exports). It could be stated that Croatia has a relatively good export rate of high-tech products (6.80% of total exports).  

4. IDENTIFICATION OF INSTITUTIONAL BARRIERS FOR INVESTMENT

Several institutional barriers complicate the inflow of foreign investments in the Republic of Croatia. Other than institutional barriers and high taxation, there are other key obstacles that should be considered: a) administrative capacities of local governments (by establishing cooperation between municipalities, towns and counties, concrete actions could be undertaken that would stimulate local governments in writing and implementation of joint projects), b) according to the law, state administration has competence over issuing permits for freight and passenger transport, which prolongs the length of issuance, c) cities with less than 35,000 residents do not have the competence to perform duties related to issuing location permits, building permits and other documents connected to construction of personal properties and surrounding area, d) slow resolution of property issues and rights over agricultural lands, e) less affluent local governments do not have sufficient means to take proper care over water treatment systems and sewage disposal, as well as waste management (which usually require the largest amount of investments), f) problems with financing the local governments that are entitled to using only 8% of Croatian public revenues, while the EU average is 29%. Other than these identified investment barriers, this paper further analyses the question of ports, maritime domains and roads in more detail.

4.1. Ports and Maritime Domains

According to the existing Maritime Domain and Seaports Act, the problem is manifested at the issuance of concessions for the economic use of maritime domains, as a concession can be issued only after a determined boundary of the maritime domain is entered in the land registry, which further complicates the whole procedure. Therefore, it would be useful to do the following:


devolution of authority over the concession system to municipalities and towns (a concession would be issued for the period of twelve years, without interventions in space, with the prior consent of the county and a 100% of concession fee used for the purpose of managing the maritime domain), and big cities (it would include the counties’ existing concession rights, which include constructing buildings with a 100% of concession fee used for the purpose of managing the maritime domain);
• when it comes to ports, “local ports” should be included in the system of special purpose ports (those used for sports and nautical tourism), for which concessions would be issued by the municipalities, towns and large cities, with prior consent of the county;
• for the purpose of economic development and increased legal security of the potential investors, it would be necessary to introduce the institute of “the right to construct”, which would generally be introduced based on the decision and the concession agreement, with prior consent of the municipality/town.

Complex issues can also be seen in the question of property rights. Transformation and legally acquired rights have not been defined under the present law and have been neglected in the framework of both port systems and maritime domains. In order to resolve the identified problem, it would be useful to:
• redefine the concept of seaport, determine boundaries of a port area, and resolve property rights within the area
• create a legal framework for the establishment of port authorities in towns and municipalities,
• create a legal framework for managing special purpose ports.

4.2. Roads

According to legal provisions of the Republic of Croatia, towns, county seats, and big cities are responsible for all the public roads within their jurisdiction, while the other local communities hold responsibility over the unclassified roads. However, large cities and middle sized towns have pointed to the problem of inconsistency in classifying roads (classified and unclassified) in their areas. This is particularly manifested in problems with spatial planning, traffic management, as well as uneven road maintenance, caused by the four year delay in passing the amendments to the Public Roads Act, according to which the roads within the town area would be transferred under their sole jurisdiction.

Recommendation:
• because the maintenance of unclassified roads falls under the Law on Communal Economy, it is recommended to transfer the classified roads within the area of specific towns (other than highways and state roads) in the sole ownership and management of local and regional governments, and to prescribe these rights in the Public Roads Act

Sources used: Law on Communal Economy – revised version (Official Gazette, No 26/03), Public Roads Act (Official Gazette, 180/04), USAID/CROATIA “Local Government Reform Project”, The Urban Institute, Zagreb, 2006
5. SWOT ANALYSIS OF THE REPUBLIC OF CROATIA AS AN INVESTMENT DESTINATION

<table>
<thead>
<tr>
<th>STRENGTHS</th>
<th>WEAKNESSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Relatively stable economy with the low inflation rate (average risk)</td>
<td>• Weak policy of attracting foreign direct investments</td>
</tr>
<tr>
<td>• Attractive destination for investors, due to its geo-strategic position and access to EU markets</td>
<td>• Unfavourable investment structure</td>
</tr>
<tr>
<td>• Country’s improved image has created a positive investment environment</td>
<td>• Lack of regional brands</td>
</tr>
<tr>
<td>• High quality of life</td>
<td>• Difficult access to financing (high interest rates, guarantee costs, too long and complicated bank procedures)</td>
</tr>
<tr>
<td>• High level of economic and civil security</td>
<td>• Problems with the monopolisation of market</td>
</tr>
<tr>
<td>• Macroeconomic and political stability</td>
<td>• High taxation</td>
</tr>
<tr>
<td>• Competitive market</td>
<td>• Investors consider tax incentives to be insufficiently transparent and efficient</td>
</tr>
<tr>
<td>• Entrepreneurial climate</td>
<td>• High labour costs and insufficient flexibility of employment</td>
</tr>
<tr>
<td>• Upcoming EU convergence</td>
<td>• Lack of expert workforce</td>
</tr>
<tr>
<td>• Membership in NATO, UN Security Council, WTO, CEFTA</td>
<td>• Privatisation within key sectors has not benefited the development of capital markets</td>
</tr>
<tr>
<td>• Multilingual workforce and high productivity</td>
<td>• Too complicated administration, which imposes a non-transparent and extremely expensive process of certification, accreditation and conformity assessment of products, processes and services with technical regulations and norms</td>
</tr>
<tr>
<td>• Entrepreneurial zones</td>
<td>• Low efficiency of public administration</td>
</tr>
<tr>
<td>• Technological development of the country</td>
<td>• Despite numerous conventions and protocols, a desired degree of alignment with the international conventions has not yet been achieved. It is extremely important to harmonise the acceptance of new unifying solutions, which will benefit the improvement of a certain segment or an industry in the Croatian economy, along with the simultaneous abandonment of the older and practically unsatisfactory solutions.</td>
</tr>
<tr>
<td>• State incentives for investors</td>
<td>• Uncertainty of economic and regulatory policies, especially with regards to protection of money transfers and/or intellectual property rights.</td>
</tr>
<tr>
<td>• The greatest density capacity and overall development of road infrastructure compared to countries of the region</td>
<td>• Insufficiently developed anti-corruption strategy and unification of the legal framework.</td>
</tr>
<tr>
<td>• The highest developed telecommunication infrastructure compared to countries of the region</td>
<td>• Unsatisfactory application of anti-discrimination measures in practice.</td>
</tr>
<tr>
<td>• ICT infrastructure</td>
<td>• Lack of cooperation between the public administration and the private sector, in order to improve the investment climate in Croatia.</td>
</tr>
<tr>
<td>• Insufficient development of the banking sector</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>OPPORTUNITIES</th>
<th>THREATS</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Enhance the country’s competitiveness through specialisation of the regions and development of regional clusters.</td>
<td>• Economic crisis- lack of mechanisms that would keep the investors in these conditions.</td>
</tr>
<tr>
<td>• Use the crisis to prepare the ground for attracting investments and creating the tools that would help identifying the companies which have the potential for investing in the FDI projects that are of significance for the Croatian economy</td>
<td>• A system should be strengthened on the multilateral level that would secure investments in the developing countries (MIGA, for example), through issuing guarantees for securing the investments, which would decrease the investors’ perceived risk of investing in Croatia, and would strengthen its position.</td>
</tr>
</tbody>
</table>
• Reform of the financial system
• Improve accessibility of land, through unifying data in cadastres and land registries and creating a unique property cadastre system.
• Improving regulations in the field of trade and workforce.
• Additional increase in efficiency of regulations that affect foreign investments.
• Strengthen the role of the Agency, and continue focusing on what is vital for the present and potential future investors, through the “Investors Club”, and harmonise it with our existing resources, priority sectors and the market, following world best practise.
• Establish stronger and quality cooperation with the embassies, consulates and regional development agencies, with the purpose of proactive attracting of investment and promotion of Croatia as an investment destination.
• Possibility of developing the retail market, as Croatia has around 110m2 of retail space on 1000 residents, which places Croatia behind most SEE/CEE countries.
• Relatively low prices of medical care, quality staff, mineral baths and attractive destination for tourists enable the development of health tourism in Croatia, which could attract investors. A strategy should be developed on the state level, as Croatia has only 18 registered health resorts, which would make tourism less dependant on the season.
• Investing in the construction, upgrading and modernisation of the main (corridor) railway tracks on the territory of Croatia, along with modernisation and increasing capacities of Croatian ports, would enable Croatia’s competitive participation on the entire European transport market.
• Focusing on the increased share of private sector in generating GDP brings to increasing the aggregated productivity and creating an improved investment climate.
• Sharp fall of the competitiveness level.
• There is a lack of strategy of what kind of country we wish to be and what type of investors we wish to attract, without which it is impossible to brand the country appropriately.
• High level of administrative burden when employing foreigners.
• Poor quality of traffic infrastructure (capacities of ports and air traffic).
• Due to lack of financial resources coming from domestic and European banking groups, there has been a slow development of already planned projects and land transactions.
• Because of favourable prices (high rate of investment return in real estate and favourable currency exchange rates), there has been a decrease in number of investors on the Croatian market, which directly affects the rate of investment activity and causes an evident shift in the demand rate (occupiers’ and investment sector).
• Decline in property values throughout Europe, up to 40%, has led to seemingly high prices of real estate in SE Europe, compared to reasonable values on the more mature markets. Price rates in Croatia should be in balance with the change of prices on the European markets, in order to remain competitive and attractive to investors.
• A system which controls the quality of tourist offers should be introduced, in order to stop the trend of an uncontrolled construction of capacities.
• Customs system should be centralised and computerised, in order to perform all the procedures related to import/export on on place, which would shorten the procedure. Customs system should be harmonised with EU standards, in order to avoid high reference process of imports.
• Unsatisfactory implementation of intellectual property protection.
• High rate of foreign debt.


6. CONCLUSION

In today’s world of highly turbulent markets, things are rapidly changing. Change increases risks of inadequate structure of foreign capital inflow, and it is precisely the identification of strengths, weaknesses, opportunities and threats that places Croatia as an investment destination in a specified position of risks and potential revenues. What is the method of attracting strategically oriented investments to the economy? This is one of the crucial questions imposed to all host countries. With scientific and qualitative methods used in this paper, we can conclude that the Republic of Croatia, as host country for investments, belongs to more developed transition countries of Europe, based on the rate
of “per capita” investment. It should also be stressed that investors have recognised the attractiveness of Croatia as an investment destination, through reinvesting the profits of foreign companies. However, it should be stressed that an unfavourable structure of currently realised investments points to necessary changes. The investment process is complicated by definition, and sometimes very long, and it involves a constant engagement of all participants in the realisation of the investment project—starting from the investor, local and regional government, suppliers of infrastructure, to the national bodies in charge of the investment stimulation and promotion.

As shown by the detailed analysis presented in this paper, the motives of a foreign partner to get involved in a joint venture with a Croatian company is manifested through: the level profitability of investing personal monetary and non-monetary assets, business reputation and solvency of partners from our country, market prospects and safety of investment, especially from the perspective of all commercial and non-commercial risks that follow such investments. However, because of numerous institutional obstacles that complicate the very inflow of FDIs to Croatia, it is of significant importance to create a clear platform of joint action, in order to successfully complete the project, attract strategically most important investments, and benefit all the participants involved in the investment process. To conclude, it is my hope that this paper will make a relevant contribution to the field of economics and be used in future research.

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