

Scientific Society of Economists Annual General Meeting

Zagreb, 15th March 2014

Conclusions on social/income inequalities and poverty in the Republic of Croatia

At its Annual General Meeting, held at the beginning of 2013, the Scientific Society of Economists decided to organize and carry out a study into the causes and possible remedies for social disparities and poverty in the Republic of Croatia. It was also decided the results of this research would be discussed in a plenary session at the next annual general meeting, to be held in early 2014. These tasks have been carried out successfully. Therefore, starting from the results of this research, the open discussion and the scientific notions of the roots and principles as well as the methods of addressing social inequalities and poverty in modern societies, the Annual General Meeting of the SSE considers itself called upon and duty-bound to point out the following:

1. European causal reflections on Croatian social realities

The economic and social crisis (resulting from years of recession, but also from other earlier causes) in the Republic of Croatia reflects, essentially, the general crisis of European societies in the late twentieth and early twenty-first century. This crisis is an expression of the general collapse of the social model based on the predominant role of capital, the dominance of financial markets and financial capital over the real sector of the economic system and constructed values derived from it. The collapse of the “welfare state” and the social market system is at the core of the crisis. In contemporary Croatian society, these processes are not different. The growing problems of the late twentieth century and the beginning of the twenty-first century have erupted in a trichotomy of problems such as slowing economic growth, rising unemployment and inflation that turned into the insidious problem of deflation and the “demobilization of capital”. The neoliberal dictatorship has begun to solve these problems with a devastating impact on the civilizational achievements of modern societies, manifested in the secular tendencies towards social egalitarianism. In this way, it seeks to revitalize the

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capitalist mode of production and recover so-called “demobilized capital”. For neoliberalism, as to succeed in its dictatorship, it was necessary to relativize the strengthened democratic (so-called “golden”) tendencies in social development which came to the fore after World War II. It paved the way for the hegemony of neoliberal democracy. In such a process, big business, especially the financial sector, imposes the idea that “politics doesn’t need more, but less democracy.” For this reason, democracy and democratic institutions weaken in nation-states. This process is supported by strengthening certain non-democratic institutions, as, for example, central banks, the highest judicial bodies, and it is likely that some executive bodies in the domain of fiscal policy will be relieved of the obligation of democratic, accountable decision-making. All of this is carried out with the excuse of promoting greater efficiency, while neglecting the social dimension. It is often forgotten that Europe/EU as a community of nations linked by common interests, makes no sense if it is not strongly social, instead of being organized only in the interests of big business. It is all about undemocratic processes in which the forces of neoliberalism shift the burden for the revitalization of the capitalist system and the fight against economic and social crisis on the civilizational socioeconomic achievements and values of European societies.

Croatia’s economic and social reality in no way differs and is not behind these anti-democratic tendencies, now present in Europe. The antisocial attack on labor and pensioners is in no way weaker. On the contrary, it is stronger because (supposedly) it is necessary to balance available income and consumption (plus debt). This balance, through the mediation of the political elite, is achieved at the expense of labor, not the social groups that have more, as required by the basic scientific principles of vertical and horizontal equity. Hence, there is a constant pressure by owners of capital and large incomes to ease the tax burden, (a term that means the avoidance of real estate taxation). In fact, it is the capital in capital-labor relation that is revitalized and protected.

2. State of social relations in Croatia

The neoliberal economic and social concept has led to serious social consequences in Europe, i.e. it has caused social destruction. Therefore, the social situation in today’s Europe reflects the fact that at present the number of the poor reaches 126 million as well as the uncertainty of existence of ordinary people. The social situation in Croatia is an expression of that: the number of unemployed is 350,000 while job vacancies are around 7000, the number of retirees has surpassed the number of the employed and average pensions are about 40% of the average wage, (uncontrollable) devastation of the countryside, while the extremely harmful destruction of productive capacity (farms) which tied a huge amount of public capital and market pressure of “big players” on farmers, is borne by them

alone. Furthermore, in Croatia there is a significant imbalance in the distribution of assets i.e. capital. Although there is hardly enough scientific understanding about this issue, initial studies have shown the transformation and privatization of state-owned companies to be the fundamental cause of this inequality. The distribution of income in our population is particularly disturbing and is one of the fundamental causes of inequality and social injustice. In 1995, 64.7% of the population (in the lowest income bracket) had 37.7% of total income at its disposal, and in 2001, approximately 36% of the population disposed of a little more than 13% of total income. It should be noted that the population in this income bracket was reduced by a little less than half, but, on the other hand, total disposable income was reduced by three times! At the same time, in the two highest income brackets, 2.8% of the population in 1995 controlled 11.4% of total income, while in 2001, we were faced with a significant increase of inequality in the distribution of income when slightly more than 15% of the population already controlled about 37% of total income! At that time, the upper third (the richest social group) possessed 73% of total assets (income and capital). Such a change in the distribution of income raised the value of the Gini coefficient from 0.37 to 0.39 at the beginning of this century. The growth in income inequality has not, however, stopped. In 2007 (i.e. before the onset of the economic and social crisis), one third of the population had at its disposal only between 10 and 11% of gross income (almost 13% of the net). However, the richest third could claim 65% of gross and around 60% of net income. It is clear, too, that paid liabilities (of the wealthiest segment of society) did not significantly disturb existing relations in the distribution of income. The value of the Gini coefficient of inequality has increased to 0.43. The crisis has had its own impact as well. It has deepened the distributive imbalance, which happens during a crisis, and is not the case only in Croatia. That is why in 2012 around 59% of Croatians could dispose of only 37% of the gross total distributed income (net around 32%) while a minority of about 4% of the population in the wealthiest upper third appropriated 18.5% of the gross total income (about 15% of the net). Since the calculation of these relationships did not include capital gains (which typically belong to the wealthier segments of the population), the abovementioned relative measures are even more undermined in the bottom third of the income distribution. Of course, Gini coefficients of inequality are also an expression of such distributions. The value of the coefficient increased to 0.44.¹ The negative dynamic in the distribution of income did not result in the deterioration of the coefficient of inequality alone, but was followed by a general worsening of poverty in the Republic of Croatia.

¹ Gini coefficients of inequality: 2005 – 2012 (Source: CBS based on surveys, meaning that all forms of income are included in the calculation of this indicator, and not only those based on tax declarations):

Year:	2001	2005	2006	2007	2008	2009	2010	2011	2012
Gini coefficient:	0.28	0.29	0.28	0.29	0.29	0.27	0.32	0.31	0.31

The difference in the value of the coefficients is more than significant. The CBS coefficients are derived from survey data and include all forms of income, e.g., they include capital gains.

This is a growing trend. Its growth is particularly pronounced and associated with the economic and social crisis of 2008. Croatia is the record holder for the highest growth of the at-risk-of-poverty rate among EU member states. Comparing the MP (Multidimensional Poverty) index and the material deprivation rate does not show significant differences. Therefore, it can be concluded that, although Croatia is classified as a country with high per capita income, in relation to the degree of poverty in Croatian society, it cannot be classified as a developed country. In 2012, at-risk-of-poverty rate was 20.5% and was higher by about 14 percentage points (at the same time, the rate of the EU-27 was 17% and increased by only 3 percentage points). The crisis, as was expected in this case, had a devastating effect: in the period from 2008 to 2012 the at-risk-of-poverty rate increased by 18.5 percentage points, while the increase for the EU-27 amounted to only 3 percentage points. Therefore, it is high time that the main causes of the social destruction that has afflicted Croatian society in recent years were identified and addressed.

3. The causes of social inequality in Croatia

The causes of the abovementioned social realities date back to the very beginning of the introduction of capitalism in the Croatian economic system. The fundamental causes are related to the privatization process and the implementation of the so-called stabilization program. A logical extension of this process was an economic and social policy which was mainly based on the affirmation of the ownership model, which provided a social minority with the means to control most of the existing assets and total income.² Results of scientific research on the functional characteristics of the distribution of income from economic-related activities are particularly important for the abovementioned relations. The results have shown the significant effects of these relations on social i.e. income relations. Basically, as one of the primary factors, it has been proven that the accumulation of capital in Croatia was primarily determined by income from labor (i.e. Croatia had *wage-led accumulation*), it also had a stagnationist growth regime and demand-side shocks were more significant for labor market dynamics than supply-side shocks. However, the results also show that in that period Croatia had an accelerating growth regime, i.e., the capacity utilization was *profit-led*. Therefore unemployment is mostly determined by demand factors and to a lesser extent by income distributions, while the supply-side effects are indeterminate. The featured relations are the best answer to advocates of so-called flexibilization of the labor market and to those for whom workers' wages are never low enough in the Croatian economy. Moreover, it has come to the point where jobs are viewed as a fortuitous opportunity or can they (still!) be considered a guaranteed right!? So, the situation has progressed to the

² According to a study conducted by the Institute of Economics in Zagreb in 2001, 1% of owners controlled half of all privatized assets.

point where work is no longer a constitutional category?! But, guaranteed profits, according to this logic, are not to be questioned. Because, if that were not the case, “society would have to reconcile itself with economic and political entropy and its mournful consequences?!” The above factors that have caused the social destruction of Croatian society are threatening to even worsen the social condition.

Monetary policy is one of the “strong” factors that generates social and income inequalities in Croatian society. It is not a coincidence. This is a consequence of the economic and financial interests of the individual (interest) social groups, corrupt importers, foreign capital, expert-consultant cheering and incompetent politicians. However, the factor of monetary policy has not been seriously investigated in Croatian scientific circles. Moreover, it can be stated that the problems of inequality caused by the activities of monetary authorities and monetary policy are being consistently ignored. In this regard, particularly negative are: the routing of the monetary mass which bypasses the manufacturing sector; excessively high interest rates and banking fees; the discount rate policy at the macro-level (fixed exchange rate) has a negative impact on the competitiveness of Croatian industry and agriculture (in debates on competitiveness being totally ignored) and, lastly, excessive banking expenditures also have an impact on Croatia’s low competitive power (banking costs are many times higher in Croatia than in most countries in the region). Thus, economic and monetary policy cause a contraction of economic activity that generates high unemployment and an excessive outflow of people into retirement while reducing pensions imply the steadily deteriorating position of pensioners in the distribution of income. The high degree of “Euroisation” and so to speak, full compliance of Croatian monetary system with EMU is considered by monetary authorities as the reason for its inability to implement effective anti-recession measures?!

National monetary policy is denied the possibility, even though it is not formally in the EMU, to objectively use available monetary instruments in order to combat poverty and the recession. Therefore, one must ask the questions: in whose name and why has the national monetary system been brought into such a state? The system’s priority, in fact, its only concern is stability, not economic growth and employment. These goals were a priority with all monetary authorities in the course of overcoming the acute recession, but not in Croatia.

4. Strategy and measures for overcoming the unacceptable social and income imbalances in Croatian society

The fact is that the Republic of Croatia has no meaningful and rounded development strategy for its overall socio-economic system. Therefore, measures are generally adopted in a partial, incoherent, often contradictory, but above all in

an ideologically biased manner. The sporadic and palliative measures taken up to this point cannot compensate for the failures which made it impossible to precisely define the foundations of the socio-economic system of Croatian society. It is precisely such a lack of definition that allows and facilitates the imposition by the neoliberal conception of an orientation that deviates from the values that should form the essence of a welfare society. At the same time, the fundamental principles and solutions offered by a responsible and objective contemporary social science are the least accepted. However, the neoliberal doctrine, as can be seen, dismantles social civilizational achievements. For this reason we should commit ourselves to a strategy for building a welfare society that will include:

Firstly, amendments to the Croatian constitution that will clearly establish the principles that should be taken into consideration in the building of a socially responsible Croatian society and define responsibility for deviations from these principles; One of these principles should be the provisions of the Declaration of the Rights of Man and of the Citizen, Article 1, which states that social distinctions can be allowed only if they promote the common good; Furthermore, responsible modern economic science is in agreement that, for example, income differences must not exceed the level measured with the Gini inequality coefficient of 0.30. *Secondly*, without adequate economic growth and the creation of material output the main principles of a welfare society are not sustainable. It is therefore essential: to make changes in the economic doctrine implemented through models of economic and development policy and then to direct society towards a gradual change of social relations where social values will at least have the same role and position as capital – following this direction, reforms of economic and social system should be implemented.

The fact is that poverty is a structural problem, resulting from the liberal-capitalist system. Therefore, this socioeconomic problem cannot be solved within that system. The solution is in bringing about changes to the system. Owners of capital and governing structures should keep in mind that the chosen solutions for the unacceptable social relationships in European societies caused by neoliberal capitalism will determine the direction in which a future Europe will move, whether it will be a process of oligarchy, a strengthening of autocracy or if Europe will move in the direction of creating a participative and democratic welfare society. This is the essence of the required reforms in the EU and Croatian society. Regarding the latter, it is clear that neoliberal capitalism is unable to resolve the economic and social crisis which it has caused, by the democratic methods and means that were used during the functioning period of the welfare state in Europe. This should be a lesson and a roadmap for the players whose decisions determine the future of Croatian society as well. Our society is not isolated from these processes.

If we are committed to building a welfare society that is equal in relation to capital, it is necessary to implement a development strategy which will provide a basic

social safety net to so-called “lower” social groups i.e. labor. It has been shown that this social category works more in relation to other categories. This means that it objectively creates the material basis for raising its own well-being, rather than improving it through a system of redistribution of society’s newly added value. Despite the objectivity of such relations, the economic history of society has shown that it is impossible to create healthy societies without the redistribution of resources, wealth and power – in the context of existing capitalist relations.

It is clear, however, that the priority task is to stop the current recessionary path and achieve production growth in the shortest time possible. Long-term investments cannot achieve this task. These are, objectively, two separate tasks. Pulling the Croatian economy out of its long recession, this being the priority for any discussion on economic and social issues, is impossible with medium-, and even less with long-run investments. Likewise, it cannot be done through illusions about effective structural reforms. Pulling the economy out of the recession and, afterwards, directing it towards an increase of production, are two separate tasks: to stop the recession, significant investments are unnecessary, but the production with its available and unused capacities (and these are: according to the available data for the period from 2002 to 2012, the installed capacity in the manufacturing industry were used only by 62% and around 39% SMEs stopped their production and were closed down while the percentage of the great enterprises is around 60%) needs to be “fed” by working capital to finance production and reproduction of aggregate demand. This was the preferred anti-recession method at the beginning of 2008 in all other countries except in Croatia (by the time planned long-term investments are realized the Croatian economy will collapse); concurrently an appropriate investment policy should be implemented to achieve sustainable medium-term and long-term GDP growth.

It may be noted that beyond this orientation and task, by which we mean, first of all, stopping the recession and giving momentum to a trajectory of growth of production by means of activating unused capacity (fixed equipment), monetary policy itself cannot be absent, regardless of the illusions of its holders on the need to care for the stability of macroeconomic aggregates (stability is noticeably absent in a context of massive unemployment that threatens with social and political disaster – a salient question would be whether monetary authorities are willing to shoulder such a responsibility?). By actively employing monetary policy unacceptable social differences in Croatian society, which are generated through channels of the monetary system, could be alleviated. Holders of monetary policy should introduce a normal, flexible exchange rate policy, which would follow the variations of costs in the industrial and agricultural sectors and reduce the discount rate of the CNB, which, because of its high value, is de facto most responsible at the macro level for the unacceptably low level of competitiveness (acting on the formation of relative prices and the referencing of commercial banks on the CNB's rate of discount).

Furthermore, it is necessary to significantly reduce the interest rates of commercial banks and all forms of bank fees for transaction services, which the banks have taken over. All of these monetary policy measures would create the necessary conditions for increasing the competitiveness level of industry and agriculture by increasing domestic and export sales. In the next stage, these measures would lead to an increase in employment and public revenues, which would undoubtedly cause a positive chain reaction in all areas of existence of the Croatian population.

However, regardless of the involvement of all the above factors and short-term and long-term measures for the recovery of the Croatian economy, it must be pointed out that the underlining ideas, proposals and the results of our research conduct towards the conclusion that market forces alone can never be relied on to produce a fair or equitable society. The problems of the social security system in Croatia are the result of, first of all (neoliberal ideology and) the model of economic growth, and less as the aftermath of the demographic situation. Therefore we find that the overall social contributions and labor taxes lead to statistically significant improvements in income inequality and social at all. Particularly, we support the taxation of wealth with the priority being inheritance and real estate taxation, of course, in accordance with the principles of social rights.

In order to decrease income inequality in the labor market there should be increased investments in specially targeted active labor market policies and improved coordination between social partners in collective bargaining. At the same time, it has to be mentioned, the results demonstrate that investing more in higher education will not decrease income inequality. Progressive taxes reduce income inequalities and the up-skilling of the workforce should bring a lessening of income inequality if effectively used. At last, the science of taxation and the results of the research recommend the changes of tax and labor market policies, related to the redistributive impact of taxes. Tax policies must be perceived to be fair and maintain social cohesion. In this context, it could be stated that the system of social transfers has to be improved in terms of its impact. Tax system, social assistance and social insurance have a positive effect towards income inequality. According to the obtained results of the analysis the most important conclusion was that social security, the pension system and other transfers lessen poverty and income inequality, but the development of the social security system and social transfers in Croatia still has a long way to go. Obtained results of this analysis contribute to a better insight into the efficiency of the system of social transfers in Croatia.

In terms of the assessment of the institutional-systematic implications of the obtained results, it is necessary to remind that social transfers can encourage the use of household resources in a more productive fashion. In designing social transfers it is important to take into account existing vulnerabilities, institutional factors, and delivery capacities. Social transfers can contribute to enhanced investment by the poor through raising household income, and can overcome problems of insecurity

for the poor. Substantial poverty and inequality reduction could be achieved in Croatia by careful reallocation of expenditures and improvement of coordination among existing social programs. Also there is a need to constantly monitor and survey the implementation of particular programs. In order to arrive at a precise view and objective estimate of the role of transfers and to get answers to the question on what types of social transfers contribute most to a reduction of poverty and inequality, in future research it will be necessary to study the effectiveness of each transfer program by itself. Possible further improvement of the social transfer system and its targeting would without doubt pay off very soon in improving the situation regarding poverty and income inequality in Croatia.

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