

# The Dilemma over Washington Consensus Guidelines or Industrial Policy: Lessons from Croatia

## Dilema između primjene smjernica Washingtonskog konsenzusa ili industrijske politike: primjer Hrvatske

### Abstract

During the 1990s Croatia went through the process of transition to market economy mostly following the Washington Consensus policy guidelines. Since the period before the last global financial crisis, Croatia has shown almost no convergence to developed European Union member states and has been among the least developed ones. This paper examines the causes of Croatian development lag, while providing an overview of contemporary development policies and international production fragmentation trends that affected them. The paper points out to several important factors that shaped the Croatian development path. Expectations from foreign capital were overrated, as the foreign direct investment consisted mainly of brownfield investment in large monopolistic companies and was rarely directed to export-oriented sectors. Accession to the World Trade Organisation was followed by stronger growth of imports than exports and joining the European Union did not bring economic growth as fast as expected. Lack of industrial policy implementation has led Croatia to deindustrialisation and increasing importance of the tourism sector as a form of the Dutch disease.

**Keywords:** Washington Consensus, industrial policy, global value chains, Dutch disease

**JEL classification:** O20, F63, F68

### Sažetak

Hrvatska je potkraj prošlog stoljeća prošla kroz proces tranzicije na tržišno gospodarstvo uglavnom slijedeći smjernice Washingtonskog konsenzusa. U razdoblju prije posljednje globalne financijske krize, Hrvatska nije pokazala gotovo nikakvu konvergenciju s razvijenim članicama Europske unije te je pripadala skupini najmanje razvijenih članica. Ovaj rad istražuje uzroke zaostajanja Hrvatske, pružajući istovremeno pregled suvremenih razvojnih politika i međunarodnih trendova fragmentacije proizvodnje koji su na njih utjecali. Rad ukazuje na nekoliko važnih čimbenika koji su oblikovali hrvatski razvojni put. Očekivanja od priljeva stranog kapitala bila su precijenjena, jer su se izravna inozemna ulaganja uglavnom sastojala od *brownfield* ulaganja u velika monopolistička poduzeća i rijetko su bila usmjerena na izvozno orijentirane sektore. Pristupanje Svjetskoj trgovinskoj organizaciji popraćen je snažnijim rastom uvoza od izvoza, a pridruživanje Europskoj uniji nije donijelo gospodarski rast onako brzo kako se očekivalo. Nedostatak implementacije industrijske politike doveo je Hrvatsku do deindustrijalizacije i sve veće važnosti turističkog sektora kao oblika nizozemske bolesti.

**Ključne riječi:** Washingtonski konsenzus, industrijska politika, globalni lanci vrijednosti, nizozemska bolest

**JEL klasifikacija:** O20, F63, F68

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## 1. Introduction

Washington Consensus is a set of guidelines for developing countries recommended at the beginning of the 1990s and offering a path to economic development. While it considered liberalised trade, privatisation, macroeconomic stability and pricing policies as a prerequisite for good economic performance, it also gave a turn from an important role of the government to minimising its role after succeeding in the mentioned tasks (Williamson 1990; Stiglitz, 1998). Thus, it promoted neoliberal economic policy with the minimal role of the state, arguing that imperfect markets are always superior to imperfect states.

At the end of the 20th century its recommendations were largely followed by a range of developing countries, especially those in transition process to market economies. Following the neoliberal orthodoxy has brought different results among countries. The literature has shown several lacks of this approach as well as needed actions to complement the liberalisation process, but not many changes have been made across a range of developing countries to improve their future growth prospects. While cross-national research is underlined to be essential to explain the different responses to the market reforms (Kaltwasser, 2011; Teichman, 2019), research in this field mainly regards to Latin American, African and Asian countries (Heidhues and Obare, 2011; Galchu, 2018; Ban and Blyth, 2013).

Some research point out that Europe was going further than any other country or integration in internalising prescriptions of the Washington consensus, which can be seen as a primary culprit for relatively low growth since the financial crisis (Fitoussi and Saraceno, 2013). Central and Eastern European (CEE) countries have not been largely explored in this context, although they have shown different development paths in the last thirty years since the fall of the Berlin wall and the collapse of Yugoslavia. Most of the CEE countries joined the European Union (EU) at the beginning of the 21st century, while Croatia did it a decade later. However, in the case of Croatia, following the Washington Consensus guidelines did not bring success and convergence with developed EU member states, as expected.

In this paper, the case of Croatia is explored, which has shown almost no convergence to the EU developed countries during the last few decades. The paper discusses the main general pitfalls of Croatian development path following the Washington Consensus recommendations, while giving a comparison to some of the other EU New Member States (NMS) in the Central and Eastern European region. The main goal of this paper is to provide a review of contemporary development policies and an overview of the Croatian path choosing the neoliberal Washington consensus prescriptions over industrial policy approach in the last thirty years.

The paper consists of four parts. After the introduction, a literature review of development policies after the 1950s in the context of international production fragmentation process is presented. The part that follows focuses on the case of Croatia and explores its development policy outcomes through overview of selected economic indicators. The conclusion summarises the main lessons for developing countries and gives recommendations for further research.

## 2. Overview of industry transformation trends and development policy options

### 2.1. International production fragmentation

The ongoing process of global industry transformation has been strongly connected with the changes in transportation and communication technologies, reduction of tariff rates through World Trade Organisation (WTO) and General Agreement on Tariffs and Trade (GATT) negotiation rounds but also with policies that developing and developed countries were undertaking that enabled the transformation. According to Baldwin (2013), this process can be broadly divided in two phases: (1) "trade-led globalization", and (2) "factory separation". The first unbundling called "trade-led globalization" began with the invention of the steam engine and ended in the 1970s. Within this phase, the separation of production from consumption has occurred. It was primarily enabled by the decline in transport costs, and its main characteristic was asymmetric industrialization and development in the world, leading to increasing inequality.

The second unbundling referred to as “factory separation” was determined mostly by the impact of the revolution in the field of information and communication technologies which enabled organizing production in geographically dispersed locations, thus making use of each countries comparative advantages within a global value chain (GVC) (Horner and Nadvi, 2018). This phase is characterized by the transfer of the know-how from developed to developing countries. Not rarely, operations moved to developing countries located near developed countries as the foreign direct investment (FDI) flows show.

This process of geographical fragmentation of production started in the 1960s and intensified at the end of the 20th century, affecting the gross trade figures, as product components cross borders several times before being purchased on the consumer market. The highest growth in intermediate goods trade was recorded after 1988 (Sturgeon and Gereffi, 2012). The Uruguay round of GATT trading negotiations and the founding of the WTO in 1995 has contributed to trade liberalization, with the ultimate goal of creating global prosperity through the globalization process (Stiglitz, 2009). There was also a substantial increase in foreign direct investment that followed in the 1990s. According to the World Bank data (2019), in the 1990 global FDI inflow was USD 196,32 billion, in the 2000 USD 1.48 trillion, reaching its highest level in 2007, before the onset of the global financial crisis, when it was USD 3.14 trillion. For almost five decades, the EU countries had a leading position in the FDI inflows. However, in 2017 and 2018, China outperformed the EU.

Deindustrialization referring to the decline in industrial employment share, and the share of the manufacturing industry in GDP has been the characteristic of developed countries since the 1950s, but in the last decades also of developing countries, mostly being premature due to their low levels of GDP per capita (Tregenna, 2015). In some of the developing countries it is accompanied by the “Dutch disease” through replacing its production in the manufacturing industry with primary production resulting from the discovery of natural resources, but also growth in services, including tourism (Palma, 2005).

The processes of industrialization and de-industrialization have been greatly influenced by the emergence of GVCs, especially since the early 1990s (Milberg et al., 2014). These developments have led to income redistribution among developed and developing countries. While the first have started deindustrialising, the latter have started industrialising. FDI enabled technology and knowledge transfer to developing countries, and their engagement in GVCs without the need to create their national chains facilitated and accelerated their industrialisation. However, not all the developing countries have used these opportunities and increased the share of manufacturing in their GDP.

Given the technological dynamics and tradability of manufacturing sector products, it is specific to any other sector (Rodrik, 2016). Having in mind that manufacturing contributes to economic growth like no other sector (Tregenna, 2009; Szirmai and Verspagen, 2015), leads to the permanent lagging of developing countries not specializing in tasks within the manufacturing industry GVCs. Without the manufacturing sector, development opportunities for developing economies that are deindustrializing prematurely are largely reduced (Tregenna, 2009; Tregenna, 2015).

## 2.2. The evolution of development policies

After the Second World War, many developing countries have sought to accelerate their development by restricting imports of industrial products to ensure the domestic market for infant industries. Through import substitution these countries strived to change their position in the world division of labour, where they specialised in food and raw materials exports, while had to import manufacturing goods from developed European countries and the United States (Baer, 1972). Thus, the most significant argument for import substitution industrialization was the protection of the infant industry in imperfect markets. This development model implied that countries were building the value chain starting with downstream activities and moving upstream (Baldwin, 2013). This thinking especially dominated policies in Latin America in the 1950s and 1960s (Baer, 1972). Several problems related to this model emerged, such as permanent balance of payments deficit,

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financial crisis, sectoral disequilibrium, persisting social and economic inequalities (Alarcon and McKinley, 1992). As a result, this strategy has shown to be highly ineffective for development, and some economists, as Stiglitz (1998) points out, put the blame on the government failures to create internal competition more than the protectionist measures.

At the same time, from 1950s to 1970s export-oriented industrialisation emerged as a new policy direction led by Japan and Germany and adopted by several developing economies in East Asia (Hong Kong, Taiwan, South Korea and Singapore), known as the East Asian Tigers (Palley, 2013). Their focus was not on their internal market, as in the former policy, but on the developed countries, where their products were meant to be sold. The arguments of their export orientation included the importance of relative abundance of production factors for specialisation, while stressing the benefits of openness for controlling rent seeking and for growth (Palley, 2013). Palley (2013) points out integration into the global economy, undervalued exchange rate and suppression of wages and social standards as key elements of this strategy.

Most arguments in favour of an export-led growth strategy emphasize the role of trade openness, arguing that countries that are more involved in international trade are more likely to achieve long-term economic growth, than countries that are less open to international trade. The success of East Asian Tigers was used as prescription of opposing development schools, those supporting free market outward orientation, but also those supporting aggressive protectionist measures (Easterly, 1995). What is important to point out, although these countries were following some of the main measures of the neoliberal policies that were later coined as Washington Consensus, contrary to its recommendations, they have also designed industrial policies in order to close the technological gap between them and more advanced countries (Stiglitz, 1998).

With the range of economic, political, and ideological changes at the end of the 1980s, there was an emergence of neoliberal economic ideas promoting deregulation, liberalization, and privatization as key economic measures that would lead to economic development. This led to forming

a framework including a set of economic policy recommendations for developing countries, known as the Washington Consensus. Agreed among International Monetary Fund, World Bank and the US Department of the Treasury, it emerged in 1989 with the main aim of helping Latin American countries overcome the debt crisis. John Williamson (1990) proposed a package of measures deemed necessary to cope with the crisis. His approach consisted of 10 axiomatic generalizations which were generally agreed by scholars and practitioners concerned with economic growth in developing countries (Gore, 2000). The approach advocated for macroeconomic discipline (especially fiscal), market orientation, and openness as a basis for economic recovery. It included measures of trade and investment liberalization, tax reform, competitive exchange rates, privatization, deregulation, and market interest rates.

Soon, Washington Consensus, predominantly advocating for privatization, liberalisation and macroeconomic stability mostly considering price stability (Stiglitz, 2004), became not only a substitute for central planning and import substitution industrialization strategies, but was considered as a typical example of neoliberal economic ideas proposed to be implemented in all developing countries across the world. It exerted some pressure on developing countries to shift from import-substitution strategies to export-oriented strategies, leading to the involvement of third world countries in global economic flows through investment and growth of their capabilities (Gereffi, 2001). Thus, given the political, economic, and ideological changes taking place in Europe after the fall of the Berlin Wall, the collapse of the Soviet Union and Yugoslavia, market-led development strategy was implemented by most of these countries as well.

Washington Consensus was focusing on the first order importance issues and gave an easily reproducible framework to establish prerequisites for development, but it did not include the improvement of technology issue or offer an answer to important questions for long-term development of individual countries taking into account their specifics (Stiglitz, 1998). Some scholars disagreed with the idea that the proposed ten reform measures,

which advocated a set of uniform economic reforms, were appropriate for all developing countries at all times and stages of development and sufficient to reach high development growth rates. In the early 1990s, budgets became more balanced, inflation lower, external indebtedness declined and economic growth was recorded. Nevertheless, at the same time, unemployment increased in many countries, and poverty expanded. Market openness has made countries more vulnerable to the effects of globalization, especially to the phenomenon of short-term capital inflows and capital flight. The crisis of the late 1990s in East Asia and Latin America showed downsides of Washington Consensus ideas, particularly of the one relying on foreign capital (Birdsall and Fukuyama, 2011). Literature also points out that most of the countries used some form of industrial policy although they nominally followed the Washington Consensus agenda.

Other strategies, such as Beijing Consensus (Ramo, 2004), were endorsing more interventionist visions, while choosing a gradual approach rather than "one big shock-therapy leap". Beijing Consensus emphasised the innovation-based development while pointing out sustainability and level of equality, not only GDP per capita as measures of economic success. It also included the theory of self-determination regarding USA, thus giving an opposition to the Washington Consensus and striving to spread Chinese influence by example.

The last global financial crisis made it clear that the Washington Consensus era and its market-oriented development model are outdated, and the only question was what policies were going to replace it (Rodrick, 2006). In parallel, the WTO's role has diminished in comparison to liberalization through regional integrating, the productive capacity of developing countries has increased and there has been financialization of non-financial corporations. As a consequence of these changes, the political power of developing countries is growing (Milberg et al, 2014).

Meanwhile, industrial policy has started its return to the centre of the development debate (Stiglitz, 1998.; Rodrik, 2008). In the last ten years, industrial policy gained new attention from economic policymakers in developed and developing

countries (e.g. Robinson, 2010; Warwick, 2013; Rodrik, 2016; Stiglitz, 2017).

There are several reasons for the increasing interest in industrial policy. First is the situation after the financial crisis, which needed a solution to high unemployment rates and economic growth. Then, the success of East and Southeast Asian countries, which increased competition with developed countries, but also encouraged those less developed to join the GVCs. Also, the fear of premature deindustrialization made the industrial policy a necessary element of economic development (Andreoni and Tregenna, 2018). The key elements of industrial policy have changed significantly. Whereas in the past (up to the 1970s) industrial policy included import substitution, protection of infant industry and development of individual sectors and selective opening of the market to competition, in the 1980s and 1990s the focus was on the horizontal policy. Recently, key elements have been completely changing. Since 2000, specialization and increasing productivity through the knowledge economy and GVC have been one of the primary goals of developing economies. Today's industrial policy requires a focus on the relationship between local and global actors. It must take into account the interests, power, and reach of leading networks, accepting international business networks as an appropriate area for play. UNCTAD (2019) points out that modern industrial policies often address myriad topics beyond conventional industrial development and structural transformation, including GVC integration and upgrading, knowledge economy development, sustainable development goals and competitive positioning for the Fourth industrial revolution.

Economic development usually entails upgrading within GVCs, implying changes in the production structure, involving the transformation of the industry towards activities that have higher value-added, which is an important form of contemporary industrialization (Milberg et al., 2014). Lin (2015) proposed "new structural economics framework" which stresses the importance of differences in the optimal industrial structure for countries in different stages of development. These differences are mostly addressed to their relative endowment structures and comparative advantages according

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to them. It still stresses the importance of reliance on the market as the optimal resource allocation mechanism at any given stage of development, but acknowledges the importance of facilitating role played by the state in the process of industrial upgrading and structural transformation (Lin, 2015). Peneder and Streicher (2018) emphasise that institutions and policies that can influence the relative abundance of skills, the design of innovation systems and the quality of infrastructure that supports development, affect the comparative advantages of countries.

Although many developing countries have modified and modernized their industrial policies, their implementation and real effects are questionable. Upgrading to higher value-added activities is not a simple task as it requires adequate infrastructure, political, and institutional frameworks to support reforms. In contrast to Washington Consensus development model, based on the primacy of market liberalism, the limited role of the state, and outward orientation, emerging trends in development policy reveal and emphasise a different, more state-interventionist path, that a range of countries began to follow at the turn of the century and continued afterwards which resulted in reaching higher growth rates (Onis and Senses, 2005).

### 3. Development path of Croatia

In this part, Croatia's development path since the 1990s will be analysed. Until the 1990s, Croatia was a part of Yugoslavia, thus having a centrally planned economy, mostly not following its comparative advantages and having very limited international trade outside of Yugoslavia. At the beginning of the 1990s, together with other former members of Yugoslavia and several countries

belonging to the Soviet Union in the CEE, Croatia started the transition to the market economy and building a new economic, ideological, political and social order. Development in the last 30 years in these countries can be divided into three phases (Grieverson et al., 2019). The initial „shock therapy“ at the beginning of the 1990s brought a steep GDP decrease and it took years for their economies to recover to the 1989 levels. The second phase, so called „the boom years“, included the years from the beginning of 21st century to the financial crisis, when most of these economies recorded significant growth. The third phase covers the years after the financial crisis when most of the countries recorded growth and also experienced positive outcomes.

The transition of a large number of countries in the region gives an opportunity to test a range of economic theories and further analyse the sources of their different development paths. The Visegrad economies (Czech Republic, Hungary, Poland, and Slovakia) have experienced a significant growth, especially in the last two decades since joining the EU, while on the contrary, Croatia has been lagging. This trend is shown in Table 1 through a comparison of the Croatian GDP per capita, expressed as percentage of other economies GDP per capita, in the selected years since 1995.

At the end of the five-year Homeland War in Croatia, which significantly and adversely affected its development, GDP per capita was at the level of only 15% of German's GDP and at the level of 24% of the average GDP per capita in the EU (when calculated in current prices). On the other side, when compared to Visegrad countries, only Czech Republic had higher GDP per capita than Croatia, while when comparing to Bulgaria and Romania, Croatian GDP was more than twice as large. These figures started to change quickly through

**Table 1** Croatian GDP per capita (current \$) expressed as a percentage (%) of other countries GDP per capita (current \$)

	1995	2000	2005	2010	2015	2018
EU	24.37%	26.70%	36.13%	41.32%	36.51%	40.69%
Germany	15.27%	20.55%	30.32%	33.35%	28.46%	30.85%
Czech Republic	83.72%	81.06%	78.83%	70.36%	66.50%	64.43%
Hungary	107.83%	105.17%	93.89%	106.45%	94.21%	93.29%
Poland	131.58%	108.47%	131.17%	110.62%	93.70%	96.40%
Slovak Republic	100.97%	90.19%	90.16%	83.96%	72.80%	76.07%
Bulgaria	215.89%	302.70%	271.89%	203.66%	168.44%	160.35%
Romania	293.63%	293.57%	227.83%	169.76%	131.22%	120.88%

Source: authors' calculation, World Bank (2019).

**Table 2** Openness to trade (international trade as a percentage of GDP)

Country	1995	2000	2005	2010	2015	2018
Croatia	63.51	76.06	84.86	75.64	93.90	101.09
Czech Republic	83.89	98.23	122.02	128.97	156.10	150.39
Hungary	78.26	136.99	127.35	158.35	169.84	168.28
Poland	43.68	60.79	70.27	82.11	95.90	107.20
Slovak Republic	111.24	110.70	148.68	154.12	183.12	192.35
Bulgaria	55.60	78.29	100.50	103.21	128.06	128.14
Romania	56.29	48.52	59.36	71.24	82.66	86.49

Source: World Bank (2020).

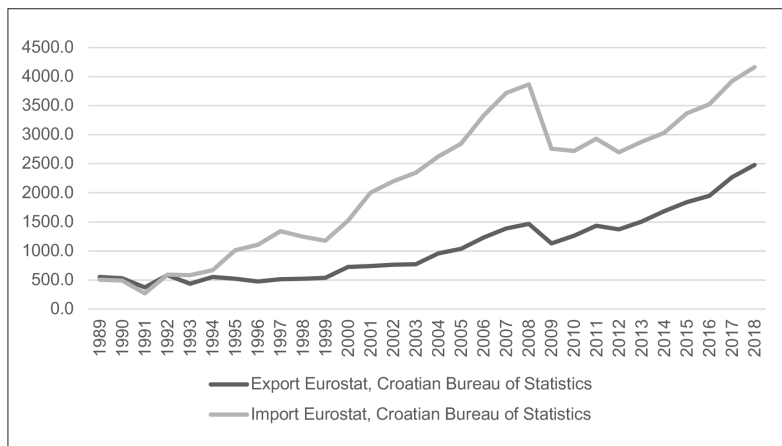
the 2000s. In 2018, Croatia's GDP per capita was 31% of German's and 41% of the EU's, showing convergence over time. On the other side if we compare the figures with Visegrad countries, we can easily see they have all significantly improved a lot more than Croatia, and that Croatia is falling behind. Bulgaria and Romania have also converged on a faster track, and their lagging has decreased significantly, which can lead to surpassing Croatia if their GDP per capita growth continues at the same pace.

All of these countries have nominally followed the Washington Consensus and most importantly, opened their economies to foreign direct investment and trade. However, the question is what made the difference for Croatia and caused its lagging? Through a short overview of other economic indicators that show the integration

in the global economy we strive to grasp general trends that led to Croatian lagging, and give an overview of the Croatian development path following the Washington Consensus guidelines.

As the Table 2 shows, in 1995 the least opened among CEE countries were Poland, Bulgaria and Romania. Substantial changes over two decades have occurred. However, Romania still holds the last place (86%), followed by Croatia (101%) and by Poland (107%). Somewhat lower openness indicators in the case of Poland are due to its economic size in comparison to other countries taken into account. The most significant lagging in this indicator for Croatia was created in the last decade, following the financial crisis as it is shown in Table 2.

To give a closer look at the Croatian economic integration into the global economy in terms of

**Figure 1** Croatia's import and export of goods (mln EUR)

Source: WIW according to Eurostat and Croatian Bureau of Statistics data (2019).

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trade, changes in goods import and export over the last 30 years are shown in Graph 1.

As shown in Graph 1, Croatia had the same timing and control problems with liberalizing markets and opening them to trade as some other developing countries. Imports grew faster than exports, creating a problem of phasing in liberalization. As Wachtel (2000) explains, this was due to import liberalization being easier to control, while exports are depending on the competition and access, and therefore less responsive to market liberalization. Thus, export markets take more time to develop and are less assured than import markets. This graph shows that the decrease of openness was mostly due to a sharp decline in imports of goods, which was due to the economic crisis, decreasing purchases of imported goods. The economic crisis that decreased Croatian GDP by more than 12% (WIIW, 2019) started in 2009 and has ended five years later, while in most of the other EU countries it ended already in 2010. After the crisis period, Croatia has returned to the path of increasing exports and imports, almost at same pace as other analysed countries.

It is also important to analyse the level of participation in the GVCs and the structure of exports in order to see if Croatia has used the opportunity to reindustrialise and specialise in the new global context. Many firms in transition economies were based in industries that were not based on comparative advantages of these countries and their survival was relying on subsidies and similar government measures (Lin, 2015). In some cases, governments were over-focused on the Washington Consensus guidelines, leading to investments in unproductive companies which resulted in decline or stagnation of the economy (Lin, 2015).

According to the research of Croatian economy participation in GVCs from 1995 to 2011 using WTO Trade in Value Added data (Kersan-Škabić, 2017), Croatian economy has a significant and almost not changing lag to the EU NMS in overall economy backward participation (measured as share of other countries value added in Croatian exports) and forward participation (measured as share of Croatian value added in other countries exports) in GVCs. Also, its manufacturing industry was the least included in GVCs among the EU NMS in the period from 2000 to 2014, according to the input-output analysis, with lowest backward indicator and stagnating forward integration indicator at an average group value (Barišić, 2020).

Thus, Croatia did not use the opportunity to improve its productivity through backward participation and did not show enough effort to improve its specialisation in specific tasks in these networks what can be seen through its forward participation. The reasons for relatively low participation in the global production network can be sought through the comparative analysis of export sectors and FDI inflow in selected countries over the last decades. Prior research have indicated GDP growth, previous participation in GVCs, FDI, development of the financial sector, the share of services in GDP, share of high-tech products in export, and level of wages as important determinants in EU countries (Kersan-Škabić, 2019).

Table 3 shows the share of manufacturing industry (including standard international trade classification - SITC 5, 6, 7 and 8) in merchandise exports of selected countries.

Table 3 shows a different trend in Croatia in comparison to other countries. All countries besides Croatia have increased the share of the manufacturing industry in merchandise exports in

**Table 3** Share of the manufacturing industry in merchandise exports (%)

Country	1995	2000	2005	2008	2010	2015	2018
Bulgaria	n.a.	57	59	51	49	56	58
Czech Republic	82	88	88	87	86	89	91
Croatia	74	73	68	70	68	67	66
Hungary	68	86	85	80	83	n.a.	87
Poland	71	80	78	80	79	79	80
Romania	78	77	80	77	79	78	82
Slovak Republic	82	84	83	86	87	89	90

Source: World Bank (2019).



**Table 4** Manufacturing industry sectors exports as a share (%) of total manufacturing industry exports of selected countries in 2018

Industry/ Country	Bulgaria	Croatia	Czech	Hungary	Poland	Romania	Slovakia
Food and live animals	11%	11%	3%	6%	11%	6%	3%
Beverages and tobacco	1%	2%	1%	1%	2%	1%	0%
Crude materials, inedible, except fuels	6%	7%	2%	2%	2%	4%	2%
Mineral fuels, lubricants and related materials	9%	11%	2%	4%	3%	4%	4%
Animal and vegetable oils, fats and waxes	1%	0%	0%	0%	0%	0%	0%
Chemicals and related products	10%	13%	6%	12%	9%	4%	4%
Manufactured goods classified chiefly by material	23%	17%	15%	11%	19%	17%	17%
Machinery and transport equipment	23%	23%	58%	54%	37%	47%	60%
Miscellaneous manufactured articles	13%	15%	12%	9%	17%	15%	10%
Commodities not classified elsewhere	3%	0%	1%	0%	0%	1%	0%

Source: World Bank (2019).

the period from 1995 to 2018, what can also be addressed to the Croatian low insertion in GVCs that are most prominent in the manufacturing industry. These results might reveal that most of the companies in the Croatian manufacturing sector were not viable, thus making the transition shock more of a hard time. As Lin (2015) points out, "firms in an industry are viable in an open, competitive market only if the industry is consistent with the comparative advantage determined by the economy's endowment structure". Contemporary research points out the importance of understanding that trade liberalization does not create competition automatically and there is a need for promoting competition among export sectors. Table 4 shows the structure of all manufacturing industries exports share in total manufacturing industry exports of analysed countries according to ISIC classification in 2018.

Croatian share of exports in 2018 in the machinery and transport equipment (23%) is significantly lower than in Czech Republic (58%), Hungary (54%), Poland (37%), Romania (47%) and Slovakia (60%). This is also in line with the previously mentioned low participation in GVCs, given the fact that the transport industry, especially the automobile industry is one of the pioneers in GVC production. Meanwhile, other export components such as food and live animals (11%), crude materials (7%), mineral fuels, and related materials (11%) and chemicals (13%) had larger shares than other analysed countries.

Lin (2015) suggested that the developing countries,

especially those in transition, should include the state in providing the information about new industries that would be consistent with the new comparative advantage, coordinating investments in related industries and improvements in infrastructure, subsidizing activities with externalities in the process of industrial upgrading and structural change and catalysing the development of new industries by incubation or by attracting foreign direct investment to overcome the deficits in social capital and other intangible constraints. Little of the mentioned was done in Croatia, although previous research shows the importance of export development and improvement of trade relations for the Croatian economy growth (Bilas et al., 2015). Part of the companies were largely subsidised, such as shipbuilding, while a large share of monopolistic companies were sold to the foreign investors following the Washington consensus prescriptions. Given its recommendations, FDI has been in the mainstream of public policy, considered as the key development driver due to the potential technology and knowledge transfer and spillover effects.

According to WIIW data (2019), over the period from 1993 to 2018 Croatia received an average of 275.4 EUR per capita FDI, what places Croatia behind Czech Republic (424.4 EUR per capita) and Hungary (325.6 EUR per capita), while it was more successful in attracting FDI than Romania (147.5 EUR per capita), Poland (205.5 EUR per capita), Bulgaria (246.13 EUR per capita), and Slovakia (265.8 EUR per capita). When comparing the amount of

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FDI as an average share of GDP (WIIW, 2019) results are slightly different, with Bulgaria on the first place due to several years of very high volumes of FDI before and upon joining the EU (making the average of 6.7%). Hungary is on the second place (4.6%), followed by Slovakia (3.7%), Czech Republic (3.4%), Croatia (3.4%), Romania (3.2%) and Poland (3.0%).

In Croatia, Bulgaria, and Romania, more than 70% of the FDI came from the EU-19 countries, while more than 80% was made by all EU member states (WIIW data, 2019). A large share of investment in this region was brownfield investment related to the privatisation process, especially of the local large monopolistic companies. The prevailing share of FDI in Croatia went to the financial service activities (more than 30%), while other most important sectors that in largest share received brownfield investment include real estate activities, wholesale trade, telecommunication, retail trade, manufacture of coke and refined petroleum products and manufacture of basic pharmaceutical products. It can be easily concluded that FDI in Croatia went mostly into non-production sectors, very often made through cherry-picking the industry leaders, while little included the manufacturing sector, unlike the other analysed countries (Jurčić and Barišić, 2018).

The sectors receiving FDI also show that consumers might have benefited through cheaper goods produced by foreign affiliates, which could at the same time lead to weakening local producing positions and increasing imports (Lipsej, 2004). Jurčić and Barišić (2018) show that in the period from 2000 to 2016, only dividends and retained profits recorded within the BoP primary income have reached almost 60% return on the total equity investment in Croatia. It is also important to note

that Croatia has received most of the FDI inflow before the financial crisis, and the only high inflows in the years that followed were connected to reinvested earnings in specific sectors. Thus, joining the EU in 2013 did not show to be as significant as expected for attracting FDI. Due to relatively high labour costs, Croatia was not so attractive to new EU investment, which has already been placed among other countries that have joined the EU before.

Following neoliberal advice, Croatia did not form the FDI strategic sectors for developing its industry. This fact together with a relatively strong currency, made a large portion of its produced merchandise non-competitive on the global market, which led to a decrease of its industrial base. Even after the transition process ended Croatia remained sticking to the Washington Consensus recommendations without forming a broad industrial policy, what led to premature deindustrialisation. As shown in Table 5, most of the analysed countries have increased their manufacturing share in GDP. Besides Croatia, which recorded a decrease from 18.5% in 1995 to 12.3% in 2018, only Poland and Romania recorded a decrease of the manufacturing industry share in GDP, but at a lower rate. The experienced premature deindustrialisation (in GDP share and employment) in Croatia was also significantly different as it was not only in relative but also in absolute figures making Croatian continuing deindustrialisation significantly different than the one that developed countries have been experiencing which was mainly driven by rising GDP per capita and gravitating towards the service sector (Penava and Družić, 2014; Škuflić and Družić, 2016). While the deindustrialisation was taking place, on the other side the importance of tourism sector in Croatia was increasing forming a kind of Dutch disease.

**Table 5** Share (%) of manufacturing industry in GDP

Country	1995	2000	2005	2010	2015	2018
Bulgaria	9,8	12,2	13,6	11,1	13,3	13,5
Croatia	18,5	16,8	14,4	13,1	13,0	12,3
Czech Republic	21,5	23,6	23,0	21,2	24,1	23,1
Hungary	18,2	19,1	19,1	18,2	20,3	18,6
Poland	19,4	16,1	16,1	15,6	17,6	16,7
Romania	23,9	19,8	21,3	22,9	19,6	19,9
Slovakia	19,0	20,0	20,6	18,2	19,5	19,7

Source: World Bank (2019).

Given the specifics of the tourism sector as it affects the results of the range of other sectors its GDP estimations are not so easy to give. The first satellite tourism account was made in 2019 for 2016, showing to 11.4% contribution of tourism in GDP and 24% of share of gross value added of tourism activities in the overall gross value added (EIZ, 2019). These figures have been increasing in recent years and have been among the largest in the EU. According to EIZ (2019) the share of tourism in total exports amounted to 36.4% in 2018, significantly contributing to the surplus of the current account.

Some of the main critiques of the Washington Consensus went for its ignoring national peculiarities and universal recipes (Babb, 2013), as it was the case with its implementation in Croatia. A more heterogeneous international regime being less uniform is needed and Croatia is yet to find its path to convergence through tailor-made industrial policy after the stagnating decades. Firstly, it needs to acknowledge the shortcomings of the previous development model and then plan a turn within its economic structure, that would make her ready for the challenges of the globalised world and the fourth industrial revolution.

#### 4. Conclusion

GVCs have significantly changed the perspective of development policies, especially in developing countries. They brought a range of opportunities to countries, as they do not have to build the whole value chain within their borders, but can join a GVC through conducting a specific task within the production process. Thus, development policies changed from import-substitution industrialisation to export-oriented industrialisation. Export-oriented industrialisation was further shaped through the Washington Consensus, that was regarded as a neoliberal agenda for developing countries offering general prescriptions mainly focusing on macroeconomic stability, privatisation and openness. Results of these guidelines have not been as expected and industrial policy is returning to the centre of the development debate. In its transition process Croatia has adopted the Washington Consensus neoliberal approach to development and disregarded industrial policy.

During the last thirty years it became one of the least developed countries among EU NMS. Nominally, EU NMS did not have much different policies, but few aspects can be pointed out that made their development outcome different. It is important to emphasise that Croatian lagging behind the economies of the region started after the end of the 20th century and convergence to the developed European countries measured by GDP per capita was hardly existing since the pre-global financial crisis period. This paper gave a short overview of the drawbacks Croatia has experienced following the Washington Consensus and provides lessons for other countries with similar economic structures that still have high expectations from implementing neoliberal guidelines. The main lesson from Croatian case is that focusing on tourism and neglecting the importance of the manufacturing industry can be one of the main culprits for countries' stagnation. Increasing share of tourism in Croatian GDP represents a form of the Dutch disease. Given the lower productivity growth rates in services compared to manufacturing, it reduces the GDP growth. After thirty years, Croatia has the second lowest share of manufacturing industry in GDP and the share has been continually decreasing, unlike in the other countries. The reason for this negative structural change can be sought in low participation in GVCs, both on the country level and in manufacturing industry, especially in the part of backward integration that enables the rise of productivity and focusing on specific tasks within the production process. Croatia attracted mostly market-seeking FDI, unlike in the Visegrad economies, which received more FDI in the manufacturing sector and have built up a strong industrial base primarily through joining GVCs. Given the relatively high salaries and strong local currency, the Croatian industry was further decreasing and giving rise to tourism. Thus, the second important lesson provided from the case of Croatia is the importance of joining the manufacturing industry GVCs and embracing development through upgrading within them. Also, while attracting FDI the emphasis should be on the export-oriented sectors where country has a comparative advantage and strives to develop it further. This paper also points out that although WTO accession and joining the EU are very

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important for each country as they offer a range of opportunities, those are not enough to induce development. They need to be facilitated and integrated in countries policies. Having this and previous arguments in mind, the most important lesson is that neoliberal agenda formed in the Washington Consensus is not enough to achieve development and a country specific industrial policy design and implementation is needed in the global value chain era. Given the changing global environment affected by developments of GVCs and the Fourth industrial evolution, Croatia is yet to find the path to reindustrialise its economy using

modern industrial policy measures. Country specific analysis and implementing tailor-made policies that could exploit the potential of the comparative advantages and develop them further are thus essential. More in-depth research on the connection of development policies and economic growth is yet to be examined, especially following the increasing industrial policy focus in development debates. Further research should recognise the complexity of different economic systems and provide analysis acknowledging them.

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