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# SIC MUR AD ASTRA

EDITORS  
GERGELY GOSZTONYI  
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DUNJA MILOTIĆ

Collection  
of papers  
on **Hungarian**  
and **Croatian**  
legal history 2022

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# **Matija MATIĆ: Transformation and privatization of property in Croatia during the 1990s**

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## **1. Historical context of privatization**

With the death of Josip Broz Tito in 1980, the phase of complete disintegration of the constitutional and political system of Yugoslavia began. Difficulties in the functioning of the system and the political crisis in Kosovo further destabilized the country, which was further provoked by a serious economic crisis caused by the collision of capitalist elements and failed components of a socialist planned economy. The growth of nationalism and the collision of two different political directions, on the one hand, Slovenia and Croatia, which advocated for decentralization and the abolishment of federal funds, and on the other hand Serbia, which sought the strengthening of political unity and centralism.

In reality, these demands were a cover for Greater Serbian ambitions.<sup>1</sup> In the 1990s, under the pressure of western liberal ideals and ideas of a free-market economy, the process of transition began. Croatia, like other countries of Central and Eastern Europe, began the transformation from a planned economy to a market economy, the transformation of social and state ownership into private ownership (privatization), and the overall transition from socialism to capitalism.

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<sup>1</sup> ČEPULO, Dalibor: *Hrvatska pravna povijest u europskom kontekstu od srednjeg vijeka do suvremenog doba* [Croatian legal history in the European context from the Middle Ages to modern times]. Pravni fakultet Sveučilišta u Zagrebu, Zagreb, 2021, p. 369.

## 2. Foundations for privatization in Croatia

Privatization can be defined as the: „*transfer by the central or local government of a business and its assets from the state to private ownership.*”<sup>2</sup> The foundation for the beginning of privatization in Croatia was marked by the Christmas Constitution, adopted on December 22, 1990. The Constitution laid the foundation of a sovereign Croatian state.<sup>3</sup> Article 48 of the Constitution of the Republic of Croatia states in paragraph 1 that: „*The right of ownership shall be guaranteed.*”<sup>4</sup> This provision meant a return to the freedoms of civil constitutionalism because the restrictions on property rights that were the essence of the earlier communist regime were removed.<sup>5</sup> In paragraph 2 of the same article, the Constitution states: „*Ownership shall imply obligations. Holders of the right of ownership and its users shall contribute to the general welfare.*”<sup>6</sup> Ownership, therefore, is not only the right to use one's property and to exclude all others from that usage but also the duty to contribute to the common interest in proportion to the amount of that property. This norm represents the constitutional basis for the legal regulation of tax obligations based on ownership.<sup>7</sup>

## 3. Special circumstances of privatization in Croatia

Privatization in Croatia had typical features of privatizations in other countries of the Communist bloc and the process was very connected with insecurity, unemployment, poverty, and inequality. But there were some special circumstances. The first problem is the special concept of social ownership. Namely, it was determined not as a legal, but as a socio-economic relationship, so there was no proper holder of rights to things.

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<sup>2</sup> VUKOVIĆ, Dijana – MAMIĆ SAČER, Ivana: The impact of privatisation process on business performance of the selected companies in the Republic of Croatia. *Ekonomski pregled [Economic review]*, Vol. 69, No. 6, 2018, p. 622., <https://doi.org/10.32910/ep.69.6.1>

<sup>3</sup> ČEPULO, *op. cit.*, p. 375.

<sup>4</sup> The Constitution of the Republic of Croatia.

<sup>5</sup> SMERDEL, Branko: *Ustavno uređenje europske Hrvatske [Constitutional arrangement of European Croatia]*. Pravni fakultet Sveučilišta u Zagrebu, Zagreb, 2020, p. 366.

<sup>6</sup> The Constitution of the Republic of Croatia.

<sup>7</sup> SMERDEL, *op.cit.*, p. 366.

The concept of rights was not absolute for anyone, so one part of ownership belonged to labor organizations (right to use, arrangement), and the other part to workers' councils (right of management, arrangement of income). Given that the councils and labor organizations included members who were politically dependent on the SKJ (League of Communists of Yugoslavia) and not experts in the economic field, this led to irresponsible business and irrational consumption. What is more, unclear property relations and property rights led to low productivity so that the system accumulated losses. Another special condition is the turbulent war and the post-war period. The war conditions inevitably resulted in great insecurities, reducing the opportunities of war-affected citizens to participate in privatization and deterring a significant part of investors.<sup>8</sup>

#### **4. Privatization models**

The privatization process could go in two basic directions. The first way is free distribution, while the second is a sale model. Croatia chose the second model considering that it wanted to obtain the necessary revenues for the already depleted treasury. However, the problem with the second model is that it takes a lot more time. It was difficult to value assets given that there is no relevant record of profitability to base it on and a large proportion of companies were ultimately not profitable.<sup>9</sup>

#### **5. Markovic's Yugoslav privatization**

Privatization in Croatia consisted of several phases that were defined by changes in legislation or institutional mechanisms that monitored the process itself. Even earlier, SFRY passed the Privatization Act, which was intended to replace the social ownership

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<sup>8</sup> RAČIĆ, Domagoj – CVIJANOVIĆ, Vladimir: *Privatizacija u Hrvatskoj: Početni uvjeti, procesi i implikacije [Privatization in Croatia: Initial conditions, processes and implications]*. Zagreb, 2004, Ekonomski institut, Zagreb, pp. 149–151.

<sup>9</sup> *Ibid.*, p. 151.

of companies with mixed ownership. It encouraged employees and other citizens to buy a limited quantity of shares at a discount, but without taking 50% or more shares, which would've resulted in taking the control of a company. Given that the breakup of Yugoslavia limited the effects of this initiative, it was ultimately poorly implemented, laying even more difficult foundations for more consistent privatization by creating yet another completely new model of ownership.<sup>10</sup>

## **6. Phases of privatization**

### **6.1. 1<sup>st</sup> phase of privatization**

The first phase (1991-1992) was marked by the adoption of the Law on the Conversion of Social Enterprises. The original goal of this phase was intended to be carried out as a controlled and decentralized sale of former socialist assets (conversion of social and mixed ownership.) The act established several possibilities that companies could choose independently. If they failed to complete the process within the deadline, their shares should have been transferred to state funds. The problem with this phase was that the deadlines were too short, so most of the shares were finally transferred back to the state funds, and the privatization practically in many cases did not even begin at all. There were also other problems, such as low liquidity of shareholders and a very small number of them. Finally, 45.95% of the companies entered the state funds.<sup>11</sup>

### **6.2. 2<sup>nd</sup> phase of privatization**

The practically unfinished privatization created the foundation for the second phase, which took place from 1993 to 1996. This phase of privatization included the sale of a huge part of property and assets to the so-called „*strategic investors*“, who in numerous cases were entrepreneurs connected to the political elite. In this phase, a very large role

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<sup>10</sup> *Ibid.*, p. 152.

<sup>11</sup> *Ibid.*, pp. 152–153.

was played by the ruling party (HDZ). HDZ managed the privatization according to its own criteria, in order to maintain political and economic power (crony capitalism). HDZ contributed majorly to weakening of legal frameworks, which was reflected in constant changes in legal provisions, a politically dependent judicial branch, arbitrariness of decisions, and a hugely politically suitable administration that lacked professional competence. The new owners who engaged in illegal manipulations were not even faced with appropriate sanctions. In line with this, even the legal regulations stipulated that there would be no trials for business/commercial offenses unless the malfeasance occurred within 5 years.<sup>12</sup>

### **6.3. 3<sup>rd</sup> phase of privatization**

The third phase, called coupon privatization, was carried out in 1997 and 1998. Since the privatization was carried out during the war and post-war reconstruction, it resulted in the unfavorable treatment of citizens affected by the war. Such citizens received privatization coupons that they could exchange for shares in the offered companies. Coupon privatization involved a shift away from a general orientation of selling towards the idea of the free distribution of shares. However, even this phase was filled with numerous malpractices of the type where numerous illiquid companies that have not operated for years were offered on the one hand, and those that had some value in them were given to privileged persons who were in a close relationship with the ruling party, again, showing an example of crony capitalism.<sup>13</sup>

## **7. Positive and negative effects of privatization**

Now that 30 years have passed since privatization, we are allowed to make a thorough assessment of the effects of privatization. We can conclude that it has both positive and negative effects. The main positive effect of the transformation of property is

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<sup>12</sup> *Ibid.*, pp. 158–159.

<sup>13</sup> *Ibid.*, p. 155.

definitely the transition from the system of „*non-ownership*“ to the system of known owners vested in private ownership. It is one of the starting points for the practical formation of a transparent capital market economy. The second effect is the beginning of the creation of an entirely new economic system based on a new level of formal-legal responsibility, and the beginnings are known to be the most difficult. Privatization carries within it the roots of transition so that in accordance with privatization, not only an economic transition was achieved, but also a political one.<sup>14</sup> However, this is a very small number of positive effects. The following should be singled out from the negative effects.

Privatization created new owners who bought companies for trading, not for business and development structuring. The cheap and coupon-based way of acquiring ownership in itself reduced the responsibility of any reasonable and meaningful management of companies, which has led to the irrational collapse of large business systems. Fragmentation and irrational distribution of potential led to a huge wave of job losses in the context of technological redundancy. The loss of work potential created the basis for mass emigration, the effects of which are particularly felt even today. In addition, the lack of a transparent privatization strategy resulted in illegal employment and the appearance of clientelism and corruption already at the very beginning of the sovereign Croatian state.<sup>15</sup> Today, the state has shares in more than 1,100 companies and majority ownership in approximately 160 companies. Most of these companies are financially doing poorly.<sup>16</sup>

## **8. Conclusion**

In conclusion, it can be said that the perception of Croatian citizens was that the privatization was carried out in a relatively unfair manner. Privatization was started

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<sup>14</sup> GREGUREK, Miroslav: Stupanj i učinci privatizacije u Hrvatskoj [Degree and effects of privatization in Croatia]. *Ekonomski pregled [Economic review]*, Vol. 52, No. 1–26, 2001, pp. 180–181.

<sup>15</sup> *Ibid.*, pp. 181–185.

<sup>16</sup> RAČIĆ – CVIJANOVIĆ, *op. cit.*, p. 157.

more out of political and budgetary necessity, and less because of the technological and managerial necessity of the companies, which would've developed their competitiveness and would've had a more positive effect on the final integration into the EU. The state today still controls a large part of the economy and subsidizes the companies it owns to a significant extent. The socially and economically sustainable system of corporate governance in Croatia is still, to put it mildly, in its beginning stages.<sup>17</sup>

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<sup>17</sup> *Ibid.*, p. 159.