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Consequences of COVID-19 Pandemic in Croatia and Call for Reforms

In the context of Croatia, the consequences of COVID-19 will depend on two aspects: the length of the pandemic, and the scale of assistance from the European Union (EU). It is clear, however, that the economic aftermath will be severe. This is an obvious threat to the dominant Croatian Democratic Union under the leadership of liberal Andrej Plenković, who is serving as the prime minister. On the other hand, the pandemic might serve as a long-awaited (by interest groups) stimulus to introduce reforms in some important areas of the country's economy. Adopted on the 28th of April, the National Reform Programme for 2020-2021 might constitute a stepping stone towards such a solution.

Scale of Recession. Croatia, alongside many other states, expects an incoming recession. The general lockdown, which was introduced at the end of March, and will last at least until June, has consequences for the economy. Equally severe is the economic decline in Germany, Italy, and Slovenia, which are three of Croatia's most important trade partners, with 37.5 per cent of the exports and 40.8 per cent of the imports in 2019, according to the State Statistical Office in Croatia. Slovenia, Italy, and Germany belong, alongside the Netherlands, Austria, Hungary, France, United Kingdom, Sweden, and Luxemburg to the top 10 largest investors in Croatia. Their combined investments equal to over 82 per cent of the overall FDIs in the state economy. Croatia's level of dependency on the Western world is even deeper due to tourism that constitutes an important part of the country's economy (between 15 and 20 per cent of the GDP).

Therefore, this year will be exceptionally bad for Croatia. And so, the GDP, which in the previous year rose by 2.9 per cent, this year, according to the estimates by the IMF, sharply fell by 9 per cent, while it is estimated to rise again by 4.6 per cent in 2021. The current account balance will decline by 4 per cent this year and the unemployment rate will increase from 7.8 per cent to 11.5 per cent. However, the scale of the crisis enables the ruling elite to introduce long-awaited steps towards the modernisation of the economy, which would correspond to the general socio-economic trends in the EU.

Reset of the Economy. The reaction of the government to the virus generally reflected the measures undertaken by the majority of governments and central banks in Europe. The economic stimulus package during the pandemic consisted of a mixture of tax exemptions and moratoriums, supplements for wages as well as state guarantees to the bank loans provided to entrepreneurs. The Croatian National Bank together with the European Central Bank established a swap line and regularly intervened to stabilise the Croatian Kuna and to ensure the liquidity of the economy. On the 27th of April, the government began the gradual liberalisation of the anti-pandemic measures and the re-vitalisation of the economy. This relative reset of the economic policy provides Andrej Plenković with an opportunity to reset the economic priorities and change the flow of the public finances.

Neither the incoming parliamentary elections nor the expected victory of the incumbent prime minister or even the opposition's (Social Democratic Party) take over power, will change the fact that reforms are required and expected by important interest groups. The latter include entrepreneurs organised within the Croatian Economic Chamber, the Croatian-German Industrial and Economic Chamber, and the Croatian Association of Employers. Moreover, additional sources of funding for reforms will be available from the European Union. Such funding relates in particular to green technologies and innovations.

In general, there are two major scenarios available, both of which affect two significant vectors of Croatia's economic policy. The first relates to the development of the modern economy, as per the guidelines provided by the EU Green Deal. The second relates to the re-cultivation of agriculture, especially in the Slavonian region. The

first scenario involves an increase in public spending with the ultimate aim of stimulating specific branches of the economy. The second scenario aims to focus on releasing the private sector from payment of certain taxes and bureaucratic burdens and, therefore, to enable the development of some branches of the economy.

The Green Deal and the Green Funds. The Croatian government has already expressed its support for the Green Deal. Zagreb, while being aware of the necessity to adjust the Croatian economy to 21st century requirements, sees the Green Deal as an opportunity to access new funds that will enable the transformation of the economy, technological progress, and innovative solutions that would satisfy environmental and economic requirements. The Green Deal could be relatively easily combined with the stimulus packages prepared to counter the negative economic effects of COVID-19. As such, the Croatian government would not only have the programme but also the funds assisting to transform the country's economy.

The Green Deal also enables Croatia to overcome a significant obstacle caused by the country's small size. Croatia is not able to compete with countries like Hungary or Poland in terms of mass production, not only because they are considerably bigger but also because they have joined the EU much earlier. This head-start allowed them to absorb EU funds into their economy and to adjust production to the requirements of Western consumers. The transition from the relatively obscure Croatian industry into the digital one would be an answer to the challenges of the modern, globalised world. The access to skilled workforce, the proximity to the Western markets, and the good economic relations with Austria, Germany, and Italy could provide additional incentives for the digitalisation and development of green technologies.

Agriculture. There is, however, another branch of the Croatian economy that requires special attention from the Croatian decision-makers, namely, agriculture. In particular, Slavonia, which is in the north-eastern region of Croatia, represents an important part of the national electoral body and remains politically frustrated, as has been shown during the past presidential elections. The Slavonian voters are ever more eager to support the anti-systemic Miroslav Škoro, who has won most of the votes in this region. For Plenković, as for many other leaders before him, the rural areas remain unpleasant, difficult, and uncomfortable issues to deal with, as they contradict the imagined Croatian push towards the West and modernity. Left unchecked, however, these rural areas are capable of creating dangerous political turmoil.

And yet, as many as 60% of the respondents of public opinion polls conducted by the *Agency Ipsos Puls* believe that the Croatian food industry must be the first strategic determinant of the Croatian economy in the future. Moreover, the Croatian food industry is already a strategic economic branch. It creates 3.2 per cent of the domestic GDP as well as 3.6 per cent of the employment. Food and beverages make up as much as 25 per cent in the total of the GDP of the processing industry and over 10 per cent of total exports of the manufacturing industry. In spite of that, the domestic production of milk and meat decreases while the import of these goods increases. Additionally, Croatia itself, as a relatively small market, does not have enough demand to stimulate the concentration of small-size (average just above 10 ha) farms.

The current response to the problem should soon be addressed by the Plenković government in a Strategy for Agriculture. For now, however, it is clear that it combines the following four general elements:

1. increasing the productivity and resilience of agricultural production,
2. enhancing the competitiveness of the agri-food system,
3. restoring the rural economy and improving the living conditions in rural areas, and
4. encouraging agri-food innovation.

Although the question of agricultural reform has long been disputed and awaited, the expected shortages in food production after COVID-19 might actually help the Croatian authorities to resolve the issue.

Conclusions: Programme for Reform. While the choice of the Prime Minister (incumbent or the future) as to the choice of the directions of domestic reforms remains unclear, the availability of the EU funds will legitimise keeping the overgrown Croatian administration on board. Adopted by the Government on the 30th of April, the national reform programme for the coming two years is focused on the modernisation of the economy according

to the principle of sustainability. The programme can be interpreted as a confirmation of Croatia's support for the EU Green Deal and its support for the development of the agriculture industry. On the same day, the Government adopted the Plan for Administrative Relief by digitalisation of some bureaucratic procedures, which is intended to unburden the economy by 686 million HRK (or over 90 million EUR).

The increase of Croatia's public debt in the eve of joining the Eurozone will result in limiting public spending. This contradicts the idea of increasing investments and the development of agriculture and green technologies. It is therefore likely that the government in Croatia will tighten its domestic fiscal policy and the collection of taxes while, on the other hand, it will increase the absorption of European funds.