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Supporting Strategies to Recover from the Crisis in South Eastern Europe

COUNTRY ASSESSMENT REPORT

Republic of CROATIA

Viktor GOTOVAC

Global Jobs Pact

DECENT WORK TECHNICAL SUPPORT TEAM AND COUNTRY OFFICE FOR CENTRAL AND EASTERN EUROPE

Supporting Strategies to Recover from the Crisis in South Eastern Europe

Country Assessment Report: Croatia

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Decent Work Technical Support Team and
Country Office for Central and Eastern Europe

First published (2011)

Gotovac, Viktor

Supporting strategies to recover from the crisis in South Eastern Europe: country assessment: Croatia / Viktor Gotovac ; International Labour Organization, Decent Work Technical Support Team and Country Office for Central and Eastern Europe. – Budapest: ILO, 2011

1 v.

ISBN: 9789221253846; 9789221253853 (web pdf)

International Labour Organization; ILO DWT and Country Office for Central and Eastern Europe

employment / unemployment / social protection / social dialogue / labour policy / economic recession / economic recovery / Croatia

13.01.3

Also available in Croatian: Strategije potpore za oporavak od krize u jugoistočnoj Europi : Ocjena Republike Hrvatske, ISBN: 9789228253849; 9789228253856 (web pdf), Budapest: ILO, 2011 ILO

Cataloguing in Publication Data

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Acronyms

ALMP	Active Labour Market Policy
CBRD	Croatian Bank for Reconstruction and Development
CBS	Croatian Bureau of Statistics
CCA	Croatian Competition Agency
CCE	Croatian Chamber of Economy
CEA	Croatian Employers' Association
CES	Croatian Employment Service
CNB	Croatian National Bank
ERP	Economic Recovery Plan
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HBS	Household Budget Survey
HRK	Croatian Kuna
ILO	International Labour Office
LFS	Labour Force Survey
LPE	Local Partnerships for Employment
MELE	Ministry of Economy, Labour and Entrepreneurship
MFIN	Ministry of Finance
PIT	Personal Income Tax
VAT	Value Added Tax

Foreword

The slowdown of world output triggered by the financial crisis of 2008, spilled over to the economies of South Eastern Europe through a number of transmission channels. Export growth decelerated sharply as a result of the recession in Western Europe and a decrease in domestic aggregate demand. Lending flows and foreign direct investment weakened and detrimentally affected those countries with large external deficits. A fall in remittances affected Gross Domestic Product (GDP) growth in countries where these played an important role in household consumption patterns. Many countries experienced rapid output declines, job losses, worsening conditions of work and mounting poverty rates. In some instances, pre-existing economic and fiscal vulnerabilities limited the policy space for large-scale anti-crisis packages. In short, the economic crisis threatened to endanger the gains in human development, stability and economic progress recorded by countries in the region over the last ten years.

At the International Labour Conference of June 2009, representatives of governments and employers' and workers' organizations adopted the *Global Jobs Pact* as a global policy instrument which places employment and social protection at the centre of crisis response. It is based on the ILO's Decent Work Agenda and the commitments made by the ILO constituents in the 2008 *Declaration on Social Justice for Fair Globalization*. The *Global Jobs Pact* addresses the social and economic impacts of the international economic crisis and proposes a portfolio of policies aimed at stimulating job creation, extending social protection, respecting international labour standards and promoting social dialogue for countries to adapt according to their national circumstances.

Against this backdrop, the ILO's Decent Work Technical Support Team and Country Office for Central and Eastern Europe (DWT/CO-Budapest) researched the impact of the crisis and the policy responses introduced by three countries in South Eastern Europe, namely Croatia, the former Yugoslav Republic of Macedonia and Serbia. It is anticipated that the resulting reports will serve as an input for constituents to understand better the country-specific challenges brought about by the crisis, assist in the development of strategies to stimulate labour demand, expand social protection, and strengthen social dialogue and rights at work.

The country assessment report of the Republic of Croatia was prepared by Mr Viktor Gotovac and undertaken as part of the DWT/CO technical assistance package *Supporting strategies to recover from the crisis in South Eastern Europe* coordinated by Ms Natalia Popova, Employment Specialist of the DWT/CO. It examines the country situation and policy responses using the Global Jobs Pact as an integrated framework for analysis.

The paper was presented during a cross country peer review workshop held in Zagreb on 21 April 2011. The meeting offered a platform for the ILO constituents of Croatia, the former Yugoslav Republic of Macedonia and Serbia to share knowledge on emerging challenges and policy responses with representatives of the government, and employers' and workers' organizations of the Republic of Slovenia. We trust that this document will be a useful contribution to policy dialogue in the countries of South Eastern Europe.

Mark Levin

Director
Decent Work Technical Support Team and
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Introduction

During the last decade, the labour market performance in Croatia failed to keep pace with high economic growth. Employment losses caused by the winding up and bankruptcy of a large number of companies in the private sector were not countered by sufficient job creation. Unemployment and low activity rates are mainly the consequence of insufficient demand for labour and the mismatch in labour supply and demand. Widespread skill mismatches appear to be major impediments to a more dynamic labour market performance.

The global financial and economic crisis has had a strong impact on the economy of Croatia, and especially on the labour market. Gross Domestic Product (GDP) declined by almost 6 per cent in 2009 and foreign direct investments (FDIs) fell by more than 50 per cent. Real GDP continued to decline in 2010, albeit at a slower pace (–1.2 per cent). Public finances came under strain, with decreasing revenues and higher spending in automatic stabilizers. The introduction of both spending cuts and increased taxes maintained the budget deficit at 3.3 per cent of GDP in 2009 and 4.2 per cent in 2010. Labour force participation rates decreased, partly as a result of worker discouragement effect Employment dropped, especially for adult men workers. Unemployment rose, particularly for young people (15 to 24). The economic crisis swept away the progress made by the country in job creation since the mid-2000s, in particular the progress in reduction of youth unemployment. These trends cause raising concerns about the risk of a lost generation, e.g. a group of disaffected young people forced to live on the margins of the labour market.

The number of jobs fell at a slower rate than GDP initially, but as the crisis continued, the fall in employment drew close to the drop in GDP rate. Expenditure on unemployment benefit increased from 0.24 per cent of GDP in 2007-08 to 0.37 per cent in 2009 and 0.43 per cent in 2010. This expenditure partially compensated for the income loss due to unemployment, and as such maintained consumption demand and dampened fluctuations in real GDP.

In April 2010 the government unveiled its comprehensive Economic Recovery Plan (ERP) aimed at raising the competitiveness of the domestic economy. The primary measures of the ERP focus on increasing labour market flexibility, reducing business costs and reforming the judiciary. The Plan achieved widespread support from the business community, but its introduction is at an early stage. The implementation of the government's reform programme will be a key challenge in creating the conditions for a return to economic growth. This will require a fundamental overhaul of some of the restrictive practices that hinder the businesses environment and the capacity of enterprises to create more and better jobs.

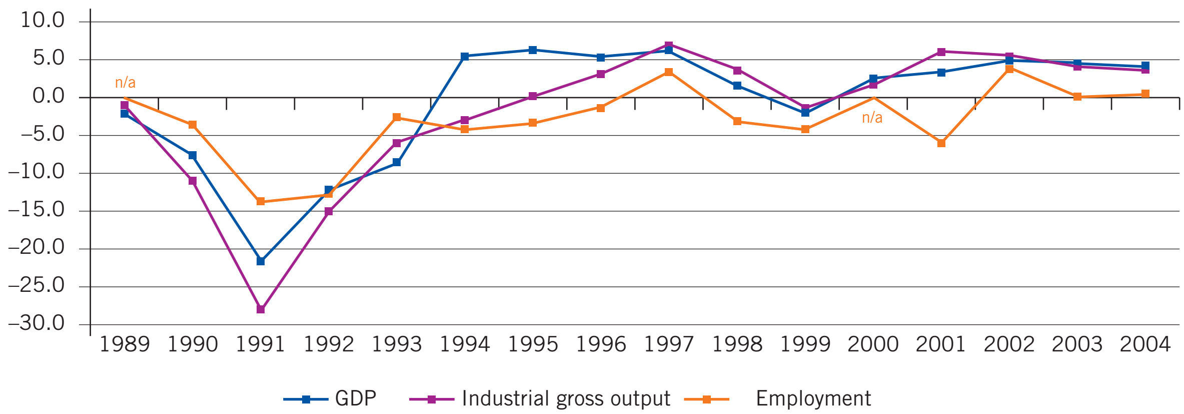
To date, the measures undertaken appear to have had a limited impact. In the first quarter of 2011 output declined by 0.8 per cent with the labour market continuing to adjust downward. Employment fell by an additional 1.6 percentage points, while the unemployment rate increased from 12.1 per cent in 2010 to 14.7 per cent in the first quarter of 2011.

1. Overview of the Social and Economic Context

The early period of transition to a market economy in Croatia was marked by a sharp contraction of Gross Domestic Product (GDP). This was mainly driven by a large decline in industrial output. Enterprise restructuring has given rise to accelerated inflows into unemployment. In 1991 the country recorded the sharpest negative growth rate in GDP, industrial output and employment (Figure 1). The stabilization programme launched in 1993 eliminated hyperinflation and stabilized prices as well as the exchange rate. Since then, industrial output and GDP started to recover, while the labour market continued to shed jobs. The recession of 2000, which affected the labour market with a three-quarter time lag, was overcome by the country thanks to the expansion of private consumption and the recovery of exports.

Figure 1

GDP, Industrial output and employment real growth rates, Croatia (1989–2004)



Source: European Bank for Reconstruction and Development (EBRD), *Economic research and data*, Paris, 2011, available at http://www.ebrd.com/pages/research.shtml.

In the period 2000–07, Croatia experienced a steady growth of economic activity (with GDP growth averaging 4.5 per cent). The basis of the country's development was the stable growth of domestic production, with retail, construction and tourism playing an important role and meaningfully contributing to GDP. In 2007, GDP growth reached 5.5 per cent, with an acceleration of 0.8 percentage points compared to the prior year. Private consumption and fixed capital investments contributed most to output growth. In the same year, GDP per capita, at purchasing power parity, reached 61 per cent of the EU-27 average, up from 57 per cent in 2005 and above the average recorded in South Eastern European (SEE) countries.[1]

Table 1 below shows that in the period 2003–2007 economic growth was mainly driven by fixed capital formation and exports.[2] Investment growth was by far the most rapidly increasing demand component, rising annually by an average of 28 per cent.[3]

Table 1

Sources of GDP growth (2003–2007)

Croatia	2003	2004	2005	2006	2007
Private consumption (% GDP)*	64.6	64.5	64.5	63.2	63.6
Gross fixed capital formation (% GDP)	27.3	26.7	27.3	29.4	29.4
Exports (% GDP)	42.6	42.9	42.3	42.7	42.1
Imports (% GDP)	50.4	49.3	48.7	49.8	49.8

Source: World Bank, *Economic indicators*, (http://data.worldbank.org/indicator).

(*) EU Directorate of Economic and Financial Affairs, *EU candidate and pre-accession countries. Economic Quarterly*, various years, (http://ec.europa.eu/economy_finance/db_indicators/cpaceq/index_en.htm)

On the supply side, the main feature of the pre-crisis period is the shift in value added from agriculture and industry towards services, with resources increasingly allocated in non-tradable sectors such as construction, wholesale and retail trade, financial intermediation and real estate at the expense of manufacturing. The value added of manufacturing to GDP decreased from 20.2 per cent in 2000 to 17 per cent in 2007, while that of services increased from 65 per cent to 67.6 per cent. Economic activity started decelerating in the last two quarters of 2008 and then became negative for the following six consecutive quarters (Figure 2). Output contraction continued through 2010, but at a milder pace (–1.5 per cent).

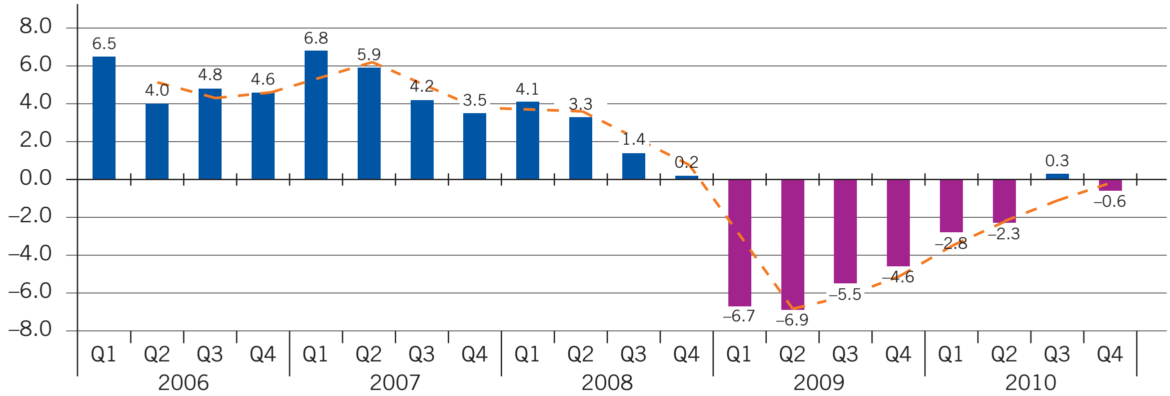
1 The level of per capita GDP reached by Croatia in 2007 was comparable to that of Poland, the Baltic States and Slovakia.

2 European Commission, Directorate-General for Economic and Financial Affairs, *The pre-accession economies in the global crisis: from exogenous to endogenous growth?,* Occasional Paper No. 62, Brussels, 2010

3 EU Directorate of Economic and Financial Affairs, *EU candidate and pre-accession countries. Economic Quarterly*, various years.

Figure 2:

Quarterly real GDP growth rate, Croatia (2006-2010)

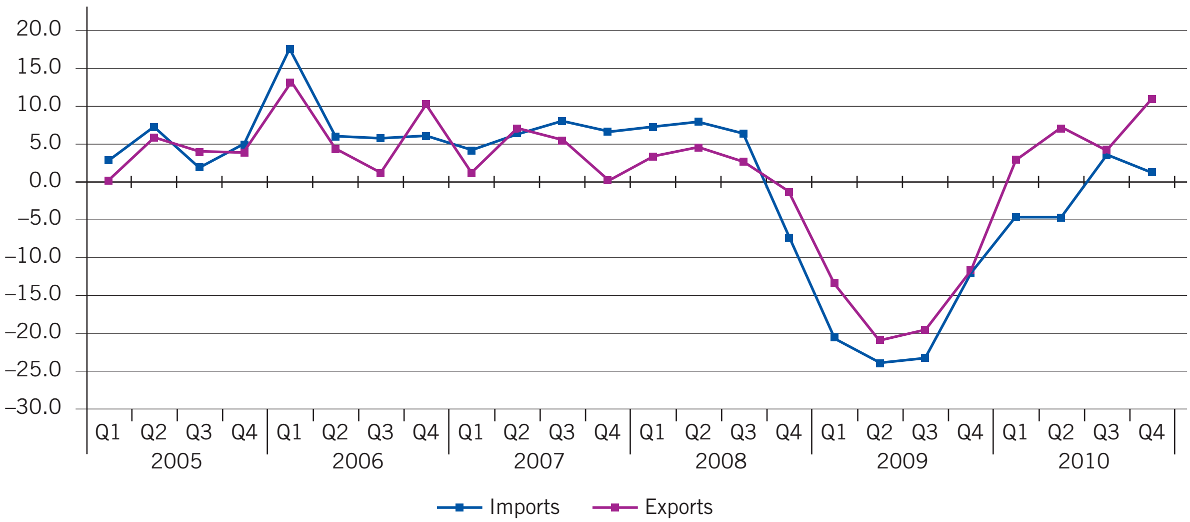


Source: Croatian Bureau of Statistics (CBS), *Quarterly Gross Domestic Product estimates*, CBS, First Release, Zagreb, 2011. http://www.dzs.hr/default_e.htm. Data are presented at market price.

Due to the collapse in export demand, industrial production fell even faster than GDP. Reduced private capital inflows and external demand aggravated the country's imbalances. With a large current account deficit and a high level of external debt, market confidence in Croatia deteriorated sharply in early 2009.[4] The first spill-over effects of the crisis materialized through a decline in both exports and imports (Figure 3). In the period prior to the crisis exports were increasing, but at a slower pace compared to imports. This, coupled with a deterioration of the terms of trade, led to a widening of the current account deficit (from 4.4 per cent of GDP in 2004 to 9.2 per cent in 2008). Depressed domestic demand in 2009 led to a drop in imports, but exports declined even more. As a result, the current account deficit decreased to 5.2 per cent.

Figure 3

Quarterly percentage change in imports and exports, Croatia (2005–2010)



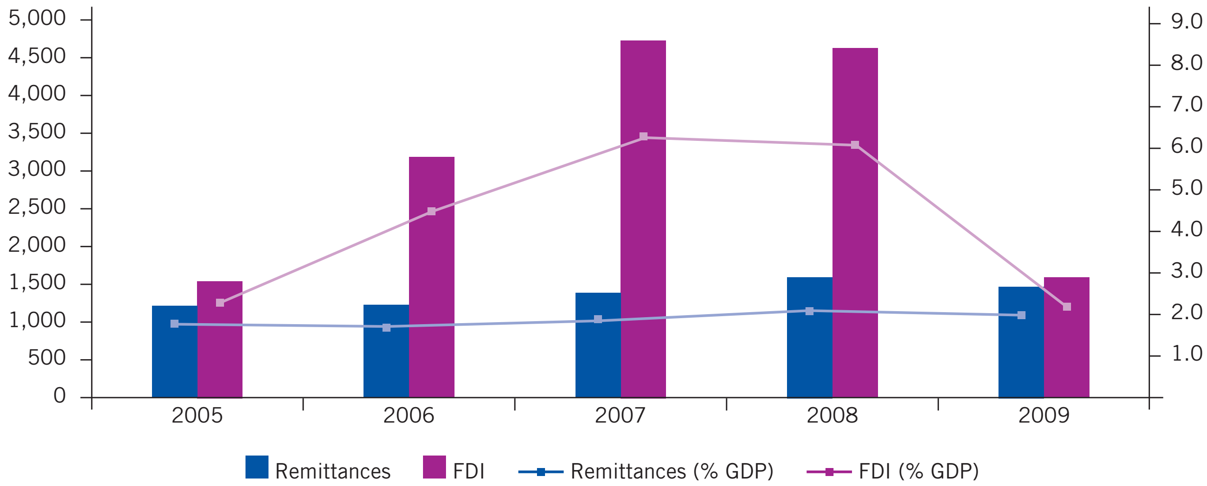
Source: Croatian Bureau of Statistics (CBS), *Quarterly Gross Domestic Product estimates*, First Release, Zagreb, 2011. http://www.dzs.hr/default_e.htm. Data are presented at market price.

4 World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, available at: www.worldbank.hr.

Inflow of Foreign Direct Investments (FDIs) increased markedly in 2007 and 2008 (Figure 3), reaching over 6 per cent of GDP. Tight capital markets led to a sharp reduction in FDI inflows in 2009 (2.2 per cent of GDP). Remittances remained mostly stable during the recession, with an increase in nominal terms in 2008. In relative terms, remittances decreased only marginally in 2009 compared to 2008 (from 2.1 per cent to 2 per cent of GDP).

Figure 4

Trends in FDIs and remittances, Croatia (2005–2009)



Source: World Bank, *Migration and remittances factbook 2011*, Washington D.C, 2011, Central Bank of Croatia, *Annual Report 2010*, Zagreb, 2010

The nominal exchange rate against the Euro depreciated by 1.6 per cent in 2009. This was caused by a strengthening of the foreign currency demand for the repayment of foreign liabilities in an environment of lower inflows of foreign capital.

The external debt of the country climbed steadily in the period 2000–05 (from 53 per cent to 72.1 per cent of GDP). The sharpest increase ever recorded, however, was in 2008–09 when the external debt jumped from 85.1 per cent to 98.3 per cent of GDP.

The growth dynamics in Croatia in the period leading to the crisis reflects a relatively high and fast growing share of private consumption in GDP, fuelled by large inflows of capitals, directed mainly to the non-tradable sectors. In the period 2002–2007 the financial sector in Croatia developed rapidly, fuelling the growth of domestic credit. Growth was accompanied by widening external imbalances and increasing reliance on external capital inflows. This made the economy vulnerable to external shocks.

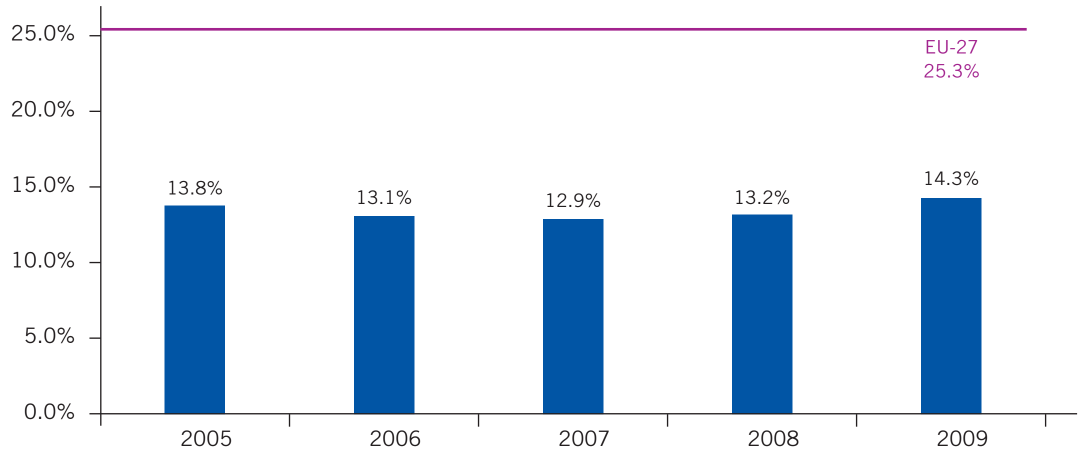
Declining output caused public finances to deteriorate quickly. The revenue shortfall and the spending pressures from automatic stabilizers required several revisions of the 2009 budget.[5] The spending cuts were applied equally across expenditure categories. However, expenditure on vulnerable groups

5 World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, op.cit

(mainly pensioners, social assistance beneficiaries and laid-off workers) remained largely stable. Social outlays – e.g. benefit for old age, survival and (partly) disability – remained at around 10.5 per cent of GDP, while expenditures for social welfare and unemployment benefits ranged from 1 to 2 per cent of GDP. Overall spending on social protection as a percentage of GDP, however, remained below the average expenditures recorded in the EU-27 (Figure 5).

Figure 5

Social protection expenditures (% GDP), Croatia (2005–2009)



Source: Croatian Bureau of Statistics (CBS), Statistical yearbook 2007 and 2010 (http://www.dzs.hr/default_e.htm). For the European Union data are for 2008, see EUROSTAT, at http://epp.eurostat.ec.europa.eu/

To protect public finances –and having failed to reach a consensus on further spending rationalization– the government introduced new taxes and increased existing ones.[6] Overall, through a combination of expenditure reduction (equal to 2.1. per cent of GDP) and revenue increase (amounting to 0.4 per cent of GDP), the government managed to keep the deficit at around 4 per cent (3.3. per cent in 2009 and 4.7 per cent in 2010).

In 2010, Croatia experienced a deceleration of output fall. Seasonally adjusted data point to an increase in the manufacturing, trade and tourism sectors, whereas growth in the construction industry remained negative. However, as foreign tourist spending is recorded as industrial turnover in the domestic market, it is difficult to estimate the real extent of the recovery. The repeal of the lower rate of the special tax on salaries, pensions and other income may also have contributed to output normalization.

The most recent economic data show that stabilization in Croatia is uneven and the recovery is sluggish. GDP growth in the first quarter of 2011 was negative (–0.8 per cent). Projection for 2012 indicate that growth may recover, fuelled by a stronger contribution of domestic demand and by an investment revival spurred by preparations for EU accession.

6 The government introduced a special tax on salaries, pensions and other incomes in 2009 (“crisis tax”) and discontinued it at the end of 2010. The purpose was to collect additional revenues to reduce the budget deficit. Act on Special Tax on Salaries, Pensions and Other Income [Zakona o posebnom porezu na plaće, mirovine i druge primitke] (Official Gazette of Republic of Croatia [Narodne novine] 94/09 and 56/10).

2. Impact of the Crisis on Employment, Enterprises and Workers

Croatia's strong economic performance in the period 2001-08 slightly improved the labour market situation, with annual employment growth averaging 1.4 per cent and decreasing unemployment rates (from 15.4 per cent in 2002 to 8.6 per cent in 2008).[7] Despite progress, however, Croatia's employment level remained among the lowest of the EU-27 countries, due to a combination of high unemployment levels and low labour force participation rates. The economic contraction of 2008 and 2009 led to a rapid deterioration of labour market indicators, with employment decreasing and unemployment increasing. The fall in work income quickly converted into rising poverty. Furthermore, budgetary constraints limited the fiscal space available to increase spending on social safety nets.

2.1 Labour Force Participation

In the period 2005–08, labour force participation rates for the population aged 15–64 remained fairly stable at around 63 per cent (Figure 6). The activity rate, however, started declining moderately in the last quarter of 2008 and more pronouncedly in 2010, when it dipped to the lowest rate recorded in the 2000s.

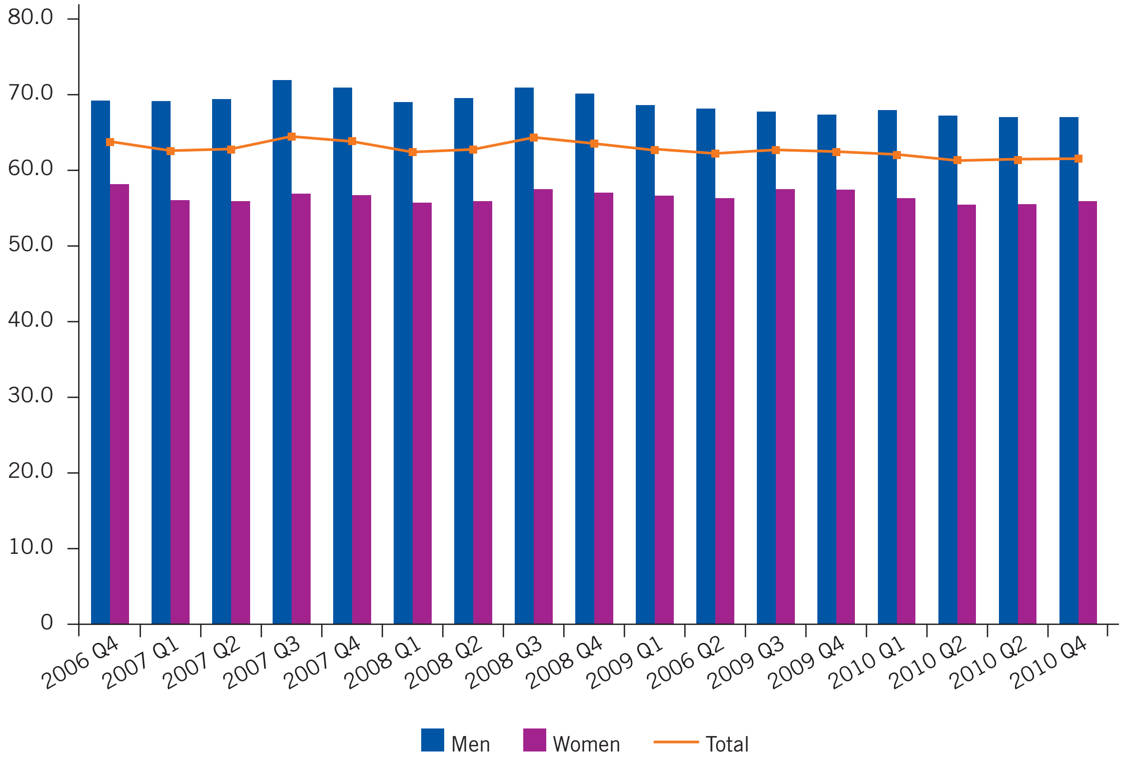
Labour force participation rates in Croatia are approximately 10 percentage points below the rates of countries in the EU-27 (71 per cent in 2010). Lower activity rates are due to the low participation of women (56 per cent compared to an average for the EU-27 of 64.5 per cent); young people (37.7 per cent against the EU-27 average of 43.1); as well as individuals aged 50 to 64 years of age, whose labour force participation was, at 49.4 per cent, more than 11 percentage points lower than in the EU-27. Participation rates of women differ significantly by age group, with young and elderly women much less active than those in the prime age group (31.2 per cent, 40.6 per cent and 79.7 per cent, respectively).

7 Detail annual Labour Force Survey data are available on the web page of the Croatia Bureau of Statistics (http://www.dzs.hr) and at EUROSTAT (http://epp.eurostat.ec.europa.eu/). This paper mostly uses the data of quarterly and annual surveys published by EUROSTAT.

As with what occurred in European countries, the share of discouraged workers, i.e. persons who stopped looking for work as they perceive that none is available, increased from 5.1 per cent of total inactive persons in 2008 to 6.3 per cent in 2010. The increase is more pronounced for men than for women, since the number of men who became discouraged is more than double that of women.

Figure 6

Quarterly labour force participation rates, by gender (2006Q1–2010Q4)



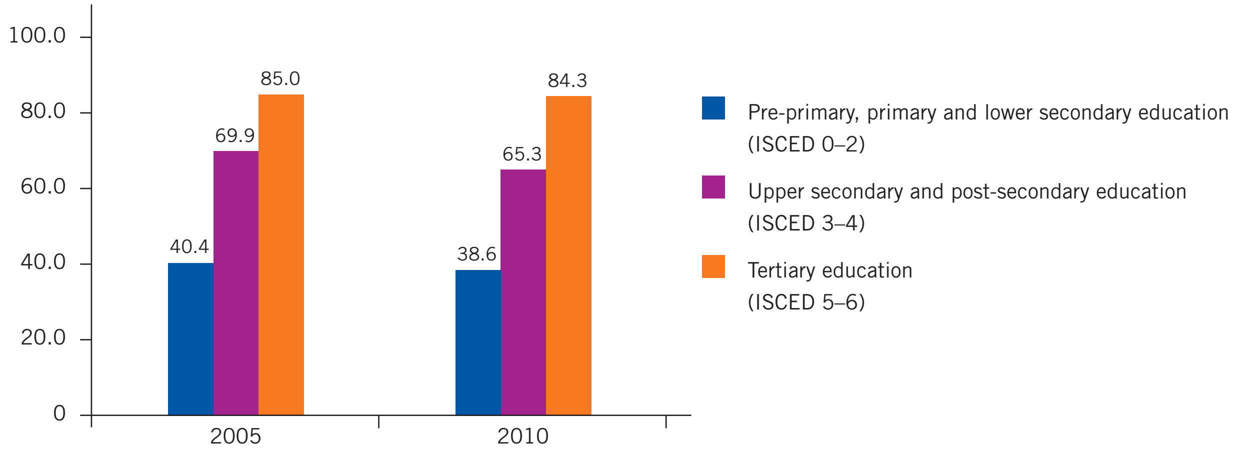
Source: Data of Quarterly Labour Force Survey (2006–2010), available at EUROSTAT, http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database

Young people (15–24) have low participation rates, nearly half the national average. The youth participation rate decreased in the period 2005–09 (from 38.1 per cent to 34.3 per cent), mainly due to higher participation rates in education.

Labour force participation is strongly related to educational attainment, with individuals with tertiary education twice as likely to be active as those with primary education or less (Figure 7). While in the period 2005-10 the participation rate of individuals with tertiary education remained fairly stable, the participation of individuals with upper secondary education declined by nearly 5 percentage points.

Figure 7

Participation rates by highest educational attainment (2005 and 2010)



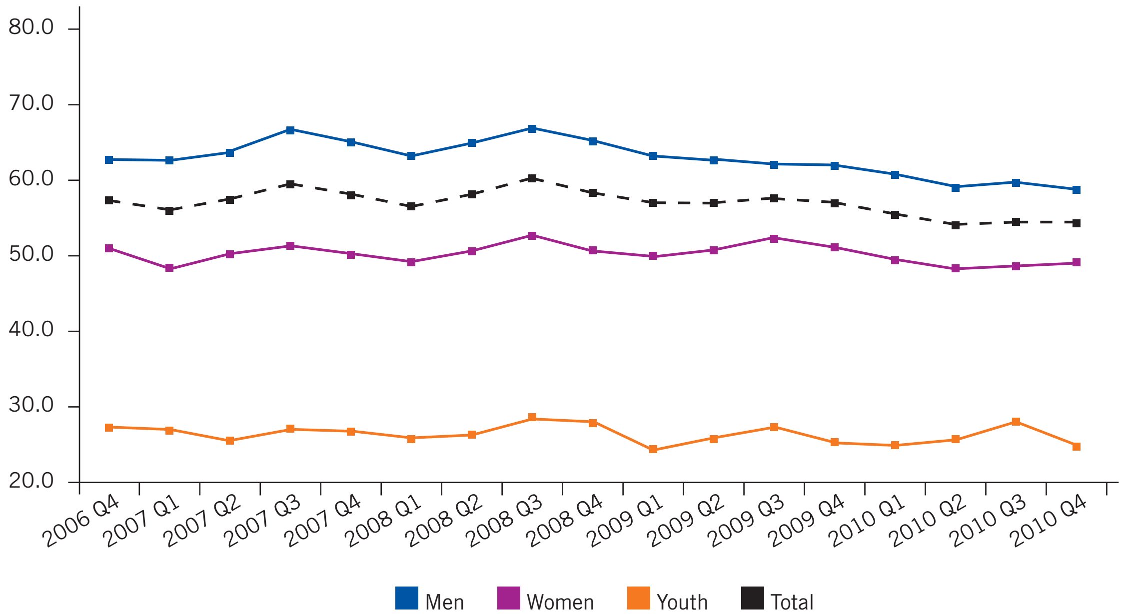
Source: Labour Force Survey (2005–2010), available at EUROSTAT, http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database

2.2 Employment Trends

In the period 2001–08 the employment-to-population ratio for individuals aged 15-64 averaged around 55 per cent. The overall employment rate increased from 52.9 per cent in 2002 to 57.8 per cent in 2008, with a similar trend for both men and women (Figure 8).

Figure 8

Employment rates by sex and age group (2006–2010)



Source: Labour Force Survey (2006–2010)

In the same period, youth employment remained stagnant at an average rate of 26 per cent. Interestingly, the pattern of youth employment in Croatia is very similar to overall employment, pointing to a strong dependency of youth employment on the trends of adult employment, at least in the period prior to the crisis. The overall employment rate (for the population aged 15–64) increases with educational achievement: from 32.6 per cent for workers with primary education or less, to 61 per cent for workers with secondary education, to over 80 per cent for tertiary educated individuals.

The overall employment rate dropped significantly in 2009 and 2010, from 59.7 per cent recorded at the end of 2008 to 53.8 per cent at the end of 2010. The employment losses of 2009-10 affected mostly adult men (25 to 64 years of age. Adult women experienced employment losses only in 2010, but overall the drop in employment affected women proportionally less than adult men (Figure 9). This difference reduced the gender gap in employment from 14.2 per cent in 2008 to 10.6 per cent in 2010. Youth employment decreased in both years, with young men more affected than young women. Employment losses affected workers at all levels of educational attainment, but employment losses were proportionally higher for workers with secondary education compared to other groups (the employment rate decreased for these workers by 5.6 percentage points in the period 2008–10).

During the crisis, more than 94,000 jobs were lost. In the first 12 months of the crisis employment dropped by about 4 per cent, which was lower than the fall of GDP (5.9 per cent). By the beginning of 2010, employment losses had accelerated, with total employment being already 7 per cent lower than prior to the commencement of the crisis.

The economic sectors most likely to suffer job losses were construction, manufacturing and certain service activities, whereas administrative support, health and social services as well as agriculture and mining increased their workforce (Figure 10).

Figure 9a

Change in employment, youth and adults, % (2007–2010)

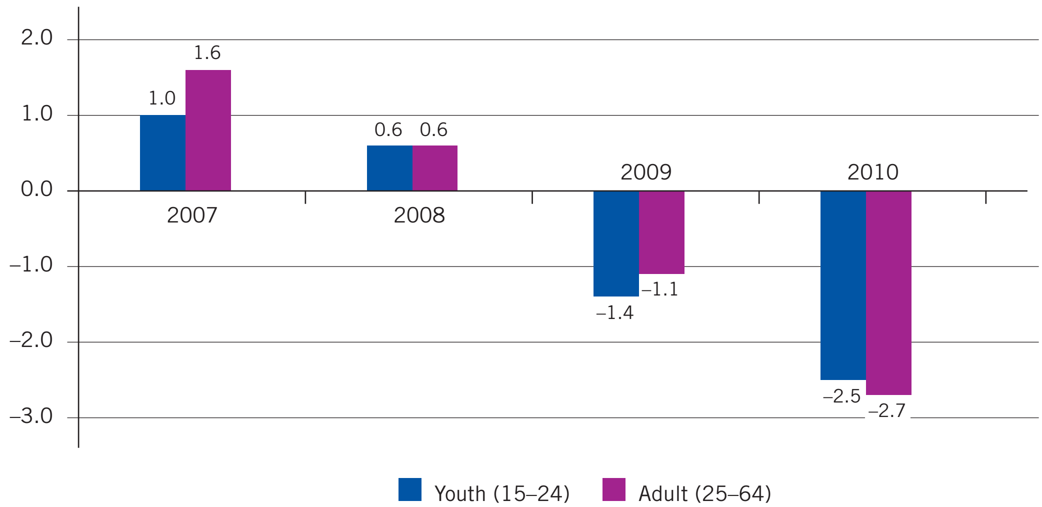
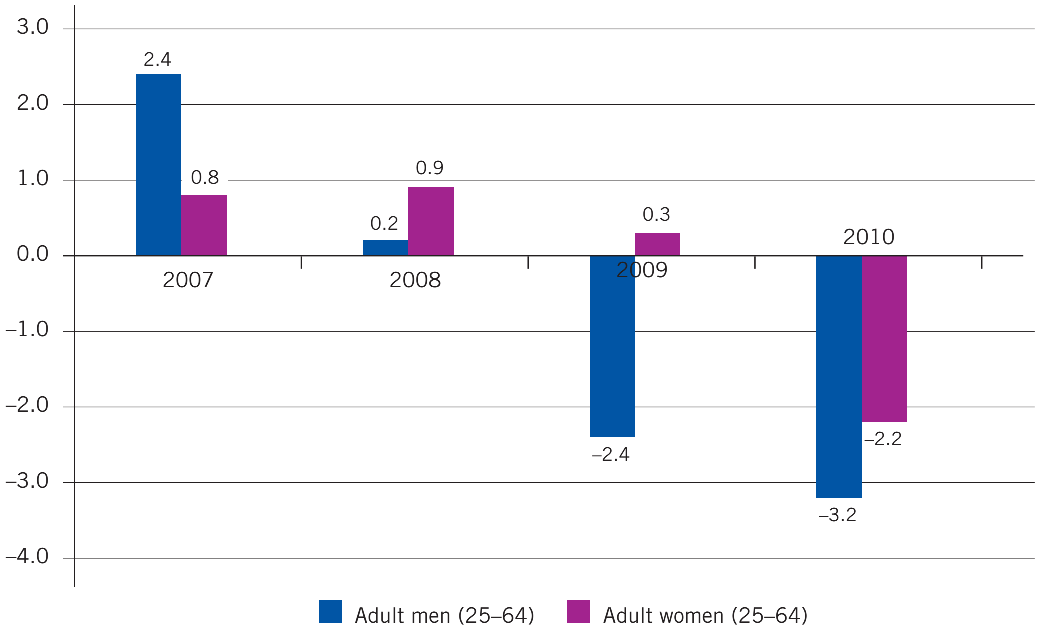


Figure 9b

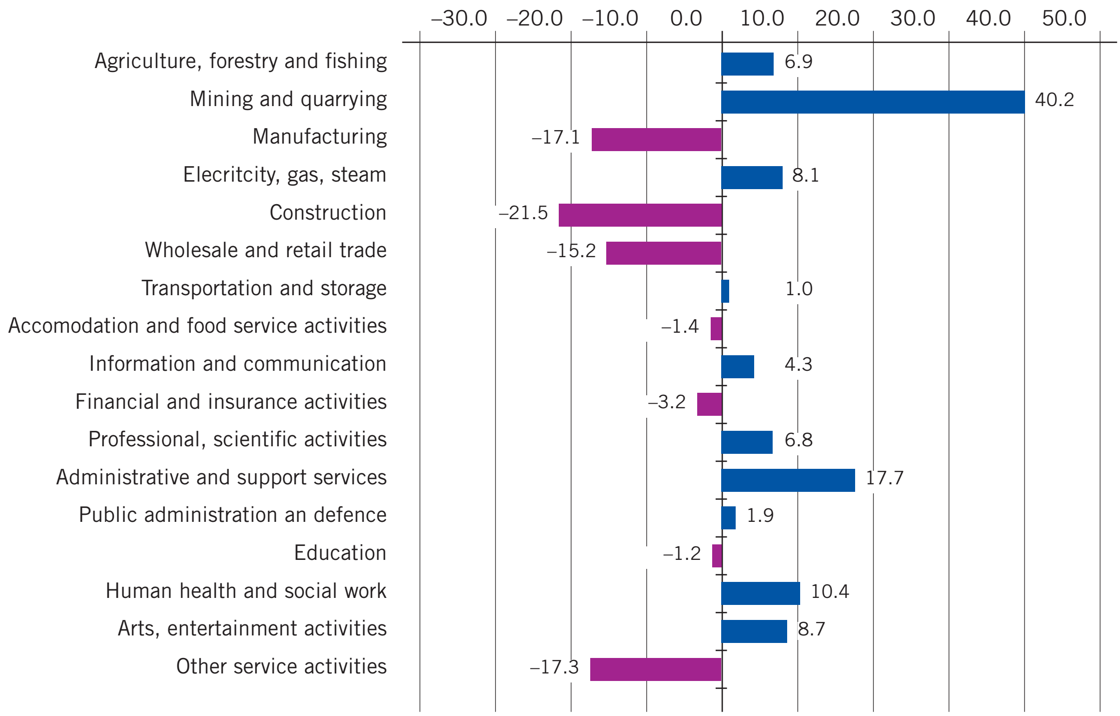
Change in employment, adult men and women, % (2007–2010)



Source: Labour Force Survey (2006–2010)

Figure 10

Change in employment by economic sector, % (2008–2010)



Source: Labour Force Survey (2008–2010)

Analysis of the employment structure offers additional insights to the overall impact of the economic slowdown on employment trends. For instance, an increase in temporary as opposed to permanent work might account for increasing workers' vulnerability. Table 2 below shows the structure of employment in Croatia by main economic sector, status in employment and type of contract.

The number of persons working under fixed-term contracts had decreased prior to the downstream effects of the crisis on labour market (from 12.9 per cent in 2006 to 11.6 per cent in 2009). As labour shedding accelerated, this affected both temporary and permanent workers (both rates decreased between 2009 and 2010 by 0.7 per cent). However, the figures disaggregated by age group and gender show that young workers, and especially young women, working on temporary contracts lost their jobs in greater numbers compared to adults. Overall, the rate of temporary work for youth decreased by 3.2 per cent, with young women twice as likely to lose their job compared to young men. One of the most troubling figures, however, is the share of involuntary temporary work. In 2010, one in every two workers accepted work on temporary contracts because they could not find a permanent job.

The share of part-time employment in total employment largely remained stable, with a modest increase (from 6.9 per cent in 2008 to 7.6 per cent in 2010).[8] The share of youth working part-time is similar to that of adults (7.6 per cent and 7.5 per cent, respectively). However, the percentage of women working part-time is twice that of men's (10.1 per cent and 5.4 per cent, respectively in 2010), but the number of men that work part-time on an involuntary basis is twice that of women's (in percentage terms 32.1 compared to 16.2 in 2010).

Table 2

Structure of employment, Croatia (2006-2010)

Economic sector	2006	2007	2008	2009	2010
Agriculture	11.5	10.9	11.3	11.7	12.9
Industry	30.4	31.4	30.8	29.0	27.2
Services	58.2	57.7	57.9	59.4	59.9
Status in employment	**2006**	**2007**	**2008**	**2009**	**2010**
Employee	79.9	80.6	80.8	81.0	79.8
Self-employed	18.3	17.5	17.4	17.2	18.0
Contributing family member	1.8	1.9	1.8	1.8	2.3
Type of contract	**2006**	**2007**	**2008**	**2009**	**2010**
Full-time	93.0	93.4	93.1	93.1	92.4
Part-time	7.0	6.6	6.9	6.9	7.6
Involuntary part-time	24.9	21.1	21.0	21.4	22.4
Permanent	87.1	87.4	87.9	88.4	87.7
Temporary	12.9	12.6	12.1	11.6	12.3
Involuntary temporary work	51.7	50.0	52.5	50.0	48.4

Source: Labour Force Survey 2006–2010.

8 Franičević, Vojmir, "Croatia: Prolonged Crisis with an uncertain ending", in Vaughan-Whitehead, D*: Inequalities in the world of work: The effects of the crisis,*, International Labour Organization, Geneva2011.

In the period 2008–2010 industry reduced its contribution to employment by more than 16 per cent, mainly due to the sharp declines in the construction and manufacturing sectors (–17 and –21.5 per cent, respectively), while the contribution of agriculture and the service sector increased (6.9 per cent and 2.2 per cent, respectively). The modest rise in employment in the service sector in this period was mainly due to a contraction of the wholesale and retail trade sector (–15.2 per cent). As a consequence, the regions where these industries play a dominant role suffered the highest employment losses.

The 2008–10 figures on employment status reveal that the share of wage employment decreased, albeit moderately, while the shares of own account workers and contributing family members increased. This raised the share of vulnerable employment from 19.2 per cent in 2008 to 20.2 per cent in 2010.[9]

The national accounts gap between income and expenditure shows that the scale of the informal economy in Croatia diminished from 37 per cent of GDP in 1993 to 7 per cent in 2000. Figures for 2009 estimate the size of the informal economy at 15–19 per cent of GDP. However, the drop in formal (registered) employment in 2009–2010 was equal to the fall of GDP (roughly 6 percentage points), while total employment decreased by approximately 2.4 percentage points. This means that the share of informal employment increased during the crisis, but less than proportionally.[10]

2.3 Unemployment Trends

Prior to the crisis Croatia had experienced a significant easing in overall unemployment, with the unemployment rate for those aged 15-64 dropping from 15.4 per cent in 2002 to 8.6 per cent in 2008. This latter rate is not far from that recorded in the EU-27 in the same year (7.1 per cent). The drop in unemployment was slightly more pronounced for women –whose unemployment rate decreased from 17.8 per cent in 2002 to 10.4 per cent in 2008 – than for men (from 13.5 per cent to 7.1 per cent in the same period).

Croatia also managed to reduce the youth unemployment rate– from 36.3 per cent in 2002 to 28.9 per cent in 2008. However, it remained well above that recorded in the EU-27 in 2008 (15.5 per cent), with young women's unemployment rate consistently higher than their male peers (by roughly 5 percentage points).

Like other South Eastern European countries, the ratio between youth and total unemployment rates deteriorated, reflecting the worsening of the labour market position of young people over the last ten years. This is shown by the youth-to-adult unemployment rate ratio, which increased in Croatia from 2.7 in 2002 to 3 in 2007.

9 Vulnerable employment is the share of self-employment and unpaid family workers in total employment.

10 See World Bank, *Croatia. Social impact of the crisis and building resilience*, op.cit.

Table 3

Key unemployment indicators, Croatia (2006–2010)

	2006	2007	2008	2009	2010
Total (15–64)	**11.5**	**9.8**	**8.6**	**9.3**	**12.1**
Sex					
Men	10.1	8.5	7.1	8.2	11.7
Women	13.2	11.4	10.4	10.6	12.6
Age group					
Young people (15–24)	28.9	24.0	21.9	25.0	31.5
Adults (25–64)	9.4	8.1	7.0	7.5	9.5
Educational attainment					
ISCED 0–2[11]	14.2	12.1	10.6	10.6	13.2
ISCED 3–4	12.4	10.3	9.2	10.3	13.2
ISCED 5–6	6.1	6.1	4.8	5.3	8.1
Other indicators					
Youth to adult unemployment rate	3.1	3.0	3.1	3.3	3.3
Long term unemployment	60.1	61.6	63.1	56.1	44.5

Source: Calculations based on data from Labour Force Survey (2006–2010).

The positive link noted between the level of educational attainment and employment performance is valid also for unemployment, but only for adults (25–64). Adults with tertiary education levels experience unemployment rates that are approximately half those recorded for persons with primary education or less (4.1 per cent and 9.5 per cent in 2008, respectively). For young people however, the unemployment rate among young graduates is higher than for youth with secondary education (32.5 per cent against 20.6 per cent in 2008).

The labour market gains of the previous decade were swept away by the global crisis. Although the initial effects on the labour market relative to the fall in output were modest, the pace of job shedding accelerated over time. In 2009 and 2010 the unemployment rate in Croatia was 9.3 and to 12.1 per cent, respectively, compared to 8.6 per cent in 2008. Since the economic sectors that suffered most were male-dominated, the percentage increase in the unemployment rate for men in the period 2008–10 equalled 4.6 percentage points (from 7.1 to 11.7 per cent), while for women it increased by 2.2 percentage points (from 10.4 to 12.6 per cent). Hence the gender gap in unemployment decreased from 3.3 per cent in 2008 to 2.2 per cent in 2010.

11 ISCED levels 0–2 refers to pre-primary, primary and lower secondary education; ISCED levels 3–4 are upper secondary and post-secondary education (non-tertiary) and ISCED levels 5–6 indicate tertiary education.

Figure 11 shows that young workers, and especially young men, were most affected by unemployment increases, as their unemployment rate increased more than three times compared to that of adults.

Figure 11a

Change in the unemployment rate, youth and adults, % (2007–2010)

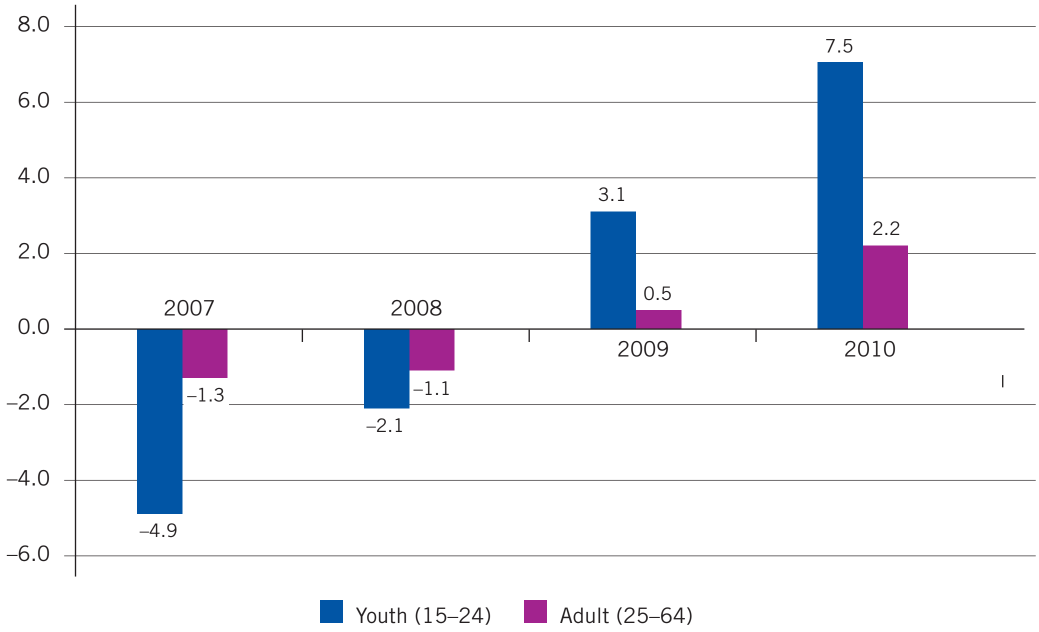
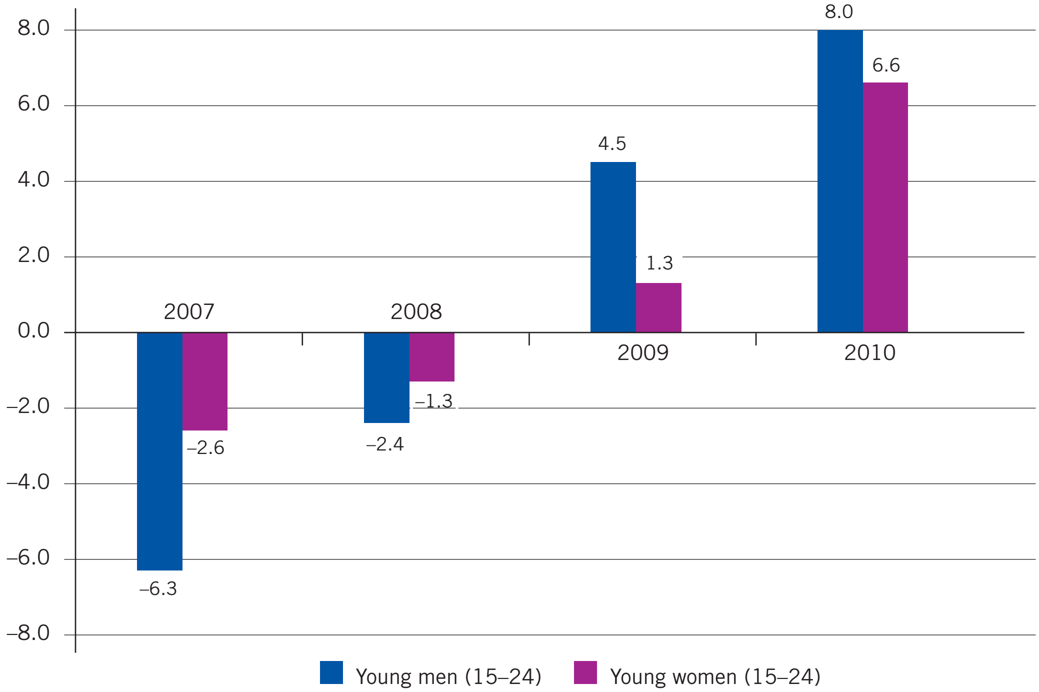


Figure 11b

Change in unemployment rate, young men and women, % (2007–2010)



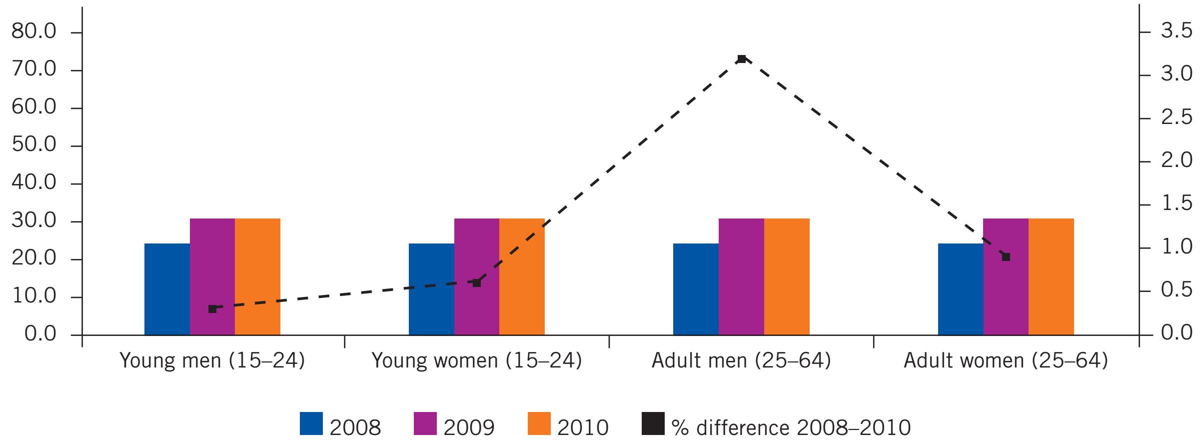
Source: Labour Force Survey (2006–2010)

The key indicators of Croatia show that the economic downturn had a higher impact on adult men, compared to other groups. Not only did their employment rate decrease and did unemployment increase, but they also experienced higher inflows into inactivity (Figure 12). This negative trend is driven by a fall of activity of men in the age cohort 25 to 49 years old (3.3 percentage points), in part due to the workers' discouragement effect. Employment losses experienced by adult men partly reverted into unemployment and partly into inactivity (with an increase of 3.2 percentage points).

Youth unemployment levels were pushed upwards by the number of young men that lost their job (e.g. the 5.3 percentage point decrease in the employment rate for young men), due, to a large extent, to the "last-in, first-out" effect, as well as the diminished employment opportunities for youth looking for their first job. As youth are more exposed to temporary employment compared to adult workers, when enterprises started to shed jobs, young people were the first to be affected.

Figure 12

Inactivity rates and percentage change, youth and adults, % (2008–2010)



Source: Labour Force Survey (2008–2010)

More than a quarter of all workers in Croatia have tenures lasting more than 20 years, while another fifth have tenures between 10 and 20 years. These figures are high compared to other transition countries and developed economies, which typically have 25 to 40 per cent of workers with tenures longer than 10 years. Low labour turnover means that young people attempting to enter the labour market and older workers losing their jobs have a hard time finding employment. Older workers are increasingly represented among the unemployed, and especially among the long term unemployed. Many become discouraged workers. The employment rates for persons of 55 years of age and over – at 35.7 per cent – are roughly 10 percentage points lower than in the EU-27 (46.3 per cent); just as young people are late in joining the workforce, so older people leave it early.[12]

12 Botrić, Valerija, *Unemployed and long-term unemployed in Croatia: Evidence from Labour Force Survey*. Revija za socijalnu politiku, No 16, 2009.

Age and work experience are significant determinants in finding a job and define the position of individuals in the Croatian labour market.[13] Even in periods of strong economic growth young people without work experience face daunting challenges in entering the labour market. Labour force entry in Croatia occurs at a later age and this reduces the youth labour force participation rate.[14] In addition, the number of young people entering the labour force in the last decade declined sharply, due to fewer youth in the total population and to higher participation rates in education.[15] The cumulative effect could mean as much as 200,000 fewer economically active young individuals by the end of this decade. Employment remains a significant problem for young people who are often employed on a short term or casual basis and find it difficult to get a permanent, career job. Young people, however, usually find jobs faster than adult workers, albeit on a fixed-term basis. This is evidenced by the share of long-term unemployment among youth (45.7 per cent in 2008) compared to that of adults (70.8 per cent in the same year) and by the higher share of young workers employed under fix-term contracts compared to their adult peers (37.9 per cent and 9.2 per cent in 2008, respectively). Thus, young people often shift between fixed-term employment and unemployment, before they are able to settle in a permanent, career job. The small, but significant, proportion of youth entering long term unemployment become a risk in terms of social exclusion and welfare dependency.

While in some parts of Croatia unemployment increased by around 10 per cent during the economic crisis, in others it increased by over 35 per cent.[16] These marked differences result from regional development disparities. Regions where unemployment was low before the downturn were either regions with a large share of manufacturing and trade industries, or regions relying on tourism. Therefore, labour market conditions deteriorated faster in industrialized regions as compared to less industrialized, rural areas.

According to employment service statistics, in the period from 2005 to 2008, the number of registered unemployed dropped by approximately 23 per cent. A particularly significant decrease was recorded in 2008 (approximately 10 per cent). However, around half of registered unemployed had been looking for a job for more than a year, and more than one-third for more than three years.[17] Educational attainment significantly affects the duration of registered unemployment, with unemployment spells declining with higher level of education. For example, only 15 per cent of the unemployed with primary education are able to find a job within the first six months of unemployment, compared to 40 per cent of workers with university qualifications.

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13 Matković, Teo. *Tko što radi? Dob i rod kao odrednica položaja na tržištu rada u Hrvatskoj.* Revija za socijalnu politiku, No. 15, 2008.

14 This issue is also related to a prolonged studying period, which on average takes up to seven years.

15 Vehovac, Maja, "Ponuda rada i izazovi starenja radne snage – Hrvatska u EU perspektivi", in Franičević, Vojmir; Puljiz, Vlado, *Rad u Hrvatskoj: Pred izazovima budućnosti*, Zagreb, 2009.

16 World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010 op.cit

17 The recent decrease of share of long-term unemployment in 2009 and 2010 to 45.2% and 46.9% is caused by the increase in total unemployment.

According to the Croatian Employment Service (CES) data, almost 94,000 jobs were lost in a single year. As a response to the fall in product demand, employers cut back on hiring. Job vacancies plunged by around one-third and the unemployment/vacancies ratio doubled.[18] At the beginning of 2010, there were 22 newly registered unemployed for every ten vacancies. This means that there were no job vacancies for almost 55 per cent of the newly registered unemployed.[19]

2.4 Labour Market Vulnerability

The industrial profile of the crisis translates into the socio-economic profile of affected workers. Compared with the unemployment profile before the crisis, a newly unemployed person is more likely to be a skilled blue-collar male worker. Women and white-collar workers appear to be less affected. However, the differences in socio-economic profile between those who became unemployed before the crisis and those unemployed following the crisis are not that pronounced. Still, these figures may have significant implications for poverty. This is because the crisis disproportionately affected primary earners. In contrast, before the crisis, it was mainly secondary earners (youth and women) who bore the brunt of labour market adjustment. Unemployment of a primary earner is more likely to push households into poverty than unemployment of a secondary earner.[20]

Persons at risk of poverty are primarily those who lost jobs in the wake of the crisis. Most of them would now be looking for new jobs, and given that they tend to be younger and better educated than the long-term unemployed, their job prospects would seem relatively good. Their poverty is, therefore, likely to be transitory and associated with the temporary worsening of labour market conditions. These "new poor" would appear to have a good chance of escaping poverty once the economy recovers. Such an escape is less likely in the case of the "old poor" whose poverty usually is of long-term nature and associated with economic inactivity, poor skills and old-age. Other vulnerable groups are those with low educational attainment and low skill levels.

Before the crisis the level of poverty was low and shallow in Croatia, thanks to strong economic growth coupled with job creation, and high spending on social safety nets which had taken place in the previous years. Relative poverty was also low because of the relatively low income and consumption inequality. Poverty was associated with long-term unemployment and inactivity, which were concentrated among low skilled workers. The crisis has had a substantial impact on both the poverty rate and the profile of poverty. The fall in employment coupled with the fall in real wages caused a reduction in incomes, and consequently pushed many unemployed into poverty.[21]

18 The trend on vacancies is available on the web page of the Croatian Employment Service (CES), http://www.hzz.hr/default.aspx?id=4130, but this figure stems from administrative data, not from job vacancy surveys.

19 World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, op.cit

20 Ibid.

21 Ibid.

The at-risk-of-poverty rate recorded in 2007–08 (17.5 per cent) was accentuated during the crisis (18 per cent in 2009). For 2010, estimations are that the poverty headcount rate increased by about 3.5 percentage points. The at-risk-of-poverty rate for women is higher by two percentage points compared to men. Individuals older than 65 years have an at-risk-of-poverty rate above average and for this age group the difference between men and women is largest (4 percentage points, 24 and 28 per cent, respectively).

Households headed by economically active workers, either employed or unemployed, were more likely to be affected by the crisis than other households. Specifically, it is estimated that the poverty rate among households headed by an employed person increased by 2.3 points and as much as 6.5 percentage points for households headed by an unemployed person. However, the increase in the poverty incidence is estimated to be particularly prominent among farmers (7.1 percentage points).

2.5 Wage Developments

The real growth of wages significantly slowed at the end of 2008, following the deceleration of GDP.[22] In June 2008 the new *Act on Minimum Wage* prescribed that the share of the minimum wage in the average wage would amount to 39 per cent.[23] The proportion of full-time workers earning the minimum wage in Croatia has been relatively stable since its introduction. It is estimated to be between 3 and 5 per cent of total employment (the limited statistical data on wage distribution preclude a more precise estimate).

In April 2009 the government lowered salaries in the public sector (mainly education, health and public administration) from between 3.1 to 5.2 per cent. This meant gross salaries returned to 2007 levels. The minimum wage legislation moved the average wage in the opposite direction and in the second and third quarter of 2009 the wage growth turned mildly positive.

In 2009 the average growth of the net wage continued its multi-year upward trend, with a nominal annual increase of 7.0 per cent. However, due to inflation, the real net wage grew only by 0.8 per cent. In the period January to December 2009 the average monthly net wage in the private sector was higher by 2.6 per cent in nominal terms and by 0.8 per cent in real terms compared to the previous year. In 2010 the net wage increased by only 0.1 per cent in nominal terms, as shown in Figure 13.

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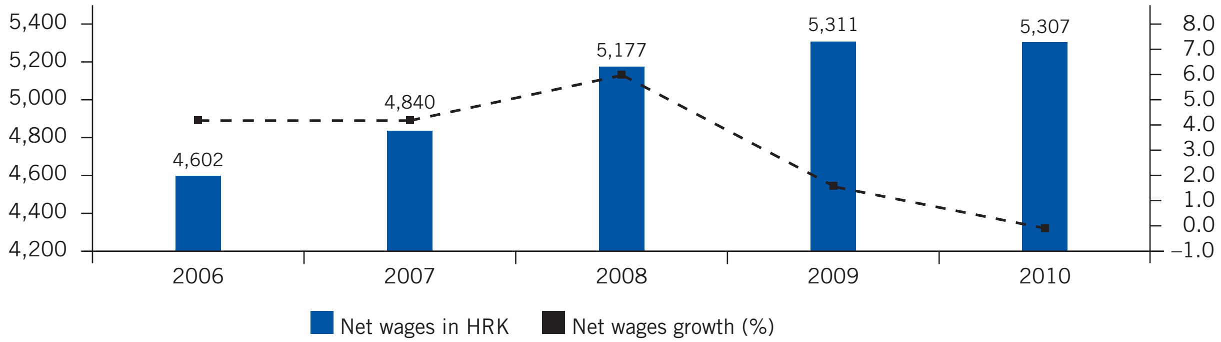
22 Nestić, Danijel, "Trendovi, problem i očekivanja, in Franičević, Vojmir; Puljiz, Vlado, *Rad u Hrvatskoj: Pred izazovima budućnosti*, Zagreb, 2009, op.cit.

23 Act on Minimal Wage [Zakon o minimalnoj plaći] (Official Gazette of Republic of Croatia [Narodne novine] 67/08). The minimum wage does not differentiate by work experience, age or region. However, the law stipulates some differences by sector. For workers in the labour-intensive textile, wood processing and leather industries the minimum wage is set at 94 per cent of the national minimum wage in the first year, 96 per cent in the second year, 97 per cent in the third year and 98 per cent in the fourth year of implementation. Nestić, Danijel. *Plaće u Hrvatskoj: Trendovi, problem i očekivanja*, op.cit.

Figure 13

Annual average net wages, level and percentage change (2006–2010)



Source: Croatian Bureau of Statistics, *Statistical report*, Zagreb, 2010

2.6 Human Capital Formation

Public investment in education in Croatia has been growing steadily since 2002 and reached 4.3 per cent of GDP in 2008. This is comparable to the average investment of the EU-27 countries (over 4.9 per cent).

The country has relatively low rates of pre-primary enrolment by EU standards. EUROSTAT data show that in 2008, only 54 per cent of four years old Croatian children attended pre-school compared to an EU-27 average of 90 per cent. In 2008 the net enrolment rate in basic education (ISCED 1 and 2) was 91 per cent, with no sex gender differentiation. However, this is lower than the average recorded in Central and Eastern Europe (about 97 per cent). Both sexes are equally represented in primary education, with almost identical prospects of progressing to secondary education.[24]

Enrolment rates in secondary and tertiary education have been on the increase since 2006. In 2008 the secondary enrolment rate was 88 per cent, with female enrolment rates slightly higher than males (88 and 87 per cent, respectively). Similarly, tertiary enrolment increased from 45 per cent in 2006 to 50.6 per cent in 2009, with female enrolment rates 10 percentage points higher than for males (54.8 per cent and 43.9 per cent respectively). Young women are more likely to choose social sciences, humanities and arts for their tertiary education programmes, but are still under-represented in engineering.[25]

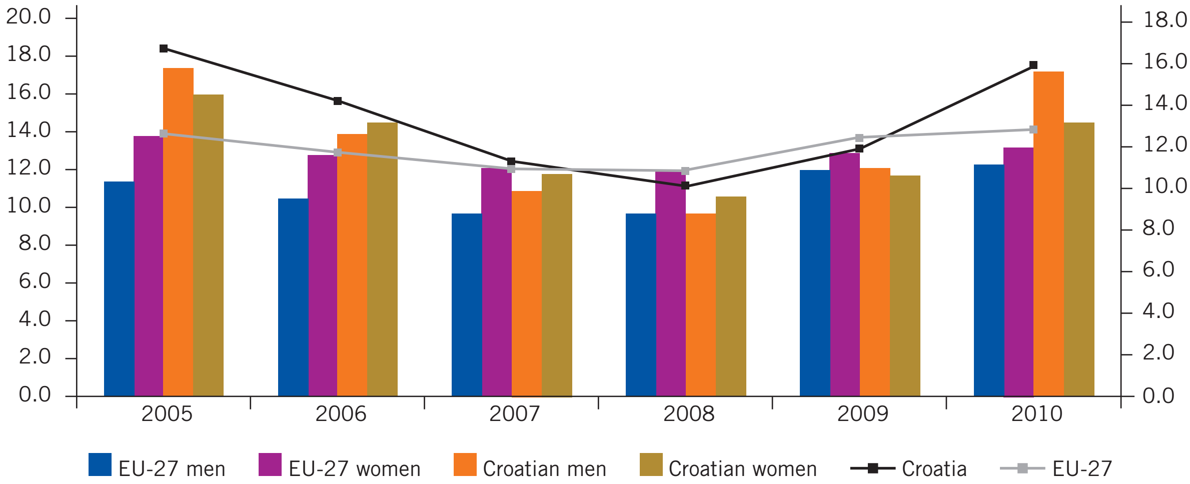
In recent years, researchers have focussed attention on indicators measuring the percentage of youth who are neither in employment nor in education or training (NEET). The non-employment rate offers the advantage of calculating unemployment and inactivity that are not due to school attendance.

24 World Bank economic and social indicators, available at http://data.worldbank.org/topic.

25 Croatian Bureau of Statistics (CBS), *Women and men in Croatia*, Zagreb2011 (available at: www.dzs.hr).

Figure 14

Youth (15–24) not in education, employment or training, (NEET) % Croatia and the EU-27 (2005–2010)



Source: EUROSTAT, Transition from school to work data.

Youth who are not in employment, education or training in Croatia (see Figure 14 above) decreased considerably in the period 2005-08, and levelled out at just over 10 per cent, as per EU-27 rates. The combined effect of lower employment and higher unemployment rates pushed the NEET rate to nearly 16 per cent, which is four percentage points higher than that recorded in the EU-27 in the same year. In the years leading to the crisis, Croatia faced skill mismatches as well as shortages.[26] Enterprises were experiencing difficulties in finding skilled workers, e.g. workers with secondary and tertiary technical education, reflecting a shortage of high and specialized skills and a surplus of low and general skills. In 2007, Croatian employers, and small and medium-size enterprises in particular, were reporting skill shortages as a significant obstacle to their competitiveness.

Skills shortages have a direct negative effect on productivity and competitiveness. But they also have an indirect effect through giving rise to wage pressures that may translate into an increase in unit labour costs, again worsening firms' competitive position. It is expanding firms, that is, those increasing employment, that are hardest hit by skill shortages. As these firms expand to be more productive, they seek workers with higher skills. But this means that skill limitations, if not addressed, may become a binding constraint on the growth and competitiveness of Croatian enterprises, which in turn transmits to a slower pace of job creation and stymies economic growth.

Skill levels also affect economic growth through the channel of labour productivity. In 2008, almost 25 percent of Croatian firms identified skills shortcomings as a very severe or major obstacle to the

26 World Bank, *Croatia's EU convergence report: Reaching and sustaining higher rates of economic growth*, World Bank, Washington, D.C., 2009.

expansion of business. Consistent with this employer sentiment, estimates show that around 20 percent of the variation in total factor productivity in the manufacturing sector in Croatia can be explained by the quality of the labour force.

Educational attainment (years of schooling and the quality of education) and the matching of skills to labour market needs are key elements for economic growth. Croatia's skills gap is related partly to the educational attainment of its labour force (still lower than its peers, Table 4), and partly to the poor matching of competencies to labour market requirements. There are still low, albeit increasing, tertiary education enrolment rates and an insufficiently developed life-long learning system. EUROSTAT figures for 2010 show that in Croatia only 2 per cent of the adult population (25 to 64) participated in education and training, compared to 9.1 per cent in the EU-27.

The school life expectancy level recorded in 2009 (13.8 years) compared unfavourably with the EU-27 average (17.2 years) and neighbouring countries (e.g. 16.7 years in Slovenia, 15.3 in Hungary and 15.2 in the Czech Republic).[27] Only 28 percent of Croatian enterprises offer formal training for their workers, compared to 70 percent in Slovenia.

27 European Commission, *Key Data on Education in Europe 2009*, Education, Audiovisual and Culture Executive Agency, Brussels, 2009.

3. Policy Responses to Counteract the Impact of the Economic Crisis

Croatian government policies in 2009015010 were primarily shaped by efforts to lower the budget deficit. The revenue shortfall and the spending pressures from automatic stabilizers, caused by the contraction of output and inflow of investments, required several revisions of the 2009 budget. The 2010 revision of the budget offered an opportunity to rein in spending; make a shift in economic policy; create a favourable investment environment; and set the basis for economic recovery and ensure adequate social transfers. However, the budget did not propose major structural reforms. The key spending categories – salaries and pensions – remained at the same levels, while measures on the revenue side were limited to increasing taxes. The revised 2010 budget increased the deficit from the planned 2.6 per cent of GDP to 4.2 per cent.

3.1 General Stimulus Measures Introduced in Response to the Crisis

Several measures for economic recovery were undertaken by the government, many aimed at supporting enterprises as an instrument for job preservation. As part of the anti-recession package, several acts and decisions were adopted in 2009 (summarized in Table 4). To protect public finances, the government introduced new taxes and increased existing ones, thus adopting a pro-cyclical strategy.[28]

28 The government introduced a special tax on salaries, pensions and other incomes in 2009 ("crisis tax") and discontinued at the end of 2010. The purpose was to collect additional revenues to reduce the budget deficit. *Act on Special Tax on Salaries, Pensions and Other Income* (94/09 and 56/10).

Table 4

Main legislative instruments adopted, Croatia (2009)

Legislation	Description
Amendments to the Value Added Tax Act	The value added tax (VAT) standard rate increased from 22 to 23 per cent. More than 60 per cent of the budget revenues are collected through the VAT.
Support to job preservation	Employer introducing short working hours can receive subsidies up to 20 per cent of the total salaries and contributions of workers.
Special tax on salaries, pensions and other income	This so-called "crisis tax" was adopted in July, 2009. The base is calculated by deducting the paid contributions, insurance premiums, withheld personal income tax (PIT) and surtax on income. Two tax rates, of 2 and 4 per cent, are applied to the tax base. If the base is lower or equal to HRK 3,000 (€400), the tax bracket is zero. This tax was discontinued in 2011.
Amendments to the Act on Employment Mediation and Unemployment Rights	The maximum amount of unemployment benefit in the first 90 days may not be higher than the minimum salary, while for the rest of the period it may not be higher than 80 per cent.[29]
Salaries in regional self-government Base rate for salaries of civil servants	The first decision establishes a new basis for computing public sector salaries, while the second establishes criteria for salaries of local government officials and employees

In April 2010, the government of Croatia adopted the Economic Recovery Program (ERP) along with a detailed action plan for its implementation. The action plan contained measures aimed at enhancing liquidity, supporting enterprises, as well as improving the effectiveness of labour and social policies. By adopting the ERP, the Croatian Government for the first time openly recognized the limits of the previous growth model, which had focused on domestic demand and the accumulation of external imbalances. In a way, the ERP is more a structural reform plan – rather than an anti-recession programme – aimed at downsizing the state's role in the economy. Means of achieving this include rationalizing public administration, reducing budget expenditures, simplifying the tax system, reshaping the state subsidy schemes and boosting investment activity with a view to improving the growth potential and international competitiveness of the country.

Measures aimed at extending credit to enterprises, enhancing liquidity and creating an enabling environment for economic recovery include the financing of business projects and the establishment of a guarantee fund. These measures establish a framework for co-operation among the government, the Central Bank, the Bank for Reconstruction and Development and commercial banks. The financing of sustainable economic projects envisages the participation of the state through the Bank for Reconstruction and Development as a means to promote the involvement of commercial banks, improve liquidity and promoting economic activity. The guarantee fund envisages the partial risk coverage of bank credit exclusively for development/investment projects. It is expected that this set

29 In 2010, the amendments to the Act on Employment Mediation and Unemployment Rights was derogated with the re-introduction of the average, and not minimum wage as a reference for the unemployment benefit.

of instruments will promote investment in projects that will have a positive spill-over in the economy, by contributing to the growth of production, employment and competitiveness of Croatian enterprises. The Funds for Economic Co-operation, established in January 2010, targets growth of the economy, preserving jobs and creating new ones, as well as promoting enterprise start-up and expansion. These are venture capital funds with the participation of the government up to one billion HRK.[30]

The *Guidelines for supporting companies facing difficulties* – adopted in April 2010 – have the objective of supporting enterprises through:(i) total or partial write-off of corporate debts to the government (loans, taxes, contributions and customs duties); and ii) transforming government claims into equity. The engagement of a number of authorities (Ministry of Finance, Competition Agency and, finally, the government) in the approval process gives rise to a number of problems, namely: i) how to decide whether the debt is to be written off or transformed into equity stakes; ii) definition of "company facing difficulties" and exemptions, and iii) institutional capacity to verify enterprise compliance with rather complex criteria, including those emerging from the distortion of competition, and the estimation of the impact of the aid on the overall economy.

3.2 Measures Aimed at Supporting Jobseekers: Labour Market Policies

The *Economic Recovery Programme* includes a number of measures to improve the effectiveness of labour market policies (Box 1).

Box 1

Economic Recovery Programme, 2010

The measures envisaged by the Economic Recovery Programme to improve labour market policies include:

1. Investing in vocational education and training programmes targeting the unemployed and inactive individuals to increase their occupational competencies;
2. Introducing time limits to the full unemployment benefit entitlement to motivate the unemployed to actively search for a job and conditioning part of the unemployment benefit to the participation in training programmes. At the same time, unemployed at risk of long-term unemployment would benefit from a longer duration of the cash unemployment benefit;
3. Expanding apprenticeship, internship and work practice programmes targeting young people to help them acquire work experience, highly valued by employers;
4. Strengthening the capacity of the Croatian Employment Service to provide career information, counselling and guidance and improve service delivery to the most disadvantaged groups by enhancing cooperation with the Centres for Social Welfare and the Vocational Education and Training Agency.

Source: Government of the Republic of Croatia, *Plan provedbenih aktivnosti Programa gospodarskog oporavka,* May 2011

30 *Decision on the Intention to Participate in the Establishment of Funds for Economic Co-operation* [Odluka o namjeri sudjelovanja u osnivanju fondova za gospodarsku suradnju] (Official Gazette of Republic of Croatia [Narodne novine] 08/10).

In Croatia labour market policies are financed by the state budget, with the unemployment benefit absorbing most of the available funds. Spending on labour market policies equals 0.4 per cent of GDP, with most of the allocation being spent on passive (income support) programmes and active labour market policies (ALMPs) receiving a meagre 0.1 per cent of GDP. This is in sharp contrast to countries in the European Union where expenditures on active labour market programmes, in most cases, represent at least one-third of total labour market expenditure.[31]

The unemployment benefit coverage is rather low (28 per cent of the total registered unemployed). In 2009, recipients of unemployment benefits increased by 22.4 per cent on an annual basis, but in 2010 the increase was marginal (1.9 per cent).The benefit covers only a small proportion of workers affected by the crisis, as young workers with limited job tenure, new labour market entrants and workers in the informal economy are not entitled to it. At the same time, persons in the bottom income quintile received 41 per cent of the total unemployment benefit expenditure, which appears generous enough to lift many recipients out of poverty.[32]

Active labour market programmes were, until few years ago, mostly oriented to subsidies that did not improve the skills of the unemployed and had high deadweight, substitution and displacement costs.[33] The situation improved substantially in the last few years with programmes increasingly targeting individuals with the lowest level of employability and persons at risk of long-term unemployment.

ALMPs, however, still play a negligible role in Croatia. In the years preceding the crisis, the coverage rate was slightly over 3 per cent, while at the lowest point in the downturn it fell to 2.5 per cent. The number of unemployed involved in active labour market programmes, therefore, is simply too small to have any impact on aggregate unemployment.[34] Due to budgetary constraints, funds for ALMPs were reduced and available funds were channelled into training and public works programmes. This caused a drop in total participation into ALMPs by 26 per cent in 2009 relative to 2007.

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31 Expenditure on the unemployment benefit is countercyclical, i.e. it increases during a downturn and decreases during an upturn. Spending on active labour market policies, on the other hand, may increase or decrease during a downturn, depending on the fiscal space available. In many countries of the EU the amount spent on ALMPs increased substantially during the recent downturn to mitigate negative labour market effects.

32 World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, op.cit.

33 *Deadweight loss* means that programme outcomes are not different from what would have happened in the absence of the programme. *Substitution effect* occurs when a worker hired in a subsidized job is substituted for an unsubsidized worker who would otherwise have been hired. The net employment effect is thus zero. *Displacement effect* usually refers to displacement in the product market. A firm with subsidized workers increases output, but displaces/reduces output among firms who do not have subsidized workers

34 The coverage rate is the percentage of the unemployed that participated in any ALMP measures, such as training, subsidized employment or public works. As training is also provided to employed workers, the estimate of coverage is probably biased upwards.

Table 5

Active labour market programmes in Croatia

Programme	Targets	Description
Employment subsidies	– Youth (under 29 year of age) without prior work experience; – Long-term unemployed (over 12 months); – older workers (50+); – other disadvantaged workers (e.g. war veterans, drug addicts)	Subsidy paid to employers hiring individuals referred by the CES. The subsidy is pegged to the minimum wage and depends on the educational attainment of the worker and the size of the employer. The subsidy varies from 30 per cent of the minimum wage for a large employer and a worker with primary education, to 170 per cent for a small employer and a worker with university education The programme has a maximum duration of 12 months (8 months for individuals with a university degree).
Training for known employer	Enterprise employees	Subsidy paid to employers providing training to the firm's workforce. The subsidy (6 months) includes a reimbursement of training costs (70 per cent for SMEs and 60 per cent for large employers). Subsidies for specific skills training amount to 35 per cent for SME and 25 per cent for large companies.
Labour market training	Long-term unemployed	Training allowance of about 35 per cent of the minimum wage paid to beneficiary plus reimbursement of the travel costs for 6 months.
Public works	Long-term unemployed	Reimbursement of wages (75 per cent of the minimum wage and 100 per cent for unemployed 38 months and longer) and travel costs to the municipal authorities who provide public utility jobs to the unemployed. Additional discretionary allowances may be paid by local governments.
Business start-ups	Unemployment benefit recipients	Lump-sum payment equal to the whole amount due under the unemployment benefit.

Only two new programmes were introduced in this period. The first was the short-time work subsidy programme (2009) intended to support labour demand in firms affected by the crisis and to discourage lay-offs. However, the take-up rate was extremely low due to limited incentives provided to employers and strict eligibility conditions.[35] The second was the work experience programme (2010) aimed at providing individuals with their first work experience and thus increase their employability.

Training and public works were the two main programmes implemented during the crisis. In 2009 training accounted for over 58 percent of total ALMP enrolment. Training was in fact the major programme before the crisis, but in response to labour demand contraction its relative importance was further enhanced. However, there was a shift from the so-called "training for a known employer", which is usually provided to already employed workers, towards labour market training provided to the unemployed.

35 Four firms applied for them but only two were found eligible to participate in the programme. Altogether the subsidy was paid for 27 workers (data as of February 2010).

Public works programmes were also significantly expanded during the crisis period, and accounted for 31 percent of total enrolment in 2009. Public works provide temporary employment and are primarily meant as an income-support scheme. As such, they do not substantially improve the future employment prospects of the participants. Regardless, public works and related programmes (such as workfare or work experience programmes) can be used as a means to provide temporary income support to those unemployed who are not (or are no longer) eligible for the unemployment benefit.

Table 6

Distribution of participants to active labour market programmes, Croatia

Programme	2008 (percentage)	2009 (percentage)
Subsidies for youth with no work experience	13.3	3.4
Subsidies for long-term unemployed	17.1	4.7
Subsidies for unemployed aged 50+	9.4	1.8
Subsidies for special groups of the unemployed	4.7	1.0
Training for known employer	14.7	10.2
Labour market training	31.4	48.0
Public works	9.3	30.7
Public works (individual projects)	0.2	...

Source: Croatian Employment Service. *Yearly Report* and *Monthly Statistical Bulletin*, 2008–2009

Notwithstanding the limited financial resources available and the large outlays for the unemployment benefit, some progress has been made in the implementation of ALMP, primarily better targeting of measures directed to those groups with the lowest employability and the longest unemployment spells. In 2010 the scope of some measures were enhanced. For instance, a programme aimed at promoting entrepreneurship among women was expanded. To remedy the burden of family responsibilities of women entrepreneurs, the programme subsidizes 75 per cent of the costs of child care for one year. There was also an increase in the number of people employed through labour market training.

The employment service has an intensive programme of counselling and guidance. In the period 2009–10, approximately 20,000 unemployed received vocational counselling on an annual basis (17 per cent of who were youth less than 24 years old).[36]

Until recently Croatia had no adequate framework for the implementation of Local Employment Partnerships, which can be an important tool to counter the effect of the crisis at local level. To promote

36 Unemployed persons are also referred to group counselling. The CES regional offices, according to the needs of the regional labour market, also organize information sessions on seasonal employment for school leavers, on encouraging the long-term unemployed to become active job-seekers, for students, and so on. In the period from 2009 to 2010, more than 50,000 unemployed people were involved in such workshops, of which 10,000 were younger people.

such partnerships, the Croatian Employment Service undertook a capacity building initiative at local level to identify potential stakeholders, promote human resource development approaches at local level and strengthen the capacity of potential grant beneficiaries to develop ALMP measures within the partnership approach.

3.3 Building Social Protection Systems and Protecting People

Overall spending on social assistance in Croatia is, at 3.6 per cent, nearly double the amount of GDP invested by other countries in Central and Eastern Europe. However, despite such a large allocation, the coverage of the poorest quintile of the population was only 52 per cent in 2008. Hence, there is scope for improving the system's effectiveness.[37] High costs are due to reliance on categorical benefits compared to needs-based ones, with means-tested programmes accounting for 7 per cent of total spending in 2009. The highest share of expenditures is for war veterans (1.8 percent of GDP) and families with children (0.8 percent of GDP). The social welfare support programme and allowance for elderly and disabled persons' care amount to 0.28 percent of GDP.

To cover the poorest 10 per cent of population, the social welfare programme would need to be quadrupled. The programme covers only about 2 per cent of the total population, which is less than the 4 per cent coverage rate recorded in the EU new Member States. The number of social assistance beneficiaries was shrinking before the economic downturn (by 9.6 per cent between end 2007 and end 2008). However, the number of beneficiaries (at around 94,000) lagged behind the expected increases throughout 2009, underscoring the fact that the social assistance programme is not operating as an automatic stabilizer, i.e. expanding with an increase of beneficiaries, which is expected during a recession. This is due to the strict eligibility conditions and the low benefit threshold, which, at HRK500, is 40 percent less than the poverty food basket.[38]

In the field of social assistance, the Economic Recovery Programme addresses: i) the rationalization of social assistance programmes and the determination of a common methodology for means-testing ii) the streamlining of benefit administration and the establishment of a one-stop place for the disbursement of social benefits, and iii) establishment of an IT-based integrated social transfer system at all government levels.

In 2010 the government modified the pension insurance system. Early retirement is penalized, (the penalty increased from 1.8 per cent to 4.08 per cent per year), and retiring five years before the statutory retirement age entails a reduction of the pension benefit by around 15 per cent.

Improved co-operation and co-ordination between the various institutions has been achieved in the social policy sphere. This is partly a consequence of the economic crisis and the increasing numbers of

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37 World Bank, UNDP, *Social Impact of the Crisis and Building Resilience*, Zagreb, 2010, op.cit.

38 The *Social Welfare Act* currently being debated in Parliament proposes increasing the monthly benefit threshold to HRK 600.

benefit recipients, but is also part of the preparation of Croatia for EU membership. In the pilot project *Development Planning of Social Services at Local Level*, representatives from local institutions, service providers (centres for social welfare, employment services, health institutions and so on) and beneficiaries participated in the development of local social services plans, focusing on employability and employment promotion. The emphasis is on integrating the local network of service providers and strengthening their partnership with civil society organizations.

3.4 Social Dialogue

Social dialogue and the relationship between social partners have been deeply affected by the crisis. At the onset of the downturn, social dialogue negotiations were undertaken at national level on issues such as the minimum wage and the introduction of the crisis tax. However, as the crisis progressed, social dialogue came to a virtual standstill.

In the summer of 2010, the government initiated amendments to the *Labour Act* aimed at limiting the prolonged application of collective agreements and at introducing more flexible forms of employment – partially in response to calls from employers to ease the procedures for termination of contracts.[39] Trade unions strongly opposed the proposal and called for a national referendum on the issue. This prompted a standstill of tripartite social dialogue throughout 2009 and 2010. Tripartite social dialogue was reinstated only in April 2011.

A weak tradition of social partnership in Croatia seems a drawback in the current context. Discussion on the minimum wage took place almost exclusively at the national level and tripartite dialogue has overridden bilateral talks. Unlike sector-level dialogue, company-level collective bargaining has been improving, albeit unevenly across industries.[40]

The state of play concerning social dialogue is also of interest in the accession negotiations between Croatia and the European Union. The Progress Report by the EU Commission recognizes some progress in the area, but also notes the somewhat weak capacity of the social partners. Nevertheless, the chapter on social policy and employment was provisionally closed in December 2009.[41]

Through media campaigns a number of policy response proposals were put forward by the Croatian Employers' Association (CEA) during the downturn.[42] Such proposals focused not only on measures

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39 Labour Act [Zakon o radu] (Official Gazette of Republic of Croatia [Narodne novine] 149/09).

40 Nestić D., Rašić Bakarić I., *Minimum wage systems and changing industrial relations in Europe: National report Croatia*, Institute of Economics, Zagreb, 2010

41 Commission of the European Union, *Croatia progress report*, Brussels, 2009

42 October 2008 saw the implementation of the "5 minutes to 12" campaign, followed in February 2009 by "5 minutes past 12".

for economic recovery, but also on a more strategic approach centred on economic growth, the creation of employment opportunities, improved effectiveness of the welfare state, the promotion of fiscal decentralization and the fight against corruption. Trade unions also voiced their desire for structural changes.

Deteriorating liquidity scenarios and the reappearance of wage arrears in private enterprises, combined with broad support for the national referendum initiated by the trade unions hindered consensus on a number of issues. Bipartite dialogue at branch level was especially neglected in those sectors most exposed to output contraction. Furthermore, the inability of employers to meet obligations stemming from collective bargaining agreements caused a breakdown in bilateral social dialogue. The main issues confronting employers were either a reduction of the obligations stemming from collective agreements or downsizing. Employers demanded to speed up the "hire-fire" cycle, to make the rules on employment contracts more flexible and have the ability to terminate collective bargaining agreements. On the other hand, trade unions sought statutory protection for fixed-term workers, and challenged compensation levels provided by the welfare system. In such an environment the climate for bilateral negotiations deteriorated even further.

It could have been expected that the crisis would negatively impact trade union density. However, the initiation of the national referendum worked in the opposite direction and it has given the trade unions a certain political legitimacy. In this sense, decreasing numbers of members and the restructuring of major trade union organizations were compensated for by an increasing regard amongst the public. The outlook for the employers' organisations remained stable throughout the period, even though two renowned CEA leaders joined the government in 2009–10.

Employer organizations launched an intensive information campaign on flexible working hour arrangements, promoting awareness of the reduced level of social security contribution payable for part-time workers (as per amendments to the *Act on Contributions*).[43]

43 Act on Amendments to the Act on Contributions [Zakon o izmjenama i dopunama Zakona o doprinosima] (Official Gazette of Republic of Croatia [Narodne novine] 152/08); Act on Contributions [Zakon o doprinosima] (Official Gazette of Republic of Croatia [Narodne novine] 84/08, 152/08, 94/09 and 18/11)

4. Roadmap: Policy Priorities for Job Recovery

The spreading of the global financial crisis to the Croatian economy become apparent in the last quarter of 2008 with decelerating output growth and plummeting inflows of FDIs. In 2009 overall economic activity declined by 5.9 percent, driven by a fall in consumption, gross domestic investment and exports. The fiscal position of the country deteriorated quickly. Marked shortfalls in revenues and increasing pressures on government spending caused several revisions of the 2009 budget. The spending cuts affected public sector salaries, certain categories of social benefits and infrastructure investments. Pressure to protect public finances and the inability to achieve further spending cuts, led the government to increase existing taxes (Value Added Tax) and introduce new ones (special tax on salaries, pensions and other income ('crisis tax'). The impact of these measures was pro-cyclical and led to a contraction of consumption as well as investments. Overall, the combination of expenditure reduction (amounting to 2.1 per cent of GDP), and revenue increase (amounting to 0.4 per cent of GDP) kept the government deficit at around 4 percent.

The economic contraction led to a rapid worsening of the labour market with falling employment and rising unemployment rates. Although the initial impact on employment to the fall in output was modest, the pace of job loss accelerated over time. Labour force participation rates also fell, partly as a result of the workers' discouragement effect. The crisis harmed mainly the manufacturing, trade and construction sectors, which are predominantly male-dominated. As a result, men were more affected by the economic crisis than women. This category of newly unemployed joined other groups of workers already at a disadvantage in the labour market, such as young people, workers with low skills level, women and elderly workers.

In the first quarter of 2011, Croatian output declined by 0.8 per cent. The downward adjustment of the labour market continued, indicating that the job crisis has not yet bottomed out. Employment fell by an additional 1.6 percentage points, while the unemployment rate increased to 14.7 per cent. The youth unemployment rate reached the unprecedented level of 40.3 per cent. This situation raises concerns about the risk of a lost generation or, in other words, a cohort of disaffected and discouraged young people forced to live on the margins of the labour market.

The economic downturn exposed the limits of growth based on buoyant domestic consumption, fuelled by large inflows of foreign savings, which makes the economy vulnerable to sudden turnarounds. To make the recovery sustainable, growth will have to be grounded on enhancing domestic savings, investment and an increased contribution of labour.

Analysis of the macroeconomic developments during the crisis and the main policy responses undertaken by the government highlight a number of policy options that may be taken into consideration to ensure a faster recovery. These are summarized below.

- Budgetary policy in Croatia has being tightly constrained, with fiscal policy more focussed on falling revenues rather than on government spending, as compensation for decreasing aggregate demand. Croatia's revenues are highly reliant on indirect value added taxes, which are regressive and place a higher burden on lower income groups. In addition, decreased revenues (profit tax and social contribution) are likely to continue throughout 2011 as business development and labour market performance remain unfavourable. A better ratio of direct to indirect taxation should be considered in the medium term to allow for a more expansionary fiscal policy, when needed. Monetary policy could be eased as inflation is very low (1.1. per cent in 2011). The government may consider a lowering of interest rates to encourage credit growth. This would help address the liquidity problem which many enterprises are still currently facing.
- A comprehensive industrial policy and the acceleration of reforms to promote enterprise development (streamlining of business registration, reduction of non-tax revenues and judicial reforms to strengthen contract enforcement and bankruptcy procedures) would enhance private sector participation in the economy, as well as increase job creation. If accompanied by an acceleration of the education and training system reform and activation policies, it would also contribute to improve labour force participation.
- Constraints to both the supply and demand side of skills need to be identified and addressed. There is a mismatch between the skills provided by the education and training system and those demanded by enterprises. A review of the available skills, the needs of enterprises and the operation of the education and training system would help identify such disparities and indicate policy options to address them. The work undertaken towards the establishment of the Croatian Qualification Framework is a first step in this regard. However, such reform will have a positive effect on workers' labour market prospects only in the medium to long-term. In the short term, the expansion of subsidized skill development programmes would improve employment prospects for workers with low or inadequate skill levels and address the erosion of competencies resulting from long unemployment spells.
- The jobs crisis has hit young people harder than other age groups. This is being felt mainly in terms of unemployment and longer job search periods. The long unemployment spells young people face when entering the labour market during a recession may have long lasting effects in terms of future employment and wages. This can lead to labour market detachment for some categories of youth, which in turn would aggravate the labour force participation crisis the country is facing. As young people are a heterogeneous group and face different types of labour market disadvantages, an early identification of individual risk factors and of the determinants of labour market disadvantage is of crucial importance to provide appropriate and effective employment assistance. Multi-component interventions that combine remedial education and training with work-experience programmes and job-search assistance, as well as incentives for employers to hire young workers, have demonstrated to be more cost-effective than single measures based on age alone.
- The only social protection programme which expanded during the crisis in Croatia is the unemployment benefit. Its coverage, however, is relatively low and reaches only a fraction of newly

unemployed workers. A temporary relaxation of eligibility criteria for the unemployment benefit accompanied by measures making income support conditional on participation in active labour market programmes may protect the income of workers losing their jobs, while at the same time improve the functioning of the labour market. However, the cost-effectiveness of such a measure, as well as its fiscal deficit implication, needs to be carefully appraised prior to its implementation.

– Available funding for active labour market programmes in Croatia were rightly channelled into training and public works. The impact of these programmes, however, was limited by the low amount of funding available. The short-time work subsidy programme, introduced in the mid 2009 to help employers ease labour costs without resorting to lay-offs, had a low take-up due to strict eligibility conditions, the low level of subsidies (reduction of social insurance contributions by 20 per cent) and onerous administrative requirements. Short-term options for improving the impact of active labour market programmes include the scaling up of those programmes that are cost-effective in mitigating weak labour demand (employment subsidies, apprenticeship schemes and public works). However, active labour market programmes are more successful when they are well targeted, respond to labour market requirements and involve the social partners in their design, monitoring and evaluation. Finally, for the medium term, Croatia should consider activation policies to re-integrate the long term unemployed and social welfare recipients into the labour market.

– The effectiveness of the social protection system could be improved by streamlining and simplifying the existing social protection programmes and enhanced targeting. This would improve the efficiency and quality of social assistance programmes and have a significant effect on poverty. In the medium term, institutional fragmentation of the social safety net needs to be addressed at both central and local level.

– The challenge of making employment a key target of economic policies requires coherence and coordination across several ministries and labour market institutions. Effective monitoring mechanisms that include employment indicators would facilitate coherence and cooperation among different stakeholders.

– Industrial relations systems, in general, and collective bargaining, in particular, have an important role to play in dealing with the challenges wrought by the crisis. Unfortunately, tripartite negotiations on structural reforms have suffered setbacks, including the virtual stop of the Economic and Social Council meetings at the very peak of the crisis. As Croatia still faces a number of challenges in tackling the effects of the crisis on the labour market, it is of key importance that social dialogue institutions have a role in the monitoring of the implementation of anti-crisis measures on the one hand, and in shaping structural reforms on the other. In addition, existing practices of bipartite negotiations leading to collective agreements at branch and enterprise level should be further encouraged in order to promote a sustainable recovery.

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