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Fruzsina Sigér

**FOUR YEARS IN THE CLUB: FROM EXTERNAL TO
INTERNAL EUROPEANIZATION IN CROATIA**

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Four years in the club: from external to internal Europeanization in Croatia

Author:

Fruzsina Sigér

Assistant professor, University of Debrecen Faculty of Economics and Business
Administration, Institute of World Economy and International Relations

email: siger.fruzsina@econ.unideb.hu

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Four years in the club: from external to internal Europeanization in Croatia¹

Fruzsina Sigér²

Abstract

Croatia joined the European Union on 1 July 2013 after a long and meandering road. On the one hand, the preparation for the negotiations was long already, on the other hand, the negotiation process itself also went slowly. Croatia was hit by the crisis severely, which also means that the accession process went parallel with an acute crisis management. The question arises whether the two processes had strengthened or rather hampered each other. So what impact of the membership can be identified in Croatia? Could the membership enhance the recovery from the long-lasting recession? Has the EU any role in this story? Almost four years has passed since the entrance conditions were replaced by a new set of internal rules: Croatia faces internal Europeanization pressure. What has changed in Croatia's Europeanization pattern when it turned from internal to external?

JEL: F50, P52

Keywords: European Union, Transitional Economies, Europeanization

Introduction

After a long and meandering road Croatia joined the European Union (EU) on 1 July 2013, more than nine years after the first round of Eastern enlargement. On the one hand, the preparation for the negotiations was long already: it was June 2006, when the first chapter of the accession negotiations were opened. On the other hand, the negotiation process itself also went slowly: in the meantime the EU was struggling with

¹ Earlier versions of this paper were presented at the 29th Annual EAEPE Conference at Corvinus University of Budapest, 19-21 October 2017, as well as at Centre for Economic and Regional Studies HAS - Institute of World Economics on 15 January 2018. Useful comments by István Benczes and Andrea Éltető are appreciated.

² Assistant professor, University of Debrecen Faculty of Economics and Business Administration, Institute of World Economy and International Relations. Böszörményi út 138, H-4032 Debrecen, Hungary. E-mail: siger.fruzsina@econ.unideb.hu

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enacting the Lisbon Treaty and both parties had to deal with the financial and economic crisis that reached Europe in 2008. Croatia was hit by the crisis severely, which also means that the accession process went parallel with an acute crisis management. The question arises whether the two processes had strengthened or rather hampered each other. The evidence shows that the accession negotiations and especially the pre-accession surveillance procedure served as important anchors for structural reforms and post-crisis consolidation.

Croatia “entered the club” in 2013, when its economy contracted for its fifth year in a row which reflects both spillovers from adverse external factors and the persistence of deep structural problems. In the light of this deteriorating economic environment, signing the accession treaty and becoming the 28th member of the EU promised vital opportunities for Croatia to manage its economic challenges and become a competitive economy (see: Madzarevic-Sujster 2013). At the same time the country arrived to an ailing community that struggled with its own recovery and suffered from enlargement fatigue.

Between 2008 and 2014, Croatian GDP shrunk by more than 12% in real terms, and unemployment surged from below 9% to more than 17% (EC 2016). In 2015, a six-years-long recession has finally ended in Croatia. The macroeconomic imbalance procedure³ of the European Union found that Croatia continues to experience excessive macroeconomic imbalances: vulnerabilities linked to high levels of public, corporate and external debt combined with high unemployment. So what impact of the membership can be identified in Croatia? Could the membership enhance the recovery from the long-lasting recession? Has the EU any role in this story? Almost four years has passed since the entrance conditions were replaced by a new set of internal rules: Croatia faces internal Europeanization pressure. What has changed in Croatia’s Europeanization pattern when it turned from internal to external? Is the role of external anchor still present? Vachudova (2005:241) argues that the EU’s active leverage in the accession countries, i.e. the leverage of pre-accession conditionality was diminished

³ The macroeconomic imbalance procedure (MIP) aims to identify, prevent and address the emergence of potentially harmful macroeconomic imbalances that could adversely affect economic stability in a particular EU country. The MIP was introduced in 2011, after the financial crisis.

right after the invitation for full membership had been given. Does this scenario apply also in Croatia?

Theoretical framework

The theoretical framework with which this paper tries to answer the above defined questions is Europeanization, embedded in a political economy framework. The theory of Europeanization⁴ tends to explore how European factors influence domestic structures. The definition of Europeanization is a rather debated issue in the international literature. The concept itself comes from the field of political science and European studies and the majority of authors agree that Europeanization occurs when something in the domestic political or economic system is affected by “something European” (Vink 2002:1). The term “European” most usually refers to the European Union, therefore Europeanization very often examines the influence of the European integration. We suppose that the answer to our puzzle cannot be found only by examining economic issues. Thus the scope of the study is widened and extended to political, social, ideological and cultural aspects. The theory of Europeanization, as we understand, provides space for this “expanded approach”. All the economy, politics, society, ideology and culture can be Europeanized. Europeanization pressure reaches every sphere of a country’s life.

Europeanization can be interpreted both as internal and external impact. The internal point of view reflects on the internal process of changes in the European Union and the adaptation capacity of the member states. At the same time, Europeanization means not only the adjustment of national systems, but also the adjustment of the European level, since the European Union builds upon institutions and policies of its own member states (Csaba 2007b:148). The external perception conceptualizes Europeanization as an external (mostly EU-led) process guiding applicant countries’ complex domestic economic, social and political transformations (Demetropoulou 2004:6). The external Europeanization process differs from the interaction between the EU and its member states: it is not mutual but unilateral acceptance instead (Csaba 2007b:149).

⁴ See e.g. Börzel-Risse (2000).

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Whichever definition of Europeanization we consider, there are three conditions⁵ that make possible to talk about Europeanization. First, there must be a misfit or incompatibility between domestic and European institutions, policies or processes. Second, this misfit should generate adaptation pressure. The adaptation pressure only show up when the misfit is perceived (see: Sigér 2010). The presence of misfit can be described more or less objectively but whether it creates adaptation pressure depends on more subjective factors. As a general rule, the lower the compatibility between European and domestic institutions, policies or processes, the higher the adaptation pressure. The adaptation pressure is necessary but not sufficient for changes. The third condition is the existence of factors (actors or institutions) that foster respond to the adaptation pressure.

The external concept of Europeanization is associated with transition/transformation. After the collapse of the communist regimes in Central and Eastern Europe the concept of Europeanization got a new meaning. In the context of transition countries, Europeanization offered a general conceptual framework for transition because it was not only about democratization and marketization, but about a particular type of political, economic and social system change (Ágh 1998:49). As Grabbe (2002) highlights, the European Union has played twofold role in the process of post-communist transformation. On the one hand, the EU has been an aid donor that imposes conditions on countries. On the other hand, it has been guiding these countries towards membership, within which the EU creates incentives and judges progress in fulfilling EU models. According to official EU publications, accession and transition are part of the same process and preparations for EU entry are identical with overall development goals. EU-driven institutional change has two key benefits that may outweigh the possibility that these EU-recipes are suboptimal choices for the applicants. First, EU's conditionality may provide a framework to overcome inertia and avoid a lengthy search for a domestic political consensus on institutional models in some areas. Second, the EU accession process provides a set of incentives for rapid institutional change and protects them from lobbying and backsliding (Grabbe 2002:263).

⁵ Based on Börzel–Risse (2000:5) who identify two conditions.

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In the context of post-communist countries, two different mechanisms of Europeanization can be identified. The first mechanism is coercion, based on control and conditionality. In course of control, certain policies are inspired by positive or negative sanctions. In this case the EU plays an active role, i.e. it is an actor, and its bargaining strategy is reinforced by rewards. The second mechanism is mimicry, based on contagion and consent. Via demonstration effect and interactions between international processes and domestic groups, the EU plays an inactive and indirect role, i.e. it serves as a point of reference and as a framework (Demetropoulou 2002:89-90). Through processes of persuasion and learning the EU socialize the countries rather than coerce them. Furthermore, the countries might consider EU rules as effective benchmarks for domestic policy changes and adopt them independently of EU conditionality (Schimmelfennig–Sedelmeier 2004:670).

Europeanization has also a “soft” meaning when it refers to influence on people’s identity. As Risse (2001:200) highlights, adaptation pressure has little sense regarding collective identities. The preambles of the EC and EU treaties refer to some kind of European identity but as a matter of fact, there is no contractual obligation to develop such common European identity. At the same time, the values and norms that are also listed in the preamble of EC and EU treaties (and in other all-European agreements) connect to or rather be part of the European identity. In this sense European identity has already existed when these treaties referred to it. Individuals and social groups has multiple identities and thus the question is how much space there is for “Europe” in collective identities. The goodness of fit in this sense is understood as the degree of resonance between ideas about European order and identity on the one hand, and collective nation-state identities on the other.

According to our approach, the process of Europeanization may be caught in several fields of economy, politics and society. In the following we gave a general overview about the Croatian economy in the light of the European developments, than we examine Europeanization on different fields.

The Croatian macroeconomic environment

By the time of the opening of accession negotiations in 2005, the real GDP growth was 4.3%, up from 3.8% in 2004 (Figure 1). The growth was mainly driven by domestic

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demand, while net exports added only 0.1 percentage point to real GDP growth (EC 2006:19). In 2006 real GDP growth further accelerated to 4.8% year-on-year and continued on the back of stronger private investment (total real investment increase was 10.9% 2006, up from 4.8% in 2005). The economic performance remained strong, with real growth rates above potential growth (EC 2007:17). Growth remained robust in 2007, annual GDP increase showed a remarkable acceleration to 5.6%, but started to slow down in the last quarter of the year. Private consumption in 2007 indicated the highest growth rate since 2002 and accelerated strongly to 6.2%, compared to 3.5% in 2006. Total investment growth decelerated from 10.9% to a still robust 6.5% (EC 2008:18).

Figure 1: Real GDP growth rate – volume, percentage change on previous year



Source: Eurostat database

Note: EU 11 stands for the new member states (2004, 2007 and 2013 enlargements)

The global financial and economic crisis reached the Croatian economy in 2008, in the last quarter of the year GDP growth dropped to 0.2% year-on-year. For the whole 2008, annual GDP growth slowed to 2.4%. Private and public consumption increase slowed considerably in the course, while real investment growth still accelerated, mainly because of strong non-housing construction activity (EC 2009:19). The global crisis has led to a significant economic downturn in 2009, the GDP declined by 7.4%, which was among the worst in Europe that time. Private consumption fell sharply and investments fell even more. The economic recovery did not take hold in 2010, real GDP declined by 1.7%, while the EU28 average showed positive numbers that time. Investment

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continued to fall back at a double-digit rate and the decrease in private consumption diminished notably (EC 2011:17).

In 2011 GDP still fell by 0.3%. Final domestic demand continued to contract, particularly due to a further drop in investment activity (EC 2012:10). The output recession continued in the 2012 (2.2%) when the EU28 also experienced 0.5% GDP shrinkage. Finally the country entered the common market with negative GDP growth (-1.1%) in 2013. During its candidacy Croatia experienced similar adverse macroeconomic trends in the pre-crisis years as the EU members. In contrast to its regional peers, six years after the bust of the financial bubble, Croatia still stranded in recession and grappled with the rebalancing of its economy. The prolonged decline has decreased real GDP by 12.5% (EC 2015b:3).

In 2015 the six-years-long recession finally ended. The economy grew on the back of a good tourist season, a strengthening of external demand and reductions in oil prices (TR 2017:86). Before the crisis the sustained growth was based on unsustainable drivers. The credit-driven consumption and investment boom generated a large amount of domestic and external liabilities, mostly denominated in foreign currency. At the same time public finances maintained a broadly pro-cyclical stance. As a result, Croatia entered the crisis with limited room for manoeuvre and adjustment, the country mainly relied on internal devaluation (EC 2016:1). As a small, open and highly euroised economy that also has to adjust its economic policy to the EU policy framework, Croatia has limited scope for action in order to increase its international competitiveness using monetary policy measures drawn towards (nominal) devaluation of the national currency (Ćorić et al 2013).

Employment

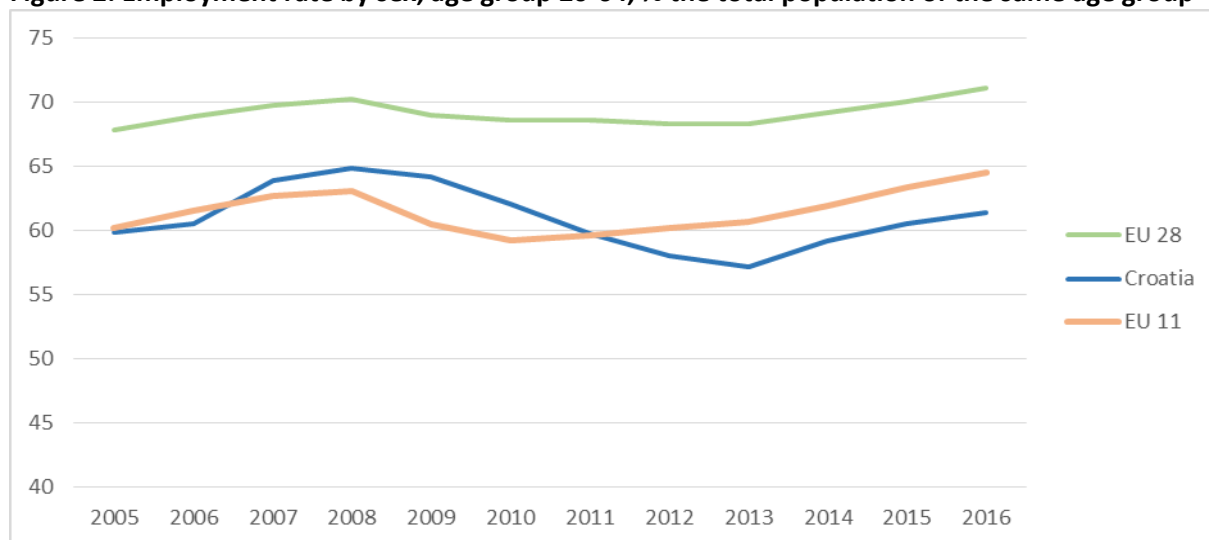
Although employment rate in Croatia is relatively low compared to the EU average (Figure 2), GDP growth was driven essentially by employment growth, with limited productivity gains⁶. The Commission warns that Croatia's productivity growth had already been relatively weak before the crisis and a bigger employed population can sustain growth in the short or medium term only. In the long run productivity is the only

⁶ Real GDP growth can be broken down into productivity growth and employment growth — the latter being the outcome of demographic dynamics and labour market performance.

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source of growth. Compared to other new member states (EU11), it seems that common factors that shaped economic transition have been put to less productive use in Croatia (EC 2015b:13).

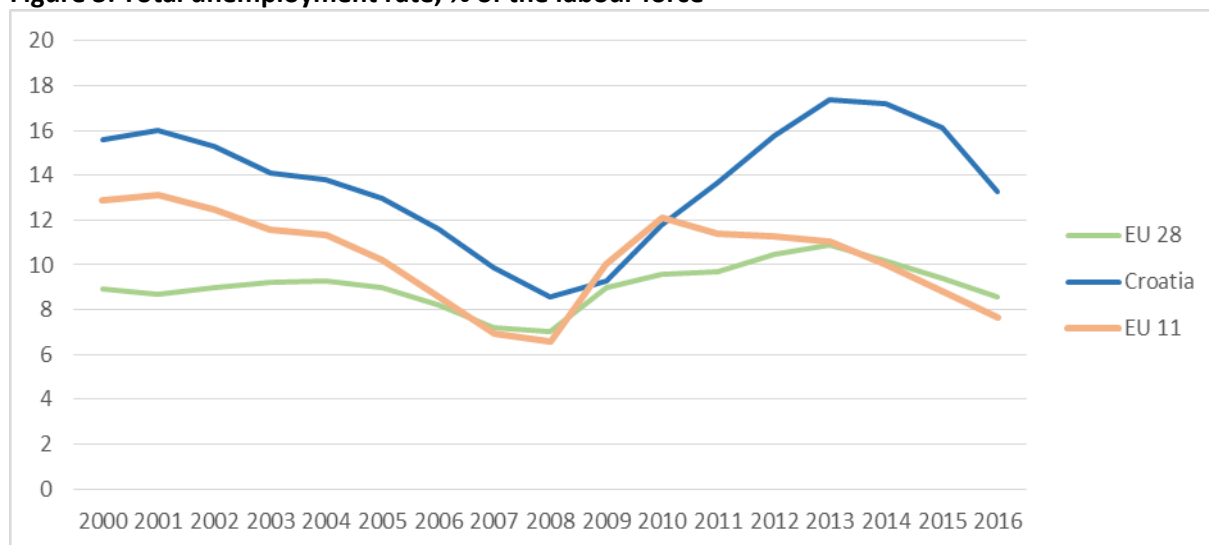
Figure 2: Employment rate by sex, age group 20-64, % the total population of the same age group



Source: Eurostat, based on the EU Labour Force Survey

Unemployment rate had been consistently high in the pre-crisis period as well (Figure 3), signalling structural weaknesses of the labour market. Despite recent signs of improvement, these structural weaknesses cast a shadow on future employment prospects (EC 2015b:17), especially when full freedom of movement for workers will come into effect from July 2018.

Figure 3: Total unemployment rate, % of the labour force



Source: Eurostat

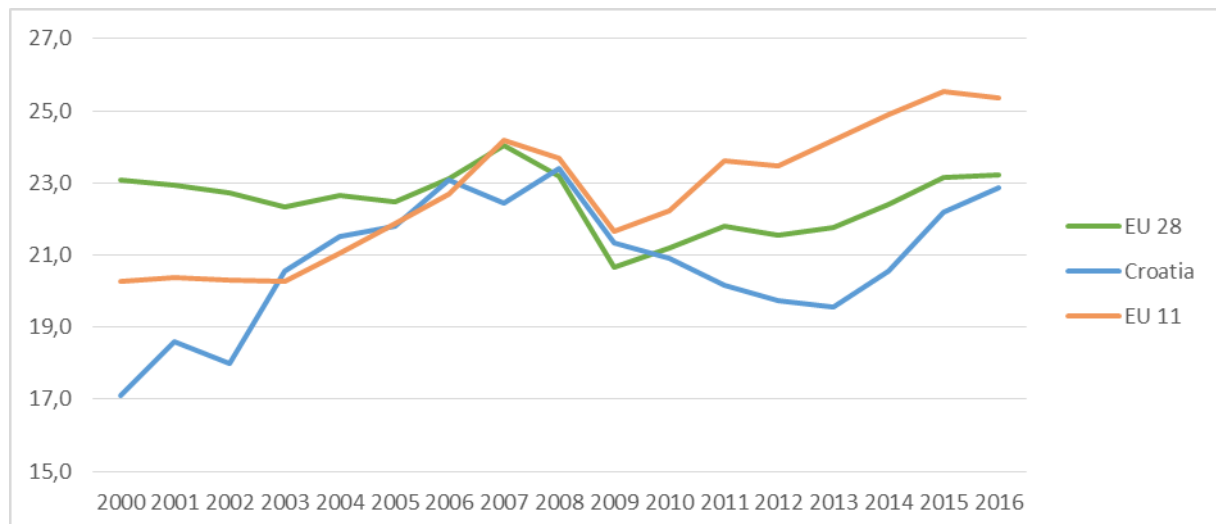
Structural adjustment

The accession process had required major structural reforms from the very beginning. To see the curve of development, it is useful to compare the recent situation with previous analyses and expectations. Franičević and Kraft warned in 1997, that after four years of a successful stabilization program, the economic growth had not materialized, because of the complex structural problems of the economy. The authors considered four steps to be important in order to speed up the economic growth. (1) a high rate of domestic saving and investment; (2) a thorough restructuring, both on the level of firms and of the state itself; (3) further and consistent hardening of the soft budget constraints; (4) full rehabilitation of the banking system (Franičević–Kraft 1997:686).

Twenty years later, and as a member of the European Union do these obstacles still hamper the Croatian economy?

(1) In connection with the war Croatia experienced extreme low domestic saving ratios in the mid-1990s. It was 8.5% in 1995 and it almost tripled by 2008. With the crisis it reduced to 19-20% for some years but a slow recovery and closing-up to EU average started in 2015 (21.5%) (Figure 4).

Figure 4: Gross domestic savings (% of GDP)



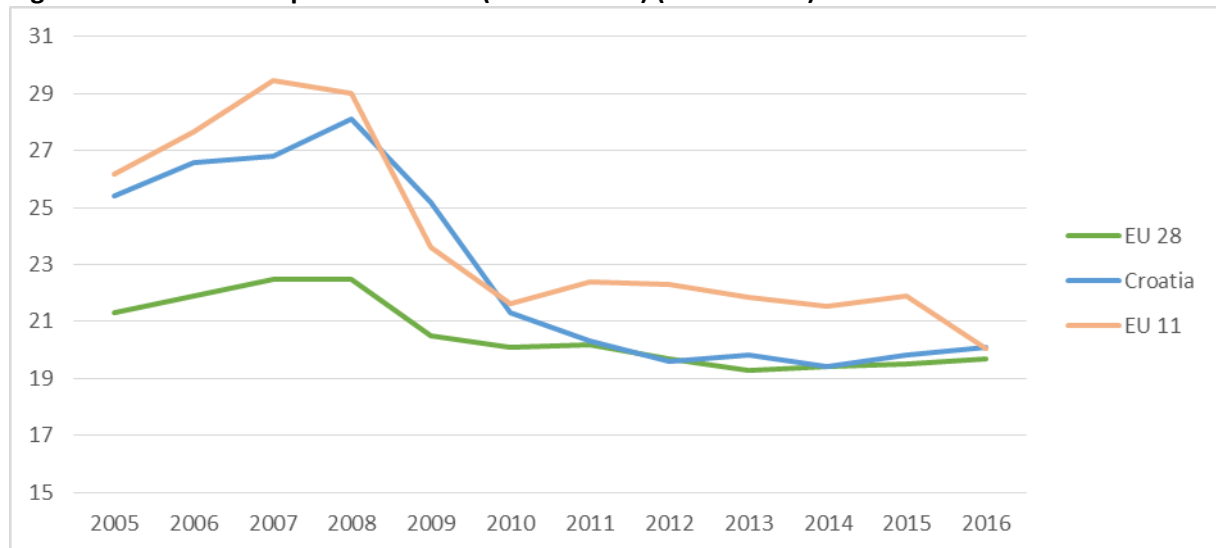
Source: World Bank

Gross fixed capital formation makes over 90% of domestic investment. Domestic investment have a constant trend of growth from 1995 to 2008, it grew about 5 times in

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current prices (Ivanović 2015: 141). With the economic crisis it has fallen about 40%, and reduced to the level of the EU28 level (Figure 5). Troubles around Agrokor⁷ experienced in the first part of 2017 may hold back investment, but after a solid rebound, it is expected to continue rising, according to the European Commission (Ecfm 2017). However, high corporate debt and a cumbersome business environment continues to hamper on private investment (EC 2016:3).

Figure 5: Gross fixed capital formation (investments) (in % of GDP)



Source: Eurostat

(2) One of the most sensitive areas of the Croatian European integration process had been the thorough restructuring, both on the level of firms and of the state itself. Even in the latest progress reports, the Commission urged important competition policy reforms. Croatia administers a large portfolio of state-owned enterprises⁸ (SOEs) whose accountability and transparency have improved, according to the Commission. In its macroeconomic imbalance procedure assessment, the Commission highlighted that Croatian firms are still burdened by costly administrative procedures and weaknesses in the business environment results higher costs of doing business for Croatian enterprises (EC 2016).

Considering the state, the Commission warns that the fragmentation and complexity of the state administration system weigh on efficiency (EC 2016:71). Examining

⁷ Agrokor is Croatia's largest privately-owned company, with a debt of close to 15% of the country's GDP.

⁸ In the EU we find 420 state-owned multinational enterprises from which 10 are headquartered in Croatia (WIR 2017).

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Croatia's detailed doing business points, dealing with construction permits and starting a business are the two weakest points among the indicators (DB 2017). All in all, long-standing structural weaknesses, including limited business environment reforms and high corporate over-indebtedness still limit the medium term growth prospects (EBRD 2017).

(3) The successful privatization of the banking sector created hard budget constraints in the financial sector. However, delays in the privatization process of the state-owned companies had sustained the risk of the soft budget constraint for a time. Before EU accession, state subsidies had a significant level in Croatia that hampered the efforts of establishing hard budget constraints. In addition, large share of the subsidies went to loss-making companies (EC 2011:24). Considering the average return on assets in 2012-14, the profitability of state-owned enterprises was well behind the Central and Eastern European peers. Subsidies amount to 2.2% of GDP, significantly above the EU average (TR 2017b). The EU accession process and the obligation of implementing the common state aid rules resulted in a trend of decreasing volume of subsidies. However, efforts to enhance the operational efficiency of SOEs have been slow, supervision of public enterprises continues to be fragmented and incomplete (EC 2015b:51).

4) The rehabilitation of the banking system was carried out successfully after the banking crisis of the 1990s. In 1998-99 new bank law was adopted, banks were consolidated and privatized during the decade, mainly by foreign investors. By 2003 the share of foreign investors in the Croatian banking sector was 90.8%. Strong capital inflows that founded the robust growth before the 2008 financial crisis were partly channelled through the banking sector. The crisis led to high level of private sector debt and huge stock of non-performing loans, 17% in September 2015. Household indebtedness has been exacerbated with currency risk due to long-term loans denominated in EUR and CHF. Albeit profitability was hampered, the financial sector in general withstood the crisis. In September 2015 legislation on the conversion of household CHF loans was adopted. Thanks to the liquidity provisions of the Croatian National Bank (Hrvatska narodna banka, HNB), enough liquidity has been created in the banking sector to finance the recovery being about to start (EC 2016).

The European Union as an anchor

One of the core issues of Europeanization is whether the EU serves as an anchor during the transformation process of the post-communist countries, i.e. whether the EU is able to be the point of reference and to catalyse the process of changes. As Harrold and Hahm (2012) note, Europe has invented a “Convergence Machine”. The machine functions so, that the EU welcomes poor countries and helps them to become high-income economies, the authors claim.

The question is whether it works with every country. The “Convergence Machine” is certainly an opportunity but not a guarantee. Gyórfy (2008) finds evidence that the EU is powerless even regarding its own member states when the requirements did not reflect the domestic political and social convictions but they appear only as external expectations.

There is certain evidence that in case of Central and Eastern European countries the EU served as an anchor during their transformation process. These economies had a point of orientation all across the years of their systemic change. The Commission tried to maximise its leverage following from the broad mandate it had, as well as from its being the conductor of the accession negotiations. Signalling and screening were widely used both in formal and informal matters. “From the safety of water boilers to the appropriate techniques of monetising the fiscal debt or taxing investors and granting them exemptions, a large number of issues, normally remaining within the exclusive competence of national administration, have become subject to scrutiny and public evaluation” (Csaba 2004:339). Beyond the formal pressure, the informal “beauty contest” among the accession countries in Central and Eastern Europe did help sustain the reformist momentum in otherwise sensitive areas. Thereby, the external – European – influence acted as an anchor, as a catalyst of change, while in cases where this role was either entirely missing (e.g. in Serbia), or proved to be marginal (e.g. in Croatia) path dependence became the dominant feature (Csaba 2004:340).

Croatia could have joined this group of countries and might have been a frontrunner in Europeanization based on the country’s identity, historical and cultural heritage. As a consequence of certain conditions (most of all the Yugoslav war in which Croatia was

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involved from the very beginning of its transformation process) Croatia did not get into the group of Central and Eastern European countries as Slovenia. Croatia has experienced a detour from the “mainstream Europeanization path”, it became a late-comer candidate, a special case, and meanwhile the attitude of the EU and the dynamics of Europeanization has also changed. In case of Western Balkan countries the role of the EU as an anchor has been weaker mainly because the lack of clear promise of membership. The euphoric Europeanization dynamics of the first round of Eastern enlargement did not attain the Western Balkan region. When the accession negotiations with Croatia went on after 2008, the prospects for the future were very different in Europe. It was not the transition process any more that needed to be anchored. Instead, it turned to a recovery from the crisis.

Even if in a slower pace than in the “benchmark” CEE countries, the pressure from the EU (and from other international organizations) have always had remarkable impact on the Croatian policy making. The EBRD stated in its 2007 report (EBRD 2007:118) that cooperation with international financial institutions and the accession negotiations with the EU remain important anchors for structural reforms in Croatia. It has been a long road until this statement.

The 2008 Progress Report (EC 2008) described the overall progress being made by Croatia as good. Based on the fact that a number of conditions were met by Croatia, in March 2008 EC President Barroso stated that as part of the 2008 enlargement package the Commission presumed to submit an indicative timetable for the technical conclusion of the negotiations by the end of the following year. In order to reach this goal, five conditions were laid down. Firstly, Croatia should meet all opening benchmarks by June 2008, including the two crucial chapters of judiciary and fundamental rights, and competition policy. The most sensitive issue concerning the latter chapter was the restructuring of shipbuilding. Secondly, Croatia must comply with all legal obligations under the Stabilisation and Association Agreement (SAA). Here again further efforts were needed in case of restructuring the shipbuilding sector. Thirdly, Croatia must continue to comply with the general conditionalities of the Stabilisation and Association Process (SAP). Fourthly, Croatia urgently needed to improve its management of EU financial assistance under the PHARE and IPA programmes. The good progress made

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was needed to be translated into concrete progress on the ground. Fifthly, Croatia must suspend all aspects of the Ecological and Fisheries Protection Zone, with respect to EU vessels.

The 2009 Progress Report stated that Croatia had made good overall progress in line with the roadmap. The roadmap successfully galvanised efforts to meet the benchmarks in order to open and close the chapters according to the indicative timetable. However, the border dispute with Slovenia held back the accession negotiations. More chapters could not be opened or closed until October 2009 although they were technically finalised earlier. Beyond this bilateral issue, delays in certain areas meant that opening of the two sensitive chapters could not progress in line with the roadmap: chapters on the judiciary and fundamental rights and competition. After all, the Commission evaluated the overall progress achieved in Croatia that the negotiations were nearing their final phase. At the end of 2009, relying upon the Commission's recommendation, a working group was set up to draft the Treaty of Accession with Croatia. In the Enlargement Strategy 2010-2011 the Commission welcomed the entry into force of the Lisbon Treaty, which gave a new momentum to the EU's enlargement process. The accession negotiations with Croatia were finally closed on 30 June 2011. The Comprehensive Monitoring Report adopted by the Commission in 2012 (EC 2012) identified ten priority areas which requires particular attention during the interim period until accession. The Monitoring Report adopted by the Commission in March 2013 (EC 2013) imposed very concrete actions as well. In a referendum 66% of voters wished to join the EU in 2012. Finally Croatia became the 28th member of the European Union on 1 July 2013, without any specific transitional arrangements, more than nine years after the first round of Eastern enlargement. Our original expectation (i.e. that Croatia could have been a frontrunner in Europeanization) was based on deeper roots of the Croatian identity, historical and cultural heritage. The realization of this expectation seemed to be delayed but not overwritten.

Since Croatia joined the European Union in the midst of a six-year long recession, the "convergence machine" had certainly a lot to do. The World Bank establishes that entering the single market and having been able to absorb the EU grant funds has helped

the recovery that started in 2015. Let us see what impact of the EU is perceptible after four years of accession?

Measuring Europeanization

Europeanization can be seized from several sides. From economic point of view Europeanization is the result of economic integration, may be described by the level of trade or FDI flows. In this case the tighter the country's trade and FDI flow interrelations with the EU as a whole, the more it is Europeanized. If we consider the convergence of income differences, the more the country or region converges to EU income average, the more it is Europeanized. The Europeanization of national policy-making may be described as the scope and extent to which national policies are shaped by EU law and policy. To measure it, we can identify the share of national legislation that has been influenced by a "European impulse" (Töller 2010). When it comes to the Europeanization of public mind, Eurobarometer can be used to examine the changes in climate of opinion.

In this study we consider economic factors first: merchandise trade and a special sector of trade in services, tourism. Foreign direct investments are also analysed together with the investment opportunities and business environment of Croatia. Two examples of influencing national policymaking are presented: the fight against corruption and the excessive deficit procedure. Both cases include policy steps which most probably would not happen without the pressure of the EU. Another direct effect is the financial assistance through which the EU influences national priorities. This effect may be estimated by the exploitation of EU funds. Last but not least the Europeanization of the general public will be measured by confidence towards the European Union, using Eurobarometer results.

Trade

The EU accession meant changes in Croatian foreign trade, partly because of entering the single market, but also due to the simultaneous exit from CEFTA (Central European Free Trade Agreement). Concerning the direction of trade, the main trading partner of Croatia has been the EU long before the accession. Trade liberalization started with the Stabilization and Association Agreement in 2001 which was asymmetrically in favour of

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Croatia. The EU has granted Croatia duty-free access to its markets for almost all products except for veal meat, seafood products and wine. At the same time Croatia completely eliminated its custom duties on imports of industrial products from the EU by 2007 and reduced tariffs on agricultural products and fisheries. From 2007 to 2013 foreign trade with EU27 countries reached 60% of the total Croatian foreign trade which made the EU its most important trading partner (Table 1). Since 2013 both exports to the EU and imports from the EU has been continuously increasing (Figure 7 and Figure 8). The largest Croatian trading partners from the EU are Germany, Austria and Slovenia. With almost all member states Croatia records trade deficit. In 2015 Croatia belonged to the group of member states that are net importers of goods not only in their trade with European Union partners but also with trade partners outside of the EU. Croatia's share of total EU28 export is relatively low (0.3%) and equals with the size of share of Latvia or Estonia (Figure 6).

Despite its small size, Croatia still proves to be a relatively closed economy: exports of goods and services represented only 51.4 % of GDP in 2016, compared with 60-90% for most countries in Central and Eastern Europe⁹. The access to the single market significantly improved the export capacity of Croatian companies. Still, Croatian firms appear to be less integrated in global value chains and to be less involved in inter-industry trade compared to other Central and Eastern European firms. As a relatively late-comer, Croatia missed the wave of expansion of western manufacturing CEE peers experienced (Orsini 2017).

Four years are too short time period to see similar growth in value of exports of goods to partners in the EU28 as it was visible in case of Bulgaria, Czech Republic or Lithuania after their accession (in these cases more than 200% between 2003 and 2015). However, EU accession together with economic recovery boosted exports (from 43% of GDP in 2013 to 51.4% in 2016) which also paved the way to a turnaround in the current account balance. Croatian value of exports of goods doubled between 2003 and 2015.

⁹ <http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS?locations=HR-EU>

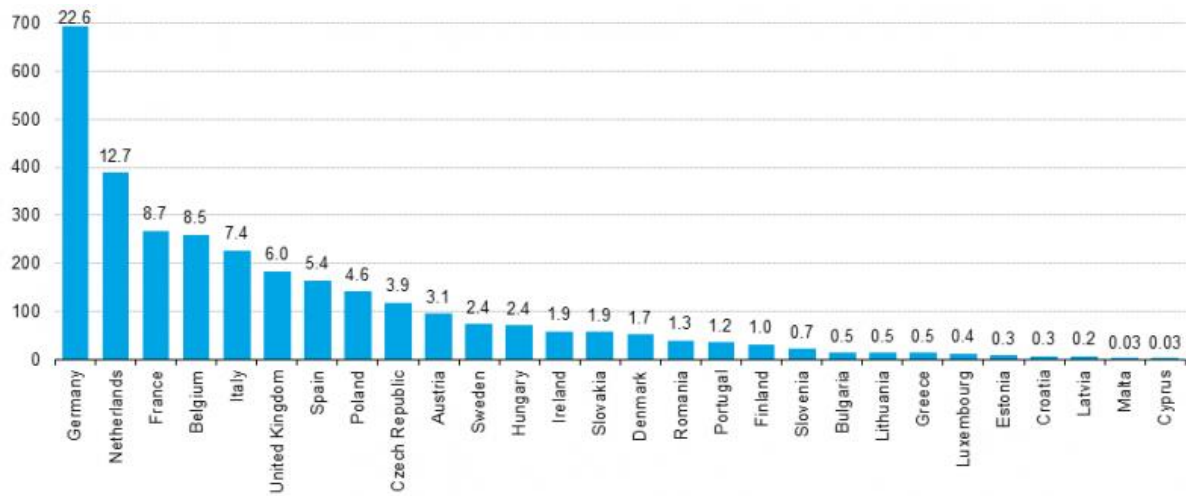
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Table 1: Trade with the EU, as % of total

	1996	2006	2016
Exports from EU	51%	63%	77.2%
Imports to EU	59%	65%	66.3%

Source: EUI country profiles for 1996 and 2006, WTO for 2016

Figure 6: Exports of goods to other Member States, share of EU28 exports, 2015

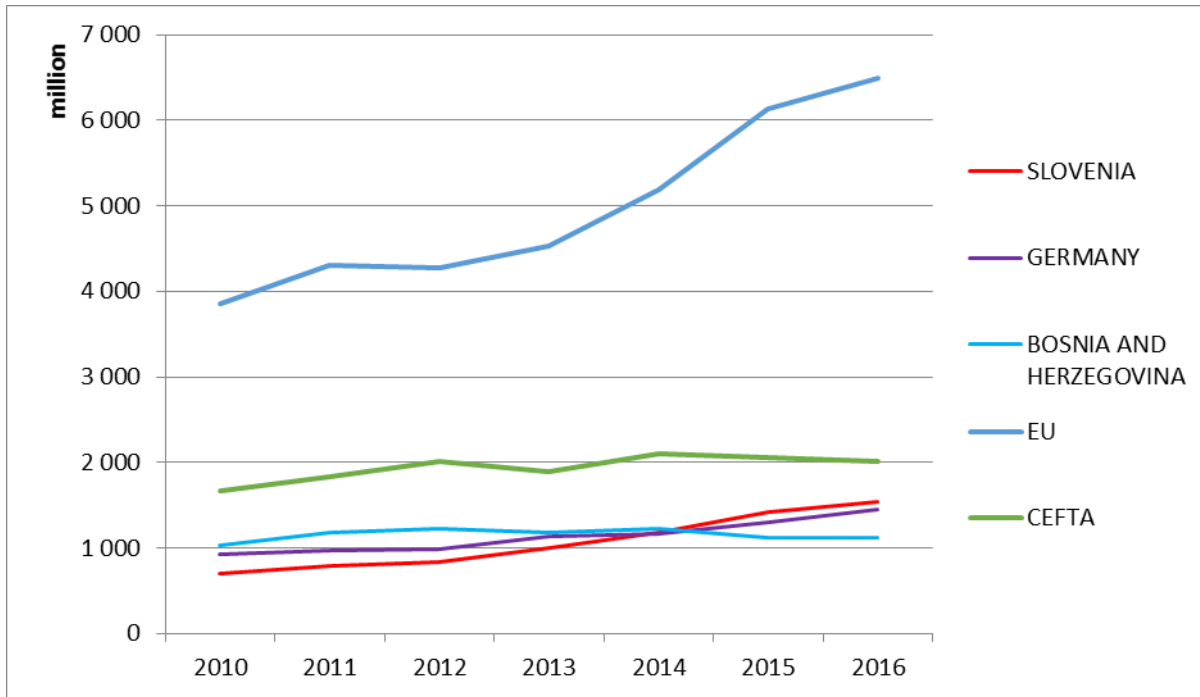


Source: Eurostat. Comext table DS- 057009

With entering the Single Market Croatia left CEFTA, the member of which it had been since 2003. About 20% of exports went to CEFTA countries, where Bosnia and Herzegovina and Serbia were its biggest trade partners. In 2013 Croatian foreign trade with CEFTA countries started to decrease (fall in exports was 5.8% and 4.8% in imports right in the first year of EU membership). However, later both imports and exports recovered to the pre-2013 level or even exceeded it (Figure 7 and Figure 8). As during the previous two enlargements, the EU launched consultations with CEFTA countries with which it has signed Stabilization and Association Agreements (Albania, Bosnia and Herzegovina, Montenegro, Macedonia and Serbia) regarding the mitigation of changes in terms of exports for Croatia. According to this, from the day of accession Croatia enjoyed duty-free bilateral trade in industrial products without a period of adjustment and trade in agro-food products at basic, reduced and zero customs rates with these countries. With Kosovo and Moldova Croatia applies duties under the most favoured nation (MFN)

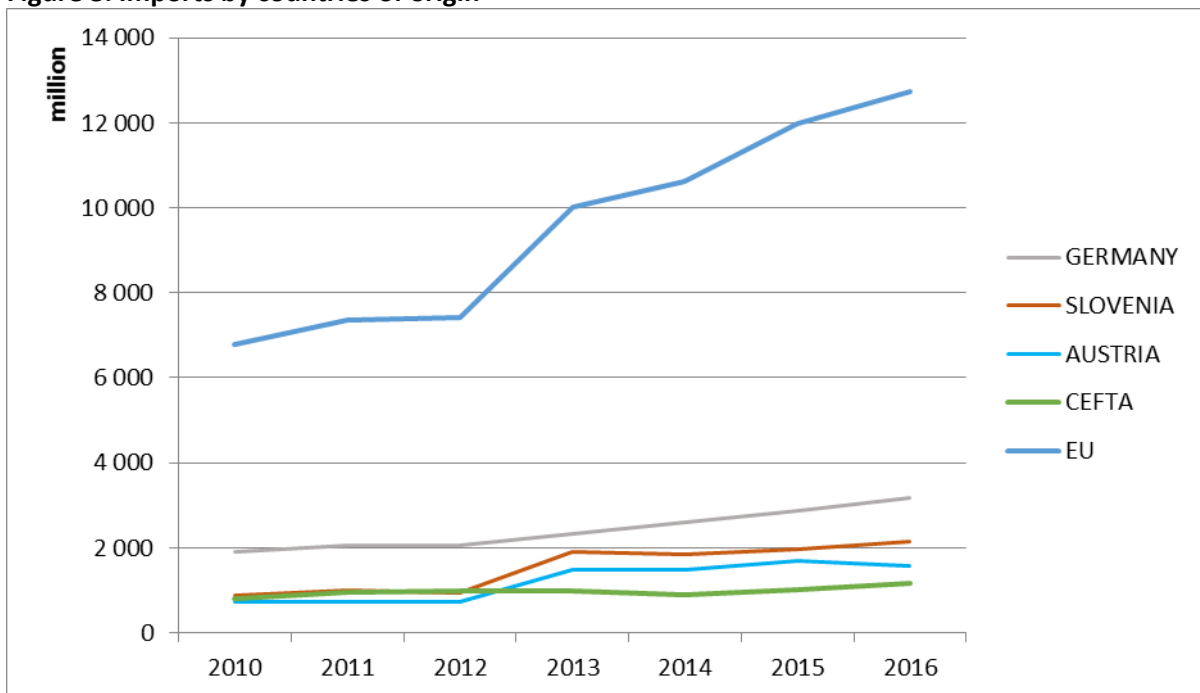
status since EU did not signed SAA with the above-mentioned countries (Štulec et al. 2014).

Figure 7: Exports by countries of destination



Source: Croatian Bureau of Statistics

Figure 8: Imports by countries of origin



Source: Croatian Bureau of Statistics

Tourism

International tourism plays an outstandingly important role in the country's external position. With 37% international tourism receipts of total exports in 2015, Croatia stands high above all the other member states in this respect. This sector not only generates revenues but also drive up the import of consumption goods. Contrary to most of the EU11, Croatia's imports appear to be mainly driven by exports of services (primarily tourism), while exports of goods and investments play only a secondary role (Orsini 2017). Travel and tourism's direct contribution to GDP in Croatia was 10.7% in 2016, compared with the EU average of 3.7%. The sector's direct contribution to employment is the double of the EU average (10% and 5% respectively in 2016) (WTTC 2017).

Compared with the EU28, Croatia's tourism activities are much more seasonal. This seasonal character is visible also in the import dependence of the country which is driven by the surge in consumption of non-domestic residents during the peak tourist season.

Tourism in Croatia is mainly focused on guests from within the EU. In 2012 only 11% of guest nights were spent by tourists from outside the EU. The top 5 countries of origin were Germany (24%), Slovenia (11%), Austria (9%), the Czech Republic and Italy (both 8%) (Demunter–Dimitrakopoulou 2014). The tourism sector is clearly a beneficiary of the EU accession, although the potential benefits are far from being totally utilized. Croatia is still not a member of the Schengen zone, and becoming a member is certainly a priority for the country. In June 2017 Croatia connected to the Schengen Information System (SIS) which helps to reduce waiting time at Slovenian and Hungarian land borders. This also means that Croatia has met the technical and legal requirements of the Schengen evaluation and a phasing-in process can begin. Foreign Minister Miro Kovač hopes to be fully admitted to Schengen zone in 2018¹⁰ (Morgan 2017). As EC

¹⁰ Bulgaria and Romania (who joined the EU in 2007, six years before Croatia) have been considered ready by the Commission to join Schengen treaty since 2010, but their accession has been blocked by member states, (incl. the Netherlands, Germany and France). Schengen accession requires the unanimity of its members. "If we want to strengthen the protection of our external borders, then we need to open the Schengen area to Bulgaria and Romania immediately" – said European Commission President Jean-Claude Juncker in his 2017 State of the Union speech.

President Juncker said in his 2017 State of the Union speech, Croatia should be allowed to become a full Schengen member once it meets all the criteria.

FDI

In most Central and Eastern European economies, EU accession process had a significant impact in shaping the scale and the nature of the FDI. Even the prospect of EU membership ushered in sizeable foreign direct investments which underpinned their progressive integration in global value chains, especially in automotive industry (Orsini 2017). Croatian firms have shown relatively low level of internationalisation. Despite sizeable FDI, it bypassed the export-oriented sectors, contrary to the trend in Central and Eastern Europe where FDI had contributed significantly to export restructuring. While most EU11 countries also succeeded in increasing exports mainly in higher-end technology sectors, Croatia mostly specialised in exporting lower-end technology products (EC 2015b:29). Although Croatian manufacturing sector confirm that companies that have received FDI are more successful regarding their capital, sales, employment and productivity growth (compared to domestically owned ones), FDI failed to increase the employment rate, exports, productivity or competitiveness of the economy significantly.

Due to the drop in real estate sector, investment had been very low from 2008. After the crisis, investments gain in recovery momentum in 2015, increasing by 4.6% in 2016. The expected materialization of newly announced publicly-funded projects together with a greater efficiency in attracting and absorbing EU funds give cause for optimism regarding the mid-term investment outlook (CEO 2017:4).

Concerning the origin of FDI, EU countries have been the largest investors in Croatia. Since 1993 the share of the EU15 has grown, on the basis of net incurrence of liabilities, in 2017 the top three investment partners were the Netherlands, Austria and Italy. At the same time the most important destination countries of Croatian outward FDI (net acquisition of financial assets) were Netherlands, Bosnia and Herzegovina and Slovenia in Q1 of 2017¹¹.

¹¹ <https://www.hnb.hr/en/statistics/statistical-data/rest-of-the-world/foreign-direct-investments>

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Together with its geo-strategic location and high quality of road infrastructure (the 10. best according to EU transport scoreboard 2016), Croatia's attractiveness has certainly developed with the EU accession. Beside all the already mentioned obstacles, an improving business environment (Table 2) emerges since the EU entry.

Table 2: Doing business in Croatia, measured in DTF (distance to frontier)¹²

year	overall DTF
2017	72,99
2016	72,78
2015	72,20
2014	63,79
2013	62,65
2012	62,98
2011	61,76
2010	61,33

Source: Doing Business Custom Query

Fight against corruption

During its candidacy, Croatia was categorized as a country with high, systemic corruption that requested very elaborate and constant measures to root it out from the society and the Croatian polity (Grubiša 2010). The fight against corruption (especially political corruption) was ranked high on the list of EU priorities during the Croatian accession negotiations that have also continued after the accession. The EU forced a tough civilising mission in Croatia, based on the country's nesting orientalism and nationalism. At the same time, Croatia was eager to escape the "Balkans" and considered the EU enlargement process as a chance to "Europeanize". As a consequence, during the negotiations the country did all it took to convince the EU of its rule of law institutions. This EU's civilizing and Croatian self-civilizing mission together explain how the former Prime Minister, one of the most powerful persons in Croatia was indicted (Hajdinjak 2016). In 2012 November former PM Ivo Sanader was sentenced to 10 years in prison on corruption charges. He was accused of diverting money from state-run firms and

¹² An economy's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier. For example, a score of 75 in 2016 means an economy was 25 percentage points away from the frontier constructed from the best performances across all economies and across time. A score of 80 in 2017 would indicate the economy is improving.

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institutions during his two terms in office from 2003 to 2009, making illegal financial gains for his party and himself. “You have damaged Croatia’s reputation (...) this verdict is a message to those engaged in politics that crime does not pay” the judge said at Zagreb county court (Reuters 2012). Sanader strongly denied charges and regarded the trial as politically motivated. The trial was seen as one of the most important corruption cases in Croatia since the country’s independence. Many considered Ivo Sanader’s sentence as demonstration of Croatia’s efforts to suppress political corruption before it formally joined the EU, and that he and the party membership behind him were sacrificed to convince the EU of the quality of Croatian institutions. Moreover, the EU’s conditionality on anti-corruption was so strong and effective that the Croatian political elite neglected the threat it posed to their own political survival (Hajdinjak 2016).

Contrary to many new EU members, in Croatia we do not see massive reversal in anti-corruption progress during the post-accession period. The authority of USKOK¹³ and strengthened capacities acquired during the accession negotiations could provide an obstacle for deterioration of the achieved improvement (Hajdinjak 2016:66).

Excessive deficit procedure

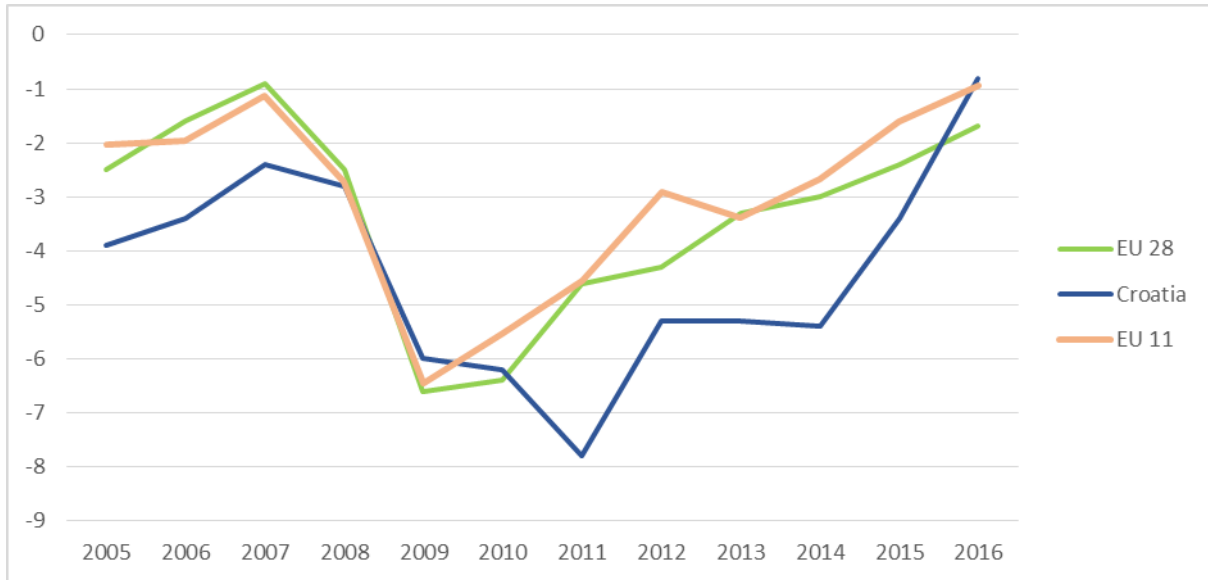
Shortly after the accession, an excessive deficit procedure was opened in January 2014 because both the deficit and debt criteria were in breach. After peaking with 7.8% of GDP in 2011, the general government deficit was 5.4% of GDP in 2014 – with 86.6% public debt to GDP ratio which stood exactly by the EU average (Figure 10). The Council issued a recommendation to correct the deficit by 2016. Croatia's general government deficit reached 0.8% of GDP in 2016, down from 3.4% of GDP in 2015. The Commission’s 2017 spring economic forecast has projected the deficit to rise to 1.1% of GDP in 2017, and to fall back to 0.9% of GDP in 2018. As a consequence the Council concluded that Croatia's deficit has been corrected and set to remain below the 3% of GDP reference value over the forecast horizon. The 2016 debt ratio (84.2%) was considered to fulfil the forward-looking element of the EU's debt reduction benchmark. In June 2017 the excessive deficit procedure was closed (Council Decision 2017). Together with the

¹³ Ured za suzbijanje korupcije i organiziranog kriminaliteta, Croatian State Prosecutor's Office for the Suppression of Organized Crime and Corruption

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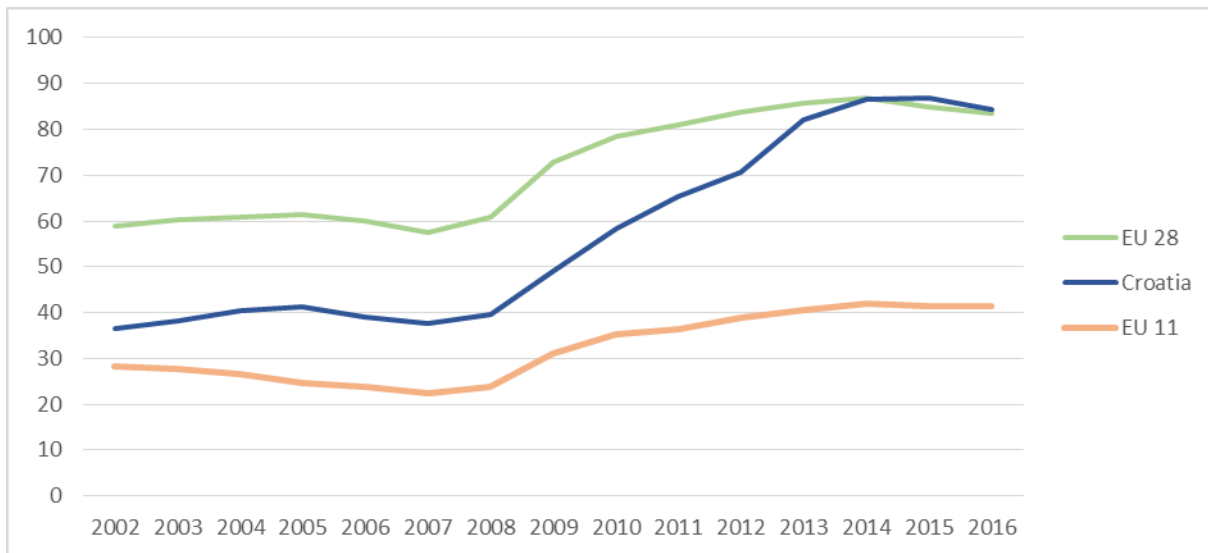
impetus of the economic recovery, the excessive deficit procedure seemed to anchor the fiscal consolidation in Croatia.

Figure 9: General government deficit, % of GDP



Source: Eurostat

Figure 10: General government gross debt, % of GDP



Source: Eurostat

Exploitation of EU funds

In 2012, Harris and Hahn warned about the need to create fiscal space to co-finance a six-fold increase in EU funding: right before the accession Croatia lacked the fiscal space

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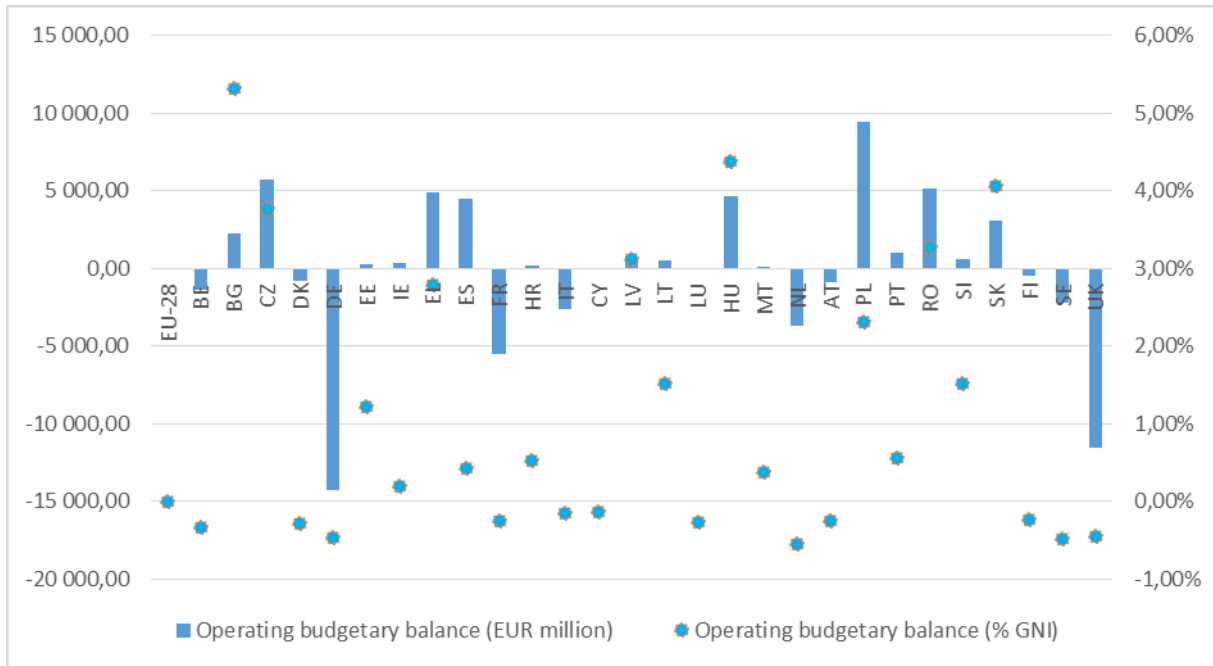
to co-finance EU funded projects. Croatia's operating budgetary balance started with 173.4 million in 2014 and improved to 226.7 million euro in 2015 (Table 3). However, the 0.52% of GNI as operating budgetary balance is the worst number among peer countries (Figure 11). Croatian Chamber of Commerce (Hrvatska Gospodarska Komorna, HGK) reported that during its three and a half years Croatia has absorbed 19% of the funds available to it (a little under 2 billion euro). According to their calculations, Croatia absorbed twice as much in 2016 as in 2015. The weaker absorption capacity right after the accession was mainly due to a high number of uneven project proposals, lack of staff in relevant bodies and frequent tender documentation changes. With an improvement in number of the tenders, stronger administrative capacities in EU fund management, and the financial sector's openness to back applicants, Croatia could take more advantage of EU funding in 2016 (EBL 2017). In April 2017 Prime Minister Andrej Plenković said that the money available to Croatia in EU funds represents "an obligation, a challenge and a task" in order to absorb and use these funds for specific projects (Vlada 2017).

Table 3: Operating budgetary balance of Croatia

	2013	2014	2015
Gross National Income (GNI), EUR million	42 732,2	41 772,8	43 596,5
Operating budgetary balance (EUR million)	+49,6	+173,4	+226,7
Operating budgetary balance (% GNI)	+0,12%	+0,42%	+0,52%

Source: European Commission, Budget in figures

Figure 11: Operating budgetary balance by member states, 2015



Source: European Commission, Budget in figures

Feeling European

Looking into the Eurobarometer reports, Croatia entered the EU in a highly pessimistic mood: in spring 2013 the vast majority (97%) of the respondents evaluated the economic situation of the country as “total bad”. Regarding the *trust towards the EU*, 37% tended to trust the EU and 54% tended not to trust, which reflected more confidence in the European Union than the EU27 average in spring 2013 (EB 2013a). The first results after the accession showed slightly less trust towards the EU (EB 2013b). In spring 2015 people tended to trust the EU (51%) outweighed those who tend not to (38%), which was vice versa in the EU28 (EB 2015). Trust towards EU has been higher compared to trust towards national parliament or government. In general, since 2013 confidence towards the European Union has increased compared to the years of candidacy and potential candidacy. Since 2015 people tend to trust the EU have been above 40% constantly until 2017. By the end of 2017 the majority of the population distrusted the European Union while the opposite was true in spring 2017 (EB 2017b). Concerning the other CEE countries, the results are very mixed, trust in the EU is highest in Lithuania (64%) and Bulgaria while the majority of respondents tend not to trust the

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EU in ten countries, including the Czech Republic as well (56%). The CEE average of trust (43%) was slightly above the EU28 average (41%) in autumn 2017.

Right after the accession, in autumn 2013, 58% of the respondents *felt they are a citizen of the EU* and 42% felt not. By spring 2015 it has changed so that 61% felt they are a citizen of the EU and 38% felt not (EB 2015) and this trend remained unchanged until the end of 2017, when this indicator has reached the 70% threshold (EB 2017b). The feeling of EU citizenship in the EU11 tend to be weaker compared to the average of the old member states, and Croatia belongs to the less committed even within the EU11.

First conclusions

In their opinion article, Harrold and Hahm (2012) collected Croatia's strengths and weaknesses compared to four EU11 countries' (Slovakia, Czech Republic, Slovenia and Estonia) position in the European Union.

Among the strengths we find trade, "the first leg of the convergence machine". The evidence show that just like the peer countries, Croatia clearly benefits from the trade integration with the EU. The other strength is financial integration, "the second leg of the convergence machine". The authors claim that Croatia benefits from capital flows from EU members.

At the same time Croatia faces several weaknesses that may hamper to realize potential benefits of the EU membership: the poor climate for private enterprises, the limited support for research and development, and innovation, the low level of labour productivity and employment, and the too large government. As the Commission highlights, restrained growth, delayed restructuring of firms and the limited performance of employment have common roots: inefficiencies in the allocation of resources. The unfavourable business environment is a major obstacle on the adjustment capacity of the economy (EC 2015b:1). These issues partly overlap with the ones Franičević and Kraft mentioned already in 1997. At the same time essential improvements are visible in the past twenty years, partly as answers to the Europeanization pressure.

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Putting Croatia's Europeanization process in comparative perspective may be feasible in two different ways. On the one hand, we can compare its process with the 2004/07 accession countries, i.e. the first (and second) wave of Eastern enlargement, including one former Yugoslav successor state (Slovenia) and two Southeastern European state as well (Romania and Bulgaria). On the other hand, we may compare Croatia with the so called Western Balkan¹⁴ countries, from which group Croatia became the first of the seven countries to join. Croatia may be seen as a late-comer Central and Eastern (or Southeastern) European country, or a forerunner Western Balkan state. Most of the studies represent the first comparison, and consider the 2004/07 enlargement as a kind of benchmark.

Whichever version we choose, we should keep in mind that the "convergence machine" has also changed, and the dynamics of the 2004/07 enlargement cannot be repeated. These days the EU model is clearly not working as it worked at the new millennium, since the EU finds itself in a stalemate in its response to new challenges. Öniş and Kutlay (2017) write about limits of the EU's transformative power in the European periphery, regarding both internal (member) and external (not member) countries. The authors identify two groups of factors that raise important concerns regarding the EU's political and economic appeal as a norm-setter. The one are the EU's multiple crises and inability to respond adequately to contemporary challenges. In other respects, factors associated with the political economy of the changing global order and the rising powers in the post-crisis equilibrium are also leading to substantial change in the EU's relations with countries in the periphery. While the authors write about de-Europeanization in case of Hungary and Turkey, regarding Croatia we only see a feeble anchor capacity. Take a look back onto the Europeanization process of Croatia we see a twofold phenomenon: Croatia wanted less from the EU (from both material and mental incentives it offered in return for political and economic conditionality) and as times have changed, the EU wanted and was able to give less as well. The Croatian Europeanization is a different story.

¹⁴ From 1998 the EU introduced the terminus technicus "Western Balkans" that was used also by NATO and referred to Bosnia and Herzegovina, Croatia, Federal Republic of Yugoslavia (dissolved since than), FYR of Macedonia and Albania. Today Montenegro, Serbia, FYR of Macedonia and Albania are official candidates. Bosnia and Herzegovina and Kosovo are potential candidate countries. How Croatia became a Western Balkan country is an entangled story (see Sigér 2010:84-85).

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Croatia's Europeanization process turned from internal to external. From an outsider the country became an insider, a full member with all the decision rights. The EU anchor also externalized, Croatia left the stabilization and association process and stepped in the European Semester or the macroeconomic imbalance procedure. The fact that the country arrived to the EU alone, may limit its ability to enforce its interest. Since the EU prefers group enlargement, single entry has not happened since 1981. Croatia arrived as a lonely newcomer among the old SEE or CEE countries, including Slovenia, its ex-Yugoslav peer, with whom its relationship is far from being unclouded. In many indicators Croatia lags behind all the other member states. The question is whether the EU's active leverage has diminished after the accession. Croatian National Bank Governor Boris Vujčić said in January 2017 that Croatia is planning to introduce the euro. "We need to meet the Maastricht criteria and we are on the right track" – he said. The convergence process could be a strong anchor for further reforms and after the recovery from the long recession it could be a determinant priority of Croatian policy making. Most probably those researches are right, which state that the EU is an opportunity for Croatia but not a guarantee. The opportunity offered an anchor for economic restructuring and catching up, complemented with financial support as well. If these opportunities remain unutilized, and the losers of the EU accession stay uncompensated, the disappointment with the membership is inevitable. Although it is clear that there will not be further enlargement in the near future, a credible enlargement perspective for the Western Balkans must be maintained, as EC President Juncker stated in his State of the Union 2017 speech. Croatia can set a good example for this region which may contribute to the long term stability of the Western Balkans as well.

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