

PROGRESS AND CHALLENGES OF PRIVATIZATION: THE CROATIAN EXPERIENCE

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1. INTRODUCTION

Profound political and economic changes have radically altered formerly communist Eastern and Central European countries. Significant changes in the law have accompanied the metamorphosis resulting from social and economic reform, and have provided the framework for the implementation of change. Each country has pursued an individual path toward democracy and a free market economy, which is necessitated by differing historical, social, and economic factors. This Article reviews one aspect of the transformation process in Croatia, the privatization of socially-owned businesses. Formerly a part of Yugoslavia, Croatia was once considered one of the most likely countries to move swiftly and successfully towards a market economy.¹ Croatia was one of the economically strongest areas in Yugoslavia, having an active tourism industry and possessing abundant natural resources.² When war ensued following Croatia's declaration of independence in 1991, however, the prognosis for a successful transformation

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¹ See Ben Slay, *Economic Reformers Face High Hurdles*, RFE/RL RES. REP., Jan. 3, 1992, at 100, 103 (noting that toward the end of the 1980s, former Yugoslavia was rated second only to Hungary as the country best positioned to transform its economy). The civil war has been seen as a "tragic fate" for the "country once thought to be the best hope for 'socialism with a human face.'" *Id.*

² See CROATIAN CHAMBER OF ECONOMY, HOW TO DO BUSINESS WITH CROATIA 6 (1994) [hereinafter BUSINESS].

dimmed.³ Despite the signing of a truce, many uncertainties remain.⁴

This Article first provides a historical and economic background of Croatia. Croatia's history is briefly discussed in Section 2, and provides a basis for understanding the laws designed to achieve privatization, which are outlined in Section 3. Section 4 describes the legal and political issues and challenges that have emerged in implementing laws relating to privatization. Despite uncertainties, challenges, and obstacles, privatization is moving forward in Croatia at a determined pace.

2. BACKGROUND

The long, rich history of the Croat people and their nation is filled with both accomplishments and strife.⁵ The location of Croatia along the Adriatic Sea, at the intersection of the Danube River Valley and the Mediterranean Valley, has shaped it into a center of commerce and a major crossroads for trade and transportation.⁶ Croatia's critical location also has made it the target of many empires over the centuries, and the Romans, Turks, Slavs, and others have all fought over the territory which is now Croatia,⁷ in large part because of its geographically significant location.⁸

Croatia's history of conflict continues today. Commentators estimate damages caused by the war between Croatia and Yugoslavia at more than U.S.\$20 billion.⁹ The monthly cost of refugee relief is an estimated U.S.\$70 million for the seven

³ See Slay, *supra* note 1, at 103.

⁴ See *Truce Begins in Croatia*, ROANOKE TIMES, Aug. 27, 1995, at A5.

⁵ It is not within the scope of this Article to discuss the cultural, political, and ethnic background or the present political status of Croatia. For a discussion of these topics, see MILAN RAKOVAC, CROATIA (1987); PEDRO RAMET, NATIONALISM AND FEDERALISM IN YUGOSLAVIA 1963-1983 (2d ed. 1992); SABRINA P. RAMET, BALKAN BABEL: POLITICS, CULTURE, & RELIGION IN YUGOSLAVIA (1992) [hereinafter BABEL].

⁶ See ECONOMIC DIVISION, CROATIAN MINISTRY OF FOREIGN AFFAIRS, A BUSINESS PORTRAIT OF CROATIA 7-8 (1992).

⁷ See RAKOVAC, *supra* note 5, at 46.

⁸ See ECONOMIC DIVISION, *supra* note 6, at 7.

⁹ See ZLATKO MATEŠA & FILIP BREKALO, REPUBLIC OF CROATIA AGENCY FOR RESTRUCTURING AND DEVELOPMENT, THE COUNTRY PRIVATIZATION REPORT - 1992, CROATIA 2 (1992).

hundred thousand people displaced by the war.¹⁰ An estimated 30% of Croatia's "economy potential" has been destroyed or damaged, transportation has been hindered by impassable roads, and the entire infrastructure of the country has been tremendously impaired.¹¹

Despite financial hardships and physical destruction, Croatia is moving forward toward its privatization goal with perseverance. The privatization process in Croatia is unique when compared with other nations of Eastern and Central Europe because of its history as a part of Yugoslavia and its worker-management economy and property structure.¹² Croatia's historical and economic background, including the events of the late 1980s in Yugoslavia, contributed significantly to its privatization design.

2.1. *Historical Background*

The earliest known history of Croatia is the great migration of Slavic peoples in the seventh century. During the migration, Croats, one of the South Slavic groups, settled in the region currently known as Croatia.¹³ In the ninth century, the region was governed in separate principalities.¹⁴ Tomislav, the first Croatian king, led the unified principalities into statehood in 925 and created a Croatian state.¹⁵ In 1102, Croatia signed the *Pacta Conventa* and entered into a union with the Hungarian dynasty.¹⁶ Croatia, however, retained its separate statehood within medieval Hungary.¹⁷

One important example of the development of law in Croatian society is the 1288 Vinodol Law Code, in which the representatives of nine Vinodol communities pledged their loyalty to feudal lords, the Frankopan princes.¹⁸ The Law Code is quite compre-

¹⁰ See *id.* at 7.

¹¹ See INVESTMENT IN CROATIA 91 (Pero Jurković ed., 1992) [hereinafter INVESTMENT].

¹² See discussion *infra* section 2.2.

¹³ See RAKOVAC, *supra* note 5, at 60.

¹⁴ See CROATIAN CHAMBER OF ECONOMY, CROATIA (1994).

¹⁵ See *id.*

¹⁶ See *id.*

¹⁷ See DUBRAVKO HORVATIC, THIS IS CROATIA 62 (1991).

¹⁸ See FERDO CULINOVIC, DRZAVNOPRAVNI RAZVITAK YUGOSLAVIJE 28 (1981).

hensive, and is significant because it is one of the oldest Croatian legislative documents written in the Croatian language. The code provided for private property and a degree of independence in the developing merchant towns.¹⁹

In the fifteenth century, the expansion of the Ottoman Empire into the Balkans transformed Croatia into a bloody battlefield.²⁰ For many years, Croatia was the last line of defense for Europe.²¹ After suffering a significant defeat by the Turks and the subsequent death of the Hungarian-Croatian King Ludovc II, the Croatian Parliament, known as the Sabor,²² chose Ferdinand I of the Hapsburg Empire to be the Croatian king in 1527.²³ Croatia allied with the Hapsburgs in order to help Croatia fight against the Ottoman Empire.²⁴ Under the rule of the Hapsburg emperors over the next few centuries, Croatia retained its parliament, but it was significantly influenced by the German rulers.²⁵

The end of World War I in 1918 marked the end of the Hapsburg rule of Croatia.²⁶ In 1918, the Sabor severed all state and legal connections with Austria and Hungary.²⁷ On October 29, 1918, the Sabor proclaimed the independence of all Croat regions and declared their association with Slovenia into a new State of Slovenes, Croats, and Serbs.²⁸ By the end of 1918, the Yugoslav State was officially established with the unification of the Kingdom of Serbs, Croats, and Slovenes.²⁹ After a thousand years of struggling to maintain an independent existence,³⁰ Croatia lost its statehood and constitutional identity in this new state. In fact, the Sabor itself was circumvented and never actually

¹⁹ See *id.*

²⁰ See RAKOVAC, *supra* note 5, at 86.

²¹ See *id.* at 85.

²² See Wayne S. Vucinich, *Interwar Yugoslavia*, in CONTEMPORARY YUGOSLAVIA 3, 30 (Wayne S. Vucinich, ed., 1969).

²³ See *id.*

²⁴ See *id.*

²⁵ For a discussion of Croatian history under Hapsburg rule, see RAKOVAC, *supra* note 5, at 85-88.

²⁶ See *id.* at 85.

²⁷ See JILL A. IRVINE, THE CROAT QUESTION 44-46 (1993).

²⁸ See IVO BANAC, THE NATIONAL QUESTION IN YUGOSLAVIA 128, 128 (1984).

²⁹ See *id.* at 138.

³⁰ See ECONOMIC DIVISION, *supra* note 6, at 7.

sanctioned the entrance of Croatia into a centralized Yugoslav state.³¹

Croatians became increasingly frustrated with the new state, and debate about secession ensued.³² To forestall secession, the assassination of three influential Croatian deputies was organized in 1928.³³ Subsequently, on January 6, 1929, King Aleksandar Karadjordjevic established a dictatorship by disbanding the Yugoslavian National Assembly and abolishing the constitution and the political parties.³⁴ The name of the state also was changed in 1929 to the Kingdom of Yugoslavia, meaning the Kingdom of "South Slavs."³⁵

In October 1939, King Aleksandar was assassinated, thus ending the royal dictatorship.³⁶ The Ustasha, a radical opposition group formed and led by Croatian nationalist Ante Pavelice, was instrumental in arranging the King's assassination.³⁷ During World War II, the Axis Powers, after conquering Croatia in 1941, supported the Ustasha government as the puppet regime of the new Independent State of Croatia.³⁸ Repression, including inter-ethnic violence, followed under the Ustasha regime.³⁹ Another Croatian communist leader, Yosip Broz Tito, led the partisan army resistance to the Nazis and the puppet regime throughout Yugoslavia.⁴⁰ The partisans' governmental organization was adopted by the end of World War II.⁴¹

The political regime established by Tito and the communist party after World War II created a unique Yugoslavian communist government, independent of the Soviet Union.⁴² Historically, each state within Yugoslavia has consistently maintained a high

³¹ See *id.* at 218 (explaining how the leaders of the new state circumvented the Sabor by not allowing it to convene).

³² See IRVINE, *supra* note 27, at 73.

³³ See Vucinich, *supra* note 22, at 18.

³⁴ See IRVINE, *supra* note 27, at 44-46; Vucinich, *supra* note 22, at 18-19.

³⁵ See IRVINE, *supra* note 27, at 45.

³⁶ See Vucinich, *supra* note 22, at 21-22.

³⁷ See IRVINE, *supra* note 27, at 50.

³⁸ See CULINOVIC, *supra* note 18, at 239-48.

³⁹ See BUSINESS, *supra* note 2, at 6.

⁴⁰ See IRVINE, *supra* note 27, at 116.

⁴¹ See *id.* at 250.1

⁴² See IRVINE, *supra* note 27, at 249-50.

level of ethnic and national identity.⁴³ Tito attempted to de-emphasize the nationalist feelings of each region and, through strong leadership, to promote unity among ethnic groups.⁴⁴ Nevertheless, the historical conflicts between different ethnic and cultural groups reemerged, as illustrated by the armed conflict after the declaration of Croatian and Slovenian independence and the continuing conflict in Bosnia-Herzegovina today.

Croatia declared its laws supreme to those of Yugoslavia on December 22, 1990.⁴⁵ In a May 19, 1991 referendum, 93.24% of the voters supported Croatian independence,⁴⁶ and Croatia seceded from Yugoslavia on June 25, 1991.⁴⁷ A Serbian invasion ensued, and fighting and destruction continued until a cease-fire was negotiated in 1992.⁴⁸ After the cease-fire, Serbian rebels maintained control of territory in the northeast corner of Croatia and in the horseshoe area around the Bosnian border.⁴⁹ The Serbian rebels controlled approximately one-third of the Croatian territory.⁵⁰ While United Nations ("U.N.") peacekeeping troops were sent to parts of these areas, deadlines for the removal of U.N. troops and the return of the territories ultimately expired without resolution.⁵¹

In August 1995, Croatian troops recaptured the Krajina region around Bihac in four days.⁵² This victory returned approximate-

⁴³ See *id.* at 1.

⁴⁴ See BABEL, *supra* note 5, at 7 (describing how Tito ruled Yugoslavia with a formula of "brotherhood and unity").

⁴⁵ See PRIVATIZATION IN CENTRAL AND EASTERN EUROPE 91 (P. Sarcevic ed., 1992) [hereinafter Sarcevic].

⁴⁶ See Marc Weller, *Current Developments: The International Response to the Dissolution of the Socialist Federal Republic of Yugoslavia*, 86 AM. J. INT'L L. 569, 570 (1992).

⁴⁷ See Sarcevic, *supra* note 45, at 91. This day marked the effective date of the Constitutional Decision on the Sovereignty and Independence of Croatia. Croatian independence was declared on October 8, 1991, after attempts at diplomatic settlement had failed. See *id.*

⁴⁸ See Roger Thurow, *Balkan Dilemma: While World Watches Bosnia, Its Neighbors May Start Next War*, WALL ST. J., Mar. 8, 1993, at A1, A6.

⁴⁹ See Laager Louts, *ECONOMIST*, Aug. 27, 1994, at 45 (map inset).

⁵⁰ See *Croatia's President Agrees to Reduced U.N. Force*, RICHMOND TIMES DISPATCH, Mar. 13, 1995, at A4.

⁵¹ See *id.* The newest plan calls for U.N. troops to be reduced from 12,000 to 5,000. See *id.*

⁵² See Samantha Power et al., *The Croatian Army's Friends*, U.S. NEWS & WORLD REP., Aug. 21, 1995, at 41.

ly 20% of Croatia's original territory.⁵³ Although a truce is currently in effect, the Croatian President, Franjo Tudjman, continues to express his determination to gain control of Eastern Slavonia, the remaining Croatian territory controlled by the Serbs.⁵⁴

2.2. *Economic Background*

Between 1947 and 1989, Yugoslavia implemented and experimented with six different economic systems.⁵⁵ Croatia's recent privatization plan adds another system to the list. The economic system that immediately preceded privatization is significant because it provides a framework for the most recent changes. Before transformation and privatization occurred, the Yugoslavian economy was generally characterized by a worker-management system with decentralized planning.⁵⁶ Several major laws throughout the years defined the progression of these economic systems.⁵⁷

In 1950, the Basic Law on Workers' Self-Management declared an end to state ownership of property and instituted a system of social ownership and worker-management of companies.⁵⁸ More specifically, workers were given the right to use, control, and possess the means of production, subject only to the various limitations designated by statute.⁵⁹ These principles of worker-management and social property were further delineated in the Yugoslavian Constitution of 1974 and in the Associated Labor Act of 1976.⁶⁰ The 1974 constitution stated that socially owned property belonged to society, rather than to the State, workers, or individuals.⁶¹ Some commentators describe the structure as a

⁵³ See *id.*

⁵⁴ See *Truce Begins in Croatia*, *supra* note 4, at A5.

⁵⁵ See Avner Ben-Ner & Egon Neuberger, *The Feasibility of Planned Market Systems: The Yugoslav Visible Hand and Negotiated Planning*, 14 J. COMP. ECON. 768, 769 (1990).

⁵⁶ See generally Svetozar Pejovich, *A Property-Rights Analysis of the Yugoslav Miracle*, 507 ANNALS AM. ACAD. POL. & SOC. SCI. 123 (1990) (describing the worker-management system).

⁵⁷ See *id.* at 125-26.

⁵⁸ See Sarcevic, *supra* note 45, at 82-83.

⁵⁹ See *id.* at 83.

⁶⁰ See *id.*

⁶¹ See *id.*

system in which property does not belong to the State, but instead belongs to everybody and, therefore, to nobody.⁶² The Associated Labor Act limited the management of social property to labor organizations.⁶³ The Associated Labor Act hampered foreign investment because foreign investors effectively were limited only to joint ventures with Yugoslav labor associations.⁶⁴ Although small by U.S. standards, a private sector still existed (10%);⁶⁵ it comprised a relatively large segment of private crafts and small businesses in comparison with other Eastern European countries.⁶⁶

As Yugoslavia and other similarly situated Eastern European countries faced economic decline and revolutionary furor in the 1980s,⁶⁷ it once again implemented economic changes. In 1988, constitutional amendments created another category of property, called mixed property, which allowed for a combination of both social and private ownership.⁶⁸ A short time later, the Yugoslavian government established a cooperative form of ownership.⁶⁹ In an attempt to attract foreign investment, the Yugoslav Parliament amended the constitution in 1988 to allow the establishment of enterprises separate from labor organizations.⁷⁰ In order to further encourage foreign investment, the parliament enacted the Law on Enterprises ("LOE") and the Law on Foreign Investment ("FIL").⁷¹

⁶² See, e.g., *MATESA & BREKALO*, *supra* note 9, at 10 (stating that "social ownership was a product of the social self-management system and can be defined as a concept where nobody is an owner and at the same time everybody is an owner").

⁶³ See *id.*

⁶⁴ See Sarcevic, *supra* note 45, at 83.

⁶⁵ See *BUSINESS*, *supra* note 2, at 25.

⁶⁶ See *MATESA & BREKALO*, *supra* note 9, at 3.

⁶⁷ See generally Pejovich, *supra* note 56, at 126-27 (describing Yugoslavia's economic problems in the 1980s); Egon Zizmond, *The Collapse of the Yugoslav Economy*, 44 *SOVIET STUD.* 101 (1992) (describing the economic and political breakdown of Yugoslavia).

⁶⁸ See Sarcevic, *supra* note 45, at 85.

⁶⁹ See *id.* at 84-85.

⁷⁰ See *id.*

⁷¹ The FIL became effective January 8, 1989, and the LOE became effective in 1988 and was amended in 1989 and 1990. The English text of the LOE and the FIL can be found in 5A *CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS* (Vratislav Pechota, ed., 1995).

2.3. *Development of Enterprises*

The LOE “marked a return to ‘classical’ company law”⁷² and established four categories of business ownership: social ownership, cooperative ownership, mixed ownership, and private ownership.⁷³ Privately owned enterprises could be formed, including foreign investor ownership, individually or in conjunction with domestic persons.⁷⁴ The FIL mirrored the 1988 constitutional amendment by giving business entities with foreign investment the same legal rights as socially-owned enterprises.⁷⁵ The four types of enterprises were delineated as public enterprises (socially owned), joint-stock companies, limited liability companies, and partnerships (both general and limited).⁷⁶ The joint-stock company corresponds generally to the corporation in the United States because owners have limited liability and the joint-stock company has the potential for a perpetual existence.⁷⁷ Partnerships, as defined by the LOE, are similar to the U.S. concept of partnerships, including the distinction between general and limited partnerships.⁷⁸ The limited liability company does not issue shares of stock, and an investor cannot sell his share in the company to a third party unless all other investors agree to the sale.⁷⁹ Investors in limited liability companies may only be liable for the amount that they have invested in the company.⁸⁰ The new laws introduced further reforms by permitting all enterprises to own property.⁸¹ The LOE allows companies to establish their own rules of governance and organization through the creation of by-laws.⁸² The aforementioned forms of enterprises described are important because they provide the first step

⁷² See Sarcevic, *supra* note 45, at 84.

⁷³ See LOE, *supra* note 71, art. 2.

⁷⁴ See *id.* art. 138.

⁷⁵ See FIL, *supra* note 71, art. 8; Sarcevic, *supra* note 45, at 85.

⁷⁶ See LOE, *supra* note 71, art. 2.

⁷⁷ See *id.* arts. 85 (comment), 101(9).

⁷⁸ See *id.* arts. 109, 115.

⁷⁹ See *id.* arts. 104, 107.

⁸⁰ See *id.* art. 104.

⁸¹ The new laws expanded permissible types of business ownership to include social, co-operative, mixed, and private enterprises. See Sarcevic, *supra* note 45, at 85.

⁸² See LOE, *supra* note 71, arts. 49, 101, 106, 110.

toward a legal and organizational framework for a private property system. Independent Croatia has adopted the Yugoslavian LOE and the FIL with some revisions and amendments.⁸³

On November 23, 1993, the Croatian Sabor passed the new Company Act.⁸⁴ The Company Act replaces the LOE and the FIL. The legislation was published December 15, 1993 and became effective, as applicable to newly formed companies, eight days later. All existing entities were required to conform to the provisions of the Company Act by January 1, 1995. The business entities established by the Company Act are somewhat similar to the basic legal entities in the United States, but they more closely resemble German forms of business entities.⁸⁵ University of Zagreb Professor Yaksa Barbic recommended that Croatia adopt a Central European approach to company law rather than the U.S. system.⁸⁶ Barbic reasoned that the law was already well developed and suggested that the joint-stock company be modeled after German or Austrian law.⁸⁷ Laws of the United States and Britain, he believed, were inappropriate because these countries' legal systems were traditionally different from continental systems.⁸⁸ Finally, Barbic reasoned that a unique enterprise system would lead to "legal isolation," and that Croatia should have considered adopting laws similar to the laws of those countries with which they would have the most contact or business.⁸⁹

The Company Act defines a "sole trader" as an individual who does business personally, similar to a sole proprietorship in the United States. While a sole trader entity does not need to follow formalities which other entities must adhere to, a sole trader must

⁸³ See Sarcevic, *supra* note 45, at 92.

⁸⁴ See Zakon o trgovackim drustvima, People's Gazette, No. 111/1993 [hereinafter Company Act].

⁸⁵ For a general description of German enterprises, see SETTING UP A COMPANY IN THE EUROPEAN COMMUNITY: A COUNTRY BY COUNTRY GUIDE (Brebner & Co. eds., 1989); see also Mark M. Nelson, *Two Styles of Business Vie in East Europe*, WALL ST. J., Apr. 3, 1995, at A10 (discussing the U.S. and German influences on the development of law in Eastern Europe).

⁸⁶ This information is found in the English summary section of J. Barbic, *Legal System and Entrepreneurship Development*, in KAKO DO USPJESNOG PODUZECA? 265 (Croma ed., 1992).

⁸⁷ See *id.*

⁸⁸ See *id.*

⁸⁹ See *id.*

register the business with the Commercial Court Register if its annual income is at least 4 million deutsche marks ("DM"). The sole trader also may request registration when its annual income is between DM 500,000 and DM 4 million. The sole trader must personally assume any liability that the firm incurs and may utilize a power of attorney to do business.⁹⁰

Entities similar to both general and limited partnerships exist under the new Croatian law.⁹¹ General partners have unlimited joint and several liability, equal rights of management, and equal obligations.⁹² Partners regulate their relationship by agreement, and the provisions of the Company Act apply only when the agreement is silent concerning an issue.⁹³ Equal rights and obligations prevail unless there is agreement to the contrary.⁹⁴ In comparison to U.S. partnership law in which all profits are shared, only one third of the annual profits are divided equally between the general partners in a Croatian partnership if the agreement does not provide otherwise.⁹⁵ Presumably, the remainder of the profits remain with the partnership.

A partnership will dissolve automatically upon the death, bankruptcy, or withdrawal of a partner, upon a dissolution by court action, or upon agreement by the partners to dissolve upon termination.⁹⁶ A new partner assumes unlimited personal liability for the previous liabilities of the partnership as well as for any future occurrences.⁹⁷ Although the Company Act does not specifically address the admission of new partners, it can be inferred that a general partnership continues when a new partner is admitted.

Each limited partnership has at least one general and one limited partner.⁹⁸ The general partner's liability is unlimited,

⁹⁰ See Company Act, *supra* note 84, art. 3.

⁹¹ The term "partnership" is used in this Article because these Croatian entities bear a similarity to U.S. partnership entities. The Croatian terminology, however, does not easily translate.

⁹² See Company Act, *supra* note 84, art. 68.

⁹³ See *id.* art. 71.

⁹⁴ See *id.* art. 78.

⁹⁵ See *id.* art. 87.

⁹⁶ See *id.* art. 97.

⁹⁷ See *id.* art. 96; see also *id.* arts. 94, 95 (regarding joint and several personal liability of partners).

⁹⁸ See *id.* art. 131.

while the limited partner's liability is limited to the amount of his or her capital contribution. The general partner manages the partnership.⁹⁹ Each limited partnership must file a registration statement which contains information including the identity, relationship, and contributions of each partner.¹⁰⁰

The Croatian joint-stock company is owned by a minimum of one stockholder and is governed by a supervisory and managing board.¹⁰¹ Stockholders are not personally liable for the company's obligations.¹⁰² The joint-stock company must have a minimum capitalization of DM 30,000,¹⁰³ and the nominal value of each share of stock cannot be less than DM 10.¹⁰⁴

In the Croatian limited liability company, the investors own share capital instead of stock.¹⁰⁵ The company must have at least DM 5,000 in capitalization,¹⁰⁶ and an investor is required to invest share capital of at least DM 200.¹⁰⁷ Owners retain limited liability, and a supervisory and managing board governs the company.¹⁰⁸

In addition to the entities described above, the Company Act also describes a "secret company."¹⁰⁹ A secret company is a company in which an undisclosed individual invests and participates in the profit and loss of the company according to an agreement.¹¹⁰ The Company Act specifically states that this arrangement does not create a legal entity.¹¹¹

Lastly, the Company Act defines the role and rights of foreign companies. Foreign companies must establish and register a subsidiary to do business in Croatia.¹¹² A foreign corporation may act as a general partner only if the partnership has a domestic

⁹⁹ See *id.* art. 136.

¹⁰⁰ See *id.* art. 134.

¹⁰¹ See *id.* art. 159.

¹⁰² See *id.*

¹⁰³ See *id.* art. 162.

¹⁰⁴ See *id.* art. 163.

¹⁰⁵ See *id.* art. 384.

¹⁰⁶ See *id.* art. 389.

¹⁰⁷ See *id.* art. 390.

¹⁰⁸ See *id.* arts. 422-39.

¹⁰⁹ See *id.* art. 148.

¹¹⁰ See *id.*

¹¹¹ See *id.*

¹¹² See *id.* art. 612.

general partner as well.¹¹³ Otherwise, a “foreign investor has the same rights and obligations as a domestic person in founding and participating in a company’s business.”¹¹⁴

In summary, when the privatization process began in newly independent Croatia, the country incorporated the Yugoslavian LOE and FIL, which established a system of mixed property and provided guidelines for forming enterprises. The new Croatian Company Act, which replaced the LOE and FIL, further developed the framework for business enterprises. Instead of following the Yugoslav model of privatization, the Sabor enacted legislation dealing with privatization, the Law on the Transformation of Socially Owned Enterprises (“Privatization Act”),¹¹⁵ that charted a novel course.

3. THE CROATIAN PRIVATIZATION SCHEME

The Privatization Act may prove to be the most important piece of Croatian legislation other than the Constitution of the Republic of Croatia.¹¹⁶ Privatization not only has had a significant economic effect on Croatia, but also has created political and social changes because placing property rights in the hands of individuals alters the fabric of a society by altering group relationships.¹¹⁷ Thus, the concept of socially owned (“nobody”-owned) property¹¹⁸ and the rights of manager workers were the first issues addressed by the Croatian government during the

¹¹³ See *id.* art. 620.

¹¹⁴ *Id.* art. 612.

¹¹⁵ See Law on the Transformation of Socially Owned Enterprises, People’s Gazette, No. 19/1991 [hereinafter Privatization Act]. The Privatization Act can be found in English in 5A CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1993).

¹¹⁶ See INVESTMENT, *supra* note 11, at 106.

¹¹⁷ See MATEŠA & BREKALO, *supra* note 9, at 3-4. Furthermore,

the creation and existence of private ownership is the only barrier to totalitarianism and as a result the process of privatization is strongly being attacked by the defeated political options in the former communist countries. . . . The process of privatization, from the sociological viewpoint will bring about a social structure characterized by a civil society that has an emphasis on the establishment of a ‘middle class’ which in itself represents the stability of a democratic society as a whole.

Id.

¹¹⁸ See Sarcevic, *supra* note 45, at 86.

privatization process.

3.1. Transformation

Initially, some proponents of privatization argued that company and property ownership should be given to workers with past associations with those entities.¹¹⁹ Others suggested that property should be divided among all citizens of Croatia because everyone owned an undivided interest in social property.¹²⁰ In the end, the system that prevailed was based on the premise that socially owned property belonged to everyone, rather than to individuals and/or worker managers.¹²¹ Croatia thus pursued a unique approach by first transforming social capital companies (social property) into joint-stock or limited liability companies before privatizing them. Although workers were not given property, they were given the opportunity to be involved in the process and received discounts when buying shares of companies.¹²²

The Privatization Act defines enterprises with social capital as those socially owned or mixed ownership companies "in which no ownership rights are acquired on the basis of social resources invested in them."¹²³ The Privatization Act does not cover banks, financial companies, or insurance companies.¹²⁴ The value of a company's social capital is the difference between its assets and its liabilities.¹²⁵ Managers may decide not to include the value of company owned worker apartments when calculating the assets of the company.¹²⁶ Although inflation, accounting

¹¹⁹ See *id.*; see also Stephen S. Cohen & Andrew Schwartz, *The Tunnel at the End of the Light: Privatization in Eastern Europe*, 7 TRANSNAT'L LAW. 7 (1994) (arguing that privatization should not be implemented too quickly and that the State is needed to fill voids created during the process); E.S. Savas, *Privatization in Post-Socialist Countries*, 52 PUB. ADMIN. REV. 573, 577 (1992) (recognizing the workers' position and arguing that it would be unwise, for both workers and companies, to allow workers to own completely the companies for which they work).

¹²⁰ See Ivo Bicanic, *Privatization in Yugoslavia's Successor States*, RFE/RL RES. REP., May 29, 1992, at 43, 46-47.

¹²¹ See MATESA & BREKALO, *supra* note 9, at 13.

¹²² See *infra* notes 146-53 and accompanying text.

¹²³ Privatization Act, *supra* note 115, art. 1.

¹²⁴ See *id.*

¹²⁵ See *id.* art. 2.

¹²⁶ See *id.*

problems, and uncertainty hinder "a precise quantified evaluation"¹²⁷ of the value of the socially owned property, the total value in 1992 was approximately 406 billion Croatian Dinars.¹²⁸ This amount must be reduced by about 164 billion dinars, which were in publicly owned enterprises and 8 billion dinars, which were in banks.¹²⁹ The total amount to be privatized, then, would be equivalent to U.S.\$16 billion.¹³⁰

Under the Company Act, the management of a business¹³¹ may decide to transform the enterprise into either a joint-stock company or a limited liability company.¹³² Management must submit a plan for this transformation to the Republic of Croatia's Agency for Restructuring and Development ("Agency").¹³³ The plan must contain certain financial information about the enterprise, details on how the transformation would occur, the court registration, and a report assessing the value of the enterprise.¹³⁴ The Agency's approval of the plan is required, unless the value of the company is equal to or less than DM 5 million.¹³⁵

The Company Act required that all socially owned property be transformed by June 30, 1992.¹³⁶ Upon application, extensions could be granted for those businesses in the occupied territories.¹³⁷ As the deadline approached, some advocated extending the deadline for all of Croatia.¹³⁸ The deadline was not extended, however, and only a small percentage of companies in the

¹²⁷ INVESTMENT, *supra* note 11, at 108.

¹²⁸ *See id.* The Croatian currency was changed from the dinar to the kuna on May 31, 1994. Although the denomination was adopted because of its early historical significance, strong negative reactions arose because of its use by the Nazi puppet regime during World War II. *See* ECONOMIST INTELLIGENCE UNIT — COUNTRY REPORT: BOSNIA-HERZEGOVINA, CROATIA, MACEDONIA, SERBIA-MONTENEGRO, SLOVENIA 13, 19 (2d qtr. 1994).

¹²⁹ *See* INVESTMENT, *supra* note 11, at 108.

¹³⁰ *See id.*

¹³¹ *See* Privatization Act, *supra* note 115, art. 10.

¹³² *See id.* art. 4.

¹³³ *See id.* arts. 10-11.

¹³⁴ *See id.* art. 11.

¹³⁵ *See id.* art. 13.

¹³⁶ *See id.* art. 9.

¹³⁷ The 1992 Amendments to the Company Act allowed these extensions. *See* MATEŠA & BREKALO, *supra* note 9, at 8-9.

¹³⁸ *See* Bicanic, *supra* note 120, at 46; Sarcevic, *supra* note 45, at 93.

occupied zones went through the transformation process.¹³⁹ A total of more than 3,800 businesses were subject to transformation.¹⁴⁰ By the deadline, 2,444 (64%) had submitted transformation plans, and 274 requests (7%) for postponement were filed.¹⁴¹ Therefore, 1,082 businesses (29%) failed to file a plan or a request for postponement.¹⁴² It was estimated that at least half of these enterprises would have to be liquidated in bankruptcy, meaning that about 13% of the businesses with socially-owned capital would actually be transferred to the Funds because they were not transformed by the management of the company.¹⁴³ By January 31, 1994, the number of applications for transformation programs had risen to 2,877.¹⁴⁴ Under the Privatization Act, businesses that did not submit a plan by the due date had two-thirds of their socially owned capital transferred to the Fund for Privatization ("Fund"), and the remainder was given to the Republic Pension Funds.¹⁴⁵

3.2. Privatization

During or after the transformation stage, private owners may acquire the company using several different methods. First, the Privatization Act gives priority ownership rights and discounts to current and former workers of the company, and employees can acquire ownership interests with a value of up to DM 20,000 at a discount.¹⁴⁶ The employee discount is 20% plus an additional 1% for each year of the worker's employment with the company.¹⁴⁷ Employees also receive priority if they purchase additional shares at full price.¹⁴⁸ Employees may purchase a maximum of 50% of an enterprise at the discounted price.¹⁴⁹ If the compa-

¹³⁹ See MATESA & BREKALO, *supra* note 9, at 11.

¹⁴⁰ See *id.*

¹⁴¹ See *id.*

¹⁴² See *id.*

¹⁴³ See *id.*

¹⁴⁴ CROATIAN PRIVATIZATION FUND, PRIVATIZ[ATION] UPDATE—CROATIA 1 (Jan. 31, 1994) (copy on file with author) [hereinafter UPDATE].

¹⁴⁵ See Privatization Act, *supra* note 115, art. 5.

¹⁴⁶ See *id.* art. 19.

¹⁴⁷ See *id.* art. 5.

¹⁴⁸ See *id.*

¹⁴⁹ See *id.* art. 19.

ny shares are obtained by the investment of additional capital, then the discount is limited to 40% of the value of the business.¹⁵⁰ Employees are also entitled to pay for their shares in installments, provided that they complete their payments within five years.¹⁵¹ Originally, the Privatization Act required that 5% be paid in the first year, 10% be paid in the second year, 20% be paid in the third year, 30% be paid in the fourth year, and the remaining 35% be paid in the fifth and final year.¹⁵² This installment program, chosen by a majority of buyers, recognized that present savings of many citizens were insufficient to finance the private acquisition of companies.¹⁵³

The Croatian government later implemented several changes to the payment methods and installment plan. First, the percentages owed per year were reduced. The 10% due in year two was reduced to 5%, and the later percentages were dropped, making the balance (possibly up to 90%) due in the fifth and final year.¹⁵⁴ Second, the government revised the Privatization Act to allow employees to pay for their shares through formerly frozen foreign savings accounts. These accounts represent money owed to depositors by the government owned banks of Croatia, but which was unavailable because the assets were frozen by Yugoslavia when Croatia gained independence.¹⁵⁵ Although the use of foreign savings to buy company shares does not provide revenue for Croatia, it does ultimately decrease public debt and provide an impetus for privatization.¹⁵⁶

Another method for privatizing the transformed company is to convert creditor debt into equity shares in the business.¹⁵⁷ Holders of contract investments, such as loans and other business

¹⁵⁰ See *id.* art. 24.

¹⁵¹ See *id.* art. 20.

¹⁵² The Fund for Privatization set up the discount schedule. Interview with Dr. Yaksa Barbic, Professor of Law at Zagreb University, in Zagreb, Croatia (June 7, 1993) [hereinafter Barbic Interview].

¹⁵³ See *id.*

¹⁵⁴ See *Manje Rate Malim Dionicarima*, VECERNJI LIST, June 1, 1993.

¹⁵⁵ See UPDATE, *supra* note 144, at 6.

¹⁵⁶ See *id.* Foreign exchange savings are used to buy stocks by having banks act as intermediaries between the buyers and sellers. See *Company Stocks Offered for Public Debt Claims*, GLAS SLAVONIJE, Mar. 17, 1994, at 12, translated in F.B.I.S.: E. EUROPE DAILY REP., Apr. 22, 1994, at 45-46.

¹⁵⁷ See Privatization Act, *supra* note 115, art. 25.

financing, also may convert their holdings to equity shares.¹⁵⁸ Additional investment also will allow for the acquisition of shares or share capital through direct investment in the company.¹⁵⁹ A final method of privatization allows buyers to purchase the company, or a separable portion thereof, in a direct sale.¹⁶⁰ If the business is not completely acquired by means of investment, sale, conversion of debt to equity, or by the employees, then the remaining portion is forwarded to the Funds.¹⁶¹

The Funds must then dispose of the remaining equity by means of an auction, a public offering, or a direct negotiated sale.¹⁶² Because most sales will be by auction, the Fund has arranged for the Zagreb Stock Exchange to conduct the auctions.¹⁶³

An underlying issue related to the sale of a company's shares by the Fund is the price at which the stock will be offered to workers or to other buyers. The Sabor passed regulations which allow for flexibility in the method of valuation. Each company's own experts, who have taken the business through privatization, or other authorized persons evaluate the worth of the company.¹⁶⁴ "Other authorized persons" are defined as those who have registered and are licensed.¹⁶⁵ Final approval in the valuation process rests with the Fund, and it has the authority to require the company to perform an audit if it believes a value was not objectively or fairly determined.¹⁶⁶

Three methods are available for valuation purposes: book value, market value, and economic value.¹⁶⁷ Book value is the

¹⁵⁸ See *id.*

¹⁵⁹ See *id.* arts. 22-23.

¹⁶⁰ See *id.* art. 14.

¹⁶¹ See *id.* art. 26.

¹⁶² See *id.* arts. 14-18.

¹⁶³ Interview with Zeljko Kardum, Director of the Zagreb Stock Exchange, in Zagreb, Croatia (May 28, 1993) [hereinafter Kardum Interview]. A public auction of shares in companies is held each Thursday at 10:00 a.m. on behalf of the Fund. See *id.*

¹⁶⁴ See Privatization Act, *supra* note 115, art. 11.

¹⁶⁵ Upute za provedbu clanka 11. Zakona O pretvorbi drustvenih poduzeca, art. VII, § 2 (3), Peoples Gazette, No. 26/1991 [hereinafter Instructions].

¹⁶⁶ See *id.* § 2(4).

¹⁶⁷ See *id.* §§ 1.1-3.

difference between assets and liabilities.¹⁶⁸ Market value depends on an assessment of the market value of a company's assets.¹⁶⁹ Lastly, economic value is a "dynamic approach" which values based on a company's past efficiency and predicted future performance.¹⁷⁰ All three of these methods of valuation are susceptible to vagueness and different interpretation. The regulations require, however, explanations for all presumptions and methods, and relevant data and "proof" to accompany the valuation study.¹⁷¹ An additional incentive encouraging evaluators to evaluate accurately shares is that those who sign the study are personally responsible for the evaluations.¹⁷²

Statistics from 1992 show that employees bought 70% of small and medium sized businesses and 30% of large businesses.¹⁷³ Approximately 10% of the businesses were privatized through the process of converting debt to equity.¹⁷⁴ The remaining transformed businesses were transferred to the Funds.¹⁷⁵

By the end of 1993, the transformation and privatization program had progressed even further. The Privatization Fund had approved 82% of the applications for transformation and privatization.¹⁷⁶ Of that group, 81% completed the process by registering with the local Commercial Court.¹⁷⁷ In 1994, an analysis of the registered companies shows that the distinction between small and large companies continues to be significant. Small or medium sized companies constitute 48% of all companies, and most are completely privatized.¹⁷⁸ These companies, however, comprise only 18% of the value of companies to be privatized.¹⁷⁹ The

¹⁶⁸ See *id.* § 1.1.

¹⁶⁹ See *id.* § 1.2.

¹⁷⁰ See *id.* § 1.3.

¹⁷¹ See *id.* §§ 2(1)-(2).

¹⁷² See *id.* § 2(9).

¹⁷³ See MATESA & BREKALO, *supra* note 9, at 12.

¹⁷⁴ See *id.*

¹⁷⁵ See *id.*

¹⁷⁶ See UPDATE, *supra* note 144, at 1.

¹⁷⁷ See *id.*

¹⁷⁸ GOVERNMENT OF THE REPUBLIC OF CROATIA, MEMORANDUM ON THE FOREIGN TRADE REGIME 18 (Official English Version May 2, 1994). This publication does not explain by what criteria the categories of small, medium, or large companies were designated.

¹⁷⁹ See *id.*

15% of companies that are categorized as large contain 42% of the total capital invested, and were owned in majority (52%) by the state funds.¹⁸⁰

4. PROGRESS AND CHALLENGES OF PRIVATIZATION

The Privatization Act and the Company Act are essential laws for Croatia. These two laws provide the framework for Croatia's transformation from a socialist, worker-managed economy to an economy that embraces private property and an open market. Such an enormous undertaking is bound to encounter obstacles and opposition that are both legal and practical in nature. A discussion of both the legal and the practical issues that have arisen in Croatia during the transformation and privatization of Croatian companies follows.

4.1. *A Constitutional Question*

A major legal issue concerning privatization is the constitutionality of purchasing a transformed company by investing additional capital. The law of privatization clearly allows buyers to obtain shares in a company by investing additional capital.¹⁸¹ At least 120 buyers have invested in companies in this manner.¹⁸² One of these investors was Sinisa Catkas whose plight illustrates the controversy and debate over privatization in Croatia.

Catkas had grand plans for the Split area of Croatia.¹⁸³ He

¹⁸⁰ See *id.*; see also Slavo Radosevic, *The Generic Problems of Competitiveness at Company Level in the Former Socialist Economies: The Case of Croatia*, 46 EUR.-ASIA STUD. 489, 496-97 (1994) (concluding that privatization is not yet felt in Croatia because most ownership is still held by institutional investors).

¹⁸¹ See *supra* note 159 and accompanying text.

¹⁸² See Miomir Strbac, *Transformation Conflict in 120 Pictures*, SLOBODNA DALMACIJA, Apr. 14, 1994, at 6, 6-7, translated in F.B.I.S.: E. EUROPE DAILY REP., May 4, 1994, at 41, 41.

¹⁸³ Marko Franjic, *What Has the State Done to Caktas? [sic]*, DANAS, Apr. 26, 1994, at 28, translated in F.B.I.S.: E. EUROPE DAILY REP., May 19, 1994, at 33, 34; see also Dennis A. Rondinelli, *Privatization and Economic Reform in Central Europe: Experience of the Early Transition Period*, in PRIVATIZATION AND ECONOMIC REFORM IN CENTRAL EUROPE 1, 31-32 (Dennis A. Rondinelli ed., 1994) (noting public opposition to entrepreneurship resulting from "[t]he strong sense of egalitarianism inculcated by the Communist regime [that] still shaped people's attitudes and caused resentment of the possibility that some people would become far richer than others through individual enterprise").

bought several firms with cash and arranged to buy other businesses with the Fund using additional invested capital.¹⁸⁴ His ultimate goal was to move the industrial businesses out of the center city and to build and create a commercial center with a bridge around the quay.¹⁸⁵ The Catkas plan was comparable to the renovation of inner cities and harbors occurring in the United States. Unhappy citizens of Split (one-fourth of whom would have been employed by Catkas) created an uproar and protested against Catkas' renovations, and Catkas and his associates were subsequently imprisoned.¹⁸⁶ One newspaper commented that "[i]t seems the only thing in dispute was the possibility of someone making money with a good idea and money invested. That was a bad thing in the former system as well."¹⁸⁷

Although the extent and possible success of Catkas' changes may have provided the impetus for the public furor, he was actually incarcerated for a legal reason which originated with the Fund.¹⁸⁸ Before Catkas' imprisonment, the Fund had decided that the additional capitalization of firms would be desirable because the influx of investment would aid the overall economy and the individual businesses.¹⁸⁹ The Fund also believed that shareholders would benefit because companies would be strengthened. Practically, however, investors were unwilling to commit funds to an enterprise over which they could have no control.¹⁹⁰ This lack of control was the result of workers exercising their priority rights to buy up to 50% of the business.¹⁹¹ In response, to promote capitalization and to move closer to completion of the privatization process, the Fund began to increase the capital of businesses and to issue shares to investors willing to contribute additional funds.¹⁹² This practice allowed investors to obtain controlling interests in companies. In the language of U.S. corporations, the Fund was authorizing new stock issuances. The

¹⁸⁴ See Franjic, *supra* note 183, at 34.

¹⁸⁵ See *id.*

¹⁸⁶ See *id.*

¹⁸⁷ *Id.*

¹⁸⁸ See *id.*

¹⁸⁹ See Strbac, *supra* note 182, at 42.

¹⁹⁰ See *id.*

¹⁹¹ See *id.*

¹⁹² See *id.*

existing shareholders were denied their preemptive rights to buy additional shares in order to maintain their proportional percentage ownership; consequently, their shares were diluted.¹⁹³

In reaction, shareholders believed that

without their consent, the [F]und was unfairly seizing control over the enterprise and their own fate out of their hands, and leaving them at the mercy of a private businessman who, as he saw fit, could declare them surplus, dismiss them, pay them badly, or disband and sell off 'their' enterprise.¹⁹⁴

In response to the opposition, the Fund obtained a clarifying amendment to the Privatization Act, with no opposition from the Assembly, which specifically allowed the Fund the discretion to increase "the principal of an enterprise being transformed into a stock company by the amount of additional capitalization that was accepted."¹⁹⁵

The statutory amendment to the Privatization Act failed to abate the conflict. The presidents of the Commercial Courts met to discuss the problem and issued a resounding opinion in opposition to the Fund's actions.¹⁹⁶ The group stated that the practice of issuing additional shares was unconstitutional because it violated Article 49 of the Constitution which states, "Rights acquired through the investment of capital cannot be reduced by law or any other legal act," and it also violated Article 48 which ensured rights of ownership in property.¹⁹⁷ The presidents reasoned that the Croatian Privatization Fund "flagrantly violat[ed] the shareholders' rights, since by converting the additional capitalization proposed into additional shares, it . . . depriv[ed] the other shareholders of the right to participate in additional capitalization, and proportionately reduc[ed] the other shareholders' already acquired rights and the amount of their

¹⁹³ See *id.* at 42-43.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ See *id.* at 42-43.

¹⁹⁷ See *id.* at 42.

investments.”¹⁹⁸

In spite of the opinion of the commercial courts, the Fund continued to raise capital by issuing additional shares.¹⁹⁹ The legal situation is very confusing because “sometimes it is possible to regularize such a transaction by entering its results in the court registry, and sometimes it is not.”²⁰⁰ Thus, Catkas was caught in the middle of a heated conflict. He is in jail on suspicion of having “misused a position of authority and [having] falsified official documents in the ownership transformation procedure . . .”²⁰¹ According to the latest information available, Catkas is suing the Fund for the return of DM 4.5 million he paid to it and for additional compensatory damages.²⁰² Meanwhile, from jail, he awaits his trial and the decision of the Constitutional Court.²⁰³

4.2. *Financing*

Another issue that arose during the debate about additional capital concerned the fact that much of the money invested was borrowed from domestic banks. The Croatian commercial judges placed significance on this fact. The presidents called this additional borrowing of capital a “transfer of existing capital, and not an infusion of new capital,”²⁰⁴ thus creating “an illusion [of

¹⁹⁸ *Id.* at 42-43.

¹⁹⁹ *Id.* at 42.

²⁰⁰ *Id.* at 43. The Fund argued that the individual shareholders’ right to purchase up to DM 20,000 of shares was not changed by the addition of capital, and that stockholder’s rights could not be violated while the company was still being transformed because it was not a company yet. *See id.* Although a meeting between the president of the High Commercial Court and the Croatian government resulted in the president instructing courts to continue registering the shares until the Constitutional Court could rule, some local court registers failed to follow these directions. *See id.*

²⁰¹ *Reports on Privatization Problems Examined*, F.B.I.S.: E. EUROPE DAILY REP., May 9, 1994, at 53, 53.

²⁰² *See id.*

²⁰³ *See id.* The shareholders are waiting quietly for the decision of the court, as well. As described in the media, “[i]t does not matter whether [the shareholders are keeping quiet] because of a headache from confrontation with the legal labyrinth in which nothing is clear to them anymore, or because everything is clear to them, and so their heads ache from helplessness.” Strbac, *supra* note 182, at 43.

²⁰⁴ Strbac, *supra* note 182, at 43.

new funds] for the uninformed."²⁰⁵

This viewpoint may initially seem to be without merit. When an investor makes a legally binding contract with a bank in the form of a loan, the investor has obtained new funds to add to the company, funds otherwise unavailable. In the United States, a country with a free market economy, that may be the case. In Croatia, however, where socialism flourished, a different categorization of the value of loans resulted. Loans under communism were not necessarily made at arm's length, and the presumption was that many loans were made because of a person's political position or power, and were possibly never to be repaid.²⁰⁶ Public outcry concerning this practice of issuing these "beautiful eyes" loans caused the enactment of the Law on the Invalidity of Certain Types of Security Agreements and Loan Agreements in 1994.²⁰⁷ This law prohibits both past and future loans issued by banks to finance the purchase of shares in enterprises in which the stocks bought are security for the loan.²⁰⁸ In the United States, where the property bought with loan proceeds serves as collateral for the same loan, this interest is known as a purchase money security interest.²⁰⁹

The complete prohibition of these loans seems a drastic response and will reduce the number of people who have the additional resources to buy stocks because additional cash or collateral for the purchase will be needed. The names of those people who had bought stock in this manner were to be made public, and those named would have had to refinance the transaction before a stated deadline.²¹⁰ If the deadline was not met, then the ownership of the stock reverted to the Fund.²¹¹ Therefore, the ownership of stock previously registered could be

²⁰⁵ *Id.*

²⁰⁶ See S.G., *Law on Invalidity of Certain Types of Security Agreements and Loan Agreements in Effect: Managerial Loans for Those Without 'Beautiful Eyes'*, SLOBODNA DALMACIJA, Mar. 20, 1994, translated in F.B.I.S.: E. EUROPE DAILY REP., Mar. 20, 1994, at 52, 52.

²⁰⁷ *Id.*

²⁰⁸ See *id.*

²⁰⁹ See BLACK'S LAW DICTIONARY 1111 (5th ed. 1979).

²¹⁰ See S.G., *supra* note 206, at 52.

²¹¹ See *id.*

altered.²¹² The public perception was that the recipients of these “beautiful eyes” loans were the former managers of enterprises who had party connections.²¹³ The legislative response to this practice illustrates the strong negative reaction and desire to end preferential treatment based upon political ties.

A survey in the newspaper *Globus*, a weekly Croatian newspaper, confirms the mistrust of present government and business officials in economic affairs.²¹⁴ One question, indicating a certain bias itself, asked was, “Do you think there has been robbery and corruption in the process of privatization?”²¹⁵ The response was: 61.4% “yes”; 10.2% “no”; 21.9% “I don’t know”; and 6.5% “I don’t want to answer.”²¹⁶ Another question asked was, “Are you against directors (managers) becoming owners of a socially-owned company?”²¹⁷ The answers were: 66.1% “yes”; 15.9% “no”; 11.8% “I don’t know”; and 6.2% “I don’t want to answer.”²¹⁸ The expectation of and belief in continuing corruption by the State and by former managers in the privatization process is striking. There is a certain belief that people with influence will use their power for personal gain. This expectation extends to a general distrust of those officers administering the Fund that they may be retaining power for political and personal reasons rather than economic efficiency and the public good.

4.3. *Reactions to Change*

Although eager to rewrite the past system to eliminate preferential treatment for those with political clout, Croatians are not enthusiastic about abrogating worker control of the

²¹² See *id.* The law also prohibits and voids loans for more than 90% of the collateral value, for longer than seven years, with an interest rate lower than 5%, without a foreign exchange clause, with a greater than one year grace period, and personal property collateralized loans unless the property is worth at least 70% of the loan value. See *id.* The report of the new law seems to indicate that these limitations apply to all loans, not just to loans for the purchase of stock. See *id.*

²¹³ See *id.*

²¹⁴ See Ratko Boskovic, *Uvest Cemo Surove Zakone Kapitalizma!*, GLOBUS, Nov. 27, 1992, at 37, 37.

²¹⁵ *Id.*

²¹⁶ *Id.*

²¹⁷ *Id.*

²¹⁸ *Id.*

company's management in the process of privatization. Several examples illustrate the opposition to relinquishing worker control. Journalists boycotted the transformation opportunity to buy and plan the privatization of a publisher, Slobodna Dalmacija-Newspapers.²¹⁹ The journalists based their action on the lack of control they would have over the paper and its editorial policy.²²⁰ The newspaper union acted virtually unanimously.²²¹

The employees of the company Geofizika did not boycott the transformation process, but instead missed the deadline for submitting a transformation plan because discussions for a merger with another large enterprise failed to produce timely results.²²² After the expiration of the deadline, the companies attempted to register the merger, but the court refused to accept the transaction.²²³ Several weeks later, one of the new owners appeared at Geofizika with a copy of the sales receipt from the Fund and requested access to and possession of the company books.²²⁴ The director refused to comply because he had received no notification of the sale and had questions about the sufficiency of the receipt as proof of ownership.²²⁵ Geofizika is presently challenging the low price for the sale, has asked the government to intercede, and has filed a lawsuit to declare the sale invalid.²²⁶

Speculation about possible buyers and purchase prices can cause as much furor as an actual sale. The Light Metals Factory employs 5,000 workers and has annual sales of 250 million dol-

²¹⁹ See S.D., *Slobodna Dalmacija Journalists Boycott Privatization!*, SLOBODNA DALMACIJA, Jan. 29, 1993 at 4, 4, translated in F.B.I.S.: E. EUROPE DAILY REP., Feb. 2, 1993, at 48, 48.

²²⁰ See *id.*

²²¹ Only two abstentions were recorded. See *id.*

²²² See *Economic News Roundup: Geofizika Employees Protest Firm's Privatization*, F.B.I.S.: E. EUROPE DAILY REP., May 16, 1994, at 40, 40. *Globus* provided this information on April 22, 1994. See *id.* Merger talks were held with INA Naftaplin, a large company that was transformed into a State enterprise. See *id.*

²²³ See *id.*

²²⁴ See *id.*

²²⁵ See *id.*

²²⁶ See *id.* Two of the buyers were U.S. citizens. Although the paper value of the company was reportedly DM 40 million, the buyers obtained the company by paying only DM 2 million. See *id.*

lars.²²⁷ No buyers have emerged to accept the Fund's price of DM 66 million, however, because the company's debt exceeds its estimated value by DM 21 million.²²⁸ The pending collapse of the company has prompted criticism that its privatization would become "Croatia's robbery of the century," and has caused workers to ask whether, "someone [is] trying to bring the factory to total collapse, only to buy it then for next to nothing?"²²⁹

Change in management is a significant step, and reservations, reluctance, and criticism are natural and expected. In essence, the transformation represents not only a change of economic systems, but also indicates a fundamental societal change of values. This change has been taking place across Central and Eastern Europe, as well as in Croatia. Abandoning the job security available under socialism, "many managers feared the unknown challenges of a market economy," and "[m]any managers and workers were ill-prepared psychologically to deal with real competition."²³⁰

In addition, failure to appreciate investment strategies and entrepreneurial risks, which are inherent in the transformation from socialism to capitalism, may amplify fears concerning privatization. For example, headlines in *Globus*, trumpeted the arrival of transformation and privatization under the headline, "We Will Introduce the Cruel Law of Capitalism."²³¹ This article described an interview with Professor Jaksa Barbic, who was involved with the drafting of the privatization law, and the questions reveal a trepidation about adopting the law of capitalism.

The first question addressed the fact that, although most Croatian citizens did not have the cash to invest in stock, citizens were buying stock anyway because of the liberal payment terms.²³² Citizens assumed that the dividends paid by the company would be sufficient to fund the payments for the stock over the five-year installment plan. Barbic answered the proposed scenario by stating that any company that paid such a high

²²⁷ See Notes From the Croatian Press: *Light Metal Factory Privatization Scandal*, F.B.I.S.: E. EUROPE DAILY REP., Apr. 18, 1994, at 66, 66.

²²⁸ See *id.*

²²⁹ *Id.* at 66-67.

²³⁰ Rondinelli, *supra* note 183, at 25.

²³¹ Boskovic, *supra* note 214, at 37.

²³² See *id.*

amount in dividends would be bankrupt in five years and that Croatian citizens should not depend upon dividends to pay for the purchase price of their stock.²³³

This answer led the journalist to question the fairness of a system that would allow a person to lose the money that they had invested either by forfeiting their deposit, by falling stock prices, or by a government that could decide to give away shares in the process of transformation.²³⁴ Barbic concisely summarized the capitalist principle with the response, "It is a business risk."²³⁵ Although support exists for the theory of a market economy, it only may be through actual privatization that the enormous risks and changes inherent in the system are evidenced. Thus, the method of privatization may become the target for criticism, rather than the market economy theory.

Lastly, criticisms of privatization may arise because of problems in implementing the mechanics of a marketplace. For example, when companies began selling shares in the privatization process, no stock certificates were issued, and records of the owners were not kept. A receipt was given to buyers, but concern exists that ownership may be difficult to prove. At present, stock certificates and ownership records must be maintained by the companies.²³⁶

Privatization also impacts the social stratification of society, and thus affects an individual's place in society. One of the stated purposes of private ownership of business was to support a middle class that would be the backbone of democracy.²³⁷ From a different perspective, however, "the aim was to go from a society without classes to a society with classes, from carefree citizens who did not have capital or responsibility the intention was to create small businessmen and an eternally present lumpenproletariat, even using the aid of the state to accomplish this."²³⁸ In addition, critics argued that "the [Croatian] government obviously does not want a society of honest and poor

²³³ See *id.*

²³⁴ See *id.*

²³⁵ *Id.* at 38.

²³⁶ See Kardum Interview, *supra* note 163.

²³⁷ See *supra* note 117 and accompanying text.

²³⁸ Marko Barisic, *Daddy Buy Me a Business Firm*, DANAS, Jan. 22, 1993, at 5, translated in F.B.I.S.: E. EUROPE DAILY REP., Feb. 10, 1993 at 48, 48-49.

citizens equal in all respects, but diverse strata between which there will be friction and struggle”²³⁹ The “rapid impoverishment of the masses and the rapid acquisition of wealth by a few”²⁴⁰ is seen by some as reflected in the building of private estates, described as “castles,”²⁴¹ in areas north of Zagreb. Politicians, government officials, and businessmen are described as “Croatia’s New Ruling Class.”²⁴²

Despite criticism and cynicism over privatization, fueled at least in part by perceived governmental corruption and preferential treatment, this view does not permeate overall perceptions of the Croatian government and Croatia’s movement toward a market economy. The United States Information Agency completed a survey of attitudes in select European countries, including Croatia.²⁴³ The survey reveals that 74% of Croats are confident in the Croatian government and 67% are confident in their judiciary.²⁴⁴ Parliament receives a less favorable confidence level at 48%.²⁴⁵ All three of these ratings are at the highest, or next to the highest, of confidence levels when compared with the other countries surveyed.²⁴⁶ High levels of support are expressed for a free market (72%), privatization (83%), and foreign investment (80%).²⁴⁷ Nevertheless, as illustrated by earlier comments, there is clear dissatisfaction with the method of privatization (70%).²⁴⁸

The survey does not identify the reasons for the dissatisfaction with privatization. One source of frustration may be the slowness of the process. The failure of the Fund to sell swiftly companies has led to suspicions that the Croatian government would keep a

²³⁹ *Id.* at 49.

²⁴⁰ Snjezana Mlinarevic, *We Began Allocating Shares*, VECERNJI LIST, June 11, 1994, at 8, translated in F.B.I.S.: E. EUROPE DAILY REP., June 20, 1994, at 35, 36.

²⁴¹ See *Economic Developments Noted in Press*, F.B.I.S.: E. EUROPE DAILY REP., Apr. 28, 1994, at 55, 55.

²⁴² See *id.*

²⁴³ See OFF. RES. & MEDIA REACTION, U.S. INFO. AGENCY, PUBLIC OPINION IN CROATIA: A SPECIAL REPORT [hereinafter SPECIAL REPORT].

²⁴⁴ See *id.* at 16-17.

²⁴⁵ See *id.* at 17.

²⁴⁶ See *id.*

²⁴⁷ See *id.* at 22.

²⁴⁸ See *id.* at 23.

large number of the more profitable firms for its own profit.²⁴⁹ Although the property must be sold under the law, there is no deadline for the sales.²⁵⁰ The process itself, where companies are transferred to a Croatian government agency for sale, has been described as a statist methodology,²⁵¹ an approach which could be objectionable in view of the reforms from socialism to democracy.

Although critics object to the power of the Fund and are suspicious of the prerogatives granted to it, the worker-management system still receives support from a faction in Croatia. Despite the complaints of favoritism and, perhaps, corruption, the worker-management system regulated and guaranteed employment and benefits. Maintaining employment, rather than profitability, was a priority, and hiring a worker included more than paying wages. For example, companies maintained housing and vacation areas for workers. Self-management reinforced the concept of group welfare. In comparison, the capitalistic system emphasizes individual initiative and responsibility. Psychologically, the worker-management system is safer, and thus the capitalist system can be viewed as harsh and frightening.²⁵² Although more opportunities for individual success may be available in capitalism, so too are the possibilities for individual failure increased. It may be difficult to abandon the security of the worker-management system for the "rough-and-tumble aspects of the U.S. marketplace"²⁵³ caused by privatization.

5. CONCLUSION

The fact that Croatia, like other Eastern European countries, is undergoing political changes as well as economic changes, complicates the privatization process. The past tolls of war, and its future threat, are additional significant complications. As Professor Barbic has described it, the Croatian government still has all the "childhood diseases"²⁵⁴ that will make privatization more difficult. He compared the large undertaking in Croatia to

²⁴⁹ See Mlinarevic, *supra* note 240, at 36.

²⁵⁰ See *supra* notes 160 and accompanying text.

²⁵¹ See Bicanic, *supra* note 120, at 46.

²⁵² See *supra* note 230 and accompanying text.

²⁵³ See SPECIAL REPORT, *supra* note 243, at 14.

²⁵⁴ See Barbic Interview, *supra* note 152.

the fifteen years it took Margaret Thatcher to privatize 10% of State-owned property, and predicted that the process in Croatia will be long and painful.²⁵⁵

The economic transformation of Croatia is proceeding, based on the Company Act and the Privatization Act. The Croatian legislature has provided the legal mechanism by which economic change has taken place and will continue to occur. This legal environment will allow for an orderly progression towards a market economy. Croatia faces great challenges, but its legal infrastructure will allow Croatia to progress, even if slowly and painfully, toward its goal of privatization and a market economy.

²⁵⁵ *See id.*