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Republic of Croatia: 2000 Article IV Consultation and Request for a Stand-By Arrangement—Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Authorities of Croatia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2000 Article IV consultation with the Republic of Croatia and request for a Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the combined discussion of the 2000 Article IV consultation with the Republic of Croatia and request for a Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **December 20, 2000,** with the officials of the Republic of Croatia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on March 2, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **March 19, 2001,** updating information on recent economic developments.

- a Public Information Notice (PIN) and a Press Release, summarizing the **views of the Executive Board as expressed during its March 19, 2001, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- a statement by the authorities of the Republic of Croatia.

The document(s) listed below have been or will be separately released.

Letter of Intent by the authorities of the member country*
Memorandum of Economic and Financial Policies by the authorities of the member country*
Statistical Appendix

*May also be included in Staff Report.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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REPUBLIC OF CROATIA

Staff Report for the 2000 Article IV Consultation and Request for Stand-By Arrangement

Prepared by the European I and the Policy Development and Review Departments
(In consultation with other departments)

Approved by Jacques R. Artus and Shigeo Kashiwagi

March 2, 2001

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EXECUTIVE SUMMARY

The economy has pulled out of recession and the banking system has recovered from its recent crisis. With an improved external environment and an expected revival of private investment, real GDP growth is likely to accelerate from an estimated 3½ percent in 2000 to 4 percent in 2001, still too little to make a dent in unemployment at a time of planned public sector layoffs. After a flare up in the second half of 2000, inflation is expected to subside to 4½ percent during 2001, benefiting from wage restraint, exchange rate stability, and oil price moderation. Meanwhile, banks that survived the crisis have attracted new deposits and rebuilt their capital base. While banks now have long foreign exchange positions, foreign currency lending to potentially unhedged borrowers is likely to involve substantial indirect exchange rate risk. Ownership concentration is expected to continue within a strengthened regulatory and supervisory framework.

The authorities are committed to slashing the size of government and its financial imbalance, while maintaining price stability on the basis of a broadly stable exchange rate. The new government has made a good start in 2000 in reducing government spending, tax pressure, and the fiscal imbalance. Concurrently with fiscal adjustment, the central bank has eased monetary conditions. Under its fiscal framework for 2001–03, the government intends to reduce consolidated central government spending from 46.2 percent to 37.6 percent of GDP and the fiscal deficit from 6.5 percent to 1.3 percent of GDP.

The authorities' program for 2001 is based on further fiscal adjustment, wage restraint, and structural reform. The policies are designed to ensure the desired stability of the exchange rate under the chosen managed float regime. But the central bank will not resist persistent or large exchange market pressures or tolerate endangering achievement of its quarterly international reserve targets.

- *Fiscal policy* aims to reduce the consolidated central government deficit from an expected 6.5 percent in 2000 to 5.3 percent of GDP in 2001, implying a 4.3 percentage point reduction of expenditure in light of tax reductions and court-mandated additional pension spending. The required expenditure savings will result mainly from cuts in the wage bill, purchases of goods and services, investment, and social transfers. The deficit is expected to be financed mainly with privatization receipts, without recourse to domestic bank financing. The program contains contingency measures to offset wage policy implementation and other fiscal slippages and an adjuster for delays in privatization.

- *Wage restraint* is to be achieved by a reduction of the government sector wage bill, a freeze of average wages in public enterprises, and a social pact that limits wage increases in the rest of the economy to somewhat below productivity gains.

- *Structural reforms* aim at economic liberalization, restructuring, and privatization.

I. Introduction

1. **Parliamentary and presidential elections in early 2000 radically transformed Croatia's political landscape.** A center-left six-party coalition led by social democrats and social liberals gained an almost two thirds parliamentary majority and took over from the late President Tudjman's nationalist party, while the presidency passed to Stipe Mesić, a member of one of the smaller coalition parties. The new government was quick to capitalize on the surge of international goodwill that greeted its formation by promoting Croatia's integration in international cooperative structures (NATO's Partnership for Peace program, WTO membership, and initiation of negotiations on a Stabilization and Association Agreement with the EU).

2. **Stand-by and consultation discussions were held in four missions during 2000.**[1] On the basis of the understandings reached in these discussions, the authorities have requested a 14-month stand-by arrangement in an amount of SDR 200 million (54.78 percent of quota, EBS/01/12). The authorities have also initiated discussions with the World Bank on a US$200 million structural adjustment loan, expected to be completed by mid-2001 (Appendix III).

3. **Croatia has accepted the obligations of Article VIII (Appendix II).** It does, however, maintain a restriction on the withdrawal of certain deposits that was approved on a temporary basis at the conclusion of the 1999 Article IV consultation in January 2000.

4. In concluding the 1999 Article IV consultation, Executive Directors called for durable expenditure cuts to balance the budget and make room for a reduction in nonwage labor costs to meet the daunting challenges of an insufficiently flexible domestic economy and a still unsustainable external balance. To this end, Directors urged reforms to balance the health and pension funds, and wage restraint and further structural reforms to maintain competitiveness under the chosen exchange rate arrangement.

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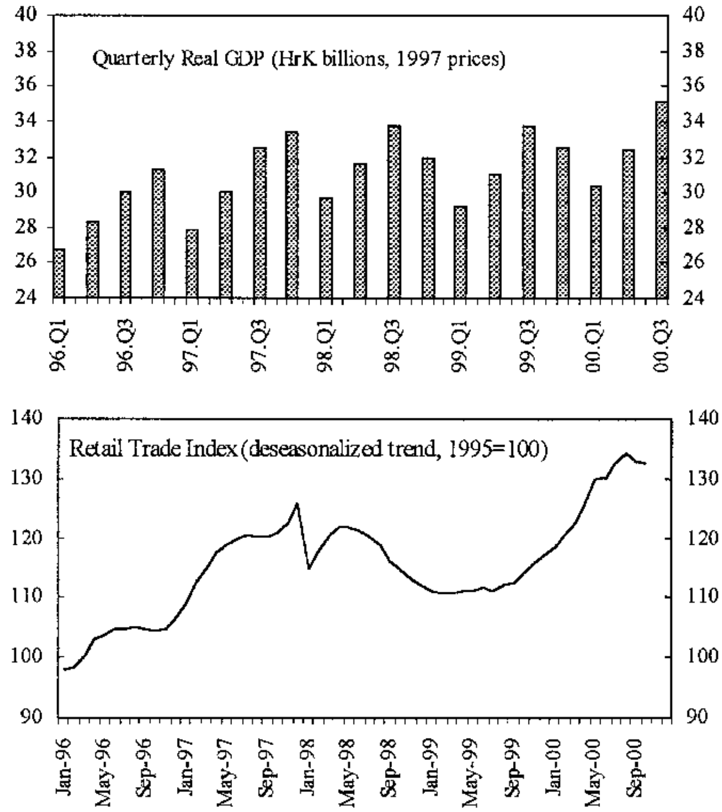
[1] Messrs. Flickenschild, Bonato, Maggi (all EU1), Lybek, Woo (both MAE), Toujas-Bernaté, Wieczorek (both PDR), O'Callaghan (resident representative) and, as assistants, Mmes. Dunne, Santayana, and Shelley (all EU1) participated in one or more of these missions, which took place in March-April, July, October-November, and December 2000. Meetings were held with the President of the Republic, the Prime Minister, the Deputy Prime Minister, the Vice Prime Ministers for economic and social affairs, the Minister of Finance, and other cabinet members, the Governor of the Croatian National Bank (CNB), the heads of the largest extrabudgetary funds and government agencies, the chairman of the parliament's budget committee, and representatives of labor unions, employers, public and private enterprises, banks, economic research institutes, and the academic community. Mr. Kapteijn (OED) and Mr. Domaç (World Bank) participated in some of the discussions.

II. BACKGROUND

A. Recent Economic Developments and Near-Term Prospects

5. **Propelled by private consumption and exports, the economy has pulled out of the 1998/99 recession (Figure 1)**. Consumption was boosted in 2000 by large wage increases granted during 1999, the lifting of political uncertainties, and monetary easing, while exports benefited from the recovery in Europe, past real effective depreciation, and a strong tourist season. Notwithstanding fiscal retrenchment, weak private investment, and a drought stricken fall harvest, real GDP is expected to have grown by 3.5 percent in 2000. With exports and private consumption likely to grow at a somewhat slower pace, the expected moderate acceleration of growth to 4 percent in 2001 hinges crucially on a revival of private investment after three years of contraction (Table 3). The prospects for such a revival are good: apart from the favorable effects of political stability, enterprise profitability is being boosted by lower nonwage labor costs, wage restraint, tax reductions, and the availability of credit at low interest rates. The 2001 growth projection could, however, prove optimistic if economic growth in Europe were to slow substantially or if oil prices failed to decline as envisaged.

Figure 1. Croatia: Indicators of Economic Activity 1996-2000



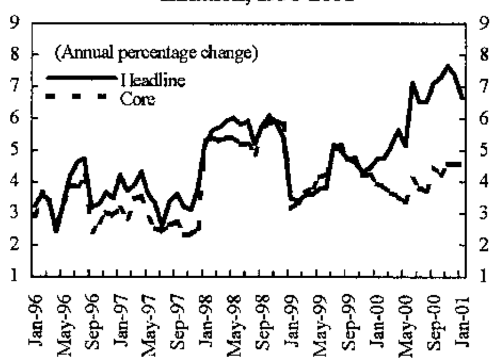
Source: Central Bureau of Statistics, ZAP, and ORESE

6. **The resumption of growth has so far failed to produce a durable increase in employment**. Registered unemployment, which considerably overstates "true" unemployment, slipped during the summer months in response to the strong tourist season, but rose again to 22.6 percent in December 2000. Meanwhile, the more reliable survey-based unemployment rate—compiled twice a year with a six-month lag—stood at 15.1 percent in the six months ended in June 2000, compared with 21.2 percent for the registered

unemployment rate. As the government plans to reduce employment in the civil service and the public enterprises during 2001, any employment gains this year will depend on the strength of the expansion in the private sector and the authorities' success in reducing the rigidities in the labor market, particularly the high dismissal costs.

7. **Although both its headline and core rates have risen in 2000, the outlook for inflation remains benign**. Despite government reluctance to let the oil company pass on higher oil prices, retail prices increased by 7.4 percent during 2000, mainly reflecting an increase in excise taxes in June and sharply higher electricity prices for households approved in August. By contrast, the core inflation rate (which excludes administered prices and excise taxes) rose only moderately from 4.2 percent to 4.6 percent (Figure 2).[2] With the disappearance of base year effects and an easing of oil prices, as well as wage restraint and exchange rate stability under the program, retail price inflation is expected to decline to 4.5 percent by end-2001.

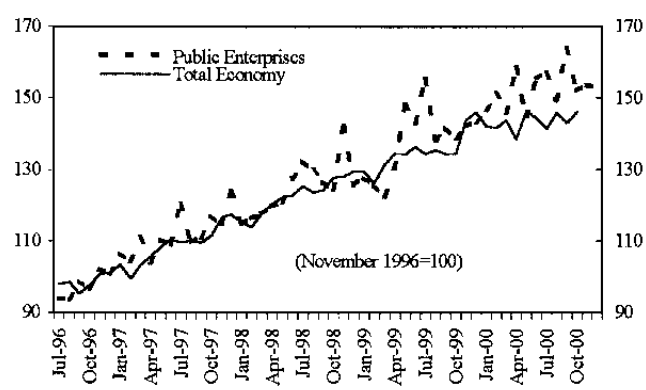
Figure 2. Croatia: Retail Price Inflation, 1996-2001



Source: Central Bureau of Statistics.

8. **Reinforced by restraint on civil service pay and income tax reductions, wage pressures subsided in 2000, a trend that is expected to continue in 2001 (Figure 3)**. Early in 2000 the new government cut top salaries in the three branches of government by 20 percent and negotiated a 5 percent rollback of the basic wage in the budgetary sphere. Under its program for 2001, average wages in the budgetary sphere are expected to fall, while public enterprise wages are to remain frozen at last year's level. Economy-wide, net wages were increased by higher income tax deductions in 2000 and a lower tax rate on low incomes in 2001. With these measures, and the planned negotiation of a social pact, the jump of headline inflation in the second half of 2000 is not expected to trigger higher wage demands in the private sector of the economy.

Figure 3. Croatia: Average Gross Wage Index 1996-2000



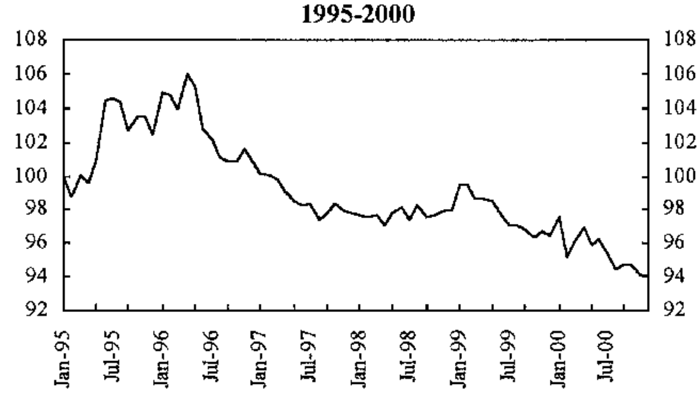
Source: Croatian National Bank.

[2] On a year-on-year basis, headline inflation rose while core inflation fell.

9. **Despite missing their original budget target, the authorities managed to reduce the central government deficit from 7.4 percent of GDP in 1999 to an estimated 6½ percent in 2000, thus reversing the deterioration of the preceding three years (Table 5).** The revenue ratio continued to slide from its 1998 peak, falling by some 3 percentage points of GDP to an estimated 39¾ percent of GDP, but the authorities successfully reduced total spending by an estimated 4 percentage points of GDP as all major expenditure categories except interest payments grew by less than nominal GDP. Privatization receipts, improved access to foreign capital markets, and ample financing from highly liquid domestic banks allowed the government to finance the deficit and scheduled amortization payments, while achieving a substantial reduction of domestic arrears, which are estimated to have declined from 6½ percent of GDP at end-1999 to about 2 percent of GDP at end-2000.

10. **Monetary conditions eased during most of 2000, continuing a trend that started in early 1996 (Figure 4).** A strong exchange market position and the repayment of government and bank liquidity credits allowed the CNB to lower its Lombard rate and its reserve requirements.[3] As a result of these measures and higher inflation, real interest rates on loans fell to historically low levels, encouraging increased household borrowing. The recovery of credit to enterprises was more muted and came later in the year, reflecting probably both still weak demand and banks' increased caution in lending. The stimulative effect of lower real interest rates was partly offset by real effective appreciation that reflected, successively, the strength of the kuna against the euro, higher inflation, and a weakening U.S. dollar (Figure 5). Monetary conditions are much easier in early 2001 than at any time during the second half of the 1990s.

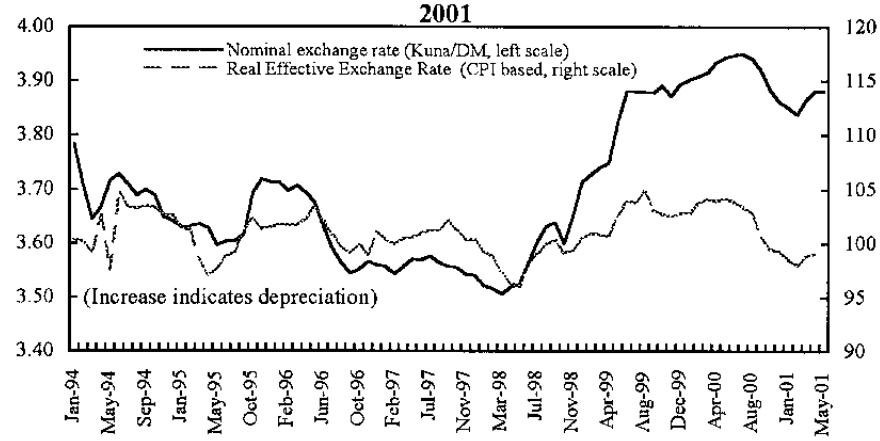
Figure 4. Croatia: Monetary Conditions Index 1/ 1995-2000



Sources: Croatian National Bank, Central Bureau of Statistics, and IFS.
1/ The index is the weighted average of the real interest rate and the real effective exchange rate, where the weights are intended to represent the relative impact of interest rate and exchange rate on aggregate demand. In this case, the ratio between the weights is assumed to be 2-to-1, that is, a 1 percentage point change in the interest rate has approximately the same impact on aggregate demand as a 2 percent change in the exchange rate.

[3] The Lombard rate was reduced to 12 percent and reserve requirements were lowered and unified at 23.5 percent.

Figure 5. Croatia: Exchange Rate Developments, 1994-2001



Sources: Croatian National Bank, and Information Notice System.

11. **Since the 1998/99 banking crisis, confidence in the banking system has been strengthening**, as evidenced by the vigorous growth of deposit liabilities, including domestic currency denominated ones. Improved profitability contributed to a sharp rise in commercial banks' risk-based capital adequacy ratio from 12.7 percent at end-1998 to 21.4 percent at mid-2000, which was also boosted by the exit of insolvent banks, some recapitalization, and regulatory changes (Appendix V). Nonperforming loans remain high at almost 10 percent, but they are reportedly well provisioned. Although banks are long in foreign exchange, considerable indirect exchange rate risk results from their foreign currency lending to potentially unhedged borrowers.[4] Three rehabilitated banks (including the country's second largest) were sold to foreign banks in 2000, and several mostly smaller banks were acquired by both domestic and foreign buyers, thereby reducing the number of banks from 60 at the end of 1998 to 44 at the end of 2000. The supervisory framework has been strengthened with the implementation of the banking law of December 1998. However, legislative changes to guarantee the independence of the CNB and increase its power of intervention in insolvency cases—as well as the privatization of three smaller banks—are still pending.[5]

12. **Strengthening foreign demand, the granting of trade preferences by the EU, rebounding tourism income, and a temporary boost to income transfers have helped reduce the external current account deficit from 7.6 percent of GDP in 1999 to an estimated 4.6 percent in 2000 (Table 4)**. Non-oil merchandise exports are estimated to have increased by almost 7 percent in real terms, with particularly strong growth of exports to the

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[4] The limit on banks' open foreign exchange position was reduced from 30 percent to 25 percent of risk-weighted capital.

[5] The new CNB law is expected to be adopted by parliament in March 2001. For additional financial sector reform measures under the authorities' program, including a new banking law, see Annex I of EBS/01/12.

EU, whose share in total exports is likely to have jumped by some 6 percentage points to 55 percent. Thanks to the improved current account and capital inflows from privatization, government borrowing and improved trade financing terms, international reserves have risen and external vulnerability indicators have improved (Appendix V). On recent trends and assuming further fiscal consolidation, the current account deficit is likely to contract further in 2001 to below 4 percent of GDP, as merchandise exports continue to grow with improving access to foreign markets and the normalization of trade relations with Yugoslavia and as the recovery in the tourist industry continues, albeit at a more modest pace. While higher oil prices are estimated to have prevented a further improvement of the current account by 1.3 percent of GDP in 2000, the staff's balance of payments projection for 2001 assumes an easing of oil prices that would improve the current account outcome by 0.6 percent of GDP.[6] On the other hand, in 2000 the current account benefited from income transfers delayed in 1999 because of political uncertainties.

B. Economic Policy Measures in 2000

13. **Economic policy implementation in 2000 focused on restoring control over the public finances**. After realizing that the fiscal position on an accrual basis had deteriorated more than previously estimated, the new government gave immediate priority to paying fiscal arrears and adopting a tight budget for 2000. Since fashioning a consensus on major structural policy initiatives required time, the authorities relied primarily on cuts in discretionary spending and on a partial rollback of previous salary increases to reduce expenditures. To fulfill electoral promises and revive the economy, the authorities lowered taxes and social security contributions during the year (Box 1). These measures are estimated to lower the revenue ratio by 3½ percent of GDP by 2002, but they also complicated what had been an unusually coherent and efficient tax system.[7]

Box 1. Measures to Reduce the Revenue Ratio

When it took power in late January 2000, the new government immediately raised the income tax exemption threshold and increased revenue sharing with local governments. In June, it reduced employers' contributions to the pension and health funds by two percentage points, lengthened the collection lag for the VAT, and raised excise tax rates. In the following months, the authorities zero-rated VAT for foreign tour operators, rolled back part of the gasoline excise rate increase, and introduced tax holidays and employment subsidies for new investment projects. Effective 2001, a reform of the personal income tax law split the middle bracket, lowering its average tax rate, and introduced dividend income taxation. A new corporate income tax lowered the nominal rate and increased depreciation allowances, but abolished the deduction for the imputed cost of equity (see Appendix II of "Republic of Croatia—Statistical Appendix").

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[6] A US$1 change in the oil price is equivalent to a little more than 0.1 percent of GDP on an annual basis.

[7] See "Republic of Croatia—Statistical Appendix" (SM/01/80, 3/6/01), Appendix II.

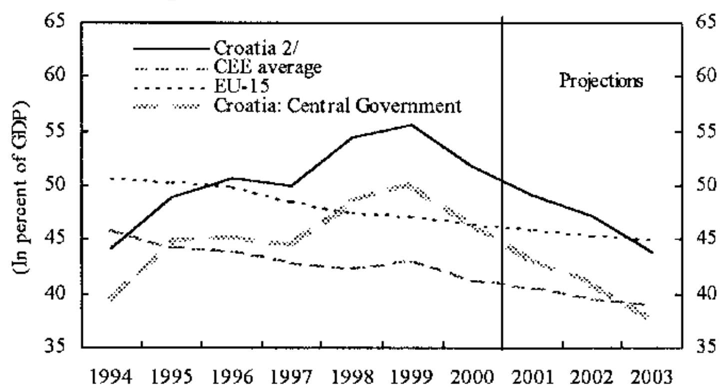
14. **The changed international attitude allowed the government to speed up the country's integration in the world economy**. WTO membership was achieved in November, with some of the negotiated tariff reductions implemented already at midyear. Asymmetric trade liberalization was obtained from the EU in September and negotiations on a Stabilization and Association Agreement started in November. Finally, as part of a drive to have some 80 percent of foreign trade covered by free trade agreements by mid-2001, a free trade agreement with Bosnia and Herzegovina was negotiated in late 2000 and entered into effect at the start of 2001.

15. **With price increases attributed to supply shocks and fiscal policy being tightened, the CNB had room to ease monetary conditions in support of the economic recovery**. Excise tax and administered price increases, the latter largely intended to pass on some of the rising cost of imported oil, were seen to have caused the jump in headline inflation after midyear. In the absence of secondary price effects and in anticipation of lower oil prices and import duty reductions, the CNB took advantage of the strong external position and rising confidence in the banking system to accumulate international reserves, ease foreign exchange surrender requirements, allow the currency to appreciate slightly against the euro during most of 2000, and reduce reserve requirements and policy interest rates. Despite falling market interest rates, however, credit to the nongovernment sector, mostly to households, expanded only moderately as banks preferred to buy government debt and strengthen their net foreign position.

III. The Authorities' Strategy and Program for 2001

16. **The authorities' overall medium-term macroeconomic strategy is to achieve a reduced, more balanced government sector and maintain financial stability**. With Croatia's government sector much larger than the average of other CEECs or the EU countries (Figure 6), the authorities realize that improved economic performance requires expenditure reductions of a size that allows both balancing the fiscal accounts and reducing the tax burden. They are equally convinced that financial stability, the other macroeconomic ingredient for improved economic performance, requires exchange rate stability (for their reasons, see paragraph 19 below).

Figure 6. General Government Expenditure and Net Lending in Selected CEE and EU Countries, 1994-2003 1/



Source: WEO.

1/ Central and Eastern European countries include: Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia, and Slovenia.

2/ Accrual basis.

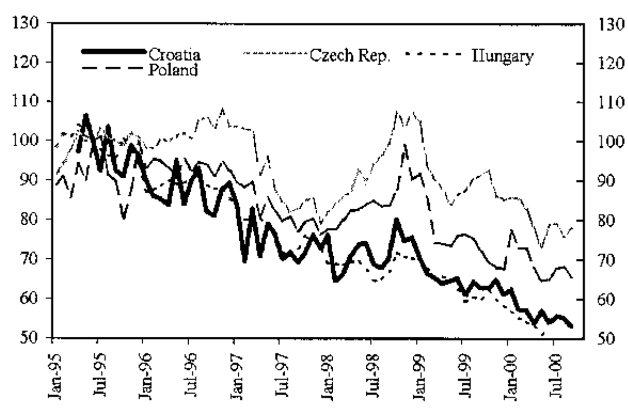
A. Objectives and Underlying Exchange Rate Policy

17. **The authorities view their program for 2001 as a precondition for realizing the government's promise to boost employment and living standards during its term in office.** The program aims at a moderate acceleration of economic growth, the reduction of inflation to the low rates experienced during most of the 1990s, and progress toward external viability by reducing the current account deficit to a level that would allow reversing part of the recent increase in the external debt to GDP ratio. In accordance with Executive Board guidance to address the policy weaknesses identified at the conclusion of the last Article IV consultation, the program relies on fiscal adjustment, wage discipline, and structural reforms in the context of continued exchange rate stability.

18. **An adequate level of competitiveness is key to the authorities' growth and external adjustment objectives.** The authorities view the strong growth of export volume in 2000 (estimated at 11 percent) as evidence that the present level of the exchange rate is appropriate. The performance of exports in 2000 does indeed lend support to staff research arguing that the lackluster export performance during most of the 1990s cannot be attributed to exchange rate overvaluation but rather to the relative deterioration in market access and the failure to adapt the product mix to the changing requirements of the EU market (Box 2). In light of rapidly improving market access and expected increases in investment, both foreign

Box 2. Competitiveness Assessment

Figure 7. ULCs in Croatia and CEECs, 1995-2000
(Index in U.S dollar terms, June 95=100)



Source: IMF staff estimates.

There is little evidence, if any, that Croatia's weak export performance in the second half of the 1990s could be attributed to a loss of external competitiveness. A range of competitiveness indicators, including CPI-, PPI- and partial ULC-based real exchange rates, were reviewed and compared with those of other Central and Eastern European countries (CEECs; Figure 7). While most of the CEECs experienced, in some cases significant, real exchange rate appreciation, Croatia's real exchange rate indicators have been remarkably stable since 1994. There is also no indication that Croatia's equilibrium exchange rate may have depreciated over the period, therefore not pointing to any misalignment of Croatia's current exchange rate. In addition, higher dollar wages in Croatia compared with most other CEECs can be explained by differences in fundamentals, such as a more advanced stage of development and relatively higher human capital.

The progressive switch from more to relatively less favorable trade relations with the EU has most likely been a significant factor behind the poor Croatian export performance. As part of the SFRY, Croatia enjoyed the benefits of preferential trade arrangements with the EU long before the rest of the CEECs. In the last decade, however, most of the CEECs signed EU Association Agreements and improved their prospects for joining the EU, while Croatia was unable until very recently to secure any improvement in its trade relations with the EU. As a result, Croatian products faced relatively higher tariff barriers, and strict rules of origin clauses included in Association Agreements discouraged other CEECs from using Croatian inputs.

The structure of Croatian exports, especially to the EU, has changed the least among the CEECs. This may have reflected a slower pace of restructuring of the Croatian economy as a whole compared with other transition economies, which could have impeded the adaptation of Croatian products to the demand in EU countries.

Source: Croatia—Selected Issues and Statistical Appendix, SM/99/301, Chapter IV.

and domestic, the staff was therefore prepared to recommend supporting a program that is sufficiently strong to allow nominal exchange rate stability and seeks to strengthen competitiveness by lowering domestic unit labor costs through wage restraint and efficiency gains from corporate restructuring, privatization, and more effective use of remaining public ownership rights.

19. **Croatia's exchange rate regime is a managed float (Appendix II) and the CNB will use the exchange rate as a key variable in aiming to keep inflation on track**. Under the program, the CNB has established ceilings on its net domestic assets to back up this regime and will consult with the Fund if base money demand is stronger than expected (see paragraph 24 below). Thus, except for the usual seasonal fluctuation, the exchange rate of the kuna is expected to remain stable against the euro during the program period. The authorities seek to maintain a broadly stable exchange rate on the grounds that a significant depreciation would jeopardize price stability, weaken unhedged balance sheet positions, and raise the cost of servicing the external debt. They also reckon that exchange rate stability will facilitate implementation of their ambitious wage policy in the public sector as well as reaching agreement on a social pact with prudent wage guidelines. Under the program, the CNB will therefore use monetary policy (including occasional exchange market intervention) to keep the exchange rate stable against the euro and smooth its usual seasonal pattern. However, in the spirit of the adopted exchange rate arrangement, the CNB would not resist large or persistent exchange market pressures. At any rate, the CNB will strictly enforce the recently tightened limits on banks' open foreign exchange positions and will not tolerate reserve losses that would imperil observance of its quarterly net international reserves targets.

B. Fiscal Policy

20. **There is considerable adjustment behind the reduction of the fiscal deficit to 5.3 percent of GDP in 2001 (Text Table 1 and Figure 8)**. Although a deficit of this magnitude is not sustainable, the authorities noted that their fiscal program for 2001 had to

Table 1. Croatia: Consolidated Central Government Operations
(In percent of GDP)

	1999 Actual	2000 Est.	2001 Prog.	2002 Proj.	2003 Proj.
Revenue and grants	42.8	39.7	37.8	36.8	36.3
Expenditure and net lending	50.2	46.2	43.1	40.9	37.6
Court mandated pension payments	1.2	1.1	2.3	2.2	1.1
Others	49.0	45.1	40.8	38.8	36.5
Consolidated central government balance	-7.4	-6.5	-5.3	-4.2	-1.3
Adjusted for second pillar introduction cost	-7.4	-6.5	-5.3	-2.8	0.0
Memorandum items:					
Second pillar introduction cost	0.0	0.0	0.0	1.3	1.3
Change in revenues and grants	-2.8	-3.1	-1.9	-1.0	-0.4
Change in court mandated pension payments	0.8	-0.1	1.2	-0.1	-1.0
Change in other expenditures	0.7	-3.9	-4.3	-2.1	-2.3

Sources: Ministry of Finance and Fund staff estimates.

shoulder the fiscal cost—estimated at 3.1 percent of GDP—of tax reductions and court mandated additional pension expenditures. The reduction of the deficit by 1.2 percent of GDP thus required lowering other expenditure by the equivalent of 4.3 percent of GDP. Apart from 0.6 percent of GDP of expenditure savings which will result from transferring spending on highway construction and maintenance to a separate agency in April 2001, all cuts are genuine. While none of the major spending categories was spared, the cutbacks of payments for wages and certain social transfers are unprecedented and have particular significance for restoring fiscal discipline on a durable basis.

21. **Two contingencies will ensure the attainment of the program's external objective and fiscal deficit target, respectively**. As a prudential measure, the fiscal program postpones discretionary spending equivalent to ½ percent of GDP until the second half of 2001. These funds will be released only after a midyear program review confirms that the external current account deficit is on target to decline to 3.9 percent of GDP in 2001. To ensure that the quarterly fiscal ceilings are observed, a number of fiscal measures have been identified (¶16).[8]

[8] References are to paragraphs in, and Annexes to, the Memorandum of Economic and Financial Policies that was circulated as EBS/01/12.

They will be implemented if the fiscal deficit ceilings are likely to be breached, or—because of the importance of wage restraint for overall adjustment—if the cumulative quarterly budgetary wage bill limits (see Annex IX) are not observed. The fiscal contingency measures are under consideration on their own merits and—if not needed during 2001—are likely to be implemented to help reduce the fiscal deficit after 2001.

22. **The fiscal deficit will be financed without recourse to domestic borrowing**. The authorities expect to raise the equivalent of 5.2 percent of GDP from the privatization of the telecommunications company, two banks, an insurance company, and a pipeline. Most of these funds are expected to be realized from the expected public sale of shares in the telecommunications company in the second quarter, but the program adjusts automatically for a possible delay of this transaction by one quarter. As the government's borrowing plans call for net external borrowing of 1.0 percent of GDP, there would be a financing surplus of 0.9 percent of GDP which will be used to reduce arrears of the government and the health fund. Accordingly, there is no need for domestic bank borrowing. On the contrary, given the front-loading of the expected external financing flows, the government would provide resources to the banking system in the first half of 2001. Although the program has been designed on the basis of privatization receipts of 5.2 percent of GDP, the authorities could offset any shortfalls in privatization receipts by additional external borrowing. In that event, the programmed reduction of the public debt ratio by 4½ percentage points to 36 percent of GDP would of course be missed by an equivalent amount.

C. Incomes Policy

23. **To achieve its inflation, growth and current account objectives, the program relies heavily on a tight incomes policy**. The main elements of the three-pronged approach to restrain wage payments in the government, the public enterprises, and the economy at large are described in ¶¶17–21 and Annex IX.

- The government's decision to cut the wage bill in the budgetary sphere by 10 percent in nominal terms in 2001 is very ambitious, but it must be seen in the context of very large wage increases in 1999 and preceding years that raised spending on wages and salaries to 11½ percent of GDP in 1999–2000 at the consolidated central government level, compared to 3½ percent on average for other CEECs (Table 8). Notwithstanding the rapid rise in social transfers, wages rose to one fourth of government spending, fueling wage demands in the public enterprises and the rest of the economy. Most of the reduction in the budgetary wage bill is expected to come from the freeze of the basic wage in combination with a more parsimonious system of job grade coefficients that will be applied uniformly across all ministries.[9] The remainder is to result mainly from the cancellation or targeting of various bonuses and allowances and, toward the end of

[9] The relevant legislation is expected to be approved by parliament in early March (prior action) and the new compensation system is to be in effect by end-March 2001.

2001, from an employment reduction of 5½ percent under a less generous severance pay system.

- Average wages in the public enterprises have been frozen for 2001 and the previously mandatory bonuses may only be paid by profitable enterprises that do not benefit from government guarantees and subsidies. The 10 largest enterprises have additionally been instructed to cut administrative staff by 10 percent in 2001. In view of the authorities' privatization plans, it is expected that these measures will not need to remain in effect much beyond 2001.

- Negotiations on a social pact, which stalled in late 2000, have resumed and the government hopes to agree soon on voluntary wage guidelines that would restrain real wage increases to somewhat below productivity gains.

D. Monetary Program

24. **The CNB's monetary program for 2001 is based on a stable exchange rate and seeks to reduce retail price inflation to 4½ percent by year-end**. The CNB expects the demand for broad money to grow further—although at a reduced rate—in 2001, reflecting the faster growth in economic activity and strengthening confidence in the banking system, especially after repayment of the balance of insured deposits in failed banks at the end of 2000 (Table 9). The CNB will use part of the rising demand for base money during the tourist season to accumulate international reserves so as to keep their gross level at about 4¼ months of imports. To observe the performance criterion on its international reserves, the CNB stands ready to tighten domestic credit if base money demand turned out to be weaker than assumed in its program. Should, however, base money demand turn out to be stronger than programmed, the CNB will consult with the Fund to determine if the inflation outlook justifies easing the limits on net domestic assets. As noted, under its fiscal program the government will have a financing surplus in the first half of 2001 and will not require any bank financing during 2001. Accordingly, all resources accruing to the CNB beyond what is required to meet its international reserves target will be at the disposal of the banks.[10] Banks should therefore be able to expand credit to the nongovernment sector by some 16 percent during 2001, in addition to some seasonal credit to agriculture and tourism financed by the government's temporary financing surplus.

E. Structural Policies

25. **Structural reforms are an important part of the authorities' program.**[11] By implementing the measures described in their policy memorandum, the authorities intend to

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[10] The attendant easing of liquidity may require the CNB to postpone further reductions in reserve requirements to later this year.

[11] Of the reform measures mentioned in ¶¶24–36 and Annex I, the steps necessary to bring the telecommunication company to the point of sale (Annex X) and to make progress in

(continued...)

improve the finances of the pension and health funds (Table 7) and the competitiveness of the economy and to attract foreign investment, directly through privatization and indirectly through a more welcoming institutional and regulatory framework. They view these measures as necessary to achieve their growth and employment objectives. Measures to strengthen the pension and health fund finances, safeguard the confidence in the banking system, increase the flexibility of labor markets, and improve enterprise efficiency are important to the present program and are likely to be part of the World Bank SAL's conditionality.

F. Risks to the Program

26. **The risks to the program relate mainly to the external environment and slippages in program implementation**.

- The current account and growth objectives depend crucially on the continued expansion in the EU (the destination of more than half of merchandise exports) and economic normalization in the Balkans. A more rapid economic slowdown than currently envisaged or a renewed worsening of the regional security situation would seriously crimp merchandise and tourism exports. Higher oil prices would also dampen current account adjustment and economic growth. By contrast, unexpected strength of the euro would have comparatively little direct effect on exports, while reducing inflationary pressure through lower oil import costs.

- The main risks to the fiscal deficit target attach to wage policy, health spending, and tax collections. (i) The wage bill reduction depends crucially on the implementation of the wage and employment measures and the correct estimation of their impact on the wage bill.[12] (ii) Health fund expenditure will be difficult to control until it is brought under the purview of the single treasury at the start of 2002. (iii) Although conservative, the revenue projections must be considered unusually uncertain in the wake of recent tax policy changes. However, contingency measures have been identified to offset fiscal shortfalls due to wage and other policy implementation slippages (¶16).

- Against the backdrop of weakening stock market valuations, the government has announced its willingness to consider selling an additional 16 percent of the telecommunication company. Any remaining shortfalls in privatization receipts could

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restructuring and privatizing the electricity and the oil and gas companies (Annex I) have been made structural benchmarks because of their importance for financing the fiscal program and raising the efficiency of the economy. Observance of the latter benchmark will be monitored largely with the assistance of the World Bank.

[12] Implementation of the envisaged wage policy measures remains on target (see Section IV.B, below) and wage expenditure in January was in line with the quarterly budgetary wage bill limit in Annex IX.

presumably be made up by additional foreign borrowing. This would, however, slow or prevent the decline of the debt ratio and risk breaching the debt ceilings.

G. The Remaining Macroeconomic Policy Agenda

27. **Further fiscal adjustment is needed before privatization revenues are exhausted**. The authorities realize that, at 5.3 percent of GDP, the fiscal deficit remains too large and that government still absorbs considerably more resources than in other CEECs (see Figure 6). Their three-year fiscal framework therefore envisages reducing the deficit to 4.2 percent of GDP in 2002 and 1.3 of GDP in 2003, with a drop of the expenditure ratio to 40.9 percent and 37.6 percent of GDP, respectively. If these reductions in expenditure can be achieved (and ¶16 identifies a number of areas for expenditure savings)[13], the deficit targets would perhaps permit some further tax relief, e.g., by lowering the VAT rate as is preferred by the government. The design of a fiscal program that is consistent with these objectives is made more difficult by the planned introduction of the second pillar of the pension system at the start of 2002. Central government revenue will fall by an estimated 1.3 percent of GDP in 2002-03 as pension contributions are diverted from the existing unfunded public pillar to the new fully funded private pillar (see Text Table 1). Some relief will, however, be provided to the 2003 budget by the expiration of special pension payments equivalent to 1.0 percent of GDP a year. The budgets for 2002 and 2003 should also benefit from the government's intention to leave the wage bill constant in nominal terms. With the cessation of severance payments to government workers laid off in 2001, the constant wage bill would allow modest wage increases in the government sector.

28. **To enhance economic efficiency and prevent a renewed increase in the public debt ratio, the privatization process should be completed in 2002**. Under public management and with political interference, the public enterprises have been decapitalized. To enhance their efficiency, the authorities intend to privatize them rapidly, after establishing appropriate regulatory frameworks in the case of the utilities. With the implementation of the authorities' privatization plan for 2001, the electricity and the oil and gas companies—along with the shipyards and parts of the railways—are the most valuable remaining public companies in need of privatization. With proper restructuring and regulation, their sale in 2002 should provide substantial budgetary resources.

IV. Design of the Proposed Stand-By Arrangement

A. Modalities of the Arrangement

29. **The arrangement is proposed to be for 14 months, covering a one-year program period for calendar year 2001.** Test dates are set at the end of each quarter. Under the arrangement, the amount of SDR 200 million (47 percent of quota on an annual basis) will be

[13] An ongoing public expenditure review, conducted by the World Bank, is likely to provide a more comprehensive basis for achieving durable expenditure reductions in the medium term.

made available in five equal purchases: the first on approval, and subsequently after each of the four test dates according to the schedule provided in Table 10. In view of the comfortable reserve level, good access to capital markets, and the positive external outlook, the authorities do not intend to make purchases and will treat the arrangement as precautionary. The CNB has provided material for a safeguard assessment which the staff is currently reviewing.

B. Program Monitoring

30. **A list of the prior actions to be implemented before the Board discussion, including the status of their implementation, is provided in Table 11**. As of March 1, 2001, all prior actions had been implemented with the exception of the enactment of the Laws on Public Administration and on Civil Service Employment (to allow establishing a new, uniform range for salary coefficients and terminate wage supplements granted by individual ministries) and the amendment of the Law on Croatian Veterans' Rights (to repeal car import privileges). These measures are expected to be approved by parliament in urgent procedure during a session that starts on March 7.

31. **The monitoring of the program will be based on the following quantitative performance criteria (Annexes III-VIII)**: (i) quarterly limits on the cumulative deficit of the consolidated central government; (ii) quarterly limits on the cumulative increase in the net credit of the banking system to the consolidated central government; (iii) quarterly limits on arrears of the consolidated central government; (iv) quarterly limits on the cumulative increase in the net credit of the banking system to selected public enterprises; (v) quarterly ceilings on the stock of short-term external public and publicly guaranteed debt and on contracting or guaranteeing of nonconcessional medium- and long-term external debt by the public sector, with a subceiling on debt with original maturity of less than five years; (vi) quarterly floors under the net usable international reserves of the CNB; and (vii) quarterly limits on the cumulative increase in the net domestic assets of the CNB. **Continuous performance clauses** rule out (i) the accumulation of new external arrears and (ii) the imposition of new or intensification of existing payments restrictions, multiple currency practices, and import restrictions.

32. **Structural conditionality will be limited to two performance criteria and two benchmarks.** The structural performance criteria, both in the wage policy area (Annex IX), will be set on: (i) enacting a government decree on salary coefficients for individual posts, to replace existing ministry-specific coefficients, with a view to reducing the wage bill, and on issuing separate decrees determining each Ministry's wage bill on the basis of the new coefficients and total number of employees (both actions to be taken by March 31, 2001); and (ii) reducing employment in the budgetary sphere by 10,000 by the end of 2001. Two structural benchmarks will measure progress in privatization and will be set on: (i) taking all steps necessary to bring at least 20 percent of the telecommunication company's shares to the point of sale by issuing the privatization prospectus and organizing the roadshow (Annex X); and (ii) making progress in restructuring and privatizing the electricity company and the oil and gas company, to be assessed by the World Bank (Annex I).

33. **There will be two reviews during the period of the proposed arrangement, before the third and fourth purchases respectively**. Both reviews will be devoted to progress in implementing the structural elements of the program, in particular wage policy and pension and health care reform. In addition, the first review would set the quantitative performance criteria for the second half of the program and decide on the release of postponed government expenditure in light of progress in reducing the external current account deficit. The completion of the second review will also be conditional on agreement on a budget for 2002.

C. Medium-Term External Outlook and Capacity to Repay the Fund

34. **The medium-term external outlook is favorable.** The current account deficit, estimated to have declined from 7.6 percent in 1999 to 4.6 percent of GDP in 2000, is expected to narrow within two years to a sustainable level of 3–3½ percent of GDP. Even under very conservative assumptions, the projected privatization receipts and greenfield foreign direct investment inflows will be sufficient to cover the current account deficit in 2001–03. Under these circumstances, the external debt to GDP ratio is expected to decline from 53 percent of GDP at end-2000 to 45 percent of GDP in 2003. The debt service to exports ratio is projected to decline from 19 percent to 15 percent during 2001–03 and then rise somewhat over the longer term reflecting the amortization of the external bonds contracted in recent years. Gross official reserves reached a record US$3.5 billion at end-2000 and are projected to stay above 4 months of exports of goods and nonfactor services.

35. **Standard indicators suggest that external vulnerability has been reduced in 2000 (Table 12)**. Gross official reserves at end-2000 exceeded short-term debt (on a remaining maturity basis) falling due over the following year by 40 percent. Moreover, with the repayment of US$400 million in prefinancing contracted in late 2000, the gross reserves coverage of short-term debt is expected to improve by some 30-40 percentage points after privatization of the telecommunication company in mid-2001.

36. **Croatia is expected to have ready access to capital markets**. In recent years Croatia established a strong track record of creditworthiness with both official and private creditors and has been awarded an investment grade rating on sovereign debt by several credit rating agencies, including Moody's and Standard&Poors. Spreads between Croatian sovereign bonds and benchmark bonds of similar maturity have narrowed by some 150 basis points since late 1999 and Croatian bonds are currently traded at about 200 basis points above comparable euro- and dollar-denominated benchmarks (Appendix V, Figure 1). In 2000, the Croatian government placed successfully two sovereign bonds—about US$800 million in total—on markets in Japan and Europe, and it has received favorable reactions to its plans of raising a similar amount in the first quarter of 2001.

37. **Should a need emerge to draw on the resources made available under the arrangement, the staff is confident that Croatia can meet its financial commitments to the Fund.** Under the proposed purchase schedule, Fund credit outstanding would peak in 2001 at 9.2 percent of gross official reserves, while debt service to the Fund would not exceed 1.2 percent of exports of goods and nonfactor services during the entire repayment period (Tables 14 and 15).

V. Surveillance Issues

38. **Although efforts to improve coverage, quality, and timeliness of data continue, monitoring and analysis of economic trends are still impaired by data deficiencies.**[14] Comprehensive and timely data on government arrears are expected to become available once all operations of the consolidated central government are channeled through the treasury single account. More timely and frequent information on general government operations and labor market developments is still needed. As to data quality, methodological inconsistencies challenge the reconciliation of monetary and fiscal financing data, while frequent revisions of national accounts and balance of payments data increase the uncertainty surrounding estimates of GDP and the external current account.

39. **In an effort to secure their access to international capital markets, the authorities plan to establish procedures for a regular dialog with private creditors**. The CNB intends to brief creditors on an ongoing basis by visiting major foreign markets (primarily London) on a regular basis and to invite emerging market analysts and representatives of major investors in Croatian bonds twice a year for briefings in Croatia.

40. **The authorities agreed to conduct a financial sector assessment under the FSAP**. In response to their formal request, a small FSAP mission is scheduled to visit Zagreb in April, to be followed by a larger team in September 2001. Although some of the financial sector reforms (e.g., the new banking law) will not be completed by then, the timing of the FSAP mission should allow timely inputs for the next Article IV consultation with Croatia.

41. **Following its accession to the WTO in November 2000, Croatia was given the most favorable rating on the Fund's trade restrictiveness index.** The agreed reductions in manufacturing tariffs were implemented in advance in summer 2000 and, at the same time, all nontariff barriers, except licensing of steel imports from non-WTO countries, were eliminated. Upon accession, Croatia began phasing in its commitments in agriculture, beginning with the tariffication of nontariff barriers combined with selective tariff reductions and an *ad valorem* capping of the compound duties levied seasonally on some 200 agricultural tariff lines. As a result of these measures, the average tariff on Croatia's imports declined from 12.1 to 7.1 percent.

42. **Croatia also made rapid progress in its regional and bilateral trade negotiations.** In September 2000, Croatia reached a preferential trade agreement with the EU, under which 95 percent of Croatia's products can enter the EU market duty free. In February 2001, Croatia concluded negotiations on a free trade agreement (FTA) with EFTA that is expected to take effect at the start of 2002. In addition to the existing FTAs with Slovenia, FYR of Macedonia, and Bosnia and Herzegovina, an FTA with Hungary, signed in February 2001, will enter into effect on April 1, 2001, eliminating barriers on manufactured goods, but delaying the

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[14] Croatia subscribes to the Special Data Dissemination Standard (SDDS) and is largely in observance of SDDS requirements (Appendix IV).

liberalization of trade in agriculture goods. The authorities expect to sign shortly similar FTAs with the Czech Republic and Poland, and soon thereafter with Bulgaria, Romania, and Slovakia, which is expected to pave the way for Croatia's accession to CEFTA by mid-2001. In total, the authorities estimate that no less than 80 percent of Croatia's trade will be conducted under preferential trade agreements by then.

43. **The frozen deposit balances in domestic banks, which give rise to an exchange restriction, were reduced by almost one third in 2000 and stood at 5.5 percent of their original value, or slightly less than 1 percent of GDP, at end-January 2001 (Box 3)**.

Box 3. Frozen Bank Deposits

In December 1991 the Government of Croatia modified the terms of certain foreign currency deposits, effective retroactively to April 27, 1991, and transformed them into deposits to be repaid in 20 semi-annual installments starting June 30, 1995. These measures were taken in order to protect Croatian banks from collapse after the foreign exchange counterpart to these deposits had been blocked by the National Bank of the former SFRY. Since then, the stock of such frozen deposits has fallen considerably, partly due to the fact that banks have been permitted to reduce the deposits more rapidly at their own discretion, but mainly due to budgetary repayments which still amount to about ¾ percent of GDP per annum. Moreover, interest payments on these deposits have been made twice annually, and in a timely fashion. However, because the frozen balances may include revenues from current international transactions that were generated prior to the 1991 freeze, the measure gives rise to an **exchange restriction** subject to approval under Article VIII, 2(a) of the Fund's Articles of Agreement.

Banks are free to pay out these deposits more rapidly than prescribed by the phased elimination schedule. As the balances have indeed been reduced more rapidly than required, the authorities are confident that all frozen balances will be released by the banks by the 2005 terminal date at the latest.

VI. Staff Appraisal

44. **The economy has pulled out of the 1998/99 recession**, assisted by strengthening external demand, domestic political change, and an improved regional security situation. Apart from continued favorable external conditions, the growth prospects for 2001 depend crucially on a revival of private investment, for which policymakers have laid a promising foundation in 2000. With inflation once more on a downward trend, wage pressures should ease and employment should stabilize despite inevitable public sector layoffs.

45. **After a major shakeout in 1998/99, the banking system is on the mend**. Surviving banks, operating under a strengthened regulatory framework and keener supervision, have attracted new deposits and rebuilt their capital base. The outlook is for further concentration of ownership, which may risk reducing competition in the sector. Notwithstanding recent progress, the supervisory framework needs to be strengthened further to reach EU standards.

46. **The combination of a rebounding economy and a recovering banking system has provided the new government with an excellent opportunity to complete the unfinished reform agenda of the 1990s**. A good beginning has been made in 2000 by reducing the fiscal imbalance and the size of government and by privatizing three banks, and the authorities are to be commended for this promising start. Much more adjustment and reform is, however, required to ensure external viability and sustainably high rates of economic growth.

47. **The authorities' program for 2001 is proof of their determination to grasp this opportunity and therefore deserves the Fund's support**. The program seeks to promote economic growth and price stability in the context of reduced external vulnerability through fiscal adjustment, wage restraint, and structural reforms. While there are risks to its objectives from the external environment, the authorities are determined to implement contingency measures if necessary to meet its macroeconomic performance criteria.

48. **Strict implementation of the fiscal and wage policy measures and privatization are key for the success of the program**. As soon as the enabling legislation is approved by parliament, the authorities need to implement the intended reduction of the budgetary wage bill and the staff reduction plan. Pressures to reduce taxes further, to restore entitlements, or to postpone privatization must be resisted.

49. **The slimming of the central government through outsourcing and devolution is a welcome supplement to outright cuts in government spending**. However, these measures should not be allowed to prevent the reduction of the size of the general government. The authorities should therefore be careful that the new highway construction agency is properly financed from nonbudgetary sources and that the local governments are given the proper incentives to discharge the decentralized tasks in as economical a fashion as possible. In this connection, the Fund stands ready to provide technical assistance on fiscal federalism.

50. **The fiscal adjustment effort needs to be continued after 2001**. With the introduction of the second pension pillar at the start of 2002 adding to the adjustment need, the authorities' efforts should focus on cutting entitlement programs and freezing the still large wage bill. Substantial revenue enhancements and expenditure savings are possible by broadening the bases for social security contributions and copayments for health services and by rationalizing benefits, including their harmonization across different groups of beneficiaries. With staff reductions, nominal wage increases will be possible despite the wage bill freeze. Further tax reductions should avoid adding to the distortions and complications introduced by some of the measures taken in 2000.

51. **Implementation of the authorities' structural reform agenda is important to ensure external viability and faster economic growth in the medium term**. Apart from the incentives already provided, the revival of private investment requires a more hospitable environment that can be achieved by cutting bureaucratic procedures, reforming the legal system, and ensuring legal security for business, including clear property rights. Speedy privatization of remaining large public enterprises is required to enhance economic efficiency and finance the still large fiscal deficits in 2001 and 2002.

52. **With improved access to foreign markets, continued regional stability, and full implementation of the authorities' program, the present level of the exchange rate should remain appropriate**, consistent with maintaining Croatia's external competitiveness. The authorities' economic program is compatible with continued exchange rate stability, but the CNB should not resist any unexpected large or persistent exchange market pressures.

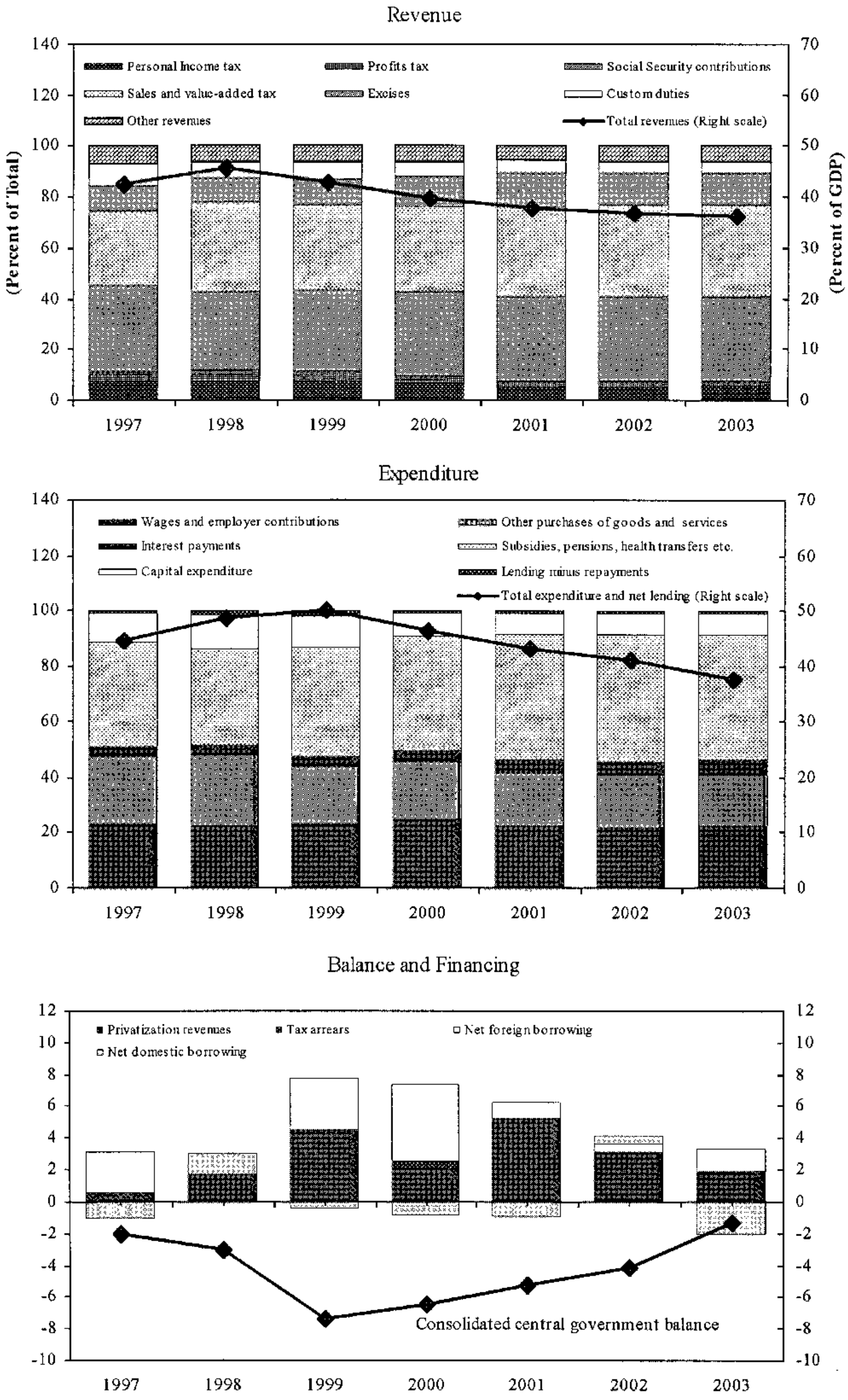
53. **The CNB needs to monitor liquidity conditions carefully and ensure that interest rates on deposits remain sufficiently high to attract financial savings**. As a result of past policy actions, interest rates have fallen to low levels and bank liquidity is now abundant. Close coordination with the Ministry of Finance will be required to accommodate the government's external borrowing plans under the CNB's monetary program. The front-loaded nature of these borrowing operations suggests that further reductions in reserve requirements, desirable as they are, will probably have to be deferred to the second half of 2001.

54. **The authorities should continue to improve their economic data**. This applies in particular to the timely compilation of data on general government operations and government arrears, leases, and guarantees.

55. In view of the further progress in paying out the frozen foreign exchange denominated deposits, even ahead of the established timetable for their phased elimination, it is proposed to grant temporary approval for the **exchange restriction** that arises in connection with the freeze on these deposits held by nonresidents.

56. It is recommended that the next **Article IV consultation** with Croatia be held on the standard 12-month cycle.

Figure 8. Croatia: Consolidated Central Government Operations, 1997-2003



Sources: Ministry of Finance and IMF staff estimates.

Table 1. Croatia: Selected Social and Economic Indicators, 1995-2001

	1995	1996	1997	1998	1999	2000	2001 Program
Real economy (percentage change)							
Real GDP	6.8	6.0	6.6	2.5	-0.4	3.5 1/	4.0
Unemployment rate (average; percent of labor force) 2/	n.a	10.0	9.9	11.4	13.6	15.1 3/	14.5
Nominal net wages (percentage change; period average)	14.4	17.7	14.8	15.4	11.2	9.0 4/	...
Retail prices (e.o.p.)	3.7	3.4	3.8	5.4	4.4	7.4	4.5
Gross domestic saving (percent of GDP)	9.9	16.1	18.2	17.2	18.7	20.2 1/	22.0
Gross domestic investment (percent of GDP)	17.6	21.9	29.8	24.3	26.3	24.8 1/	25.8
Public finance (percent of GDP)							
Consolidated central government (cash basis) 5/	-0.9	-0.4	-1.3	0.6	-2.0	-5.1 1/	-0.8
Consolidated central government (accrual basis)	...	...	-2.0	-3.0	-7.4	-6.5 1/	-5.3
Money and credit (e.o.p.; percentage change)							
Broad money	40.4	49.1	37.6	13.0	-1.1	26.5 1/	15.3
Credit to consolidated central government	-3.0	-3.4	-49.9	-2.7	41.1	19.2 1/	0.0
Other credit 6/	18.9	3.1	44.1	22.4	-6.5	4.4 1/	15.9
Interest rates (e.o.p.; percent)							
Average deposit rate	6.1	4.2	4.4	4.1	4.3	3.6	...
Average credit rate	22.3	18.5	14.1	16.1	13.5	10.5	...
Balance of payments (percent of GDP)							
Trade balance	-17.3	-18.2	-25.8	-19.2	-16.4	-17.9 1/	-17.3
Current account balance	-7.7	-5.5	-11.6	-7.1	-7.6	-4.6 1/	-3.9
Total external debt (e.o.p.) 7/	20.8	23.2	31.9	40.3	44.5	53.2 1/	50.4
Gross official reserves (USD million; e.o.p.)	1,895	2,314	2,539	2,816	3,025	3,423	3,663
Reserve cover (months of imports of goods and services)	2.4	2.8	2.7	3.2	3.7	4.2	4.3
Short-term debt in percent of gross usable official reserves 5/	31.6	40.7	45.6	75.1	77.3	96.3 1/	75.7
Exchange rate							
Nominal effective rate (1995=100; p.a.)	100.0	100.3	101.0	100.4	94.7	94.4 8/	...
Real effective rate (1995=100; p.a.)	100.0	99.3	99.6	101.3	97.1	98.8 8/	...
Geographic, social, and demographic indicators							
Per capita GDP (US$, at market exchange rates)	4,029	4,422	4,398	4,805	4,406	4,230 1/	...
Land area (km^2)					56,538	...	...
Population (thousands)	4,669	4,494	4,572	4,501	4,554	4,470 1/	...
Population density (people per km^2)						73.1	...
Population growth (in percent)	0.4	-3.7	1.7	-1.6	1.2	-1.8 1/	...
Life expectancy at birth (years)	72.1	72.4	72.5	72.7	...	...	...
male	67.8	68.2	68.3	68.6	...	...	...
female	76.5	76.8	76.9	77.1	...	...	...
Infant mortality rate (per 1,000 live births)	8.9	8.4	8.2	8.2	...	...	...
Crude death rate (per 1,000 people)	11.3	11.3	11.4	11.6	...	...	...

Sources: Croatian authorities; Information Notice System; and Fund staff estimates.

1/ Estimate.
2/ Labor Force Survey (based on ILO standards).
3/ June.
4/ November.
5/ National presentation, with privatization receipts above the line.
6/ After inclusion of arrears repayment, credit expansion would be 15.3 percent in 2000 and 18.5 percent in 2001.
7/ Does not include debt that was excluded from the London Club agreement.
8/ October.

Table 2. Croatia: Saving-Investment Balances, 1997-2003
(In millions of kuna)

	1997	1998	1999	2000 est.	2001 prog.	2002 proj.	2003 proj.
External saving	14,316	9,737	10,829	7,229	6,556	6,411	6,419
Domestic saving-investment gap	-14,316	-9,737	-10,829	-7,229	-6,556	-6,411	-6,419
Saving	22,519	23,735	26,747	31,678	37,721	45,394	53,684
Investment	36,835	33,472	37,576	38,907	44,276	51,804	60,103
Consolidated central government (accrual basis) 1/	-1,957	-3,093	-9,033	-9,359	-8,319	-6,760	-1,757
Saving 2/	3,734	4,905	-1,020	-3,525	-2,739	-1,251 4/	3,752 4/5/
Investment 1/	5,690	7,998	8,013	5,835	5,580	5,509	5,509
Non-government sector 3/	-12,359	-6,644	-1,797	2,130	1,763	349	-4,662
Saving	18,786	18,830	27,767	35,202	40,460	46.645 4/	49,932 4/5/
Investment	31,145	25,474	29,563	33,072	38,696	46,295	54,594
(In percent of GDP)							
External saving	11.6	7.1	7.6	4.6	3.8	3.5	3.2
Domestic saving-investment gap	-11.6	-7.1	-7.6	-4.6	-3.8	-3.5	-3.2
Saving	18.2	17.2	18.7	20.2	22.0	24.5	26.6
Investment	29.8	24.3	26.3	24.8	25.8	27.9	29.8
Consolidated central government (accrual basis) 1/	-1.6	-2.2	-6.3	-6.0	-4.9	-3.6	-0.9
Saving 2/	3.0	3.6	-0.7	-2.2	-1.6	-0.7 4/	1.9 4/5/
Investment 1/	4.6	5.8	5.6	3.7	3.3	3.0	2.7
Non-government sector 3/	-10.0	-4.8	-1.3	1.4	1.0	0.2	-2.3
Saving	15.2	13.7	19.5	22.4	23.6	25.1 4/	24.1 4/5/
Investment	25.2	18.5	20.7	21.1	22.6	24.9	27.1
Memorandum items							
GDP at current prices (millions of kuna)	123,812	137,604	142,700	156,823	171,307	185,642	201,755
Gross national disposable income at current prices (millions of kuna)	129,027	141,054	143,772	159,958	173,389	188,138	204,540
Consolidated central government	29,868	37,250	30,508	29,795	27,837	29,393	33,944
Non-government sector	99,159	103,804	113,264	130,163	145,552	158,745	170,596

Sources: Croatian National Bank, Ministry of Finance, Central Statistics Bureau and staff estimates.

1/ Excludes net lending, includes change in inventories.
2/ Current revenues minus current expenditures (excluding current transfers and interest payments).
3/ Includes lower levels of government and public enterprises.
4/ Government saving is reduced and non-government saving is increased by 1.3-1.4 percent of GDP due to the introduction of the second pillar of the pension system.
5/ Government saving is increased and non-government saving is reduced by 1 percent of GDP due to cessation of payments under the Small Law.

Table 3. Croatia: GDP Measures and Projections, 1998-2003

(percentage changes)

	1998	1999	2000 est.	2001 prog.	2002 proj.	2003 proj.
Real GDP	2.5	-0.4	*3.5*	*4.0*	*4.2*	*4.5*
Domestic demand	-1.5	-1.9	*1.6*	*2.9*	*3.9*	*4.3*
Consumption	2.7	-4.5	*3.4*	*0.5*	*1.3*	*1.7*
Private 1/	-0.2	-2.7	*4.8*	*4.4*	*2.6*	*3.5*
Government	11.2	-9.2	*-1.1*	*-11.6*	*-3.5*	*-5.3*
Gross investment	2.5	-1.1	*-11.7*	*12.9*	*14.3*	*13.1*
Private 1/	-5.0	-0.3	*-5.0*	*17.9*	*17.7*	*15.5*
Government	34.5	-3.6	*-32.4*	*-8.9*	*-5.1*	*-3.8*
Exports	4.4	0.5	*11.0*	*6.8*	*6.5*	*6.3*
Imports	-4.5	-2.9	*5.6*	*4.1*	*5.7*	*5.6*
(percentage contributions)						
Real GDP	2.5	-0.4	*3.5*	*4.0*	*4.2*	*4.5*
Domestic demand	-1.9	-2.0	*1.7*	*3.1*	*4.2*	*4.5*
Consumption	2.2	-3.8	*2.7*	*0.4*	*1.0*	*1.3*
Private 1/	-0.1	-1.7	*3.0*	*2.7*	*1.6*	*2.2*
Government	2.4	-2.1	*-0.2*	*-2.3*	*-0.6*	*-0.8*
Gross fixed capital formation	0.6	-0.3	*-2.8*	*2.6*	*3.2*	*3.2*
Private 1/	-1.0	0.0	*-0.9*	*3.0*	*3.3*	*3.3*
Government	1.6	-0.2	*-1.9*	*-0.3*	*-0.2*	*-0.1*
Change in inventories 2/	-4.7	2.0	*1.8*	*0.0*	*0.0*	*0.0*
Net foreign demand	4.4	1.7	*1.7*	*0.9*	*0.0*	*0.0*
Exports	1.8	0.2	*4.6*	*3.1*	*3.0*	*3.0*
Imports	2.6	1.5	*-2.9*	*-2.1*	*-3.0*	*-3.0*

Sources: Croatian National Bank, Ministry of Finance, Central Statistics Bureau and staff estimates.

1/ Includes local government.
2/ Includes statistical discrepancies.

Table 4. Croatia: Balance of Payments, 1998-2003 1/
(In millions of U.S. dollars, unless otherwise indicated)

	1998	1999	2000	2001				2001	2002	2003
				q1	q2	q3	q4			
Current account	-1,530	-1,523	-874	-640	-376	1,085	-848	-780	-753	-744
Merchandise trade balance	-4,147	-3,299	-3,379	-649	-969	-816	-1,037	-3,471	-3,597	-3,772
Exports f.o.b.	4,604	4,395	4,531	1,138	1,145	1,279	1,259	4,820	5,120	5,480
Imports f.o.b.	-8,752	-7,693	-7,910	-1,787	-2,114	-2,095	-2,295	-8,291	-8,718	-9,251
Services and income	1,911	1,276	1,767	-175	425	1,732	28	2,011	2,144	2,308
Transportation	228	84	141	53	56	61	59	229	248	269
Travel	2,133	1,742	2,154	-6	495	1,843	65	2,398	2,531	2,670
Other services	-286	-201	-168	-57	-16	-58	-52	-182	-228	-235
Compensation of employees	70	60	67	17	17	19	19	72	70	70
Interest income	-233	-410	-426	-182	-127	-133	-64	-507	-478	-466
Current transfers	706	500	738	184	167	168	160	680	700	720
Capital and Financial account	1,595	1,948	476	515	490	-418	465	1,051	939	1,023
Capital account	19	25	16	4	4	4	4	16	16	16
Financial account	1,576	1,924	459	511	486	-422	461	1,035	923	1,006
Direct investment	801	1,374	805	115	636	183	372	1,306	792	775
Portfolio investment	15	574	739	547	0	-75	0	473	-101	139
Medium- and long-term loans	1,018	348	-210	-16	-81	33	47	-18	216	69
Disbursements	1,735	1,657	928	267	271	294	298	1,130	1,151	1,097
Amortization scheduled	-717	-1,234	-1,134	-283	-353	-261	-252	-1,148	-934	-1,028
Currency and deposits 2/	192	-296	-1,072	0	255	-546	0	-291	0	0
Short term capital flows (net) 3/	36	59	586	0	-400	0	0	-400	0	0
Trade Credits 4/	-486	-136	-388	-135	76	-17	42	-34	15	24
Net errors and omissions	96	34	916	0	0	0	0	0	0	0
Overall balance	160	460	518	-125	113	666	-383	271	185	279
Financing	-160	-460	-518	125	-113	-666	383	-271	-185	-279
Gross reserves (-= increase)	-152	-429	-490	125	-99	-663	398	-239	-150	-244
IMF (net purchases)	-9	-31	-29	0	-14	-3	-14	-32	-35	-35
Memorandum Items										
Current account (in percent of GDP)	-7.1	-7.6	-4.6	-3.2	-1.9	5.4	-4.2	-3.9	-3.5	-3.2
Current account (in percent of adjusted GDP) 5/	-5.7	-6.1	-3.7	-11.3	-6.0	16.1	-13.3	-3.1	-2.8	-2.6
Gross official reserves	2,816	3,025	3,423	3,298	3,397	4,060	3,663	3,663	3,813	4,057
in months of imports of goods and NFS	3.2	3.7	4.2	3.9	4.0	4.7	4.3	4.3	4.2	4.2
Net international reserves	2,581	2,807	3,223	3,098	3,211	3,878	3,494	3,494	3,680	3,959
in months of imports of goods and NFS	2.9	3.4	3.9	3.7	3.8	4.5	4.1	4.1	4.0	4.1
Gross usable international reserves 6/	2,320	2,249	2,528	2,403	2,502	3,165	2,767	2,767	2,918	3,162
in months of imports of goods and NFS 6/	2.6	2.8	3.1	2.9	3.0	3.7	3.2	3.2	3.2	3.3
Net usable international reserves 6/	2,085	2,031	2,328	2,203	2,316	2,982	2,599	2,599	2,784	3,063
in months of imports of goods and NFS	2.4	2.5	2.8	2.6	2.7	3.5	3.0	3.0	3.1	3.2
Outstanding debt 7/	8,708	8,937	10,053	10,583	10,102	10,060	10,107	10,107	10,222	10,430
of which: short-term debt 3/ 8/	468	473	1,059	1,059	659	659	659	659	659	659
Debt to GDP ratio 7/	40.3	44.5	53.2	55.9	52.6	51.6	50.4	50.4	47.5	45.0
Short term debt in percent of gross official reserves 3/ 8/ 9/	61.9	57.5	71.1	…	…	…	…	57.2	48.5	53.5
Short-term debt and current account deficit net of FDI in percent of gross official reserves 3/ 8/ 9/	67.2	59.7	55.8	…	…	…	…	56.1	47.6	54.3
Debt Service	-1,055	-1,691	-1,587	-546	-459	-430	-348	-1,783	-1,816	-1,569
Debt service to exports ratio	12.3	20.8	18.4	34.1	21.6	11.9	17.7	19.2	18.4	14.9
GDP (millions of U.S. dollars)	21,628	20,064	18,908	4,533	5,039	5,389	5,088	20,046	21,523	23,156
GDP (millions of Kuna)	137,604	142,700	156,823	38,893	43,127	45,987	43,299	171,307	185,642	201,755
Exchange rates										
Kuna per US dollar (pa)	6.36	7.11	8.29	…	…	…	…	…	…	…

Sources: Croatian National Bank, World Economic Outlook, and staff estimates

1/ Based upon CNB balance of payments revisions of July 2000.

2/ A significant proportion of the currency and deposit flows in 1998 and 1999 are the repatriation of foreign currency redeposit requirements held at the CNB.

3/ Data for short term commercial bank credits derived from the CNB foreign exchange department.

4/ Coverage only includes import trade credits with maturities less than three months.

5/ Includes an upward adjustment of 25 percent to GDP for the informal sector. While the exact size of the needed adjustment is not known, some such upward adjustment is clearly warranted and estimates by the Ministry of Finance and the Institute of Public Finance in Zagreb suggest that an adjustment on the order of 25 percent would be reasonable.

6/ Adjusted downward by foreign currency redeposit requirements held at the CNB, and by the amount of outstanding foreign currency CNB bills.

7/ Does not include debt that was excluded from the London Club agreement.

8/ Coverage is limited to short term debt contracts registered with the CNB.

9/ Short-term debt is presented on a remaining maturity basis.

Table 5. Croatia: Consolidated Central Government Operations, 1997-2003 1/
(percentage of GDP)

	1997 Actual	1998 Actual	1999 Actual	2000 Projec.	2001 Program	2002 Projec. 2/	2003 Projec. 2/
Revenue and grants	42.5	45.6	42.8	39.7	37.8	36.8	36.3
Current revenue	42.5	45.6	42.8	39.7	37.8	36.8	36.3
Tax revenue	40.3	43.5	40.7	37.9	36.2	34.8	34.4
Personal Income tax	3.3	3.6	3.2	2.7	1.9	2.0	2.0
Social Security contributions	14.6	14.2	13.8	13.2	12.6	12.2	12.0
Profits tax	1.4	1.8	1.7	1.1	0.9	0.9	0.8
Real Estate Transactions tax	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Taxes on goods and services	16.6	20.4	18.5	18.1	18.5	17.9	17.8
Sales tax	12.2	1.4	0.3	0.1	0.0	0.0	0.0
Value-added taxes	0.0	14.7	13.9	13.4	13.3	13.2	13.2
Excises	4.4	4.3	4.3	4.7	5.2	4.7	4.6
Custom duties	3.7	3.0	3.0	2.4	1.8	1.7	1.6
Other tax revenue	0.4	0.3	0.3	0.3	0.4	0.0	0.0
Non-tax revenue	2.2	2.1	2.2	1.8	1.6	2.0	1.9
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	44.5	48.7	50.2	46.2	43.1	40.9	37.6
Expenditure	44.0	47.9	49.1	45.7	42.6	40.5	37.2
Current expenditure	39.5	42.1	43.5	42.0	39.4	37.5	34.4
Expenditure on goods and services	21.1	23.5	22.1	21.2	17.8	16.9	15.4
Wages and employer contributions	10.3	10.9	11.7	11.5	9.6	9.1	8.5
Other purchases of goods and services	10.8	12.6	10.4	9.8	8.2	7.8	7.0
Interest payments	1.6	1.5	1.6	1.9	2.1	1.9	2.0
Domestic	0.8	0.8	0.8	0.8	0.7	0.6	0.5
External	0.8	0.8	0.8	1.1	1.4	1.3	1.5
Subsidies and other current transfers	16.7	17.0	19.8	18.8	19.4	18.6	17.0
Capital expenditure	4.6	5.8	5.6	3.7	3.3	3.0	2.8
Lending minus repayments	0.5	0.8	1.1	0.5	0.5	0.5	0.4
Consolidated central government balance	-2.0	-3.0	-7.4	-6.5	-5.3	-4.2	-1.3
Financing needs	2.0	3.0	7.4	6.5	5.3	4.2	1.3
Privatization revenues	0.6	1.7	4.5	2.0	5.2	3.1	1.9
"Tax bonds" revenues 3/	0.0	0.0	0.0	0.5	0.0	0.0	0.0
Net foreign borrowing	2.5	0.1	3.2	4.8	1.0	0.5	1.4
Net domestic borrowing	-1.1	1.3	-0.4	-0.8	-0.9	0.5	-2.0
From other general government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
From other non-banking sector 4/	0.1	2.1	0.8	-4.0	-0.9	0.9	0.6
From banking sector	-1.1	-0.8	-1.2	3.1	0.0	-0.4	-2.6
From monetary authorities	-0.3	0.1	0.0	0.0	0.0	0.0	0.0
From deposit money banks	-0.9	-0.9	-1.2	3.1	0.0	-0.4	-2.6

Sources: Ministry of Finance (MoF) and staff estimates

1/ Accrual basis
2/ Based on the Ministry of Finance three-years framework
3/ Overdue receivables settled against oustanding payables
4/ Includes net change in arrears

Table 6. Croatia: Unconsolidated Central Budget Operations, 1997-2003 1/
(percentage of GDP)

	1997 Actual	1998 Actual	1999 Actual	2000 Projec.	2001 Program	2002 Projec. 2/	2003 Projec. 2/
Revenue and grants	27.0	30.5	28.1	25.7	24.3	23.8	23.5
Current revenue	27.0	30.5	28.1	25.7	24.3	23.8	23.5
Tax revenue	25.7	29.3	26.9	24.7	23.6	22.6	22.4
Personal Income tax	3.3	3.6	3.2	2.7	1.9	2.0	2.0
Profits tax	1.4	1.8	1.7	1.1	0.9	0.9	0.8
Real Estate Transactions tax	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Taxes on goods and services	16.6	20.4	18.5	18.1	18.5	17.9	17.8
Sales tax	12.2	1.4	0.3	0.1	0.0	0.0	0.0
Value-added taxes	0.0	14.7	13.9	13.4	13.3	13.2	13.2
Excises	4.4	4.3	4.3	4.7	5.2	4.7	4.6
Custom duties	3.7	3.0	3.0	2.4	1.8	1.7	1.6
Other tax revenue	0.4	0.3	0.3	0.3	0.4	0.0	0.0
Non-tax revenue	1.3	1.2	1.2	0.9	0.7	1.1	1.1
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	28.4	32.5	35.2	31.1	29.1	27.7	24.6
Expenditure	28.0	31.7	34.2	30.6	28.6	27.2	24.2
Current expenditure	24.1	26.5	27.7	27.3	25.7	24.6	21.7
Expenditure on goods and services	16.4	17.5	16.1	14.7	12.1	11.3	10.1
Wages and employer contributions	8.9	9.5	10.3	9.9	8.0	7.5	7.0
Other purchases of goods and services	7.4	8.1	5.8	4.8	4.1	3.7	3.1
Interest payments	1.6	1.5	1.5	1.8	1.9	1.8	1.8
Domestic	0.8	0.7	0.7	0.7	0.6	0.4	0.4
External	0.8	0.8	0.8	1.1	1.4	1.3	1.5
Subsidies and other current transfers	6.1	7.5	10.0	10.8	11.7	11.5	9.8
o/w to extrabudgetary funds	3.0	3.8	5.6	7.1	8.0	8.3	6.7
to Pension Fund	2.1	2.6	3.4	4.1	5.6	6.0	4.8
to Health Fund	0.6	0.7	1.3	2.0	1.3	1.3	0.9
to Employment Fund	0.3	0.0	0.0	0.0	0.0	0.0	0.0
to Water Management Fund	0.0	0.1	0.2	0.2	0.2	0.1	0.1
to Child Benefit Fund	0.0	0.4	0.8	0.8	0.8	0.8	0.8
Capital expenditure	3.9	5.2	6.5	3.3	2.9	2.7	2.5
Lending minus repayments	0.5	0.8	1.1	0.5	0.5	0.5	0.4
Central budget overall balance, unconsolidated	-1.5	-2.0	-7.2	-5.5	-4.8	-3.9	-1.2
Memorandum items:							
Extrabudgetary funds balance, unconsolidated	-0.6	-1.0	-0.2	-1.0	-0.6	-0.3	-0.2
Transactions eliminated from financ in consolid process	0.0	0.0	0.0	0.0	0.1	0.0	0.0
Consolidated central government balance	-2.0	-3.0	-7.4	-6.5	-5.3	-4.2	-1.3

Sources: Ministry of Finance and staff estimates

1/ Accrual basis

2/ Based on the Ministry of Finance three-years framework

Table 7. Croatia: Unconsolidated Extrabudgetary Funds Operations, 1997-2003 1/
(Percent of GDP)

	1997 Actual	1998 Actual	1999 Actual	2000 Projec.	2001 Program	2002 Projec. 2/	2003 Projec. 2/
All extrabudgetary funds							
Revenue and grants	22.1	22.2	24.4	23.4	23.3	23.0	21.1
Revenue	19.2	17.6	17.3	16.2	15.3	14.7	14.4
Current revenue	19.2	17.6	17.3	16.2	15.3	14.7	14.4
Tax revenue	18.3	16.7	16.3	15.3	14.4	13.9	13.6
Non-tax revenue	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Grants	3.0	4.5	7.2	7.2	8.0	8.3	6.7
Expenditure and net lending	22.7	23.2	24.7	24.4	23.8	23.2	21.3
Expenditure	22.7	23.2	24.7	24.4	23.8	23.2	21.3
Current expenditure	21.9	22.4	24.0	23.9	23.4	22.9	20.9
Wages and employer contributions	3.5	3.7	3.9	3.7	3.4	3.3	3.0
Other purchases of goods and services	3.4	4.5	4.6	4.9	4.1	4.0	3.8
Interest payments	0.0	0.1	0.1	0.1	0.2	0.2	0.2
Subsidies and other current transfers	15.0	14.2	15.4	15.1	15.8	15.4	13.9
Capital expenditure	0.8	0.8	0.7	0.5	0.4	0.4	0.3
Lending minus repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance excluding grants	-3.5	-5.6	-7.4	-8.2	-8.5	-8.5	-6.8
Overall balance	-0.6	-1.0	-0.2	-1.0	-0.6	-0.3	-0.2
Pension Fund							
Revenue and grants	12.2	11.4	13.2	12.4	13.4	13.1	11.8
Revenue	10.0	8.6	8.8	8.3	7.8	7.1	7.0
Current revenue	10.0	8.6	8.8	8.3	7.8	7.1	7.0
Tax revenue	9.9	8.5	8.7	8.2	7.8	7.0	6.9
Non-tax revenue	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Grants	2.1	2.8	4.4	4.1	5.6	6.0	4.8
Expenditure and net lending	12.6	12.0	13.3	12.9	14.0	13.7	12.3
Expenditure	12.6	12.0	13.3	12.9	14.0	13.7	12.3
Current expenditure	12.5	12.0	13.3	12.9	14.0	13.7	12.3
Wages and employer contributions	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other purchases of goods and services	0.3	0.2	0.3	0.2	0.4	0.4	0.4
Interest payments	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Subsidies and other current transfers	12.1	11.6	12.8	12.4	13.3	13.1	11.7
Capital expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lending minus repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance excluding grants	-2.3	-3.1	-4.5	-4.6	-6.1	-6.5	-5.2
Overall balance	-0.4	-0.6	-0.1	-0.5	-0.6	-0.6	-0.5
Health Fund							
Revenue and grants	7.5	8.3	8.9	8.6	7.6	7.7	7.2
Revenue	6.9	7.2	7.2	6.6	6.3	6.4	6.3
Current revenue	6.9	7.2	7.2	6.6	6.3	6.4	6.3
Tax revenue	6.8	7.1	7.0	6.5	6.1	6.2	6.1
Non-tax revenue	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Grants	0.6	1.1	1.7	2.0	1.3	1.3	0.9
Expenditure and net lending	7.6	8.8	8.9	9.1	7.5	7.3	6.9
Expenditure	7.6	8.8	8.9	9.1	7.5	7.3	6.9
Current expenditure	7.4	8.7	8.8	9.0	7.4	7.2	6.8
Wages and employer contributions	3.3	3.4	3.6	3.4	3.1	3.0	2.8
Other purchases of goods and services	2.6	3.8	3.7	4.1	3.1	3.0	2.9
Interest payments	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Subsidies and other current transfers	1.6	1.5	1.5	1.5	1.1	1.1	1.1
Capital expenditure	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Lending minus repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance excluding grants	-0.7	-1.6	-1.7	-2.5	-1.2	-0.9	-0.6
Overall balance	-0.1	-0.5	0.0	-0.5	0.1	0.5	0.3

Sources: Ministry of Finance and staff estimates

1/ Accrual basis

2/ Based on the Ministry of Finance three-years framework

Table 8. Croatia: Consolidated Central Government Expenditures
Compared with Other CEECs 1/
(Percentage of GDP)

	1994	1999 3/	1996-99 4/
Police and defense			
Croatia	4.5	7.3	8.5
CEE average 2/	3.1	2.9	3.4
Social Spending			
Croatia	20.5	29.0	26.1
CEE average 2/	19.6	17.8	20.7
Education			
Croatia	2.9	3.5	3.1
CEE average 2/	2.8	2.6	3.3
Health			
Croatia	5.3	7.0	6.6
CEE average 2,5/	3.3	2.9	4.1
Social Security and Welfare			
Croatia	12.2	18.5	16.3
CEE average 2/	13.5	12.4	13.3
Wages and salaries			
Croatia	9.7	11.6	10.8
CEE average 2/	3.9	3.5	4.5

Source: GFS and WEO databases.

1/ Cash basis.
2/ Central and Eastern European countries as in Figure 7.
for 1996-1999 average; excluding Romania and Slovak Republic
for 1994 and 1999.
3/ For Hungary, 1998.
4/ For Hungary, 1996-1998 with the exception of public wages
and salaries; for Romania, 1996-1997 only.
5/ Reduced expenditure in 1999 partly due to
decentralization in Poland.

Table 9. Croatia - Monetary Accounts, 1999-2003

(End-period; in millions of kuna unless otherwise stated)

	1999	2000	2001 q1 prog.	2001 q2 prog.	2001 q3 prog.	2001 q4 prog.	2002 proj.	2003 proj.	1999 7/ % change	2000 % change	2001 % change	2002 % change	2003 % change
Monetary Survey 1/													
Net Foreign Assets	16,695	29,109	29,501	27,748	37,812	34,210	36,051	39,683	31.3	74.4	17.5	5.4	10.1
Net Domestic Assets	40,004	42,592	41,300	44,833	41,343	48,476	55,063	60,309	-10.4	6.5	13.8	13.6	9.5
of which: domestic credit	65,939	70,340	70,478	74,293	76,068	79,643	87,108	94,737	-1.5	6.7	13.2	9.4	8.8
to government, net	10,063	11,994	10,407	9,645	11,718	11,996	11,315	6,209	41.1	19.2	0.0	-5.7	-45.1
to other domestic sectors 2/	55,876	58,346	60,070	64,648	64,350	67,647	75,793	88,528	-6.5	4.4	15.9	12.0	16.8
Broad Money	56,699	71,700	70,801	72,580	79,155	82,686	91,114	99,991	-1.1	26.5	15.3	10.2	9.7
Narrow Money	13,859	18,235	16,895	18,174	19,500	21,413	24,752	26,901	2.4	31.6	17.4	15.6	8.7
Currency outside banks	5,959	6,593	5,913	6,452	7,020	7,923	8,911	9,415	4.2	10.6	20.2	12.5	5.7
Demand deposits	7,900	11,642	10,982	11,722	12,480	13,490	15,841	17,485	1.1	47.4	15.9	17.4	10.4
Quasi Money	42,840	53,465	53,906	54,406	59,656	61,273	66,362	73,091	-2.2	24.8	14.6	8.3	10.1
denominated in kuna	5,874	7,986	8,163	8,354	9,347	9,881	11,597	13,573	0.6	36.0	23.7	17.4	17.0
denominated in foreign currency	36,966	45,479	45,743	46,053	50,309	51,392	54,764	59,518	-2.6	23.0	13.0	6.6	8.7
Balance Sheet of National Bank													
Net Usable Int. Reserves 3/	15,529	19,813	19,772	20,693	26,316	22,980	24,890	27,572	19.2	27.6	16.0	8.3	10.8
in US dollars	2,031	2,430	2,304	2,418	3,084	2,700	2,886	3,165	-2.6	19.6	11.2	6.9	9.7
Net Foreign Assets	21,464	27,116	27,455	28,357	33,956	30,600	32,613	35,374	33.1	26.3	12.8	6.6	8.5
in US dollars	2,807	3,325	3,200	3,313	3,979	3,596	3,781	4,060	8.7	18.5	8.1	5.2	7.4
of which: banks' foreign currency reserves	4,636	5,491	5,491	5,491	5,491	5,491	5,491	5,491	177.9	18.4	0.0	0.0	0.0
CNB bills in foreign currency	1,635	1,813	1,813	1,813	1,813	1,813	1,813	1,813	15.8	10.9	0.0	0.0	0.0
Net Domestic Assets 4/	-5,219	-8,096	-8,942	-9,043	-14,128	-10,384	-10,330	-11,748	69.8	55.1	28.3	-0.5	13.7
of which: claims on government (net)	-373	-1,146	-1,146	-1,146	-1,146	-1,146	-1,146	-1,146	-14.2	207.2	0.0	0.0	0.0
claims on banks	1,139	327	327	327	327	327	327	327	8.1	-71.3	0.0	0.0	0.0
claims on other domestic sectors	277	289	289	289	289	289	289	289	27843.9	4.5	0.0	0.0	0.0
less: CNB bills in kuna	1,252	2,395	2,247	2,346	7,240	3,766	3,766	3,766	50.8	91.2	57.3	0.0	0.0
blocked deposits 5/	381	315	315	315	315	315	315	315	219.4	-17.2	0.0	0.0	0.0
Reserve Money	10,310	11,717	10,830	11,650	12,187	12,596	14,560	15,824	3.6	13.6	7.5	15.6	8.7
Currency	6,341	7,169	6,489	7,028	7,596	8,499	9,487	9,991	6.2	13.1	18.6	11.6	5.3
Deposits	3,969	4,548	4,341	4,622	4,591	4,097	5,073	5,833	-0.4	14.6	-9.9	23.8	15.0
Memorandum items:													
National Bank NDA at program exchange rate 6/		-8,461	-8,264	-8,424	-13,659	-9,931							
Narrow money multiplier	1.34	1.56	1.56	1.56	1.60	1.70	1.70	1.70					
Velocity of Kuna broad money	7.23	5.98	6.41	6.20	5.81	5.47	5.11	4.98					
Foreign currency as a perc. of broad money	65.2	63.4	64.6	63.5	63.6	62.2	60.1	59.5					

Source: Croatian National Bank and staff projections

1/ Data from Q2 1999 onwards exclude the assets and liabilities of the banks declared bankrupt in April 1999. Changes in the statistical reporting system introduced a break in the data in July 1999.

2/ The planned repayment of domestic arrears amounts to Hrk 6.1 billion in 2000, Hrk 1.5 billion in 2001, 0.8 Hrk billion in 2002, and 0.6 Hrk billion in 2003. When taking arrears repayment into account, the overall rate of growth of credit to other domestic sectors would be 15.3 percent in 2000, 18.5 percent in 2001, 13.2 percent in 2002, and 17.6 percent in 2003.

3/ See the definition in Annex VII.

4/ See the definition in Annex VIII.

5/ Blocked and restricted deposits, excluding required reserves in foreign currency.

6/ The kuna/dollar program exchange rate is equal to 8.6675.

7/ Growth rates for 1999 are affected by changes in the statistical reporting system and by the bankruptcy of various banks in the course of the year. The latter caused a drop in broad money of nearly 5 billion Kuna and a fall in domestic credit of roughly 5.4 billion. After adjusting for all these factors, estimates of the 1999 growth rate are 9.4 percent for broad money and -0.8 percent for credit to other domestic sectors.

Table 10. Croatia: Schedule of Purchases Under the Proposed Stand-By Arrangement

Date	Amount of Purchase 1/ In millions of SDRs	Amount of Purchase 1/ In percent of quota	Conditions
March 2001	40.0	10.956	Board approval of stand-by arrangement.
May 2001	40.0	10.956	Observance of end-March 2001 performance criteria.
August 2001	40.0	10.956	Observance of end-June 2001 performance criteria and completion of first review.
November 2001	40.0	10.956	Observance of end-September 2001 performance criteria and completion of second review.
February 2002	40.0	10.956	Observance of end-December 2001 performance criteria.
Total 14-month SBA	**200.0**	**54.78**	

1/ Assuming maximum proposed access. The authorities plan to treat the arrangement as precautionary.

Table 11. Croatia: Status of Prior Actions as of March 1, 2001

Policy measure	Status	Legal mechanism
1. Treasury system		
a) Startup of treasury operations	Done	Government Decision on entrusting the execution of, and operational and IT support to, the Treasury System, National Gazette 66/99
b) Channel all but routine central budget expenditures through the treasury single account	Done	Directive on the Execution of the State Budget from the Treasury Single Account, National Gazette 04/01
2. Wage policy		
a) Finalize government strategy to effect the 10 percent wage bill cut in 2001	Done	Article 53 of 2001 Budget Execution Law
b) Announce that in 2001 the basic wage for the public administration and public services shall be retained at the same level as in 2000	Done	Government Decision No. 5030104-00-6 of December 22, 2000
c) Decree that wages of higher public officials shall, in 2001, be at the same level as in 2000.	Done	Decrees Nos. 5030109-00-5 and 5030105-00-12 of December 22, 2000
d) Announce that no vacation bonuses, Christmas bonuses, or children's benefits shall be paid in the public administration and public service in 2001	Done	Government Decision No. 5030104-00-6 of December 22, 2000
e) Announce that the government shall pass a decree on the value of coefficients for individual posts within new ranges to be established by the Laws on Public Administration and Public Service in 2001, terminating allowances granted by line ministries	Done	Government Decision No. 5030104-00-11 of December 22, 2000
f) Enact the Laws on Public Administration and Civil Service Employment by February 28, 2001	Both laws, now renamed Law on Public Administration and Law on Civil Servants and Employees, respectively, were submitted to parliament on March 1, 2001 for adoption under emergency procedures in the session starting on March 7.	Government Decision No. 5030115-01-3 of February 22, 2001
g) Announce freeze in basic wage for nonbudget public sector by February 28, 2001	Done	Government Decision No. 5030104-00-6 of December 22, 2000
h) Announce and start to negotiate freeze in basic wage for public enterprises	Done. Negotiations are ongoing.	Government Decision No. 5030105-00-9 of December 22, 2000
i) Government invitation for negotiations on Social Pact to be issued by end-February 2001	Done. Negotiations are ongoing.	---
3. Complete the payout of all insured deposits in failed banks	Done	Law on Authorization of the Deposit Insurance and Bank Rehabilitation Agency to Issue Bonds, National Gazette 117/00.
4. Repeal car import privileges for war veterans	An amendment to the Law on Croatian Veterans' Rights was submitted to parliament on March 1, 2001 for adoption under emergency procedures in the session starting on March 7.	Government Decision No. 5030115-01-3 of February 22, 2001

Source: Croatian authorities.

Table 12. Croatia: Selected Indicators of External Vulnerability,[1/] 1995-2000
(percent, unless otherwise indicated)

	1995	1996	1997	1998	1999	2000 Mar	2000 Jun	2000 Sep	2000 Dec	Latest estimate	Date
Economic indicators											
RPI inflation, yearly change (e.o.p.)	3.7	3.4	3.8	5.4	4.4	5.1	7.0	7.1	7.4	6.6	January
Real GDP growth rate, yoy	6.8	6.0	6.6	2.5	-0.4	*3.7*	*4.5*	*4.1*	*3.5*		
Central government debt in percent of GDP 2/	19.3	28.5	27.3	26.2	32.7	*35.9*	*32.3*	*31.7*	...		
domestic central government debt in percent of GDP 2/	18.0	16.0	12.6	10.9	11.8	*11.8*	*11.2*	*10.3*	...		
foreign central government debt in percent of GDP 2/	1.3	12.5	14.8	15.3	20.9	*24.2*	*21.1*	*21.3*	...		
Broad money (M4, percentage change, yoy)	39.3	49.1	38.3	13.0	-1.1	2.4	16.4	24.7	29.3		
Claims on other domestic sectors 3/ (change, yoy)	18.5	3.0	44.2	22.6	-7.0	-7.1	2.9	-0.4	9.0		
35-day CNB-bill yield, monthly average, percent	25.5	8.0	8.0	9.5	10.5	10.4	8.0	6.8	6.7		
35-day CNB-bill real yield 4/, percent	21.8	4.6	4.2	4.1	6.1	5.3	1.0	-0.3	-0.8		
External indicators											
Real effective exchange rate (using retail prices) 5/, 1995=100	100.0	...	103.3	102.4	109.5	111.1	108.3	108.3	...	*108.8*	November
Export of goods and service (percentage change in US$, yoy) 6/	-0.4	10.7	4.7	4.3	-5.3	*-0.4*	*6.8*	*11.2*	...		
Import of goods and service (percentage change in US$, yoy) 6	40.4	6.3	15.2	-6.5	-8.0	*-3.9*	*-0.6*	*1.8*	...		
Current account deficit (million US$, yoy)	1,442	1,091	2,325	1,530	1,523	*1,385*	*1,156*	*807*	...		
Current account deficit (yoy) in percent of GDP 2/	7.7	5.5	11.6	7.1	7.6	*7.7*	*6.1*	*3.9*	...		
Capital and financial account (yoy) in percent of GDP 2/	6.0	12.1	15.1	7.4	9.7	*6.2*	*3.7*	*-1.1*	...		
Gross official reserves (US$ millions)	1,895	2,314	2,539	2,816	3,025	2,925	3,237	3,379	3,525	3,394	January
Gross official reserves in percent of broad money (M4)	41	35	32	31	41	41	42	42	39		
Gross official reserves in percent of reserve money	149	146	155	177	224	259	254	245	245		
Gross official reserves in months of imports of goods and NFS	2.4	2.8	2.7	3.2	3.7	*3.6*	*4.0*	*4.2*	...		
Net international reserves (US$ million)	1,674	2,105	2,306	2,581	2,807	*2,721*	*3,059*	*3,169*	...		
Net international reserves in months of import of goods and NFS	2.2	2.6	2.4	2.9	3.4	*3.4*	*3.8*	*3.9*	...		
Short-term debt in percent of gross usable reserves 7/ 8/ 9/ 10/	31.6	40.7	45.6	75.1	77.3	*82.8*	*80.5*	*73.6*	...		
Short-term debt and current account deficit net of FDI in percent of gross usable reserves 10/	63.8	126.3	74.3	81.6	80.3	*108.2*	*87.4*	*64.5*	...		
Total external debt, percent of GDP 11/	20.8	23.2	31.9	40.3	44.5	*46.8*	*47.0*	*48.6*	...		
External debt service to export ratio	9.8	9.1	9.7	12.3	20.8	*23.2*	*18.0*	*13.2*	...		
Financial market indicators											
Stock market CROBEX index (1000 at July 1, 1997), e.o.p.	...	...	1,002	712	715	952	835	824	890	887	January
Zagreb Stock Exchange, capitalization, percent of GDP	...	15.3	21.6	13.3	13.5	*16.9*	*13.2*	*11.8*	*14.1*		
Memorandum items:											
Nominal GDP (US$ millions) 12/	18,811	19,872	20,109	21,628	20,063	*18,029*	*18,990*	*20,468*	...		
Nominal exchange rate (HrM/US$, e.o.p.)	5.32	5.54	6.30	6.25	7.65	8.08	8.05	8.53	8.16	8.38	January

Source: Croatian National Bank, Ministry of Finance, Central Bureau of Statistics, Bloomberg, MediaScan, and IMF staff estimates.

1/ Italics indicate preliminary figures or program data.

2/ Quarterly figures may be affected by the quarterly annualized GDP.

3/ Claims on domestic sector excluding central government and government funds.

4/ The 35-day CNB bill yield minus the annual percentage change in the retail prices.

5/ An increase in the index reflects a depreciation. Reported by the CNB (Table H10).

6/ In January 2000, a new methodology, in line with European standards, for processing data on imports and exports was adopted. The new presentation uses the date when the declaration was cleared rather than the date when the declaration was received.

7/ Data for short-term commercial bank credits derived from the CNB Foreign Exchange Department.

8/ Coverage limited to short-term debt contracts registered with the CNB.

9/ Short-term debt is presented on a remaining maturity basis.

10/ Gross reserves adjusted downward by foreign currency redeposit requirements held at the CNB, and by the amount of outstanding foreign currency CNB bills.

11/ Does not include debt that was excluded from the London Club agreement.

12/ Using the average exchange rate for the period.

Table 13. Croatia: Selected Indicators of Financial Sector Vulnerability,[1/] 1995-2000
(percent, unless otherwise indicated)

	1995	1996	1997	1998	1999	2000 Mar	2000 Jun	2000 Sep	2000 Dec	Latest estimate	Date
Solvency indicators											
Risk-weighted capital adequacy ratio 2/	18.2	17.7	16.4	12.7	20.6	20.2	22.1	21.4	...		
Leverage ratio (tier I capital in percent of total liabilities)	...	13.4	12.0	9.6	11.3	11.0	12.1	11.1	...		
Liquidity indicators 3/											
Loan to deposit ratio 4/	129.6	92.6	98.0	107.0	102.5	99.4	94.0	86.3	85.1		
Banks' reserves in percent of deposits 5/	16.0	13.7	11.1	8.2	8.6	7.8	7.9	8.7	7.7		
cash in vaults 5/	0.6	0.5	0.5	0.5	0.8	0.6	0.6	0.5	0.8		
reserves held with the CNB 5/	15.4	13.2	10.6	7.7	7.9	7.2	7.2	8.2	6.9		
of which required reserves 5/	10.6	10.4	8.7	6.8	7.4	6.9	6.5	7.6	6.2		
CNB bills on a voluntary basis in percent of deposits 5/	1.0	2.4	1.6	4.3	5.7	5.0	6.8	6.9	6.4		
Primary liquidity ratio 6/	0.63	2.63	2.92	1.65	1.30	0.68	2.06	1.37	3.32		
Money market interest rate (weighted averages, daily)	27.2	10.4	9.4	15.8	12.7	12.6	8.9	5.6	4.5		
Credit risk indicators 7/											
Total assets (change, yoy)	14.7	7.7	26.4	9.4	-0.1	0.8	8.1	10.2	17.9		
Claims on other domestic sectors (change, yoy) 8/	18.5	3.0	44.2	22.6	-7.0	-7.1	2.9	-0.4	9.0		
Loans and advances to the domestic private sector (change, yoy)	23.5	9.0	48.8	23.9	-6.4	-6.2	5.4	0.4	9.0		
Nonperforming loans (in percent of total loans) 9/	7.6	7.7	5.9	9.3	10.3	9.8	10.5	9.8	...		
Specific provisions for identified losses (HrK millions) 10/	5.5	5.3	4.5	7.0	8.7	8.6	9.0	8.7	...		
Specific provisions in percent of total assets 10/	7.9	6.5	4.4	6.1	8.1	7.7	8.0	7.4	...		
Foreign exchange risk indicators											
Net open position in foreign exchange 11/	...	...	...	...	34	17	23	26	26		
Net foreign assets in percent of total assets	-9.3	0.1	2.8	-3.7	-5.1	-1.1	-2.5	1.7	2.0		
Profitability indicators											
Reported return in percent of assets	0.3	0.8	1.3	-3.1	0.8	...	...	...	...		
Spread between lending and deposit rates, kuna 12/	16.2	14.3	9.7	12.0	9.3	8.8	9.9	7.3	7.1		
in kuna indexed to foreign exchange 12/	6.9	9.5	6.8	5.6	5.9	5.4	4.9	5.0	5.2		
in foreign exchange 12/	11.2	14.2	8.8	3.0	2.7	3.2	3.5	3.3	4.0		
Market's assessment of banks											
Share prices of selected banks 13/	...	...	...	...	493	787	809	775	865	845	January
Deposits of private sector with banks (change, yoy) 5/	42.8	52.5	40.6	13.6	-2.3	1.9	17.0	26.2	*31.2*		
Intermediation indicators											
Assets in percent of GDP	63.7	62.5	68.9	67.8	65.3	...	...	...	*70.1*		
Loans and advances to other domestic sectors in percent of GDP	27.8	27.6	35.9	40.0	36.1	...	...	...	*35.8*		
Broad money (M4) in percent of GDP	25.0	34.0	41.0	41.7	39.7	...	...	...	*46.7*		

Source: Croatian National Bank; and IMF staff estimates.

1/ Covers deposit-taking commercial banks. Figures in italics are preliminary.

2/ The significant increase from 1998 to 1999 should be seen in context with the fact that a relatively large number of banks reported negative capital in 1998. Furthermore, the regulation was amended so large loans no longer are assigned risk-weights of 200 and 300 percent, but only 100 percent.

3/ Credits with remaining maturity of 12 months or less increased from 46.1 percent of total credits at end-1999 to 51.3 percent at end-June 2000, while deposits and borrowings, including tier II capital, with a remaining maturity of 12 months or less increased from 55.7 percent at end-1999 to 61.5 percent at end-June 2000.

4/ Loans and advances to domestic sector excluding claims on central government and its funds, in percent of demand, savings, time, and foreign currency deposits of residents, excluding central government and its funds.

5/ Deposits here include demand, savings, time, and foreign currency deposits of residents, but excluding central government and its funds.

6/ The primary liquidity ratio is the percentage of monthly day-to-day free reserves averages on monthly day-to-day averages of deposits which constitute the reserve base.

7/ Information on credit to land and real estate and credit collateralized by land and real estate is not collected regularly.

8/ Claims on domestic sector excluding central government and government funds.

9/ Nonperforming loans include loans classified in categories C-E.

10/ In addition to specific provisions, banks are required to make general provisions of, at minimum, 1 percent of their assets in category A.

11/ The net open position in foreign exchange is currently limited to 25 percent of risk-based capital, but banks subject to the Law on Converting Household Foreign Exchange Deposits into public debt are exempt.

12/ Weighted averages of monthly interest rates. A change of the maturity structure may thus affect the spread.

13/ Simple average of the share prices of Dalmatinska Banka and Zagrebačka Banka. Both banks were included under Quotation I at the Zagreb Stock Exchange until January 2, 2001 when Dalmatinska Banka was moved to Quotation TN.

Table 14. Croatia: Projected Payments to the Fund as at December 31, 2000
(in millions of SDRs)

	Overdue	2001	2002	2003	2004	2005	2006	2007	Beyond	Total
Obligations from existing drawings										
1. Principal										
a. Repurchases	0	24.2	26.6	26.6	26.6	10.2	4.8	2.4	0	121.4
b. PRGF/SAF Repayments	0	0	0	0	0	0	0	0	0	0
2. Charges and Interest 1/										
a. on Fund credit	0	6.1	4.6	3.3	1.9	0.7	0.3	0	0	16.8
b. on use of SDRs	0	-0.5	0	0	0	0	0	0	0	-0.5
Total obligations 2/	0	29.7	31.2	29.9	28.5	10.9	5.1	2.5	0	137.8
(percent of quota)	0	8.1	8.6	8.2	7.8	3	1.4	0.7	0	37.7
Obligations from prospective drawings										
1. Principal										
a. Repurchases	0	0	0	0	30	95	70	5	0	200
b. PRGF/SAF Repayments	0	0	0	0	0	0	0	0	0	0
2. Charges and Interest 1/										
a. on Fund credit	0	3.3	9.8	10.4	10.3	7.5	2.6	0.1	0	44
b. on use of SDRs	0	0	0	0	0	0	0	0	0	0
Total obligations 2/	0	3.3	9.8	10.4	40.3	102.5	72.6	5.1	0	244
(percent of quota)	0	0.9	2.7	2.9	11	28.1	19.9	1.4	0	66.8
Cumulative (existing and prospective)										
1. Principal										
a. Repurchases	0	24.2	26.6	26.6	56.6	105.2	74.8	7.4	0	321.4
b. PRGF/SAF Repayments	0	0	0	0	0	0	0	0	0	0
2. Charges and Interest 1/										
a. on Fund credit	0	9.3	14.4	13.7	12.2	8.2	2.9	0.2	0	60.9
b. on use of SDRs	0	-0.5	0	0	0	0	0	0	0	-0.5
Total obligations 2/	0	33	41	40.3	68.8	113.4	77.7	7.6	0	381.8
(percent of quota)	0	9	11.2	11	18.8	31.1	21.3	2.1	0	104.6

1/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, PRGF, and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.
2/ Overdue obligations (if applicable) will be settled in full at close of business January 01, 2001.

Prepared by Treasurer's Department

Table 15. Croatia: Indicators of Capacity to Repay the Fund, 2000-2007

	2000	2001	2002	2003	2004	2005	2006	2007
	Prel.	Projections 1/						
Fund repurchases and charges 2/								
In millions of SDRs	28.1	33.0	41.0	40.3	68.8	113.4	77.7	7.6
In millions of US dollars	37.1	43.1	53.7	52.8	90.3	149.0	102.0	9.9
In percent of exports of goods and NFS	0.4	0.5	0.5	0.5	0.8	1.2	0.8	0.1
In percent of debt service	2.3	2.4	2.9	3.3	4.7	6.8	3.3	0.4
In percent of quota	7.7	9.0	11.2	11.0	18.8	31.1	21.3	2.1
In percent of gross official reserves	1.1	1.1	1.4	1.3	2.3	3.7	3.0	0.3
Fund credit outstanding 2/								
In millions of SDRs	121.4	257.2	270.6	244.0	187.4	82.2	7.4	0.0
In millions of US dollars	160.1	336.1	354.4	320.0	246.1	107.9	9.7	0.0
In percent of quota	33.3	70.5	74.1	66.8	51.3	22.5	2.0	0.0
In percent of GDP	0.8	1.7	1.6	1.4	1.0	0.4	0.0	0.0
In percent of gross official reserves	4.7	8.7	9.2	7.9	6.2	2.7	0.3	0.0
Memorandum items								
Exports of goods and NFS (millions of US dollars)	8,635	9,307	9,879	10,538	11,249	11,995	12,786	13,631
Debt service (millions of US dollars) 2/	-1,587	-1,788	-1,829	-1,583	-1,940	-2,190	-3,124	-2,629
Quota (millions of SDRs)	365	365	365	365	365	365	365	365
Quota (millions of US dollars)	481	477	478	479	479	479	479	479
Gross official reserves (millions of US dollars) 2/	3,423	3,872	3,865	4,057	3,968	3,990	3,398	3,445
GDP (millions of US dollars)	18,908	20,046	21,523	23,156	25,012	27,017	29,367	31,922
US dollars per SDR 3/	1.319	1.307	1.310	1.311	1.313	1.313	1.313	1.313

Source: Croatian National Bank; WEO; and staff estimates

1/ As of December 31, 2000

2/ Including the hypothetical purchases under the proposed precautionary stand-by arrangement, not shown in balance of payments projections (Table 4).

3/ For the projection period: WEO assumptions of January 2001

CROATIA—STAND-BY ARRANGEMENT

Attached hereto is a letter, with an annexed table and technical memorandum of understanding, dated January 31, 2001, from the Deputy Prime Minister, the Minister of Finance and the Governor of the Croatian National Bank requesting a stand-by arrangement and setting forth:

(a) the objectives and policies that the authorities of Croatia intend to pursue for the period of this stand-by arrangement;

(b) understandings of Croatia with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Croatia will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. From the period from March 19, 2001 to May 18, 2002 Croatia will have the right to make purchases from the Fund in an amount equivalent to SDR 200 million, subject to paragraphs 2, 3, 4 and 5 below, without further review by the Fund.

2. (a) Purchases under this stand by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 40 million until May 15, 2001, the equivalent of SDR 80 million until August 15, 2001, the equivalent of SDR 120 million until November 15, 2001, and the equivalent of SDR 160 million until February 15, 2002.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Croatia's currency subject to repurchase beyond 25 percent of quota.

3. Croatia will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Croatia's currency subject to repurchase beyond 25 percent of quota:

(a) during any period in which the data at the end of the preceding period indicate that

(i) the limit on the cumulative deficit of the Consolidated Central Government, or

(ii) the limit on the cumulative increase in the net credit of the banking system to the Consolidated Central Government, or

(iii) the limit on the arrears of the Consolidated Central Government, or

(iv) the limit on the cumulative increase in the net credit of the banking system to selected public enterprises, or

(v) the limit on the stock of short-term external debt of the public sector, or

(vi) the limit on the contracting or guaranteeing of new nonconcessional external public debt with an original maturity of more than one year by the public sector, or

(vii) the limit on the contracting or guaranteeing of new nonconcessional external public debt with an original maturity of more than one year and less than five years by the public sector, or

(viii) the target for the cumulative increases in the net usable international reserves of the Croatian National Bank , or

(ix) the limit on the cumulative increase in the net domestic assets of the Croatian National Bank,

specified in Annexes IV, V, VI, VII, and VIII to the memorandum of economic and financial policies annexed to the attached letter dated January 31, 2001 is not observed; or

(b) after March 31, 2001, if Croatia has failed to enact a government decree on salary coefficients for individual posts across government ministries, as specified in Annexes III and IX to the memorandum of economic and financial policies annexed to the attached letter dated January 31, 2001; or

(c) after March 31, 2001, if Croatia has failed to issue decrees determining each Ministry's wage bill on the basis of the new salary coefficients and total number of employees, as specified in Annexes III and IX to the memorandum of economic and financial policies annexed to the attached letter dated January 31, 2001; or

(d) after December 31, 2001, if Croatia fails to reduce employment in the budgetary sphere by 10,000 employees, as specified in Annexes III and IX to the memorandum of economic and financial policies annexed to the attached letter dated January 31, 20001; or

(e) if at any time during the period of the stand-by arrangement Croatia incurs any external payments arrears as specified in paragraph 35 of the memorandum of economic and financial policies annexed to the attached letter dated January 31, 2001; or

(f) after August 14, 2001, and November 14, 2001 until the reviews contemplated in paragraph 3 of the attached letter dated January 31, 2001 are completed, or

(g) if at any time during the period of the stand-by arrangement, Croatia

(i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Croatia is prevented from purchasing under this stand-by arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Croatia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Croatia will not make purchases under this stand-by arrangement during any period in which Croatia (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation (a) in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, or (b) in respect of a purchase in support of debt and debt service reduction operations pursuant to Decision No. 9331-(89/167), or (c) pursuant to the Decision on the Compensatory Financing Facility, or (d) in respect of a purchase under Decision No. 11627-(97/123) SRF on the Supplemental Reserve Facility and Contingent Credit Lines, or (e) pursuant to paragraph 1(b) of Decision No. 5703-(78/39) or paragraph 10(a) of decision No. 4377-(74/114); or (ii) is failing to meet a repayment obligation to the PRGF Trust established by Decision No. 8759-(87/176) PRGF, or a repayment expectation to that Trust pursuant to the provisions of Appendix I to the PRGF Trust Instrument.

5. Croatia's right to engage in transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally

or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or limit the eligibility of Croatia. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Croatia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Croatia, the Fund agrees to provide SDRs at the time of the purchase.

7. Croatia shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

8. (a) Croatia shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Croatia's balance of payments and reserve position improves.

(b) Any reductions in Croatia's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of reduction.

9. During the period of the stand-by arrangement Croatia shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Croatia or of representatives of Croatia to the Fund. Croatia shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Croatia in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

10. In accordance with paragraph 3 of the attached letter, Croatia will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Croatia has outstanding purchases in the upper credit tranches, the government will consult with the Fund from time to time, at the initiative of the government or at the request of the Managing Director, concerning Croatia's balance of payments policies.

CROATIA—RELATIONS WITH THE FUND
(As of December 31, 2000)

I. Membership Status: Joined 12/14/92; Article VIII as of 5/29/95.

II. **General Resources Account:**	SDR million	% Quota
Quota	365.10	100.0
Fund holdings of currency	486.37	133.2
Reserve position in Fund	0.16	0.0

III. **SDR Department:**	SDR million	% Allocation
Net cumulative allocation	44.21	100.0
Holdings	113.01	255.6

IV. **Outstanding Purchases and Loans:**	SDR million	% Quota
Extended arrangements	28.78	7.9
Systemic Transformation Facility	92.65	25.4

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
EFF	3/12/1997	3/11/2000	353.16	28.78
Stand-by	10/14/1994	4/13/1996	65.40	13.08

VI. Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	12/31/2000	2001	2002	2003	2004	2005
Principal	--	24.2	26.6	26.6	26.6	10.2
Charges/Interest	--	6.1	4.6	3.3	1.9	0.7
Total	--	30.3	31.2	29.9	28.5	10.9

VII. Exchange Rate Arrangement:

In December 1991, Croatia left the Yugoslav dinar area and adopted the Croatian dinar as sole legal tender. The Croatian dinar was replaced by the Croatian kuna on May 30, 1994. The exchange rate of the kuna is determined by supply and demand in the interbank market, with occasional participation of the Croatian National Bank. The authorities' exchange rate policy regarding the Croatian kuna is accordingly classified as "managed floating with no pre-announced path for the exchange rate". The Croatian National Bank transacts only in euros, U.S. dollars, and SDRs. On January 31, 2001, the official exchange rate was kuna 8.376866 per U.S. dollar (middle rate).

VIII. Article IV Consultation and Recent Use of Fund Resources

Croatia is on a 12-month consultation cycle. The last **Article IV consultation** with Croatia was concluded on January 7, 2000 (SM/99/299, 12/20/99 and SM/99/301, 12/22/99, both published). Noting the daunting challenges posed by an insufficiently flexible domestic economy and a still unsustainable external imbalance, Executive Directors called for durable expenditure cuts to balance the budget and make room for a reduction of nonwage labor costs. Directors urged reforms to balance the pension and health funds, and wage restraint and further structural reform to maintain competitiveness under the chosen exchange rate arrangement.

A three-year **extended arrangement** in an amount equivalent to SDR 353.16 million (135 percent of quota) was approved on March 12, 1997, and a first purchase of SDR 28.78 million was made at that time. The first review was completed on a lapse-of-time basis on October 10, 1997, but the authorities decided not to draw on the resources then made available. Discussions on the second and third reviews did not take place and further performance criteria were not set. The arrangement expired without further purchases on March 11, 2000.

Discussions in May 1999 failed to reach agreement on a **stand-by arrangement** to help finance a prospective balance of payments gap in the wake of the Kosovo crisis. The principal areas of disagreement were wage policy—where the staff was asking the authorities to rescind previously agreed government sector wage increases—and privatization policy—where the staff urged the sale of a larger share of state enterprises in order to finance the fiscal cost of resolving a banking crisis.

IX. Technical Assistance 1992–2000

Department	Timing	Purpose
FAD	November 1992	Tax Policy and Administration
	May 1993	VAT and Tax Administration
	November 1993	Public Expenditure Management
	March 1994	Treasury Establishment
	August 1994	Budget Preparation Mission
	November 1994	Follow up Mission on Treasury Establishment
	March 1995	Treasury Management Seminar
	August 1995	Treasury implementation
	Nov.–Dec.1995	Treasury implementation
	June-July 1997	Impact of VAT
	April 2000	Implementation of Single Treasury Account
	May 2000	Tax Policy
STA	December 1992	Multi-topic mission
	October 1993	Monetary Statistics

	November 1993	Government Finance Statistics
	April 1994	Money and Banking Statistics
	July 1994	National Accounts
	November 1994	Balance of Payments
	January 1995	Money and Banking Statistics (together with EU1 mission)
	February 1996	BOP mission
	September 1996	National Accounts
	January 1998	Balance of Payments
	January 1998	Data Dissemination Standard
	February 1998	Quarterly National Accounts
	September 1998	Quarterly National Accounts
	November 1998	Quarterly National Accounts
	January 1999	Quarterly National Accounts
	February 1999	Balance of Payments
	June 1999	Quarterly National Accounts
	July 1999	Producer Price Indices
	March 2000	Quarterly National Accounts
	September 2000	Balance of Payments
	October 2000	Quarterly National Accounts
MAE	December 1992	Bank Supervision
	October 1993	Monetary Instruments; Exchange Market
	January 1994	Monetary Operations and Banking Supervision; Exchange Market
	May 1994	Payments System, Monetary Operations, Foreign Exchange, Banking Supervision, and Accounting
	Aug. 1994–Aug. 1995	Monetary Operations (9 expert visits)
	October 1994	Monetary Operations Review
	December 1994	Payments system
	Jan.–Feb. 1995	Monetary Operations, Organization and Management, and Foreign Reserve Management
	Feb.–Dec. 1995	Payments System (4 expert visits)
	Aug. 1995–Apr. 1996	Monetary Operations (5 expert visits)
	September 1995	Foreign Exchange Management
	November 1995	Foreign Exchange, Public Debt, Monetary Policy
	September 1996	Interbank and Government Securities Markets, Internal Audit, Foreign Reserve Management
	October 1996	Foreign Exchange Management
	November 1996	Payments System
	March 1997	Foreign Exchange Management (expert visit)
	April 1997	Banking Law Issues (staff visit with LEG)
	April 1997–Feb. 1998	Accounting (6 expert visits)
	July 1997	Banking Sector Strategy (staff visit)
	September 1997	Banking Sector Strategy and Banking Law Issues

	Sept.–Nov. 1997	Information Technology (2 expert visits)
	Mar. 1998–Mar. 1999	Accounting (resident advisor)
	Apr. 1998–Aug. 1999	Banking Supervision (resident advisor)
	April–June 1998	Foreign Exchange Management (2 expert visits)
	May 1998	Banking Law Issues (2 staff visits)
	August 1998	Banking Soundness and Banking Law Issues
	November 1998	Banking Supervision (with WB mission)
	March–Dec. 1999	Banking Supervision (resident advisor)
	April 1999	Foreign Exchange Operations and Reserves (two expert visits)
	November 1999	Accounting
	May-June 2000	Coordination between CNB and the Ministry of Finance, Central Bank Law, Banking Law, and Money and Securities Markets
INS	1993–97	Fiscal Policy Management (7 participants)
	1993–99	Monetary and Banking Statistics (6)
	1994	Basic Economics (1)
	1994	Tax Policy Administration (1)
	1994–95	Public Expenditure Policy and Management (2)
	1994–96	Government Finance Statistics (5)
	1994–96	External Sector Policies (3)
	1994–97	Comprehensive Course in Applied Market Economics (7)
	1994–98	Central Bank Accounting (5)
	1994–99	Foreign Exchange Policies and Operations (5)
	1995	Public Finance (1)
	1995	Tax Policy in Transition Economies (1)
	1995	Value Added Tax (1)
	1995–97	Financial Market Instruments (2)
	1995–97	Financial Programming Policy (2)
	1995–98	Banking Supervision (2)
	1995–98	Techniques of Financial Analysis and Programming (4)
	1995–99	Balance of Payments (3)
	1995–99	Macroeconomic Analysis and Policy (9)
	1995–99	Public Expenditure and Treasury Management (7)
	1996	Financial Transactions for Lawyers (1)
	1996–97	Tax Administration and Reform (2)
	1997	Payment System (1)
	1997	Banking Soundness and Monetary Policy in World of Global(1)
	1997–98	Monetary Operations (2)
	1998	Current Legal Issues Affecting Central Banks (1)
	1998	Monetary and Exchange Operations (1)
	1998	Specialized Course on Exchange Rate Policies (1)

1998	Trade and Exchange Rate Policies (1)
1999	A Decade of Transition: Achievements and Challenges (1)
1999	Management and Operational Issues for Central Bank Accountant (1)

X. Resident Representative

Mr. Norregaard took up his post in Zagreb on January 15, 2001, replacing Mr. O'Callaghan.

CROATIA: RELATIONS WITH THE WORLD BANK

1. Croatia succeeded to the membership of the Socialist Federal Republic of Yugoslavia (SFRY) in the World Bank in 1993. Croatia is current on its debt service payments in accordance with an agreement on debt apportionment reached with the Bank whereby Croatia assumed debt service responsibility for Bank loans benefiting borrowers on its territory.

2. Currently, there are twelve Bank loan projects (11 investment projects and 1 adjustment operation) totaling US$594.1 million under implementation in Croatia: The Highway Sector Project (US$80 million) became effective in July 1997 and a Farmer Support Service Project (US$17 million) in July 1996. An Emergency Transport and Mine - Cleaning Project (US$102 million) became effective in March 1997, a Coastal Forest Reconstruction and Protection Project (US$42 million) in July 1997, and an Enterprise and Financial Sector Adjustment Loan (EFSAL) (US$95 million) in November of the same year. Furthermore, an Investment Recovery Project (US$30 million) became effective in March 1998 and the Eastern Slavonia Reconstruction Project (US$40.6 million) in January 1999. The Municipal Environmental Infrastructure Project (US$36.3 million) was approved in June 1998, the Railway Modernization and Restructuring Project (US$ 101 million) in January 1999, a Technical Assistance Loan II (US$7.3 million) in April 1999 and the Health System Project (US$29 million) in October 1999 and a Trade and Transport Facilitation in Southeast Europe project (US$13.9 million) in September 2000.

3. Projects under preparation include: a Bankruptcy and Court Administration Project, a Pension Reform Implementation Project, a GEF Project, a District Heating Project, a Social Assistance Project, a Land Registry/Cadastre Project, Rijeka Port Project, a Legal/Judicial Reform Project, and a Municipal Water Pollution Control Project.

4. The essential preconditions for economic growth require adequate fiscal/macro policies and structural reforms, including reduction of the public sector deficit and the size of the state, sustainable pension and health sector reforms, safeguarding confidence in the banking system and efficient resource allocation, enhancing enterprise efficiency, market competition and investment, and mitigation of the social dimension of reforms, including fighting poverty. The absence of solid progress in structural reforms would not only delay the recovery of growth, but also jeopardize Croatia's favorable access to international markets. Upon request of the new Croatian Government a Public Expenditure Review is now in progress and a Structural Adjustment Loan (SAL), envisaged in the 1999 CAS, is in preparation. Processing a SAL will be conditional upon satisfactory progress in the areas of policy reforms mentioned above. Beyond the EFSAL and a possible SAL, the Bank is ready to provide lending and non-lending assistance in support of Croatia's accelerated accession process with the EU.

5. After recent further consultations on the design of the proposed SAL and the Government's overall strategy, the Bank will prepare a Progress Report on the 1999 CAS, which is expected to be submitted for Board discussion in early FY 02.

6. IFC has approved nine investments in Croatia to date: (1) the acquisition of a US$2.6 million equity stake in a Croatian bank; (2) a US$13.3 million loan to a cement company; (3) a US$4 million loan to a small regional bank based in Split, for the financing of small and medium-sized enterprises; (4) a US$6.2 million equity investment in and a US$14.1 loan to a paper mill plant, aimed at rebuilding and modernizing the facility; (5) a US$5.0 million equity investment in a venture capital fund; (6) a US$15 million loan to a regional bank for a credit line for onlending to small and medium-sized enterprises; (7) a US$3 million equity investment in a pension management company to be founded under Croatia's landmark pension reform law; (8) a US$6 million loan and US$6.1 million equity investment to modernize a ship repairing facility in Rijeka; and (9) a US$25 million loan to and a US$10 million quasi-equity investment in pharmaceutical company, for the construction and outfitting of a new research and development facility in Zagreb. IFC is seeking to expand its activities in Croatia. It is targeting projects in the manufacturing and financial sectors, the support of small and medium-sized private enterprises, and the rehabilitation and modernization of the tourism sector.

CROATIA: STATISTICAL ISSUES

1. The economic database in Croatia is of mixed, though improving, quality. Data on monetary aggregates have the least problems and are close to Fund standards. In other areas, deficiencies and delays in data release impact the reliability and timeliness of macroeconomic analysis. In most cases, however, remedial action has been taken to improve data quality, coverage and reliability, but in some instances progress has been impeded by insufficient budgetary support and lack of cooperation between government agencies. The recent creation of a joint committee between the Ministry of Finance and the Croatian National Bank (CNB) should promote collaboration in the statistical area to advance the reconciliation of government finance and monetary data.

A. National Accounts

2. National accounts data systems have undergone substantial improvement in the last two years, enabling publication of a broader, and more comprehensive, set of national accounts data. The Central Bureau of Statistics (CBS) compiles and publishes annual constant and current price data according to the production, income, and expenditure approaches. On June 30, 1999, the CBS began publishing quarterly GDP data by expenditure and main industry groupings at current and constant (1997) prices, thus meeting the SDDS target date. Nonetheless, shortcomings remain which limit the coverage and impair the reliability of the estimates. These include: a lack of quarterly source data for the seasonally volatile agricultural sector; incomplete coverage of the informal sector; inadequate conversion of government finance statistics from a cash to an accrual basis; insufficient access to preliminary or unpublished source data; inadequate source data for measuring changes in inventories; inadequate price deflators; and incomplete coverage of unincorporated businesses and the self employed (farmers, trade and crafts). It has yet to be decided how to ensure the continued availability of enterprise financial statistics when ZAP, the payments system agency that currently collects them, will be phased out as planned.

B. Prices

3. The CBS produces monthly indices of retail and producer prices, and a monthly cost of living index based on the consumption basket of a typical low-income, non-farm household. Data are collected around the 20th day of each month, and the indices are released on the last working day of the month. However, the price statistics are calculated using outdated weights on the basis of a small sample of observations. No import or export price deflators are produced, thereby hindering analysis of external sector developments.

C. Wages and Employment

4. Croatia produces data on average net and gross earnings per person in paid employment by industrial sector, and employment by industrial sector. Earnings data include bonuses, sick pay, and meal allowances, and are based on monthly surveys covering

70 percent of workers in permanent employment in each industrial category. It does not cover a significant part of the working population, including persons employed in trade and crafts, contract workers, farmers, and military and police workers.

5. The number of registered unemployed overstates the actual level of unemployment. A preliminary Labor Force Survey, which meets ILO standards, was conducted for the first time in 1996 on 7,200 households. The sample was subsequently expanded and the survey is now being conducted on a regular basis with semi-annual results, released only after a delay of about seven months. The most recent available data, relating to the first half of 2000, show the unemployment rate at 15.1 percent, against a level of 21.2 percent indicated by the administrative resources.

D. Fiscal Data

6. A large amount of data on government finance statistics is produced on a monthly basis with lags of between three and twelve weeks, and is available in the Monthly Statistical Review of the Ministry of Finance or provided directly to the Fund. The Ministry of Finance reports monthly GFS data for publication in *IFS* and annual data for the *GFS Yearbook*. Timeliness has generally been insufficient for SDDS observance, but the authorities have recently committed to improve the situation and reach full compliance by end-February 2001. Revenue data on a GFS basis are reliable and available on request on a next-day basis for most major categories for both the budget and the extrabudgetary funds. In 2000, the inclusion of outstanding receivables cancelled against arrears in off-setting operations diminished the transparency of the central budget accounts. Expenditure data on a cash basis are available according to GFS methodology (economic and functional classification) with extensive disaggregation for the budget and the extrabudgetary funds. These data, however, record the release of expenditure authorizations by the Ministry of Finance, rather then the actual expenditure of funds. Data on financing by non-cash methods and budget users' "own revenues" are not published, but the authorities have provided information to the staff more readily than in the past. The data on central government financing in the Ministry of Finance reports, the monetary survey and the balance of payments are not reconciled. The reliability of fiscal statistics is expected to improve considerably under a single treasury system that started operating in January 2001.

7. Data on the stock of government debt suffer from certain deficiencies although a new CNB database represents a major improvement. The detailed data on domestic public bonds published in the Monthly Statistical Review of the Ministry of Finance are now complemented by a central government debt table in the CNB Bulletin. The authorities have recently started to disseminate data on domestic debt guaranteed by the central government. However, data on expenditure arrears (formally recorded for the first time at the end of 1999), promissory notes and local governments are not included. Revisions are frequent and often reported to the CNB database with a delay.

8. Data on the operations of local governments and the consolidated general government are available only on an annual basis and with a considerable lag. In order to ensure SDDS observance, the authorities are availing themselves of a flexibility option in this respect.

E. Monetary Data

9. Data on the monetary survey and the balance sheet of the CNB and deposit money banks are published monthly with an approximate six-week lag. Key CNB data such as currency in circulation, reserve deposits, and international reserves are available on request with a one-day lag. A new statistical reporting system which enables banks to report in a single set of forms their balance sheets, reserve requirements, interest rates, etc., was introduced on July 1, 1999, together with a new chart of accounts. The authorities have recently started to disseminate data on interest rates on long-term government securities. No attempt is made by the CNB or the Ministry of Finance to reconcile the data on net bank credit to government with government financing statistics.

F. Banking Statistics

10. Banks' lending and deposit rates are published monthly in the CNB Monthly Bulletin. Banks' annual financial statements tend to understate the riskiness of their assets by misclassifying loans to certain sectors and by booking "big bonds" (government bonds issued to clear outstanding enterprise debt) and other assets at face value even though some of these assets trade at a large discount. This produces a misleading picture of the quality of bank assets, leading to underprovisioning of bad assets and overstatement of capital adequacy ratios.

G. Balance of Payments Data

11. Balance of payments data are compiled on a quarterly basis according to the fifth edition of the IMF's Balance of Payments Manual, and published by the CNB making use of information from commercial banks, the CNB, and the Ministry of Finance, among other entities. The data are generally available with a lag of two to three months; however, trade data are available with a lag of four to six weeks and data on international reserves of the CNB are available the next day by request. In January 1998 a major revision of balance of payments statistics took place which led to the valuation of imports on an f.o.b. basis and the inclusion of goods imported into free trade zones. The new surveys introduced in 1999 on transportation, travel, government services, and labor income have only been partially successful. The quality of data, particularly on travel, is still questionable. Improvements are also needed in the compilation of data on communication, insurance, and construction services. In 1999 and 2000, the CNB has increased the coverage of direct investment by identifying additional enterprises. The coverage and quality of portfolio investment data are reasonably complete and accurate.

12. The CNB regularly publishes annual data on Croatia's international investment position (IIP), and the compilation of 2000 data is in progress. The CNB plans to start with the compilation of quarterly IIP data form the first quarter of 2001.

13. The coverage of external debt data improved in 1999 with the publication of information on external debt by debtor. A large part of Croatia's external debt was contracted prior to the dissolution of the former SFRY and Croatia's share was agreed with Paris and London Club creditors in 1995 and 1998, respectively. This information has further improved in 2000 with the introduction of the new CNB database. Foreign debt statistics are available on request on the same day, but certain breakdowns (e.g., external public and publicly guaranteed debt by creditor), loans received by the resident household sector, and credits received with a maturity of less than 90 days are not covered in the standard reports. Also, there is still a problem of identifying payments arrears.

H. Special Data Dissemination Standard

14. Croatia has subscribed to the SDDS and its metadata are posted on the Fund's Data Standards Bulletin Board (DSBB). With the planned provision of timely data on central government operations and guaranteed government debt by end-March 2001, the expectation is that Croatia will be in observance of the SDDS. It has, however, availed itself of a flexibility option with respect to data on the operations of local governments and, hence, the general government.

Table 1. Croatia: Core Statistical Indicators
As of February 15, 2001

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/Imports	Current Account Balance	Central Government Balance	GDP	External Debt/Debt Service
Date of Latest Observation	January 31, 2001	January 31, 2001	January 31, 2001	January 31, 2001	December 31, 2000	December 31, 2000	Jan-2001	Dec-2000	Q3 2000	Nov-2000	Q3 2000	December 31, 2000
Date Received	January 31, 2001	January 31, 2001	January 31, 2001	January 31, 2001	January 20, 2001	January 20, 2001	February 14, 2001	January 31, 2001	December 15, 2001	Dec-2000	December 29, 2000	January 20, 2001
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly	Quarterly	Monthly
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly	Quarterly	Monthly
Source of Update	CNB Website	CNB Website	CNB Website	CNB Website	CNB Website	CNB Website	CBS Website	CBS Website	CNB Website	Ministry of Finance	CBS Website	CNB Website
Mode of Reporting	On-line	On-line	E-mail	E-mail	E-mail	E-mail	On-line	On-line	E-Mail	E-Mail	On-line	E-Mail
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

CROATIA—EXTERNAL AND FINANCIAL SECTOR VULNERABILITY

Standard indicators suggest that Croatia's external and financial vulnerability have been reduced during 2000. The latest policy developments are positive, with a tightening of the 2001 budget underway that should underpin confidence. A failure to implement the planned structural policies, however, would likely have a negative market impact and leave the economy more vulnerable to contagion risks.

The current account deficit has declined in 2000, and the increase in international reserves has somewhat mitigated the increase in external debt (Table 12).

- The current account deficit is expected to have declined from 7½ percent of GDP in 1999 to 4½ percent of GDP in 2000. The current account deficit declined significantly in the first nine months of 2000 compared to the same period in 1999. A US$1 change in the oil price, however, is equivalent to an increase in the current account deficit of a little more than 0.1 percent of GDP on an annual basis.

- Exports of goods and services (in U.S. dollars) grew faster than imports during the first nine months of 2000, reflecting stronger foreign demand and a good tourist season. The real effective exchange rate depreciated by almost 7 percent during 1999, but appreciated by about one percent during the first ten months of 2000.

- Gross international reserves of the Croatian National Bank increased from US$3.0 billion at end-1999 to US$3.5 billion at end-2000. Net international reserves increased from 3.4 months of imports of goods and nonfactor services at end-1999 to almost 4 months at end-2000.

- External debt rose from 44½ percent of GDP in 1999 to an estimated 53 percent of GDP in 2000. However, the debt service to export ratio is expected to have declined from 20¾ percent to 18½ percent in 2000. Short-term debt and the current account deficit net of foreign direct investment in percent of gross usable international reserves amounted to 80¼ percent in 1999, but is expected to have declined to 75½ percent in 2000.

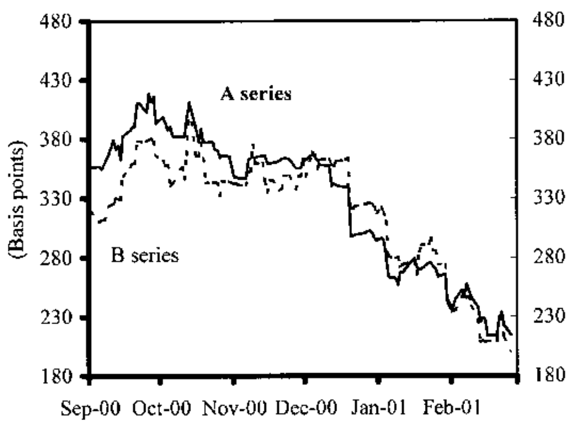
- Croatia has maintained access to international capital markets. The announcement of the successful conclusion of discussions with Fund staff on a stand-by arrangement on December 20 reduced the eurobond spread by 40 basis points (Appendix Figure 1). The spreads increased somewhat in late December, but narrowed again through late February. Croatian bonds now trade at around 200 basis points above comparable euro or dollar denominated benchmarks.

Aggregate prudential indicators suggest that the soundness of the banking sector has improved significantly since the crisis in 1998/99. The banking sector has been reorganized, recapitalized, is liquid, and is reporting increased profits. The level of nonperforming loans, however, remains high, in part due to difficulties in recovering debt (Table 13).

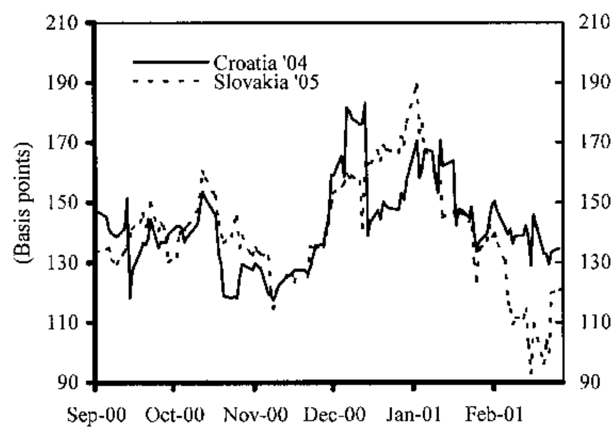
- Banks' risk-based capital adequacy ratio (CAR) increased from 20½ percent at end-1999 to 21⅜ percent in September 2000. In June, the CAR of the five largest banks, which account for almost 67 percent of total assets, ranged from 16 percent to 24 percent. The share of assets of state banks and private banks with more than 20 percent state ownership declined from

Figure 1. Croatia: Selected Spreads of Croatian Bonds, September 2000–February 2001

Stripped Croatian Brady Bond Spreads



Croatian and Slovakian Eurobond Spreads



Source: Merrill Lynch.

45½ percent at end-1999 to12 percent at end-June 2000, while the share of assets of majority foreign-owned banks increased from 40 percent to 76 percent during the same period.

- Reported nonperforming loans declined from 10¼ percent at end-1999 to 9¾ percent of total loans by September 2000. Reportedly, appropriate provisions have been made, but recovering of debt, particularly corporate debt, remains difficult. Some borrowers with loans denominated in or indexed to foreign exchange may not have a significant income flow of foreign exchange.

- Since the crisis in 1998/99, banks have remained reluctant to extend new loans, particularly to the corporate sector, but recent figures show signs of recovery. Deposits have grown, indicating increased confidence in the banking system. This has, together with an easing of monetary policy, allowed banks to become more liquid and reduce their dependence on foreign funding. Banks thus moved from having net foreign liabilities to having net foreign assets in August 2000.

- Banks on average maintained a long open net position in foreign exchange during 2000. The use of foreign currencies, particularly the euro, remains high in Croatia. Deposits denominated in foreign exchange increased from 83¼ percent of total deposits at end-1999 to 85 percent at June 2000, while deposits indexed to foreign currencies remained around 7 percent. Both the share of credits denominated in foreign exchange (from 15½ percent to 14¾ percent) and credits linked to foreign exchange (from 70 percent to 69¾ percent) declined marginally during the same period.

- Banks' average return after tax in percent of assets has reportedly increased from 0.7 percent of total assets in 1999 to 1.6 percent the first six months of 2000 (un-audited profits). The five largest banks all reported un-audited profits before tax during the first six months of 2000.

Zagreb, Croatia
January 31, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Köhler:

1. As the cornerstone of its commitment to promoting employment and raising the population's standard of living while maintaining macroeconomic stability, the Croatian government, in close collaboration with the Croatian National Bank (jointly referred to hereinafter as the Croatian authorities), has prepared a three-year economic program for the period 2001–03 that is centered on fiscal adjustment, wage discipline, and structural reforms in the context of continued exchange rate stability. To support the implementation of the program in its first year, the government of Croatia herewith requests a stand-by arrangement in an amount of SDR 200 million (54.78 percent of quota), to be made available over a 14-month period ending on April 30, 2002.

2. The implementation of our program will be monitored through quantitative performance criteria and indicative targets in the monetary, fiscal, and external sectors. In this regard, the attached Memorandum of Economic and Financial Policies (MEFP) proposes performance criteria for end-March and end-June 2001 and indicative targets for the second half of 2001. Program implementation will also be monitored through two structural performance criteria, the customary performance clauses, and two structural benchmarks, all of which are listed in Annex III and described (with the exception of the standard performance clauses) in greater detail in the following Annexes IV–X.

3. The Croatian authorities believe that the policies and measures set forth in the attached MEFP are sufficient to attain the objectives of their economic program. However, they will take any further measures that may be needed toward this end. The Croatian authorities will consult periodically with the Fund, in accordance with the Fund's policies on such consultations, about the progress being made in implementing the economic program described in the attached MEFP, and in advance of any revisions to the policies covered by the MEFP. The authorities will provide the Fund with such information as it requests on policy implementation and achievement of program objectives. In any event, during the period of the arrangement, the authorities will complete reviews with the Fund no later than August 31, 2001 and November 30, 2001, in order to (i) set the quantitative performance criteria for September 30 and December 31, 2001 (at the time of the first review) and (ii) assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives.

4. In view of Croatia's comfortable international reserves position and its easy access to international capital markets, the Croatian authorities do not intend to make the purchases under the arrangement that will become available upon approval and after observance of the performance criteria and completion of the reviews.

Sincerely yours,

/s/	/s/	/s/
Slavko Linić	Mato Crkvenac	Željko Rohatinski
Deputy Prime Minister	Minister of Finance	Governor
		Croatian National Bank

Attachment: Memorandum of Economic and Financial Policies

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. MEDIUM-TERM ECONOMIC STRATEGY

1. Our chief medium-term economic goal is to increase employment and the standard of living of the Croatian population. The associated growth of output and per capita income will promote real convergence with the more advanced countries of Europe and bring us closer to our aspiration of becoming a member of the European Union. We have therefore developed, and are already implementing, an economic strategy for this government's term in office (2000–03) that seeks to achieve sustainable high rates of economic growth with price stability and external viability. Under our strategy, these objectives will be pursued by a judicious combination of fiscal adjustment, wage discipline, and structural reforms in the context of continued exchange rate stability. Reduced government spending, wage restraint throughout the economy as well as economic liberalization, restructuring, and privatization will boost productivity—the basis for future real wage increases and higher living standards—and employment. These measures will also strengthen competitiveness, which—together with a substantial reduction of the fiscal deficit—will bolster external viability by reducing the external current account deficit to a level that allows the external debt-to-GDP ratio to first decline and then stabilize at a prudent level.

2. We believe that the policies described in Section III below will allow the economy to accelerate its rate of growth from an expected 3½ percent in 2000 to 4 percent in 2001 and some 4½ percent in 2002–03. Inflation is expected to moderate from 7½ percent in 2000 to 4½ percent in 2001 on an end-of-year basis, with further modest reductions during 2002–03. At the same time, the external current account deficit should contract from an expected 4½–4¾ percent of GDP in 2000 to just under 4 percent in 2001 and some 3¼ percent in 2003.

3. The main macroeconomic adjustments to bring about these results would be a reduction of the deficit of the consolidated central government from an expected 6½ percent of GDP in 2000 to some 1¼–1½ percent by 2003 and an incomes policy that would severely curtail wages in the public sector, while encouraging the limitation of real wage increases in the private sector to somewhat below realized annual productivity increases. To preserve financial stability and achieve our inflation targets, monetary policy will be conducted so as to keep the exchange rate stable.

II. POLICY IMPLEMENTATION IN 2000 AND EXPECTED OUTCOME

4. Upon assuming office in early 2000, the new government gave priority to paying government arrears, which had risen to the equivalent of 6½ percent of GDP by end-1999, while reducing substantially spending on goods and services and investment projects. To regain control over civil service wages, which had been raised by more than 17 percent during 1999, the government negotiated a 5 percent rollback of the basic wage in the budgetary sphere. As a signal of its determination to establish wage discipline throughout the economy, the government slashed the salaries of top civil servants, members of parliament, and judges by 20 percent. In obtaining parliamentary approval for a tough 2000 budget, the government created room to reduce both taxes and the fiscal deficit. In particular, the

government raised the income tax threshold (to raise net wages), reduced the employer's share of social security contributions (to lower nonwage labor costs), lengthened the collection lag for the value-added tax (to improve enterprise liquidity), and provided tax holidays and employment subsidies (to stimulate investment and employment). To complete its electoral promises of tax relief, the government obtained parliamentary approval for reductions of the personal income and profits taxes in December 2000.

5. For its part, the Croatian National Bank (CNB) used the strengthening external position, the repayment of government credit, and the return of confidence in the banking system to build international reserves, ease foreign exchange surrender requirements, allow the currency to appreciate slightly against the euro, and reduce reserve requirements and policy interest rates. The resulting decline in market interest rates to record low levels has, however, only recently begun to result in an increase in bank credit to the economy. Instead, banks have chosen to buy government debt instruments and strengthen their net foreign position. The CNB unified reserve requirement ratios at a lower average level in November–December, while taking all steps necessary to absorb the excess liquidity injected by the phased unification. The repayment of the full amount of insured deposits in failed banks in late December has further strengthened confidence in the banking sector.

6. The government took advantage of the changed international attitude toward Croatia to speed up the country's integration in the world economy. Successful negotiations led to the completion of WTO membership in November, while trade concessions were obtained from the EU, with which negotiations on a Stabilization and Association Agreement were initiated in November. A free trade agreement with Bosnia and Herzegovina has recently been signed and is being implemented. Other free trade agreements are currently under negotiation.

7. We now estimate economic growth to have reached 3.5 percent in 2000. A rebound of private consumption and strong growth of both merchandise and tourism exports more than account for the economic recovery, while investment and government consumption have continued to contract. Following excise tax and energy price increases, the 12-month rate of inflation rose to almost 7½ percent in December. However, core inflation remained at around 4½ percent, holding out the prospect for a lower rate of inflation in 2001. Notwithstanding higher oil prices, other exogenous factors, such as the improved regional security situation and improved access to foreign markets, and fiscal adjustment are expected to have narrowed the external current account deficit to a little more than 4½ percent of GDP in 2000.

III. The Economic Program for 2001

8. The recently approved three-year budget outlook and a yet to be negotiated social pact provide the medium-term framework for our economic program for 2001. Our 2001 program is rounded out by a monetary program that aims at reducing inflation on the basis of exchange rate stability and by an acceleration of structural reforms.

A. Objectives

9. Our program assumes a further small acceleration of economic growth to 4 percent in 2001. The acceleration is expected to stem from domestic demand. Notwithstanding greater

wage restraint, disposable income will be boosted in 2001 by income tax reduction and higher pension payments. On balance, the growth of private consumption is likely to slow somewhat after the vigorous rebound in 2000. The payment of insured deposits in failed banks may also lead to higher consumption in early 2001. Private investment, which has been almost flat in 2000, is likely to respond to improved profitability (due to lower nonwage labor costs, wage restraint, lower energy prices, and continued expansion of final demand), progress in structural reform and fiscal consolidation, and the availability of financing from a liquid banking sector at low interest rates. However, continued fiscal adjustment implies that government spending will once more exert a restraining influence on output growth. While the jump of export volume in 2000 is unlikely to be repeated, the improved security situation, better access to foreign markets, and continued expansion of demand in our major trading partners should allow the growth of exports to exceed that of import volume once more.

10. Notwithstanding the rise of headline inflation due to the supply shocks experienced in 2000, we believe that the inflation outlook is benign. Core inflation remains at a 4½ percent annual rate and the prospect of lower oil prices, greater wage restraint, further reductions of import duties, and a stable exchange rate should allow headline inflation to decline from almost 7½ percent to 4½ percent during 2001. This process will be helped by the disappearance of base year effects from tax and corrective price increases after midyear.

11. While our economic program calls for a further modest increase in net international reserves of the CNB that would maintain the reserve cover of imports of goods and nonfactor services at about 4¼ months, our principal external objective is the continued reduction of the current account deficit to a level that ensures external viability. We therefore aim to reduce the current account deficit further by about ¾ of a percentage point of GDP in 2001. The likely large inflow of privatization receipts would permit the partial reversal of last year's large increase in the external debt to GDP ratio. With privatization receipts dwindling after 2002, however, a pickup of greenfield investment and/or further current account adjustment would be needed to continue lowering the debt ratio. We believe that the favorable effects from the improved security situation and better access to foreign markets represent a permanent exogenous shift that has improved our underlying current account situation. The recent oil price decline should also help in 2001. Nonetheless, we realize the need for domestic policy adjustments to underpin the achievement of our current account target in 2001 and beyond. As we have decided to rely on a stable currency as a pillar of macroeconomic stability, our economic program relies on fiscal adjustment, wage restraint, and structural reforms to improve the current account.

B. Fiscal Policy

12. The centerpiece of our economic program for 2001 is continued fiscal adjustment. The government intends to further reduce the deficit of the consolidated central government from an expected 6½ percent of GDP in 2000 to 5¼ percent in 2001. As the full-year effect of recent revenue reductions and new measures to reduce the personal income and profits taxes will lower the revenue ratio in 2001, the expenditure ratio will fall even more rapidly, from an expected 46 percent of GDP in 2000 to 43 percent in 2001. In accordance with the government's three-year budget framework, the measures introduced under our 2001 program provide a sound basis for further reductions of the deficit to about 4¼ percent of

GDP in 2002 and about 1¼ percent of GDP in 2003 and of the expenditure ratio to about 41 percent of GDP in 2002 and about 37½ percent of GDP in 2003.[1]

13. Our revenue estimates for 2001 include the following changes to the tax system. The personal income tax has been reduced for low-income earners, and dividend income has been subjected to the lowest income tax rate (15 percent). The profits tax rate has been lowered, certain deductions have been introduced or increased, and the exemption of part of invested capital from taxation has been abolished. The excise tax on cars has been raised by broadening its base and the VAT exemption for the purchase of imported cars by war veterans will soon be repealed. The excise tax on gasoline and diesel will be increased by HRK 0.3 per liter when the responsibility for road maintenance and construction is transferred to a separate agency at the end of March 2001. Additional excise tax changes will be implemented in early 2001 to produce a revenue increase equivalent to 0.2 percent of GDP. Apart from internationally agreed import tariff reductions, the government does not intend to introduce any other tax or social security contribution changes during the program period. In particular, it will not reduce the VAT rate of 22 percent, nor will it allow further zero ratings or exemptions from VAT.

14. As the above-mentioned tax policy changes will reduce the revenue-to-GDP ratio, attainment of our fiscal deficit target for 2001 hinges crucially on a reduction of the expenditure ratio by some 3 percentage points of GDP. As the embedded table indicates, all major expenditure categories will be reduced in nominal terms except for interest payments

Croatia: Consolidated Central Government Expenditures, 2000–01

	Proj. 2000	Prog. 2001	Change	Proj. 2000	Prog. 2001	Change
	(In millions of Hrk)		(In percent)	(In percent of GDP)		
Expenditure and net lending	72,486	73,839	1.9	46.2	43.1	-3.1
Expenditure	71,641	73,009	1.9	45.7	42.6	-3.1
Current expenditure	65,806	67,429	2.5	42.0	39.4	-2.6
Wages and employer contributions	17,994	16,517	-8.2	11.5	9.6	1.8
Other purchases of goods and services	15,325	14,059	-8.3	9.8	8.2	-1.6
Interest payments	2,943	3,595	22.1	1.9	2.1	0.2
Subsidies and other current transfers	29,543	33,258	12.6	18.8	19.4	0.6
Capital expenditure	5,835	5,580	-4.4	3.7	3.3	-0.5
Lending minus repayments	845	830	-1.7	0.5	0.5	-0.1

[1] The sharp drop in the deficit and expenditure ratios in 2003 is partly the result of the expiration of special pension payments equivalent to 1 percent of GDP.

and subsidies and other current transfers, which will increase primarily because of last year's increase in government debt and the start of payments to compensate pensioners for past inadequate indexation of pensions, respectively. The reduction in wage payments of the consolidated central government includes a 10 percent cut in the wage bill of the state budget to a level that will be maintained in nominal terms in 2002–2003. The underlying wage policy and employment measures are described more fully in Section III.C and Annex IX. The expenditure cuts also result from the transfer of expenditure responsibility for roads to a separate agency at end-March 2001 and from health care reform and the devolution of some social spending to local governments at mid-year.[2]

15. The above-specified measures are judged sufficient to ensure that the deficit of the consolidated central government will not exceed 5.3 percent of GDP in 2001. As a prudential measure, however, we will defer budgeted expenditure equivalent to ½ percent of GDP to the second half of 2001. These funds will only be released if a midyear review of the implementation of our program shows that the external current account deficit is on track to decline to just below 4 percent of GDP in 2001. We do not intend to establish any new extrabudgetary funds during the program period. The fiscal deficit is financed almost entirely by privatization receipts. Net foreign borrowing of 1.0 percent of GDP would finance the remainder of the deficit while allowing the reduction of arrears accumulated by the government and the health fund in 2000 by 0.9 percent of GDP without any recourse to domestic bank borrowing. Observance of the overall fiscal deficit target and the limits on net borrowing from the domestic banking system and the level of arrears of the consolidated central government have been made performance criteria under the requested arrangement (Annex IV). Likewise, the maximum amount of short-term external credit to the government and the contracting and guaranteeing of nonconcessional external debt with a maturity of more than one year are performance criteria under the requested arrangement (Annex VI).

16. To compensate for any slippage, in particular in the implementation of its wage policy outlined in paragraph 18, the government is prepared to implement contingency measures to ensure that its fiscal deficit target will be attained. Such measures, some of which are under consideration on their own merits to meet our fiscal objectives for 2002–03, include the following: increased copayments for health services and medicines; harmonizing the income tax treatment of pensioners with that for other tax payers; reintroduction of health insurance contributions on large pensions; annual (instead of biannual) indexation of pensions; reduction of veterans' pensions and harmonizing their indexation with that for other pensions; and an increase in the excise tax on gasoline and diesel by HRK 0.3 per liter.

[2] Our projections for the consolidated central government exclude the collection of road tolls from April 2001 and a part of collections from income and profits taxes due to a change of the revenue sharing formulas with local government from July 2001. As noted, the road maintenance and construction agency will also benefit from a new excise of HRK 0.3 per liter of gasoline and diesel. While the devolution of part of social spending is neutral on the consolidated central government balance, the transfer of spending on roads to a separate agency is estimated to improve this balance by 0.6 percent of GDP in 2001, in part reflecting the fact that foreign-financed road construction was deferred from 2000 to 2001.

C. Incomes Policy

17. Wage restraint throughout the economy is a key plank of our program: it is important to strengthen competitiveness and improve the external current account, and it is needed to stimulate exports, investment, employment, and growth. For this reason, the government, in cooperation with the social partners, will implement a three-pronged incomes policy in 2001 and the period through 2003.

18. To achieve the 10 percent reduction of the wage bill envisaged in the 2001 state budget and make it sustainable in 2002–03, the government will implement measures, more fully described in Annex IX, that will progressively lower wage outlays during 2001. The basic monthly wage will remain frozen at HRK 1,425 and employment will be reduced by 10,000 (or 5½ percent) during the year.[3] Two new laws on public administration and on civil service employment, to be enacted by end-February 2001, will replace the present system of wage categories for individual ministries with a uniform range of coefficients, which the government will set by decree for individual positions. This will lead to a net reduction of some 6–7 percent in the wage bill. The new laws will also reduce the length and amount of severance payments, while eliminating the need to pay supplements and allowances for those to be laid off. Overtime pay, accounting for 2 percent of the wage bill, will be replaced by additional leave. Finally, no vacation bonuses, Christmas bonuses, or children's benefits will be paid in 2001, and an income test will be applied to the transportation allowance, with an expected annual savings of 0.3 percent of GDP. Outside the budget sphere (mainly in the health sector with its 65,000 employees) the government intends to negotiate a wage freeze.

19. We intend to keep average wages (excluding Christmas, vacation, and child bonuses) in the fully or majority state-owned enterprises (the public enterprises) at their 2000 level during 2001. The bonuses, which were mandatory until now, will be made voluntary and only profitable enterprises that do not rely on government guarantees or subsidies will be allowed to pay bonuses in 2001. In the 10 largest public enterprises, we have instructed managements and supervisory boards to implement this policy and to submit plans to cut employment of administrative staff by 10 percent in 2001.[4] Managerial contracts in those companies can henceforth only be concluded with management board members and their salaries will not be permitted to exceed those of government officials (e.g., the chairman of the board cannot receive a higher salary than a government minister). These policies will be strictly monitored in the 10 largest public enterprises, but they are also binding for other

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[3] A cut of 4,000 staff in the Ministry of Interior has already been decided by the cabinet as the first installment of the planned overall reduction of 10,000, and most of the remaining cuts will be effected in the Department of Defense, mostly from its large administrative staff. The staff reductions will be announced by end-March 2001 and implemented rapidly on the basis of new, less costly severance pay regulations. Until then, some wage savings will be realized by furloughing redundant staff at full pay, but without allowances.

[4] An agreed multiyear plan to cut employment in the railroad company (HZ) is already in effect.

public enterprises. We expect that these measures will not only improve the financial situation of these enterprises and encourage workers to leave the generally overstaffed public enterprise sector, but that it will also help overcome the resistance of workers to privatization.

20. The government's wage policy for the public sector covers almost half of total employment in the formal sector of the economy. For the remainder (including all public enterprises privatized during the next three years and enterprises with minority public participation) we will present shortly a proposal for discussions with unions and employers on a three-year social pact that would establish guidelines for the negotiation of collective wage agreements at the branch and enterprise levels. Our objective is to agree on guidelines that would keep real wage increases somewhat (perhaps by 1–2 percentage points) below realized annual productivity gains. Similarly, we would aim to base cost of living adjustments on the expected increase in the retail price index in the 12 months ahead (i.e., 4½ percent for calendar year 2001), with a catch-up provision if inflation exceeds the forecast rate by a specified threshold. Exogenous price shocks, such as oil price or indirect tax increases, would be excluded from the cost of living adjustment.

21. We expect the above described wage policy to result in a shift of employment from the public to the private sector and in a substantial increase in overall employment after 2001. As many of the laid off workers will not yet be eligible for pensions, we intend to implement active labor market policies, with financial support from the World Bank's SAL (currently under negotiation) to retrain them. Given its importance for the successful implementation of our program, the above described public sector wage policy will provide two structural performance criteria under the requested arrangement (Annex IX). Implementation of the entire wage policy will be monitored by observance of the quarterly budgetary wage ceilings, and progress in this area will be an important issue for the completion of the two reviews envisaged under the requested arrangement.

D. Monetary and Exchange Rate Policy

22. The government's fiscal and incomes policies will greatly facilitate the CNB's task of pursuing price stability over the next three years. As the preconditions for successful inflation targeting are not yet fulfilled in Croatia, we believe that the present program's inflation objective is best served by the stability of the kuna's exchange rate against the euro. Accordingly, the CNB will continue to attach great importance to the stability of that rate. We believe that—apart from the usual seasonal fluctuation of the exchange rate—the CNB's monetary program for 2001, described in paragraph 23, is compatible with exchange rate stability. However, the CNB will use monetary policy as needed to stabilize the kuna against the euro. In such an environment, interest rates are expected to align themselves more closely with those in the euro area. This does, however, not preclude temporary departures of domestic short-term rates from those prevailing abroad as the CNB intervenes in pursuit of its price stability mandate to influence domestic liquidity conditions.

23. The CNB's monetary program for 2001 aims at reducing inflation to 4½ percent by year-end. Economic growth and a further strengthening of confidence are expected to attract sufficient financial resources to allow credit to the nongovernment sector to grow by

16 percent. Any remaining liquidity needs of the business sector are likely to be met by self-financing out of rising profits, the payment of remaining government and health fund arrears, and access to foreign borrowing in the case of the larger enterprises. The government would not need any bank financing during 2001. On the contrary, its front-loaded foreign borrowing and privatization plans would allow it to temporarily reduce its bank debt in the first half of 2001. The CNB will use part of the rising demand for base money during the tourism season to accumulate international reserves in an effort to keep their gross level at about 4¼ months of imports of goods and nonfactor services at year-end. The international reserve targets will be a performance criterion under the requested arrangement (Annex VII). In an effort to rely more on market-oriented instruments, the CNB plans to further reduce the unified reserve requirement ratio, market conditions permitting. In accordance with the new CNB law, there will be no more CNB credit to the government. Accordingly, the excess of base money demand over reserve accumulation will be at the disposal of the commercial banks. In pursuit of its inflation objective, however, the CNB will conduct open market operations to absorb any buildup of excess liquidity. To guide it in implementing monetary policy during 2001, the CNB has established limits on the change of its net domestic assets. These limits will be a performance criterion under the requested arrangement (Annex VIII). Should base money demand be weaker than assumed in the CNB's program, the CNB will tighten credit sufficiently to ensure that its international reserve targets are observed. If, however, base money demand turns out to be stronger than assumed, the CNB will consult with the Fund to determine if the inflation outlook justifies easing the limits on net domestic assets. To ensure that the envisaged room for credit expansion to the nongovernment sector is not pre-empted by public enterprise borrowing, we have established limits on net domestic bank borrowing by 10 large public enterprises. These limits will be a performance criterion under the requested arrangement (Annex V).

E. Structural Reforms

24. Our macroeconomic program for 2001 and beyond relies on the realization of a large number of structural reforms, most of which will be prepared and implemented with the assistance of the World Bank and regional and bilateral development institutions. The attached matrix (Annex I) lists the most important of these reforms and the timelines for their expected implementation. Here, we describe briefly those reforms most relevant to macroeconomic adjustment, with particular emphasis on the ones to be implemented with the assistance of, and/or monitored by, the IMF.

Fiscal sector reforms

25. From the start of 2001 a new treasury system has begun operations in the Ministry of Finance. All central budget expenditure (excluding initially the extrabudgetary funds) will henceforth be authorized and certified by the treasury. All but routine items are now immediately paid by a new treasury single account. Starting on July 1, 2001, routine budget items and expenditure of all extrabudgetary funds except the health fund will also be channeled through the treasury and its single account and all separate ministerial accounts will be closed. Health fund expenditure will follow by January 1, 2002, after implementation of health care reform. These changes will enable us for the first time to prevent the buildup of government arrears and to monitor the reduction and eventual elimination of existing arrears.

The 2002 budgets of the central government and the extrabudgetary funds, which will be presented jointly to parliament on a uniform classification basis, will draw on the recommendations of an ongoing public expenditure review conducted by the World Bank. Following the adoption of stricter criteria for the extension of government guarantees, the government will develop and apply by mid-2001 a monitoring system for government guarantees and for the contracting of lease agreements. The Ministry of Agriculture will compile a list of farmers in time for the 2002 budget so as to facilitate the changeover from price-support to income-support subsidies.

26. Apart from the measures mentioned in Section III.B, the finances of the pension system are being strengthened by the phased implementation of the first-pillar reform of 1999, notably the gradual extension of the period for calculating the pensionable base from the 10 years with the highest income to lifetime earnings and the gradual increase in the statutory retirement age from 60 to 65 years for men and from 55 to 60 years for women. We are now examining further measures to strengthen the pay-as-you-go pillar, for example, by equalizing the statutory retirement ages of men and women at 65 years and adjusting replacement rates to take account of rising life expectancies of pensioners. If required by the continued adverse population dynamics, we may eventually have to resort to indexing pensions (and perhaps even pensionable bases) to prices rather than the average of prices and wages. With the recent startup of the central registry of affiliates and the regulatory authority for private pension funds, we can proceed with the introduction of the three-pillar system. By mid-2001, we expect the voluntary third pillar to start operations. And we will implement the mandatory second pillar with effect from January 1, 2002. An estimate of the transition cost of introducing the second pillar is included in our fiscal framework for 2002 and 2003.

27. As noted in Section III.B, the responsibility for maintenance and investment spending for primary health care facilities will be transferred in mid-2001 to the lower levels of government. Measures not yet taken into account in our fiscal projections include the increase in copayments for drugs and selected medical treatments and services and the reduction of widespread exemptions from such payments, and the introduction of performance-based reimbursements for doctors and hospitals in line with the new clinical guidelines. Private insurance for copayments and treatments not covered by the basic package that will be introduced in 2001 will be encouraged.

28. In proceeding with decentralization, the central government will provide the lower levels of government with adequate tax bases of their own while trying to retain as much of shared taxes as possible to reduce its own fiscal deficit. We will examine with the lower levels of government how the reporting lags with respect to their operations can be shortened sufficiently to allow future monitoring of fiscal trends at the general government level.

Monetary and financial sector reforms

29. In the monetary area, further steps to reduce reserve requirements, as referred to in Section III.D, will be taken. We will ensure that differential rates of remuneration on required reserves will not bias the choice between domestic and foreign currency deposits. By March 2001 we will amend the foreign exchange law to allow legal entities to open foreign exchange accounts with Croatian banks for any purpose and to allow domestic banks to extend foreign exchange denominated credit to residents without any restrictions. As a

medium-term objective, we subscribe to further capital account liberalization, but it would have to be gradually phased in only after financial sector soundness has been firmly established.

30. We encourage the further consolidation of the domestic banking sector and actively seek to privatize two of the remaining three government-owned banks. Privatization plans for Dubrovačka Banka and Croatia Banka have been prepared by the bank rehabilitation agency. The banks will now be prepared for privatization, and tenders for their sale will be conducted by end-March 2001 and end-September 2001, respectively. The other government-owned bank, Hrvatska Poštanska Banka (HPB), is likely to need recapitalization and the government is examining ways to improve its performance, including the possibility of privatization, while preserving its special payment service function through its vast branch network. If needed, privatization receipts of the privatization fund will be used to recapitalize HPB. The Croatian Insurance company, which still controls more than 50 percent of the domestic market, will also be privatized in the course of 2001.

31. We expect the new CNB law to be approved by parliament by March 2001. We will now prepare a new banking law that will provide the CNB with an automatic graduated response to banks not in compliance with regulations and ensure prompt bank resolution on the basis of the least-cost principle. The law will also clarify and strengthen the procedures pertaining to the insolvency of banks. We expect the new law to be adopted by parliament by December 2001. In the meantime, the CNB is applying the existing law with an eye to limiting discretion in its implementation so as to ensure gradual full compliance of banking operations with all regulations and limitations envisaged in the law. The CNB is also strengthening the framework for resolving any future banking problems.

32. Finally, we are undertaking a number of steps to improve the functioning of the money and capital markets and the payments and settlement systems and to strengthen the regulation and supervision of nonbanks. In all instances, legislative changes will be designed to achieve harmonization with EU standards.

Public enterprise reform and privatization

33. The government wants to divest most public enterprises while keeping a minority share in only some of them. Three hundred and twenty-one insolvent companies that employed some 11,000 people have recently been put into bankruptcy and are being liquidated. The government has recently reached agreements with the shipyards and the railway company (HZ) on restructuring measures and the amount of subsidization to be provided by the budget. The shipyards and as much as possible of HZ will be privatized. The privatization fund (CPF), which manages the government's share in a large number of companies on its own behalf and on behalf of the pension fund and the bank rehabilitation agency, will aim to sell 327 companies of its pooled portfolio by end-2001. These companies account for almost two thirds of the 88,000 people employed in the 520 companies managed by the CPF in which the government has a share of more than 25 percent. We now expect the IPO for at least 20 percent of shares of the telecommunications company (HT) to be completed by mid-2001. Bringing it to the point of completion for both domestic and international sale is a structural benchmark under the requested arrangement (Annex X). A

new telecommunications law will be submitted to parliament soon to regulate the market and to ensure fair pricing until HT's fixed-line monopoly expires in 2003.

34. Energy sector reform and privatization are being prepared in close cooperation with the World Bank. A package of five laws will be sent to parliament by end-February 2001 to regulate the energy market and restructure the electricity (HEP) and oil and gas (INA) companies. Following the establishment of a regulatory agency, INA will be restructured and split into an oil and gas production company and a gas transportation company and HEP's operations will be unbundled into three commercially separate power generation, transmission, and distribution companies. The INA and HEP groups will spin off noncore functions and prepare their constituent companies for privatization on the basis of two laws, which are expected to be adopted by parliament by September 2001 (a structural benchmark). Privatization of the constituent companies could then proceed in 2002. The JANAF oil and gas pipeline is expected to be privatized in late 2001, as may be some parts of HEP and INA if needed to achieve this year's budget target for privatization revenue.

Trade policy and other reforms

35. Following WTO accession and the start of negotiations with the EU on a Stabilization and Association Agreement in late 2000, the government has intensified the negotiation of bilateral free trade agreements with the EU, EFTA, and 13 bilateral trade partners. With the successful completion of these negotiations by March 2001, the government expects to have almost 80 percent of its foreign trade covered by free trade agreements. Under our program, we will not introduce or intensify restrictions on payments and transfers for current international transactions, multiple currency practices, or import restrictions for balance of payments purposes, nor will we tolerate the accumulation of external arrears.

36. With World Bank assistance, we are beginning to take measures to strengthen the capacity of our commercial courts to resolve bankruptcy cases.

Attachments: Annexes I–X

Key Structural Measures

Structural Measures	Lead Institution 1/	Prior Action	March 2001	June 2001	Sep. 2001	Dec. 2001	After 2001
Fiscal Sector							
1. Operationalize the treasury and the treasury single account.	IMF						
a) Startup of treasury operations.		X					
b) Channel all but routine central budget expenditures through the treasury single account.		X					
c) Channel all expenditures of the central budget and the extrabudgetary funds (except the health fund) through the treasury single account.				X			
d) Channel health fund expenditures through the treasury single account.							X
2. Start applying the new treasury information system to monitor arrears and payments float.	IMF		X				
3. Develop and apply a monitoring system for government guarantees and lease contracts.	WB			X			
4. Health care reform.	WB						
a) Reduce the level and duration of sick-pay benefits.			X				
b) Increase/Introduce co-payments for drugs and selected health services and reduce the exemptions.				X			
c) Introduce budget caps on spending for outpatient polyclinics.			X				
d) Moratorium on new capital investments in health sector except for those foreign-financed projects already included in the budget.			X				
e) Introduce a basic package for public health provision.				X			
f) Introduce performance-based reimbursements for the ten most frequent medical services.				X			
5. Strengthen the first-pillar reform by improving efficiency and operations of the Pension Institute.	WB		X				
6. Ensure adequate budget resources for the introduction of the second pillar of the pension system in the 2002 budget.	WB					X	
7. Ministry of Agriculture to compile a list of farmers to facilitate the provision of income support subsidies.	WB				X		
8. Prepare the 2002 budget on the basis of recommendations of the Public Expenditure Review.	WB					X	
Public Enterprises							
1. Croatian Privatization Fund	WB						
a) Adopt action plan for divestiture of all shares.			X				
b) Divest all shares in 327 enterprises.						X	
c) Divest any assets that are returned to the Privatization Fund due to the nonpayment by the beneficiary (within one year in the case of each enterprise).							
2. Complete preparation for IPO of HT. 2/	WB			X			
3. Prepare privatization and conduct tender for the insurance company.	WB				X		
4. Prepare privatization and conduct tender for the privatization of JANAF.	WB					X	
5. Any subsidization of enterprises to be transparent in the budget and not to include tax concessions (throughout the entire period).	WB						
6. Regulatory framework for public utilities.	WB						
a) Submission of regulations to parliament.			X				
b) Enactment of regulations.				X			

Key Structural Measures

Structural Measures	Lead Institution 1/	Prior Action	March 2001	June 2001	Sep. 2001	Dec. 2001	After 2001
Public Enterprises (continued)							
7. Implement the decision to unbundle the National Power Company (HEP).	WB			X			
8. Implement the decision to restructure the National Petroleum Company (INA).	WB			X			
9. HEP, INA and National Railroad (HZ).	WB						
a) Decision on divestiture of noncore assets of public enterprises (HEP, INA, HZ).			X				
b) Implementation of this decision.					X		
10. Privatization of HEP and INA.	WB						
a) Adoption of privatization laws for HEP and INA. 2/					X		
b) Privatization of both companies.							X
11. Implementation of the Government resolution to privatize/liquidate 12 enterprises listed in the Law on Rehabilitation of Selected State-Owned Enterprises.	WB			X			
Monetary and Financial Sector							
1. Bank privatization.	WB						
a) Adopt a plan to improve efficiency of Hrvatska Poštanska Banka (including budget provision for recapitalization if needed).			X				
b) Adopt a plan to rationalize Hrvatska Poštanska Banka, including the possibility of privatization.						X	
c) Prepare for privatization and conduct privatization tender for:							
Dubrovačka Banka			X				
Croatia Banka					X		
2. Obtain parliamentary approval for the draft National Bank Law to adopt price stability as the CNB's primary objective, give the CNB exclusive responsibility for monetary and exchange rate policy, ensure the personal independence of the CNB's board, prohibit the CNB from lending to the government, and formalize the procedures for consultation and information sharing between the CNB and the Ministry of Finance.	IMF		X				
3. Banking A new law to provide for CNB's automatic, but graduated response to banks not in compliance with regulations, ensure prompt bank resolution based on the least-cost principle, and lengthen the transitional period for adjusting bank exposure (if needed). The new law will also clarify and strengthen the procedures pertaining to the insolvency of banks.	IMF						
a) Submit draft law to parliament.				X			
b) Obtain parliamentary approval.						X	
4. Exchange restrictions	IMF						
a) Allow enterprises to hold foreign exchange deposits.			X				
b) Allow banks to lend to residents in foreign exchange.			X				
5. Money market	IMF						
a) Introduce monthly instead of weekly auctions of CNB bills.			X				
b) Develop repo market and establish master repo agreement.				X			

Key Structural Measures

Structural Measures	Lead Institution 1/	Prior Action	March 2001	June 2001	Sep. 2001	Dec. 2001	After 2001
Monetary and Financial Sector (continued)							
6. Bank and nonbank supervision.	WB/IMF						
a) Review current banking regulations and practices with a view to identify deficiencies vis-à-vis EU directives.				X			
b) Review securities law, regulations and practices with a view to identify deficiencies vis-à-vis pertinent EU directives.				X			
c) Adopt a plan to formalize cooperation among supervisory agencies.					X		
d) Adopt consolidated supervision for financial conglomerates.				X			
e) Increase the frequency of on-site supervision of insurance companies.				X			
f) Agree on a timetable for the full compliance with the insurance law.				X			
7. Capital market	IMF/WB						
a) Avoid issuing T-bills and CNB bills with same maturities.				X			
b) Consolidate all outstanding government bonds into one single type of bond with different maturities.							X
8. Payments system	IMF/WB						
a) Implement the new clearing system (NKS).			X				
b) Abolish the CNB's intervention credit facility.			X				
c) Steering Committee on ZAP finalizes drafting amendments to law on domestic payment system.			X				
d) Obtain parliamentary approval of amendments of domestic payment system law with a view to reorganize ZAP.					X		
e) Include the depository for CNB bills in the Central Depository Agency.						X	
f) Adopt delivery-versus-payment of securities transactions.						X	
Judicial System							
Begin to take measures to strengthen the capacity of the commercial courts to settle bankruptcy cases (measured by satisfactory progress under a new World Bank loan).	WB		X				

1/ Institution primarily responsible for providing technical assistance and general advice for implementing the structural measure(s) concerned. Except where explicitly footnoted, the structural measures listed in this matrix do not represent program conditionality.

2/ Structural benchmark.

Croatia: Medium-Term Macroeconomic Framework, 1999-2003

	1999	Estimate 2000	Program 2001	Projections 2002	2003
			(Percentage change)		
Output and prices					
Real GDP	-0.4	3.5	4.0	4.2	4.5
CPI inflation (average)	4.2	6.2	5.6	4.3	3.8
CPI inflation (end-of-period)	4.4	7.4	4.5	4.0	3.5
			(In percent of GDP)		
Savings and investment					
Gross national savings	18.7	20.2	22.4	24.8	27.0
Gross domestic investment	26.3	24.8	26.2	28.3	30.2
Central government operations					
Revenue and grants	42.8	39.7	37.8	36.8	36.3
Expenditure and net lending 1/	50.2	46.2	43.1	40.9	37.6
Overall balance	-7.4	-6.5	-5.3	-4.2	-1.3
Domestic borrowing (including arrears)	-0.4	-0.8	-0.9	0.5	-2.0
Privatization receipts	4.5	2.0	5.2	3.1	1.9
Foreign financing	3.2	4.8	1.0	0.5	1.4
			(End-of-period; in annual percent change)		
Money and credit					
Credit to the private sector 2/	-6.5 3/	4.4	15.9	12.0	16.8
Broad money	-1.1 3/	26.5	15.3	10.2	9.7
Base money	3.6	13.6	7.5	15.6	8.7
			(In millions of U.S. dollars)		
Balance of payments					
Current account balance	-1,523	-874	-780	-753	-744
(in percent of GDP)	-7.6	-4.6	-3.9	-3.5	-3.2
Capital and financial account	1,948	476	1,051	939	1,023
Overall balance	460	518	271	185	279
			(End-of-period; in millions of U.S. dollars)		
Debt and reserves					
Gross official reserves	3,025	3,525	3,764	3,914	4,157
(in months of imports)	3.7	4.3	4.4	4.3	4.3
Gross usable reserves 4/	2,249	2,629	2,868	3,018	3,262
(in months of imports)	2.8	3.2	3.3	3.3	3.4
(as a percentage of short-term debt) 5/	129.4	108.0	137.0	163.4	150.1
Debt service ratio (in percent)	20.8	18.4	19.2	18.4	14.9
Public debt (in percent of GDP) 6/	45.2	47.6	42.1	42.1	39.0
Of which : External 6/	25.9	30.9	27.9	25.8	25.1
Total external debt	44.5	53.2	50.4	47.5	45.0

Sources: Croatian authorities; and Fund staff estimates.

1/ Assumes accumulation of arrears of HRK 1.8 billion in 2000.

2/ When taking arrears repayment into account, the overall rate of growth of credit to other domestic sectors would be 15.3 percent in 2000, 18.5 percent in 2001, 13.2 percent in 2002, and 17.6 percent in 2003.

3/ Growth rates for 1999 are affected by changes in the statistical reporting system and by the bankruptcy of various banks in the course of the year. After adjusting for all these factors, estimates of the 1999 growth rate are -0.8 percent for credit to the private sector and 9.4 percent for broad money.

4/ Program definition. Excludes reserves held against CNB foreign currency bills and foreign currency deposits of domestic banks.

5/ Short-term debt is presented on a remaining maturity basis.

6/ Including publicly guaranteed debt.

Croatia: Monitoring the Implementation of the Program

Prior actions		
1.	through the treasury single account	MEFP, Para. 14 and 25,
2.	Begin implementing the government's wage policy by finalizing the strategy for the budgetary sphere, announcing the freeze of the basic wage in the budgetary sphere and the nonbudget government sector and of wages of higher public officials, canceling vacation, Christmas and child bonuses, eliminating all allowances not mandated by law and enacting the laws on public administration and civil service employment; by announcing and starting to negotiate the basic wage freeze in public enterprises; and by inviting the social partners to resume discussions on a social pact	Annex IX and MEFP, Para. 18 and 19
3.	Complete the payout of all insured deposits in failed banks	MEFP, Para. 5
4.	Repeal car import privileges for war veterans	MEFP, Para. 13
Quantitative performance criteria		
1.	Consolidated central government a) Quarterly limits on the cumulative deficit of the consolidated central government b) to the consolidated central government c) Quarterly limits on arrears of the consolidated central government	Annex IV
2.	Quarterly limits on net bank borrowing by 10 large public enterprises	Annex V
3.	Public and publicly guaranteed debt a) debt b) Quarterly ceilings on the stock of short-term external debt	Annex VI
4.	Quarterly floors under the net usable international reserves of the CNB	Annex VII
5.	Quarterly limits on the cumulative change of the net domestic assets of the CNB	Annex VIII
Structural performance criteria		
1.	Enact government decree on salary coefficients for individual posts to replace existing ministry-specific coefficients to reduce wage bill and issue separate decrees number of employees	Annex IX
2.	Reduce employment in the budgetary sphere by 10,000	Annex IX
Performance clauses		
1.	No new external payments arrears.	MEFP, Para. 35
2.	No new, or intensification of existing, payments restrictions, multiple currency practices, and import restrictions	MEFP, Para. 35
Structural benchmarks		
1.	Take all steps necessary to bring at least 20 percent of HT's shares to the point of sale by issuing the privatization prospectus and organizing the roadshow	Annex X
2.	Make progress in restructuring and privatizing HEP and INA	MEFP, Para. 34

I. Limits on the Cumulative Deficit of the Consolidated Central Government

	Ceilings
	(In millions of kuna)
Cumulative Changes from December 31, 2000:	
March 31, 2001	3,500
June 30, 2001	3,850
September 30, 2001 1/	6,300
December 31, 2001 1/	9,100

1/ Indicative limit.

The above listed ceilings on the cumulative deficit of the consolidated central government cover: (i) central government operations, that is, the central government budget (the Office of the President, the parliament, the government, the constitutional court, all ministries, other independent state administration and judicial bodies); (ii) existing central extrabudgetary funds (health, pension, employment, child benefit, and water management funds); and (iii) the proposed Fund of Assets for Investment Promotion and Fund for the Creation of New Jobs and Re-training. The government will not establish new extrabudgetary funds during the program period, but any such funds would be covered by the ceilings.

The ceilings do not include the net borrowing of the Croatian Bank for Reconstruction and Development (HBOR). HBOR's net borrowing in 2001—defined as the change in gross liabilities minus the change in total loans—is projected to be HRK 800 million and will be monitored under the program. There will be no new borrowing by the Deposit Insurance and Bank Rehabilitation Agency (BRA) or by the Croatian Privatization Fund (CPF). At any rate, their borrowing would be excluded from the ceilings. This will also be monitored under the program.

For purposes of the program, the deficit will be defined on a cash-adjusted basis (i.e., on a cash basis adjusted by the net change in arrears). The cost for recapitalizing banks will be considered as "above the line." The following will be considered as "below the line": privatization receipts, payment of arrears, payment of promissory notes issued by the Ministry of Finance and the Health Fund, payment of insured deposits, bonds issued for financing the recapitalization of banks, redemption of government bonds tendered by the CNB in connection with bank resolution, and any release of foreign-held blocked foreign assets of the former SFRY to the government.

The limit on the deficit of the consolidated central government will be adjusted downward to offset the net effect of any reduction in interest payments attributable to rescheduling of existing government debt.

The quarterly limits will be monitored from below the line on the basis of data provided monthly by the Ministry of Finance and the CNB within 30 days. Net borrowing by HBOR and new borrowing by BRA and CPF will be reported quarterly by the CNB within 30 days.

II. Limits on the Cumulative Increases in the Net Credit of the Banking System to the Consolidated Central Government

	Ceilings
	(In millions of kuna)
Stock as of December 31, 2000 1/	12,210
Cumulative changes from December 31, 2000:	
March 31, 2001	-1,550
June 30, 2001	-2,300
September 30, 2001 2/	-250
December 31, 2001 2/	--

1/ This stock of claims consists mainly of the counterpart to frozen foreign exchange deposits and "big bonds," which are restructuring bonds issued in 1991 and 1992, and held by banks in lieu of claims on enterprises; the total stock of claims as of December 31, 2000 also includes the bonds issued to finance the payout of insured deposits in failed banks.
2/ Indicative limit.

The quarterly limits are cumulative. The consolidated central government is as defined in Section I above.

For program purposes, net credit of the banking system to the consolidated central government is defined as all claims of the banking system on the consolidated central government less all deposits of the consolidated central government with the banking system.

Data on banking system claims on and liabilities to the consolidated central government are taken from the balance sheets of the banks and the CNB, and will be provided monthly to the Fund by the CNB within 30 days. All currency conversions will be done using December 30, 2000 exchange rates (in HrK per unit of foreign currency) as follows:

Euro:	7.598334	Swiss franc:	4.989712
Japanese yen (100):	7.103902	U.S. dollar:	8.155344
Pound sterling:	12.176817		

III. Limits on the Arrears of the Consolidated Central Government

	Ceilings
	(In millions of kuna)
Stock as of December 31, 2000:	3,279
Cumulative changes from December 31, 2000:	
March 31, 2001	—
June 30, 2001	-1,500
September 30, 2001 1/	-1,500
December 31, 2001 1/	-1,500

1/ Indicative limit.

Arrears include all overdue payments by more than 90 days and any promissory notes issued by the Ministry of Finance and the central extrabudgetary funds. The stock of arrears will be provided monthly to the Fund by the Ministry of Finance within 30 days.

Limits on the Cumulative Increases in the Net Credit of the Banking System to Selected Public Enterprises

	Ceilings
	(In millions of kuna)
Stock as of December 31, 2000	1,003
Cumulative changes from December 31, 2000:	
March 31, 2001	600
June 30, 2001	600
September 30, 2001 1/	600
December 31, 2001 1/	700

1/ Indicative limit.

These aggregate limits cover the 10 enterprises listed below. Net credit is defined as the sum of all short-term and long-term bank claims in local and foreign currency on these enterprises by banks resident in Croatia plus the amount of credit guaranteed by Croatian banks from domestic nonbank and foreign sources, less the sum of these enterprises' total deposits in local and foreign currency with such banks. Credit guaranteed by the government or resulting from the calling of performance guarantees will be excluded from the ceilings to the extent that it is not already reflected in the balance sheets of the banks.

The 10 enterprises are as follows:

1. Hrvatska Elektropriveda, Zagreb (Croatian Electricity Company)
2. INA Industrija Nafte, Zagreb (Oil Company)
3. Hrvatske Željeznice, Zagreb (Croatian Railroads)
4. Hrvatske Šume, Zagreb (Croatian Forests)
5. HT, Zagreb (Croatian Telecommunications)
6. HP, Zagreb (Croatian Post)
7. HRT, Zagreb (Radio and Television Company)
8. Jadrolinija, Rijeka (Shipping Line)
9. Croatia Osiguranje, Zagreb (Insurance Company)
10. Croatia Airlines, Zagreb

Enterprises on the above list that are privatized in the course of the arrangement will be removed from the limits and the limits will be adjusted downward by the amount of the net credit outstanding to those enterprises at the end of the month preceding privatization. Whenever changes in accounting practices or the set of enterprises reporting to the CNB result in changes in the data series, the Fund will be notified and provided one-quarter of data calculated with both the old and new definitions and an offsetting adjustment will be made to the limits. The limits will be adjusted downward by the amount of any bank or enterprise rehabilitation that writes off or removes these assets and liabilities from the banking system or any debt-equity swaps that convert bank debt into equity in the enterprises. Information regarding such debt-equity swaps will be provided by the Ministry of Economy if and when they occur.

The above maximum changes will be cumulative and will be monitored on the basis of December 30, 2000 exchange rates (as listed in Annex IV.II) from data collected monthly by the Ministry of Finance (ORESE) and supplied to the Fund within 30 days.

Ceilings on the Stock of Short-Term External Public and Publicly Guaranteed Debt and on Contracting or Guaranteeing of Nonconcessional External Debt by the Public Sector

	Ceilings		
	(In millions of U.S. dollars)		
	Ceilings ≤1 year	Ceilings >1 year	Subceilings <5 years
Stock as of December 31, 2000	509	5,908	508
Cumulative changes from December 31, 2000:			
March 31, 2001	500	1,250	250
June 30, 2001	100	1,300	250
September 30, 2001 1/	100	1,400	250
December 31, 2001 1/	100	1,525	250

1/ Indicative limits.

For program purposes, the term "debt" will be used as defined in No. 9 of the revised Guidelines on Performance Criteria with Respect to External Debt or Borrowing in the Fund Arrangements (Executive Board Decision No. 6230-(79/140), as amended by Executive Board Decision No. 11096-(95/100) adopted on October 25, 1995). However, for the time being lease contracts will not be covered by the ceilings. A reporting system for lease contracts is currently being set up by the Ministry of Finance. Once functional, leases will be included in the debt contracting ceilings.

The short-term debt limits do not apply to normal import-related credits.

The ceilings on medium- and long-term debt apply to the contracting or guaranteeing of new nonconcessional external debt with an original maturity of more than one year, and, within this limit, with an original maturity of more than one year and less than 5 years. Concessional loans are defined as those with a grant element of 35 percent, using currency-specific discount rates based on the six-month average commercial interest rates reported by the OECD (CIRRs) for loans with maturities of less than 15 years, and on the 10-year average CIRRS for loans with maturities of 15 years and more.

The public sector comprises the consolidated central government as defined in Annex IV, the CNB, BRA, HBOR, CPF, the 10 large public enterprises listed in Annex V, and the lower levels of government. Excluded from the limits are performance guarantees on the construction of ships (for no more than the value of advance payments), and changes in indebtedness resulting from refinancing and rescheduling, including the capitalization of interest in arrears.

The above limits also do not apply to guarantees by the central government for suppliers' credits related to imports for constructing ships during the period until delivery of the ships takes place. In case of orders for multiple ships, the import related credits could take the form of revolving external credit lines. To monitor such guarantees, data on the guarantees extended for ship building, including performance guarantees or bonds, and the payments and deliveries for ships built with these guarantees will be supplied on a quarterly basis.

Debt falling within the limits shall be valued in U.S. dollars at the exchange rates prevailing at the time when the debt is contracted.

Information on the contracting and guaranteeing of new debt falling both inside and outside the limits will be reported monthly to the Fund within 30 days by the CNB.

Targets for Cumulative Increases in the Net Usable International Reserves of the Croatian National Bank

	Floors
	(In millions of U.S. dollars)
Stock as of December 31, 2000	2,328
Cumulative changes from December 31, 2000:	
March 31, 2001	-125
June 30, 2001	-12
September 30, 2001 1/	654
December 31, 2001 1/	271

1/ Indicative floor.

For purposes of the program, net usable international reserves of the Croatian National Bank (CNB) are defined as the U.S. dollar value of gross foreign assets minus reserve assets held against foreign currency deposits by domestic banks and against CNB foreign exchange bills minus gross foreign liabilities minus off-balance sheet foreign currency obligations.

For purposes of the program, gross foreign assets shall be defined as monetary gold, holdings of SDRs, any reserve position in the IMF, and holdings of foreign exchange in convertible currencies by the CNB (the accounting values of exchange rates and SDRs are specifically defined below for program purposes). Any return to the CNB of blocked foreign assets that are not part of CNB foreign assets as of December 31, 2000 will be added to the reserve floor. Reserves that are pledged, frozen, or used as collateral shall be excluded from the gross foreign assets. In particular, any reserve assets pledged to secure government debt will be excluded from the reserves definition.

For purposes of the program, reserve liabilities shall be defined as all liabilities of the CNB to nonresidents—excluding deposits into the special accounts for external debt servicing—with an original maturity of up to and including one year, as well as liabilities arising from IMF purchases and bridge loans from the BIS, irrespective of their maturity. For purposes of the program, reserve liabilities shall also include guarantees provided by the CNB backed by reserves as collateral.

The net forward position of the CNB is defined as the difference between the face value of foreign currency-denominated CNB off-balance sheet claims on nonresidents (forwards, swaps, options, and futures market contracts) and foreign currency obligations to both residents and nonresidents. This position amounted to US$0 million on December 31, 2000. For program purposes, only the off-balance sheet obligations will be deducted from the CNB's net international reserves position. These liabilities amounted to US$0 million on December 31, 2000.

The net international reserves target for June 30, 2001 will be lowered by US$121 million, if the envisaged privatization of the telecommunications company (HT) is delayed beyond the second quarter.

For program purposes, the accounting exchange rates are equal to the mid-points of the exchange rates obtaining on December14, 2000. For the five most important currencies and the SDR, these exchange rates were (in kuna per unit of foreign currency):

Euro:	7.591856	Swiss franc:	5.051135
Japanese yen:	7.708251 (100 yen)	U.S. dollar:	8.667492
Pound sterling:	12.538160	SDR:	11.175344

The limits will be monitored from data on the accounts of the CNB supplied monthly to the Fund by the CNB within 15 days.

Limits on the Cumulative Increases in the Net Domestic Assets of the Croatian National Bank

	Ceilings
	(In millions of kuna)
Stock as of December 31, 2000	-8,461
Cumulative changes from December 31, 2000:	
March 31, 2001	197
June 30, 2001	37
September 30, 2001 1/	-5,198
December 31, 2001 1/	-1,470

1/ Indicative limit.

The net domestic assets of the Croatian National Bank (CNB) are defined as the difference between the base money and the net usable international reserves of the CNB (as defined for program purposes in Annex VII), both expressed in local currency at program exchange rates. Base money is defined as currency outside banks, vault cash of banks, giro and required reserve deposits of banks in domestic currency, and deposit money held at the CNB.

The limit for June 30, 2001 will be raised by the equivalent of US$121 million if the envisaged privatization of the telecommunications company (HT) is delayed beyond the second quarter.

If base money demand exceeds its projection, the CNB will consult with the Fund to determine whether these limits can be adjusted without jeopardizing the authorities' inflation target. The projected stocks of base money are as follows.

	Projection
	(In millions of kuna)
March 31, 2001	10,830
June 30, 2001	11,650
September 30, 2001	12,187
December 31, 2001	12,596

The limits will be monitored from data on the accounts of the CNB supplied monthly to the Fund by the CNB within 15 days.

Implementation of a Restrained Wage Policy
(Number of Affected Employees in Parentheses)

1. Budgetary sector (182,000)

a) The state budget envisages a 10 percent cut in the wage bill for 2001, under the following quarterly wage bill ceilings for the central government (in HRK million):

Quarter I	Quarter II	Quarter III	Quarter IV
3,715	3,523	3,345	3,125

Any excess in the cumulative wage bill will trigger compensatory measures as outlined in paragraph 16 of the MEFP.

b) Before end-2000
1) Finalize government strategy to effect the 10 percent wage bill cut in 2001, as mandated by Article 53 of the 2001 Budget Execution Law.[1]
2) Announce that in 2001 the basic wage for the public administration and public service shall be retained at the same level as in 2000.[1]
3) Decree that wages of higher public officials shall, in 2001, be at the same level as in 2000.[1]
4) Announce that no vacation bonuses, Christmas bonuses, or children's benefits (in cash or kind) shall be paid in the public administration and public service in 2001.[1]
5) Announce that the government shall pass a decree on the value of coefficients for individual posts within new ranges to be established by the forthcoming Laws on Public Administration and Civil Service Employment, such that any wage supplements heretofore granted by the decisions of line ministries will be terminated upon approval of these Laws. In anticipation of such supplements being abolished, travel allowances granted at the end of 2000 will be for a period of one month, rather than one year as has been customary at end-year.[1]

c) On January 15, 2001
Submit to parliament draft Laws on Public Administration and Civil Service Employment to rationalize the salary structure with a view to achieving a net reduction in wages and to introduce a 6–12-month severance period (with 90 percent pay) instead of placing people on leave for 12–36 months (with full pay) prior to dismissal.

d) By February 28, 2001
Enact the Laws on Public Administration and Civil Service Employment.[1]

e) By March 31, 2001.
1) Enact a government decree on establishing a uniform set of salary coefficients for individual posts across government ministries, to replace the current system of ministry-specific assignment of coefficients to similar posts, and with a view to reducing the wage bill.[2]

2) Issue separate decrees determining each Ministry's wage bill on the basis of the new coefficients and total number of employees.[2]
3) Announce the staff reduction plan, begin to reduce employment, and enact decrees on internal organization.
4) Begin income tests to allow means-testing of transportation allowances.

f) By July 1, 2001
Ministry of Finance to send out monthly paychecks to all employees of the budgetary sector and the extrabudgetary funds (except the health fund).

g) Remainder of 2001
Downsizing of budgetary sector increasingly effective--in total, a net reduction of some 10,000 envisaged.[2]

2. Nonbudget public sector (mainly 65,000 health employees)

a) By February 28, 2001
Freeze in basic wage for 2001 to be announced.[1]

b) By June 30, 2001
Negotiate agreement with unions to freeze the basic wage in 2001.

3. Ten large public enterprises (90,000)

a) Existing wage contracts to be repealed or renegotiated if extending beyond 2000 (by end March 2001).
b) Management and Supervisory Boards to seek 10 percent reductions of administrative staff (by end-December 2001).
c) Management and Supervisory Boards to maintain average wages in 2001 at 2000 level, without paying Christmas, vacation, or child bonuses.
d) Salaries of managers to be set at level not exceeding that for high government officials (for example, chairmen of management boards not higher than government ministers).

4. Other government-controlled public enterprises under the supervision of the CPF (40,000)
Insolvent companies pay only the minimum wage of HRK 1,700 a month, which will not be raised in 2001, for all their employees.

5. Other enterprises (583,000)
Negotiations on a Social Pact to resume in the first quarter of 2001, with a proposal from government to hold real wages to somewhat below productivity increases. Inflation adjustment to be forward looking. Government invitation for talks to be issued by end-February 2001.[1]

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[1]Prior action.
[2]Performance criterion.

Steps Necessary to Bring at Least 20 Percent of HT's Shares to the Point of Sale

By end-January 2001

- Complete the appraisal of the fixed assets.

By end-February 2001

- Submit the new Telecommunications Law to the parliament.

By end-April 2001

- Submit the amendments to the HT privatization law to the parliament with, inter alia, new proposals on the disposition of remaining government shares.
- Complete the unqualified audited accounts (present the audited financial statement).

By end-May 2001

- Decide on the size of the IPO offerings (domestic and foreign).
- Issue the privatization prospectus and organize the road show.[1]

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[1]Structural benchmark.

Statement by the IMF Staff Representative
March 19, 2001

The following information, which does not change the substance of the staff appraisal, has become available since the staff report was issued.

1. As noted in EBS/01/27, two prior actions remained to be completed before Board consideration of Croatia's stand-by request. On March 13, parliament amended the law on war veterans benefits by repealing car import privileges for all but disabled veterans with effect from June 1, 2001. On March 14, parliament approved legislation to enable the government to implement measures to reduce the budgetary wage bill. The two measures were as envisaged in the program except for a one-month delay in the repeal of the car import privileges and the extension of 0.5 percent annual seniority bonuses to civil servants and government workers with less than 5 years' tenure. The fiscal cost of these deviations is estimated at no more than 0.1 percent of GDP and the authorities have assured the staff that compensatory measures will be taken if needed to ensure observance of the fiscal performance criteria. With these parliamentary decisions, all prior actions have been completed.

2. Indicators on economic activity suggest a moderate strengthening of the economy in line with the staff projections. Summer tourism bookings from Germany, Croatia's largest market, are up by more than 50 percent on 2000. After a marked slowdown in the latter part of 2000, industrial production recorded a 14 percent annual growth in January (20 percent in manufacturing), more than could be explained by an increase in working days. Preliminary data from the third week of February show that bank credit to the private sector had already increased by 2.4 percent in 2001, mainly on account of additional credit to households.

3. Retail price inflation in February was 6.8 percent year on year, after falling to 6.6 percent in January. The uptick in inflation was due to an increase in electricity and fuel prices and is likely to be temporary. Core inflation remained flat at 4.5 percent in February. New signs of increasing wage moderation have materialized. Average gross wages grew by 2.1 percent year on year in December 2000, against an average increase of 7 percent in 2000. The exchange rate has been fairly stable relative to the euro, showing a slight tendency to depreciate against the U.S. dollar.

4. On March 7, the Croatian National Bank (CNB) cut the Lombard rate from 12 percent to 9.5 percent and the rate of remuneration on reserve requirements from 4.5 percent to 3.7 percent. These changes reflected an adjustment to market rates. Remuneration of reserve requirements was extended to all required reserves, thus rendering the move approximately neutral.

5. On March 6, following the placement of a five-year ¥25 billion Samurai bond in February at a spread of 152 basis points over yen Libor, the government successfully

- over -

launched a ten-year eurobond in an amount of €500 million. The issue, which was more than twice oversubscribed, was priced at 215 basis points over corresponding bunds.

6. On March 9, the government appointed the Norton Rose consortium as the official advisor for the restructuring of the state electricity company (HEP). On March 13, the government appointed Deutsche Bank and PriceWaterhouseCoopers as advisors for the restructuring and privatization of the oil and gas company (INA).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/30
FOR IMMEDIATE RELEASE
March 23, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with the Republic of Croatia

On March 19, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Croatia.[1]

Background

Propelled by private consumption and exports, the economy has pulled out of the 1998/99 recession. Consumption was boosted in 2000 by large wage increases granted during 1999 and the lifting of political uncertainties, while exports benefited from the recovery in Europe, past real effective depreciation, and a strong tourist season. Notwithstanding fiscal retrenchment, weak private investment, and a drought stricken fall harvest, real GDP is expected to have grown by 3.5 percent in 2000.

Increases in excise taxes and administered prices added to oil price increases in pushing up headline inflation, which reached 7.4 percent at the end of 2000. By contrast, the core inflation rate rose only moderately from 4.2 percent to 4.6 percent, reflecting the absence of underlying inflationary pressures. Reinforced by efforts to reduce civil service pay and income tax reductions, wage increases were more restrained in 2000.

Strong exports and large inflows of income transfers reduced the external current account deficit to an estimated 4.6 percent in 2000. Capital inflows from privatization, government borrowing and more favorable trade financing terms have strengthened international reserves and external vulnerability indicators have improved.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the March 19, 2001 Executive Board discussion based on the staff report.

Economic policy implementation in 2000 focused on restoring control over the public finances. The new government gave immediate priority to paying fiscal arrears and adopting a tight budget for 2000, relying primarily on cuts in discretionary spending and on a partial rollback of previous salary increases. During the year the authorities adopted a number of revenue measures that substantially lowered the revenue ratio. Despite missing their budget target, the authorities managed to reduce the central government deficit from 7.4 percent of GDP in 1999 to an estimated 6½ percent in 2000, thus partly reversing the deterioration of the preceding three years.

In the absence of inflationary pressures, the CNB took advantage of the strong external position and rising confidence in the banking system to accumulate international reserves, ease foreign exchange surrender requirements, allow the currency to appreciate slightly against the euro during most of 2000, and reduce reserve requirements and policy interest rates. As a result of these measures and higher inflation, real interest rates on loans fell to historically low levels, but credit to the economy began to expand only later in the year, reflecting probably both still weak demand and banks' increased caution in lending. The stimulative effect of lower real interest rates was partly offset by real effective appreciation that reflected, successively, the strength of the kuna against the euro, higher inflation, and a weakening U.S. dollar. Monetary conditions are much easier in early 2001 than at any time during the second half of the 1990s.

Since the 1998/99 banking crisis, confidence in the banking system has been strengthening, as evidenced by the vigorous growth of deposit liabilities. Three rehabilitated banks (including the country's second largest) were sold to foreign banks in 2000, and several mostly smaller banks were acquired by both domestic and foreign buyers, thereby reducing the number of banks from 60 at the end of 1998 to 44 at the end of 2000. The monetary policy and supervisory frameworks were strengthened, with legislative changes to guarantee the independence of the CNB and increase its power of intervention in insolvency cases—as well as the privatization of three smaller banks—still pending.

The outlook for 2001 is encouraging. In the authorities' program, real GDP growth is expected to accelerate moderately to 4 percent. With exports and private consumption likely to experience a modest deceleration, this expectation hinges crucially on a revival of private investment after three years of contraction. The prospects for such a revival are good: apart from the favorable effects of political stability, enterprise profitability is being boosted by lower nonwage labor costs, wage restraint, tax reductions, and the availability of credit at low interest rates. This expectation could, however, prove optimistic if economic growth in Europe were to slow substantially or if oil prices failed to decline as envisaged.

Inflationary pressures are likely to subside. With the disappearance of base year effects and an easing of oil prices, as well as wage restraint and exchange rate stability under the program, retail price inflation is expected to decline to 4.5 percent by end-2001.

On recent trends and assuming further fiscal consolidation, the current account deficit is likely to contract further in 2001 to below 4 percent of GDP, as merchandise exports continue to grow with improving access to foreign markets and the normalization of trade relations with Yugoslavia and as the recovery in the tourist industry continues.

Executive Board Assessment

Executive Directors welcomed the progress achieved by the new government in restoring control over the public finances and its adoption of a comprehensive economic program for 2001–2003. Directors agreed that this program, with its focus on the fiscal deficit and tax reductions, wage discipline, and structural reforms in the context of a stable exchange rate, offers the best prospects for achieving sustainable economic growth and external viability, while increasing employment and the population's standard of living in the medium term. After an auspicious beginning, and with a recovering economy and a strengthened financial system, it is now important for the authorities to implement their program in a steadfast manner.

Directors agreed that a further reduction of the fiscal deficit and of the size of government is needed to improve economic efficiency and promote sustainable growth. The one-off nature of privatization receipts and the impending introduction of the second pension pillar add to the urgency of the adjustment effort, which should be completed over the next few years so as to avoid renewed increases in the public debt ratio.

In light of these requirements, Directors reviewed the 2001 budget as appropriate. Recognizing that the budget was burdened by the effects of recent tax relief measures and new court-ordered pension obligations, they attached particular importance to the strict observance of public spending limits. The intended reduction of the public sector wage bill and the implementation of the staff reduction plan are critical elements of this policy. Directors observed that the wage policy for the budgetary sector is ambitious, but needs to be seen against the backdrop of large wage increases in the past and a wage bill that is high by international standards. Directors welcomed the government's intention to implement contingency measures in the event of fiscal slippage, and to defer some discretionary expenditure until there is evidence that the envisaged external current account adjustment is on track. They also noted that the new treasury system should facilitate the observance of the spending limits and welcomed the increased transparency of the budget process. Directors emphasized that there is no room in the 2001 budget to reduce taxes further or to restore entitlements. In view of the magnitude of the expenditure adjustment to be achieved, they stressed the importance of mobilizing a sufficient social consensus in favor of the planned public sector reforms. Directors took note of the authorities' decision to rely on external borrowing to meet the public sector financing requirements. While Croatia's credit standing has improved strongly, Directors cautioned against any substantial increases in the country's level of external public debt.

Looking ahead, Directors supported the government's fiscal objectives for 2002–03, noting that priority attention would need to be given to further expenditure cuts. The government's wage bill will need to be kept under strict control, and Directors considered that substantial savings could be realized by reducing the large imbalances in the pension and health funds. They encouraged the authorities to consider reforms aimed at broadening the bases for social security contributions and co-payments for health services and at rationalizing benefits, including their harmonization across different types of beneficiaries.

In view of the considerable easing of monetary conditions, Directors encouraged the Croatian National Bank (CNB) to monitor liquidity conditions carefully and to ensure that interest rates remain sufficiently high to attract deposits. In view of the most recent reduction of the CNB's main policy rate, Directors considered that monetary policy had, for the present, gone as far as it prudently could to stimulate credit expansion.

Directors considered that the present level of the exchange rate is consistent with maintaining external competitiveness in the improved external environment, provided the authorities implement fully their overall economic program. They stressed, however, that the CNB should keep the exchange rate flexible and avoid resisting large or persistent exchange market pressures.

Directors noted that comprehensive and sustained structural reform is indispensable to put the economy on a higher growth path and achieve a lasting reduction in Croatia's high unemployment rate. They urged the authorities to proceed with the structural reform agenda in close cooperation with the World Bank, giving priority to pension and health sector reform, financial sector stability, labor market flexibility, and greater enterprise efficiency.

In this context they stressed the need to restructure and privatize the major state-owned enterprises after creating appropriate regulatory frameworks where needed. Apart from continued favorable conditions, the growth and employment prospects now depend on a revival of private investment. Directors stressed that for this to happen further steps need to be taken to cut red tape, reform the legal system, and ensure legal security for business, including clear property rights. They also noted the importance of economy-wide wage restraint for an improvement of the employment outlook.

Directors welcomed the recovery and revitalization of the banking system under a strengthened regulatory framework and improved supervision. With most banks now in private hands, Directors called on the authorities to privatize the remaining banks and complete legislation ensuring the independence of the CNB and further strengthening its role in preventing and solving banking problems. They welcomed the authorities' agreement to participate in the Financial Sector Assessment Program (FSAP), and looked forward to discussing the results of this exercise at the occasion of the next Article IV consultation.

Directors welcomed Croatia's accession to the World Trade Organization (WTO) and commended the authorities on the recent substantial reduction in tariff and nontariff barriers.

The authorities are encouraged to continue to improve their economic statistics, in particular regarding the timely compilation of data on general government operations and government arrears, leases, and guarantees.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Croatia: Selected Economic Indicators

	1995	1996	1997	1998	1999	2000	2001 Program
Real economy (percentage change)							
Real GDP	6.8	6.0	6.6	2.5	-0.4	3.5 1/	4.0
Unemployment rate (average; percent of labor force) 2/	n.a	10.0	9.9	11.4	13.6	15.1 3/	14.5
Nominal net wages (percentage change; period average)		17.7	14.8	15.4	11.2	9.0 4/	...
Retail prices (e.o.p.)	3.7	3.4	3.8	5.4	4.4	7.4	4.5
Gross domestic saving (percent of GDP)	9.9	16.1	18.2	17.2	18.7	20.2 1/	22.0
Gross domestic investment (percent of GDP)	17.6	21.9	29.8	24.3	26.3	24.8 1/	25.8
Public finance (percent of GDP)							
Consolidated central government (cash basis) 5/	-0.9	-0.4	-1.3	0.6	-2.0	-5.1 1/	-0.8
Consolidated central government (accrual basis)	...	...	-2.0	-3.0	-7.4	-6.5 1/	-5.3
Money and credit (e.o.p.; percentage change)							
Broad money	40.4	49.1	37.6	13.0	-1.1	26.5 1/	15.3
Credit to consolidated central government	-3.0	-3.4	-49.9	-2.7	41.1	19.2 1/	0.0
Other credit 6/	18.9	3.1	44.1	22.4	-6.5	4.4 1/	15.9
Interest rates (e.o.p.; percent)							
Average deposit rate	6.1	4.2	4.4	4.1	4.3	3.6	...
Average credit rate	22.3	18.5	14.1	16.1	13.5	10.5	...
Balance of payments (percent of GDP)							
Trade balance	-17.3	-18.2	-25.8	-19.2	-16.4	-17.9 1/	-17.3
Current account balance	-7.7	-5.5	-11.6	-7.1	-7.6	-4.6 1/	-3.9
Total external debt (e.o.p.) 7/	20.8	23.2	31.9	40.3	44.5	53.2 1/	50.4
Gross official reserves (USD million; e.o.p.)	1,895	2,314	2,539	2,816	3,025	3,423	3,663
Reserve cover (months of imports of goods and services)	2.4	2.8	2.7	3.2	3.7	4.2	4.3
Short-term debt in percent of gross usable official reserves 5/	31.6	40.7	45.6	75.1	77.3	96.3 1/	75.7
Exchange rate							
Exchange rate regime			Other managed floating				
Croatian kuna per US$ (January 31, 2001)			8.37687				
Nominal effective rate (1995=100; p.a.)	100.0	100.3	101.0	100.4	94.7	94.4 8/	...
Real effective rate (1995=100; p.a.)	100.0	99.3	99.6	101.3	97.1	98.8 8/	...

Sources: Croatian authorities; Information Notice System; and IMF staff estimates.

1/ Estimate.
2/ Labor Force Survey (based on ILO standards).
3/ January-June.
4/ November.
5/ National presentation, with privatization receipts above the line.
6/ After inclusion of arrears repayment, credit expansion would be 15.3 percent in 2000 and 18.5 percent in 2001.
7/ Does not include debt that was excluded from the London Club agreement.
8/ October.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 01/10
FOR IMMEDIATE RELEASE
March 19, 2001

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves 14-Month US$255 Million Stand-By Credit for Croatia

The Executive Board of the International Monetary Fund (IMF) today approved a 14-month stand-by credit for SDR 200 million (about US$255 million) for Croatia. The decision will enable Croatia to draw SDR 40 million (about US$51 million) from the IMF immediately. However, in view of the comfortable reserve level, good access to capital markets, and the positive external outlook, the authorities do not intend to make purchases and will treat the arrangement as precautionary.

Following the Executive Board discussion on Croatia, Stanley Fischer, First Deputy Managing Director and Acting Chairman, said:

"The Croatian authorities are commended for adopting a three-year economic program for 2001-03 that seeks to achieve sustainable high rates of economic growth with price stability and external viability through fiscal adjustment, wage discipline and structural reforms in the context of continued exchange rate stability. Reduced government spending, a lower tax burden, wage restraint throughout the economy as well as economic liberalization, restructuring, and privatization will help boost productivity—the basis for future real wage increases and higher living standards—and employment. The program is ambitious, as is necessary for Croatia's economic stability and development, and its successful implementation will require firmness on the part of the authorities and support by parliament and the public at large.

"The authorities have acted forcefully to implement their program for 2001 by adopting a restrained budget, introducing a new treasury system, and laying the foundations for a tight wage policy in the public sector. The full implementation of this policy is crucial for attainment of the government's deficit target and for the adoption of a social pact that establishes responsible wage guidelines in the rest of the economy. It is therefore urgent for the government to translate its legislative authorization into actual wage scales for civil servants and other government workers, and to adopt and start implementing specific employment reduction plans. The finances of the pension and health funds should be firmly controlled while more fundamental reforms are being prepared with the assistance of the World Bank. If slippages in the fiscal area were to materialize despite these efforts, the authorities should not hesitate to activate the contingency measures identified in their program.

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"The 2001 budget's heavy reliance on privatization receipts makes it essential for the authorities to press ahead with their privatization plans. Prompt and decisive action in this area will inspire confidence in the authorities' economic program and improve economic efficiency over time.

"With improved access to foreign markets, continued regional stability, and full implementation of the program, the present level of the exchange rate should remain appropriate, thus maintaining Croatia's external competitiveness during the program period. The Croatian National Bank's (CNB) monetary program for this period is consistent with a stable exchange rate, but the CNB should not resist any unexpected large or persistent exchange market pressures," Mr. Fischer said.

ANNEX

Program Summary

Croatia's economy has pulled out of the 1998/99 recession and the banking system has recovered from its recent crisis. Consumption was boosted in 2000 by large wage increases granted during 1999, the lifting of political uncertainties, and monetary easing, while exports benefited from the recovery in Europe, past real effective depreciation, and a strong tourist season. Real GDP growth is likely to accelerate to 4 percent in 2001 from an estimated 3.5 percent in 2000. However, this moderate acceleration is still too little to make a dent in unemployment at a time of planned public sector layoffs. Although both its headline and core rates have risen in 2000, the outlook for inflation remains benign, with retail price inflation subsiding to 4.5 percent during 2001 from 7.4 percent in 2000 as a result of wage restraint, exchange rate stability, and oil price moderation.

The authorities are committed to slashing the size of government and its financial imbalance, while maintaining price stability on the basis of a broadly stable exchange rate. The new government has made a good start in 2000 in reducing government spending, tax pressure, and the fiscal imbalance. Concurrently with fiscal adjustment, the CNB has eased monetary conditions. Under its fiscal framework for 2001-03, the government intends to reduce consolidated central government spending from 46.2 percent to 37.6 percent of GDP and the fiscal deficit to 1.3 percent of GDP from 6.5 percent.

The authorities' program for 2001 is based on further fiscal adjustment, wage restraint, and structural reform. The policies are designed to ensure the desired stability of the exchange rate under the chosen managed float regime. But the CNB will not resist persistent or large exchange market pressures or tolerate endangering achievement of its quarterly international reserve targets.

Fiscal policy aims to reduce the consolidated central government deficit to 5.3 percent of GDP in 2001 from an expected 6.5 percent in 2000, implying a 4.3 percentage point reduction of expenditure in light of tax reductions and court-mandated additional pension spending. The required expenditure savings will result mainly from cuts in the wage bill, purchases of goods and services, investment and social transfers. The deficit is expected to be financed mainly with privatization receipts, without recourse to domestic bank financing. The program contains contingency measures to offset wage policy implementation and other fiscal slippages and an adjuster for delays in privatization. Wage restraint is to be achieved by a reduction of the government sector wage bill, a freeze of average wages in public enterprises, and a social pact that limits wage increases in the rest of the economy to somewhat below productivity gains.

The CNB's **monetary policy** for 2001 is based on a stable exchange rate and seeks to reduce retail price inflation to 4.5 percent by year-end. The CNB expects the demand for broad money to grow further—although at a reduced rate—in 2001, reflecting faster growth in economic activity and strengthening confidence in the banking system, especially after repayment of the balance of insured deposits in failed banks at the end of 2000. The CNB will use part of the rising demand for base money during the tourist season to accumulate international reserves so as to keep their gross level at about 4.25 months of imports.

Meanwhile, banks that survived the 1998/99 banking crisis have attracted new deposits and rebuilt their capital base, reflecting strengthened confidence in the banking system. While banks now have long foreign exchange positions, foreign currency lending to potentially unhedged borrowers is likely to involve substantial indirect exchange rate risk. Ownership concentration is expected to continue within a strengthened regulatory and supervisory framework

Structural reforms aim at economic liberalization, restructuring, and privatization. The authorities intend to improve the finances of the pension and health funds and the competitiveness of the economy to attract foreign investment, directly through privatization and indirectly through a more welcoming institutional and regulatory framework. They view these measures as necessary to achieve their growth and employment objectives. Measures to strengthen the pension and health fund finances, safeguard the confidence in the banking system, increase the flexibility of labor markets, and improve enterprise efficiency are important to the present program.

Croatia joined the IMF on December 14, 1992, and its quota[1] is SDR 365.1 million (about US$465 million). Its outstanding use of IMF financing currently totals SDR 121 million (about US$155 million).

[1] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing and its share in the allocation of SDRs.

Croatia: Selected Economic Indicators

	1995	1996	1997	1998	1999	2000	2001 Program
Real economy (percentage change)							
Real GDP	6.8	6.0	6.6	2.5	-0.4	3.5 1/	4.0
Unemployment rate (average; percent of labor force) 2/	n.a	10.0	9.9	11.4	13.6	15.1 3/	14.5
Nominal net wages (percentage change; period average)		17.7	14.8	15.4	11.2	9.0 4/	...
Retail prices (e.o.p.)	3.7	3.4	3.8	5.4	4.4	7.4	4.5
Gross domestic saving (percent of GDP)	9.9	16.1	18.2	17.2	18.7	20.2 1/	22.0
Gross domestic investment (percent of GDP)	17.6	21.9	29.8	24.3	26.3	24.8 1/	25.8
Public finance (percent of GDP)							
Consolidated central government (cash basis) 5/	-0.9	-0.4	-1.3	0.6	-2.0	-5.1 1/	-0.8
Consolidated central government (accrual basis)	...	...	-2.0	-3.0	-7.4	-6.5 1/	-5.3
Money and credit (e.o.p.; percentage change)							
Broad money	40.4	49.1	37.6	13.0	-1.1	26.5 1/	15.3
Credit to consolidated central government	-3.0	-3.4	-49.9	-2.7	41.1	19.2 1/	0.0
Other credit 6/	18.9	3.1	44.1	22.4	-6.5	4.4 1/	15.9
Interest rates (e.o.p.; percent)							
Average deposit rate	6.1	4.2	4.4	4.1	4.3	3.6	...
Average credit rate	22.3	18.5	14.1	16.1	13.5	10.5	...
Balance of payments (percent of GDP)							
Trade balance	-17.3	-18.2	-25.8	-19.2	-16.4	-17.9 1/	-17.3
Current account balance	-7.7	-5.5	-11.6	-7.1	-7.6	-4.6 1/	-3.9
Total external debt (e.o.p.) 7/	20.8	23.2	31.9	40.3	44.5	53.2 1/	50.4
Gross official reserves (USD million; e.o.p.)	1,895	2,314	2,539	2,816	3,025	3,423	3,663
Reserve cover (months of imports of goods and services)	2.4	2.8	2.7	3.2	3.7	4.2	4.3
Short-term debt in percent of gross usable official reserves 5/	31.6	40.7	45.6	75.1	77.3	96.3 1/	75.7
Exchange rate							
Exchange rate regime			Other managed floating				
Croatian kuna per US$ (January 31, 2001)			8.37687				
Nominal effective rate (1995=100; p.a.)	100.0	100.3	101.0	100.4	94.7	94.4 8/	...
Real effective rate (1995=100; p.a.)	100.0	99.3	99.6	101.3	97.1	98.8 8/	...

Sources: Croatian authorities; Information Notice System; and IMF staff estimates.

1/ Estimate.
2/ Labor Force Survey (based on ILO standards).
3/ January-June.
4/ November.
5/ National presentation, with privatization receipts above the line.
6/ After inclusion of arrears repayment, credit expansion would be 15.3 percent in 2000 and 18.5 percent in 2001.
7/ Does not include debt that was excluded from the London Club agreement.
8/ October.

Statement by J. Wijnholds, Executive Director for
Republic of Croatia
March 19, 2001

The set of documents present a candid but fair assessment of Croatia's economic achievements and its remaining vulnerabilities. The Croatian authorities are grateful to staff for their tireless efforts in helping them steer through the economic reform course, and have expressed their intention to publish the entire set of (first-rate) documents. The authorities intend to use this Stand-By Arrangement as precautionary.

Fiscal Policy

One of the main accomplishments of the government, and one that will be further sustained under the Fund arrangement, is the enormous improvement in the structure of public finances. Between 1999 and 2003 consolidated central government expenditure is set to decline by an impressive 12.5 percentage points to 37.6 percent of GDP! The tax burden on the economy will commensurately decline but at a slightly slower pace, allowing the budget deficit to be reined in from –7.4 percent GDP in 1999 to –1.3 percent GDP in 2003. As part of this fiscal consolidation, domestic arrears are estimated to have been reduced by 4.5 percent GDP in 2000. Also notable is the fact that, for the first time, the government released three-year budget projections with clear fiscal targets. As such, transparency and accountability have been greatly enhanced.

Privatization revenues and external borrowing are expected to cover this year's entire government financing need, while the current account deficit is fully covered by foreign direct investment. Moreover, as Staff notes in its supplement, the recent 10-year Eurobond issue (raising the equivalent of roughly 2.5 percent GDP) was very successful, and twice oversubscribed. Croatia is increasingly seen as a European "convergence credit", which is evident from the tight trading range between for instance Croatian and Slovakian bonds - roughly 200 basis points over Bunds. Within JP Morgan's EMBI Global Index, Croatia was the best European performer in February, with a decline in the spread of 36 basis points.

Monetary and Exchange Rate Policy

Croatia's National Bank (CNB) has been one of the most successful in Central and Eastern Europe, and kept inflation within the single digits for over half a decade (following the introduction of Croatia's new currency, the kuna, in 1994). Last year's up-tick in inflation can be primarily explained by the higher energy prices and some increase in excises. Core inflation remains stable at just over 4 percent. The exchange rate, as a result, has also been quite stable even though it is allowed to float. Reserve levels are steadily increasing and now comfortably cover short-term debt (on a residual maturity basis).

The Financial Sector

In large part thanks to forceful intervention in the banking system by CNB (in the face of sometimes substantial vested interests), the banking sector has been significantly strengthened. Capital adequacy is an average of 22 percent, and non-performing loans are well provisioned for. Moreover, the number of state-owned banks has been greatly reduced, with their share in total banking assets falling from 40.4 percent in 1999 to 6.2 percent mid-2000. At the same time, foreign ownership of Croatia's banks has increased substantially with the share of assets of majority-foreign-owned banks rising from 40 percent to 76 percent in the same period. The increased foreign ownership has injected additional expertise and competition into the banking sector, and likely improved credit policies further.

Staff rightly points to a vulnerability which is discussed in somewhat more detail in this year's staff report – that of banks' foreign exchange (linked) lending to potentially unhedged borrowers. Although data is sketchy or absent, it seems plausible that not all of the lending to the nonfinancial sector is hedged (i.e. this is separate from the net open long position in foreign exchange of $ 458.4 mln, which the supervisory authorities have been reducing by lowering the limit on the open position from 30 percent to 25 percent of risk-weighted capital). The supervisory authorities are keenly aware of the risks and have discussed this with commercial banks. New foreign ownership has brought improved credit policies and some banks are internally making efforts to reduce the number of foreign exchange denominated or indexed loans. Also, many banks are now including out-of-court procedures in many loan contracts with households, which facilitates loan recovery. The FSAP mission will undoubtedly also further examine this issue later this year.

Structural

Unemployment remains high (roughly 15 percent on an ILO basis) and will likely not decline much, in the short run, given the envisaged public sector layoffs and the privatization process. Over 10,000 employees in the central government are scheduled to be cut in 2001 (5.5 percent of public sector employment), mostly from the Ministry of Interior and the Ministry of Defense.

At the same time, significant headway is being made in privatizing the large number of (partly) government owned firms. Following the establishment of new management in the privatization fund (CPF) at the beginning of 2000, 321 insolvent companies that employed some 11,000 people have recently been put into bankruptcy and are being liquidated. Moreover, by the end of this year, the CPF intends to sell an additional 327 companies (employing over 50,000) out of its portfolio, amounting to two thirds of the companies left to privatize by the CPF. It should be noted that the CPF is responsible for privatizing all but the 10 largest enterprises (which include the oil and gas company, the electricity company and the telecommunications company) and that the budget, prudently, has not assumed any revenues emanating from the CPF privatizations.

Thanks to recent WTO membership, a free trade agreement with Bosnia and Herzegovina and other regional partners, and now the move towards a Stabilization and Association Agreement with the EU, tariffs have been further reduced. Croatia now ranks a '1' on the Fund's trade restrictiveness index, putting it among the most open economies.