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## Conference Paper

# Main Issues of the Croatian Regional Policy

39th Congress of the European Regional Science Association: "Regional Cohesion and Competitiveness in 21st Century Europe", August 23 - 27, 1999, Dublin, Ireland

### Provided in Cooperation with:

European Regional Science Association (ERSA)

*Suggested Citation:* Malekovic, Sanja; Polic, Mario; Fröhlich, Zlatan (1999) : Main Issues of the Croatian Regional Policy, 39th Congress of the European Regional Science Association: "Regional Cohesion and Competitiveness in 21st Century Europe", August 23 - 27, 1999, Dublin, Ireland, European Regional Science Association (ERSA), Louvain-la-Neuve

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**39 European Congress of the Regional Science Association  
Regional Cohesion and Competitiveness  
in 21<sup>st</sup> Century Europe**

**Dublin, August 23-27, 1999**

***MAIN ISSUES OF THE CROATIAN REGIONAL POLICY***

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## **1. INTRODUCTION**

Regional policy is an issue which has been to a certain degree neglected in Croatia during the nineties. This can be explained partly by the fact that in the past few years the country has been faced with complex and simultaneous developmental problems as a consequence of the processes of transition to a market economy, post-war reconstruction, and industrial restructuring, as well as owing to the pressing need to develop a number of new developmental policies, institutions and legal frameworks that an independent state needs to have in place.

In such circumstances the focus of the central government institutions was more inclined towards the relevant issues of overall macroeconomic stabilization, which was relatively successful in the first phase of the government's stabilization programme.

The elaboration of the country's regional policy was also hindered by the fact that Croatia did not have an overall economic development strategy, nor strategies/policies for industrial and technological development. In such circumstances, regional development issues were only partly tackled in various governmental documents, while the specific developmental problems of the country's underdeveloped regions (most particularly those suffering industrial decline, effects of the war and problems of border and island localities) were completely left to the initiative of the local authorities.

Furthermore, the overall economic situation has substantially deteriorated as a result of the unsuccessful effort to continue the good results of the stabilization programme. Namely, industrial restructuring issues have not been successfully tackled in any of the 21 Croatian counties (our regions), and the overall recent macroeconomic indicators confirm that the country finds itself in a period of economic stagnation.

## **2. CURRENT CIRCUMSTANCES REGARDING REGIONAL DEVELOPMENT AND POLICY**

### ***Recent Initiatives From the Part of the Central Government***

Several documents and programmes elaborated in the past two years on the initiative of several central government institutions directly or indirectly treat regional development issues, i.e., issues which reflect concrete developmental problems of Croatia's main problem regions. From this point of view the following documents are important:

- Strategy of Territorial Development
- National Programme for the Development of Islands
- Elements for the Strategy for Developing Small and Medium Sized Enterprises
- National Programme for Technological and Innovation Development
- Strategy for Industrial Policy
- Strategy for the Development of Transport
- National Programme of Employment
- Agricultural Development Strategy

- The Strategy of Economic Development (elaborated several months ago, and still in the process of parliamentary debate).

The National Programme for the Development of Islands deserves particular attention from the point of view of regional development. We are referring to maybe the only concrete step which was undertaken from the part of the central level in approaching the most urgent regional development problems in Croatia, since the islands are faced with accentuated demographic and economic stagnation.

The government's initiative in promoting change in these mostly depressed Croatian localities supported extensive research on the basis of which a clear picture was obtained related to the present situation, problems and needs, as well as proposed policy measures for these areas. The research project was followed by a Strategy document (National programme) for the development of Croatia's islands, which was discussed on the Parliamentary level. This programme is now being followed by a law on the development of this region (actually embracing parts of 7 counties), with specific incentives and support measures targeting the island population and stagnating economic activities. The implementation of this initiative, and the processes it involved appears to be the first concrete step which gives good grounds and a solid base for concrete development activities. This assumption is even more confirmed by the fact that within the Ministry of Reconstruction and Development a center for the development of islands has been established, which will be monitoring and evaluating the implementation of this Programme.

It is also worth mentioning the activities and measures of the Ministry of Economy, which has initiated the preparation of the document entitled "Elements for the Strategy of SME Development in Croatia" (which has a strong local and regional dimension). We are referring to the following initiatives to promote SME development on the local and regional level:

- establishment of a network of local consultants for SMEs throughout Croatia, with the aim of providing elementary advice and start-up support as close as possible to the entrepreneurs,
- provision of financial resources, which, together with resources from the local and regional governments, formed the financial basis for initiating the establishment of the first Croatian economic support institutions for SMEs (business incubators, business centers, free trade zones),
- promotion of SME development on the local and county level through seminars and conferences.

Even though these initiatives face a number of problems and their results are below the expectations, these activities confirm that SME development measures, and particularly the importance of a decentralised approach and focus on the local and regional dimension, are finally being recognized as crucial for promoting local employment and change in Croatia.

Regardless of the above-mentioned initiatives, the current situation regarding regional development (and its close liaison to SME development) is still characterized by the following obstacles:

- a consensus has still not been reached on the central level regarding the issue of decentralisation, as well as SME development,
- partial and *ad hoc* measures, programmes and initiatives prevail, with a lack of efficient coordination, flow of information and common understanding regarding these issues,
- absence of a critical number of non-governmental and private institutions, as well as associations, informal clubs of entrepreneurs, and similar structures is very strongly felt,
- the policy regarding the development of the economic support infrastructure on the regional and local level is inconsistent and undefined (there is no consensus as to which institutions should be established and where),
- the mechanisms for monitoring, control and evaluation of the already implemented initiatives related to SME development on the central and county levels have not been worked out,
- little importance has so far been given to capacity building on all government levels, which substantially hinders the process of change.

Furthermore, regardless of the initial support from the part of the Ministry of Economy, one of the key shortcomings which currently hamper local and regional development is the still very strongly felt lack of economic support institutions in Croatia. For example, there is just one regional development agency in Croatia, and so far only a handful of business support centers and two business incubators are successfully operating. In the absence of associations, entrepreneurial clubs and similar structures, the elementary framework for the successful operation of local actors or initiators in promoting local development and change is missing. In such circumstances, debates regarding future development goals and visions of economic development are seldom conducted, and all initiatives are left to isolated local actors, who often receive no support from the local authorities, administration and community. Having in mind that local and regional development agencies have an important role to play in building bridges on the level of the locality, but also between different government levels, it is not surprising that these links are often only formal – with very little opportunity for promoting new ideas and initiatives, as well as support from all levels for strategically important changes.

These and a number of other relevant issues are given considerable importance in the Project/Document “Concept for Croatia’s Regional Policy”, which was initiated by the Ministry of Economy in 1998. It has recently been finalized, but has not yet been adopted as an official policy document.

The document confirms that Croatia’s regional policy is currently at a crossroads, and indicates possible options for future approaches and policy measures.

### **3. FUTURE OPTIONS FOR CROATIA'S REGIONAL DEVELOPMENT POLICY**

Future options for Croatia's regional policy are elaborated in the previously mentioned "Concept for Croatia's Regional Policy". The following chapter will focus on some of the target issues of this Concept.

#### **3.1. New Approach to Regional Development**

Current circumstances, along with the stressed needs for further decentralisation, which implies a changing role of the central government level, ask for a different approach to regional and local development and policy in Croatia. Within this new approach, it is proposed that a much more significant role be given to the localities in initiating, implementing, monitoring, evaluating and financing development initiatives geared towards promoting social and economic changes.

The reasons for attributing an important role to the local authorities, but also local and regional private entities, can be explained by the fact that it is by now evident in Croatia also that the central government institutions have not been very successful in initiating local development and creating innovative and entrepreneurial surroundings on the local level. Due to the previously mentioned reasons for a very centralized approach, the central government institutions have failed to show flexibility in tackling local change and supporting local initiatives. This can of course partly be explained by the fact that, like elsewhere, they simply do not have the adequate knowledge of local problems, nor are they capable of considering all local developmental needs. They also appear to be incapable of mobilizing and coordinating development resources and reacting promptly to developmental problems in the localities (Stöhr, 1989, 1992).

The advantage of local or regional actions and development initiatives in the process of restructuring consists precisely in the fact that they can identify, mobilize and combine different potential local resources much better than the central policy.

From this point of view, the recent Concept for Croatia's regional policy advocates that more importance be given to the "bottom-up" approach to regional development. It is proposed that the key factors within this approach should be the following:

- development of human resources and local knowledge and skills
- local actors, initiators and practitioners (both formal and informal)
- local development initiatives (initiated, implemented and monitored at the local level)
- local resources and development potential
- local social and cultural factors (traditional mentality, entrepreneurial environment, business culture, social and other facilities and cohesion, readiness for change, political stability, existence of social solidarity and similar)
- small and medium sized enterprises and their linkages.

It is expected that more focus on the “bottom-up” approach will facilitate the implementation of regional policy measures under the condition that current responsibilities and relations between the three government levels change. This should be a policy of more efficient vertical and horizontal cooperation and participation of all levels in managing and decision making regarding issues of local economic development.

In the framework of such a proposed approach in Croatia, among other, the following issues will be relevant:

- strong local governments, with good knowledge and understanding of local problems and relations and of the local labor market, capable of reacting and integrating local communities’ interests, as well as representing them to the higher government levels
- large number of participants in development initiatives
- developed public-private partnerships, mutual confidence and consensus regarding the main development objectives
- seeking of new compromises with the central government
- new modalities of financing which enable local control
- focus on the service sector, as well as sector linkages which were previously neglected or very poorly developed
- international cooperation and internationalization of business.

### ***3.2. Basic Determinants and Goals of the New Regional Policy***

In the framework of the above mentioned approach, the proposed determinants within the Concept for Croatia’s Regional Policy are the following:

**1. The Croatian counties are not just economic, but also social and cultural entities.** This implies the interdisciplinary and qualitative dimension of the development process. This principle is important because issues such as social and cultural factors, traditions, social qualifications, regional identity, cohesion, local entrepreneurial capabilities and similar were to a great extent neglected during the socialist economy period.

#### **2. Human resources are the basic factor of our regional development**

Due to this fact, development initiatives which will be targeting capacity building, vocational training, upgrading of skills and knowledge of the local population should have a priority.

**3. Decentralization is an important prerequisite for future regional development.** The reasons in favor of decentralization are, among other, the following:

- it fosters readiness for change and competition among public institutions
- it is cheaper and lowers costs as well as access to information
- it facilitates the design of development objectives and policy measures
- it facilitates the obtaining of local financial resources and working potential
- it enables more flexibility in implementing government measures.

4. **The principle of subsidiarity should be applied on the county and local level whenever possible.**
5. **Public-private partnerships are of key importance.**

The objectives of Croatia's regional development derive from the country's general social and economic development. These objectives should thus be an integral part of the objectives of the overall economic development.

The main goals of regional policy, as proposed within the Concept for Croatia's regional policy are the following:

- to create and implement a concept of sustainable development
- to accelerate the reconstruction and development of the war affected regions
- to promote change in regions lagging in economic development: border, islands, highland regions
- to raise incomes and education levels of local population
- to raise employment levels and decrease regional disparities in unemployment rates
- to decrease regional disparities
- to strengthen competitive advantages of certain regions and the entire economy
- to accelerate the creation of export-oriented counties
- to promote industrial restructuring in the main industrial decline regions
- to attract foreign investments in the less developed counties
- to encourage the development of innovative and technology based economic activities
- to contribute to entrepreneurial development on the county and local levels.

### ***3.3. Focus on the Development of Small and Medium Sized Enterprises /SMEs/***

The development of SMEs is one of the key issues of Croatia's regional development. Even in the absence of all the previously mentioned government's policies, their development was supported and sponsored from the part of central, county and local governments in the past 2 years. The reasons for this reflect the general opinion of policy makers, experts and the business community regarding their potential role in post-war reconstruction, industrial restructuring and further economic development.

It is particularly important for Croatia to focus on SME development within its regional policy since it is expected that these enterprises can:

- contribute to the design and implementation of the concept of sustainable development suitable to Croatia's needs;
- accelerate the process of transition to the market economy by fostering the development of entrepreneurial culture and environment;
- speed up Croatia's development relying on the competitive advantages of its economy as a basis for integration into the highly complex process of globalization;

- promote the development of the export-oriented economy;
- attract foreign investments;
- accelerate industrial restructuring in regions faced with problems of industrial decline;
- speed up the reconstruction of the war-affected counties and the development of underdeveloped counties;
- increase employment, especially of young educated people, stop the brain drain and loss of the best human resources in the lagging regions;
- raise living standards in Croatia.

The role of SMEs is particularly stressed in Croatia's war-affected regions, which are the highest priority of the government's regional policy. Small enterprise development has conventionally played a key role in addressing the reconstruction and development needs of many post-war regions, where the collapse of the economic, physical, institutional, social and business infrastructure has been extensive.

Although an extensive literature has arisen focussing upon the contemporary features of small enterprise development in Italy, Japan and Germany, it is also the case that reconstruction and development policies in these countries immediately after World War II relied extensively upon the development of the small and medium enterprise sector. These initial policies and their offspring not only brought about rapid economic recovery, but also led on to stunning regional and national economic success over the longer term (Friedman, 1988; Porter, 1990; Sengenberger, Loveman and Piore, 1990; Pyke, Becattini and Sengenberger, 1990; Pyke and Sengenberger, 1992).

First, SMEs are ideally situated to provide an immediate boost to the supply of critically needed consumer and other goods. This service takes place before larger production units can be restarted and before foreign suppliers are willing to work in the region. Local entrepreneurs will have a good idea of what is most in demand. In most instances, the first response is overwhelmingly to supply these needs through trading activity. However, once political and economic stability is assured, the entrepreneurial sector then begins to favor small-scale production or local sourcing, which begins the process of employment creation (Bateman et al., 1996).

Second, small enterprises are a very rapid way of "bottom-up" employment generation in the immediate aftermath of a war in order to begin the economic development cycle once more (UNDP, 1996b, 1996c).

Third, there are very important social benefits to be gained by local communities from rapid small enterprise (especially micro-enterprise) development. Local activity avoids the emergence of a "culture of dependency". The encouragement of community participation through small enterprises is also vital to the process of developing an entrepreneurial business culture and a stronger democratic political culture. Small enterprise development was, for example, the key to the success from the 1950s onwards of the Mondragon group of enterprises in the Basque region of northern Spain, when local political self-reliance and cultural self-expression were ensured through business success and economic autonomy.

Further, small enterprises can provide that critical supplier base, around which the larger enterprises can develop and expand, as they proved to be so instrumental in Germany and Japan after World War II. Moreover, large-scale domestic, and possibly later on foreign investment too, will more likely be attracted into the regions if there exists a fabric of small-scale manufacturing enterprises able to provide quality small-scale inputs, technologies, services, and so on. In fact, large enterprises increasingly base their location/investment decision on the depth and quality of the local supplier base (Porter, 1990). Thus, such large-scale investments into a post-war region will be discouraged until there exists a fabric of emerging small enterprises able to take maximum advantage of the associated new business opportunities (Bateman et al., 1996).

SME Development is of course of strategic importance for all other Croatian regions, but the case of the war-affected areas was chosen due to the fact that this is currently still a number one priority. Namely, the first phase of post-war reconstruction has been completed, with most of the physical infrastructure rebuilt, as well as most houses of returnees. However, as was to be expected, local population which left these occupied regions, particularly the young and educated ones, are very reluctant to return until they have a possibility to find a job. Since opportunities for this are very scarce, due to the overall lack of all social facilities and economic activities, entrepreneurship is looked upon as a means of economic survival.

### **3.4. New Role of the Government**

A different approach to regional development and policy asks for changes in the role of the government. This, however, does not imply that its role should be completely minorised. Because, contrary to the doctrine of neo-classical economy, markets are not self-regulating systems. Supply and demand for products and production factors are not automatically balanced by way of the market mechanism of prices and wages. Human beings have different social functions other than working ones, and they participate in the production process with only one of their characteristics – their capability to work and manage. This process takes place in a competitive society, along with other social processes. After all, working and development capabilities are not exclusively individual. They have a strong collective dimension, which again depends on the systematic efforts of upgrading and the quality of the institutional framework (Baletić, 1998).

Furthermore, social processes do not take place outside the economic sphere. They are crucial for the reproduction of work, knowledge, private ownership, exchange of goods, regulation of economic conflicts, and similar. Government institutions do not stand apart from the process of capitalistic development, but at the same time they cannot be its mere infrastructure. Regardless of how active a participant they are in this process, governmental institutions must retain their autonomy as an arbitrator in conflicts between social actors and suppliers of non-market services. The state is interested in successful economic development since this is crucial for the well-being and maintenance of its own institutions. The right to control and direct, as well as the consequent income redistribution, will again be the consequence of this basic function (Baletić, 1998).

This does not, of course, imply that the role of the state should be idealized. Its institutions often follow contradictory goals and programmes of social action, and it is difficult to secure complete consistency, or at least a balance of its functions. This is the reason why this is often an area of

division and confrontation, in which particular social groups try to optimize their own interests. The possibilities for social conflicts and growing disparities are usually greater at the time of major changes and slow economic growth. The need for intervention is then greater, and the available resources are smaller. In such circumstances it is difficult to obtain a social consensus. Nevertheless, then again the main criterion of state redistribution should be the strengthening of social solidarity, which is obtained by supporting the threatened parts of society and improving efficiency as well as fair social transfers.

All these reflections relate to the state's regional policy also. Regional policy makers are currently faced with the reality of a very unstable global economy. This is particularly so in a small, new and still politically and economically unstable country like Croatia. Growing international competition is exerting an increasing pressure on Croatian regional entities. The central government – which traditionally had the regional development policy under its competence – is left without the necessary resources for protecting and restructuring regional economies and is accordingly limiting its activities. This is one of the reasons why the issue of decentralisation is finally coming to the fore in Croatia. Namely, since the central government cannot tackle the key issues of industrial restructuring and improve employment levels in industrial decline localities, it is not surprising that it should be shifting responsibility to the lower levels. Unfortunately, they are still not well equipped, nor do they have the capacity to take such a burden and responsibility so suddenly.

Functioning in global conditions, Croatian localities are seeking a creative answer for the new challenges they are faced with, seeking for new niches in circumstances of scarce technological capabilities. After all, globalization is not a one way process, as is evident from the experience of a great number of emerging dynamic innovative localities throughout Europe, but also from the cases of many lagging regions which remain passive in their reactions to these changes.

Policy makers on the central level, but also from Croatia's problem regions, are extremely aware of the very delicate position of our country related to the oncoming foreign investments and competition. Being aware of the necessity to be open to foreign competition, they are also considering the experience of Ireland, Scotland and other parts of Europe which were severely affected by foreign competition. Such issues are currently often debated, with many contradictory and conflicting viewpoints. There is still no consensus regarding the way to tackle these strategically important questions - to protect the most sensitive segments of problem regions' economies or to have a completely liberal approach and let the market mechanisms do its work? The prevailing opinions are somewhere in between: a market-oriented approach with a very active role of the local level and initiatives, combined with a more top-down approach (along with its short-term protective mechanisms) where the least developed regions are concerned, namely, the war-affected regions, border regions, and islands.

The role of the central level will in the future always be irreplaceable in restructuring the economy and redistributing income, but it is evident that such a role is not sufficient. Developmental processes ask for a combined role of the activities of the central, regional and local level, enterprises, business associations and investors.

After all, local development does not imply a "de-activation" of the higher government levels, nor a simplification of decentralisation by way of replacing management and organisation on the central level with the local one, but rather the development of such a local policy which would be complementary to the central government's policy, and which would be a part of a coordinated, integral approach with the aim of creating a more independent and stronger local economy (Sengenberger, 1993).

It seems that a balance should be achieved between the forces acting "from below" and these affecting development "from above" – including market processes and the role, although changed, of the government. A "bottom-up" approach, namely, makes for guidance, for proposals, incentives, training, informing, linkage, complementation and adjustment - all of which act in favor of regional, industrial and technological development and growth of entrepreneurship. It is also to be expected that the current debates and political pressures will produce planning processes that will be not only more flexible but also operate in both directions, "bottom-up" and "top-down", including closer cooperation and compromise between local, county and central levels of government.

According to this new role, the government does not directly interfere in the operation of market mechanisms but imposes non-selective horizontal industrial policy measures. Such measures support the

development of all sectors of economy by way of assisting the development of human resources, "soft" and "hard" infrastructure and technological development, anti monopoly laws and similar.

It is expected that this issue, as well as the proposed alternative approaches which advocate and particularly emphasize the role of the locality, local actors, as well as local development initiatives, will give rise to interesting debates (and possibly disputes) among experts and policy makers in the coming months.

#### **4. CONCLUDING REMARKS**

Croatia is evidently not in an enviable position regarding regional development and policy. The non-existence of the government's regional policy can hardly be substituted by a number of separate development programmes and strategies which were elaborated for particular segments of the Croatian economy.

Due to the current economic crisis, war damages, serious problems of industrial decline and transition, in the case of a small and industrially and technologically undeveloped country like Croatia we can refer to global challenges more in the sense of global hazards for our regional development. In such circumstances, future options for our regions are still rather uncertain and many questions are being raised and often loudly disputed. Among the most frequent ones we can mention the following: in which direction should we strive to go? What is our main vision of future development? How to compete and with what on the global market, having in mind the enormous challenges we are faced with? How to improve our institutional capacity for overcoming traditional barriers for accepting and promoting changes, and, of course, a number of other.

One thing is certain and there is a consensus related to it: Croatia sees its position in Europe, along with all the other market oriented, technologically developed and democratic civil societies. In this sense, there is no dilemma - Croatia has to respond to the current challenging global processes. It has to proceed with the already initiated preparations for European integration. The mentioned options and basic regional development objectives, as stated in the Concept for Croatia's regional policy, are in this sense currently only a proposal for our policy makers. It is the opinion of the Croatian regional scientists that there is no alternative approach to the proposed principles and goals which are herewith proposed - unconditional decentralisation and a combination of "top-down" and "bottom-up" initiatives geared towards the development of dynamic, innovative and internationally open local production systems, which will be better equipped to meet the challenges of the 21<sup>st</sup> century.

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