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Statement by the Hon. **BORISLAV SKEGRO**,
Governor of the Bank for the **REPUBLIC OF CROATIA**,
at the Joint Annual Discussion

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THE WORLD BANK GROUP

STATEMENT BY Mr. BORISLAV ŠKEGRO
DEPUTY PRIME MINISTER AND MINISTER OF FINANCE
OF THE REPUBLIC OF CROATIA,
THE GOVERNOR OF THE WORLD BANK

October 6, 1998

Mr. Chairman, Governors and Distinguished Guests,

It is a great pleasure and privilege to address the 1998 Annual Meetings of the Boards of Governors of the World Bank and the IMF.
I would like to take the opportunity of this Annual Meeting to warmly thank Mr. Wolfensohn and Mr. Camdessus for the past year.

Mr. Chairman, *allow me first to refer briefly about the economic developments and achievements in the Republic of Croatia.*

Since the introduction of the stabilisation programme in October 1993, the Republic of Croatia has achieved remarkable fundamental macroeconomic stability and has increased GDP growth with low inflation - one of the lowest levels in the region. Economic recovery continued from 1994 and consumer spending stimulated growth with import expansion. The post-war reconstruction took off as real GDP grew to 6%. Croatia has become one of the successful cases among the transition economies in Emerging Europe, with inflation between 3-4% and above-average GDP growth.

Turning briefly to the fiscal performance I am happy to report that in 1998 Croatia is expected to be one of the few Emerging European countries to achieve a balanced budget. Budget revenues doubled in the first half of 1998 with the introduction of a 22% VAT on all products and services. The new tax system has also improved collection, especially by introducing heavy fines for delays in tax payment. The statistics on the government budget indicate a surplus of 2,5 percent of the total budget, which will be used for the financing of reconstruction needs, major infrastructure projects and the covering of social expenditures.

A few words about monetary policy. Croatia's domestic currency, the Croatian kuna, has been floating and it has shown remarkable stability both in nominal and in real terms. Monetary policy remains tight and the first half of 1998 was marked by a decrease in the money supply (M1) and high growth of total bank credits. At the end of 1997, net foreign assets of the central bank amounted to more than 95 percent of its total balance sheet. Presently, the amount of international reserves is about 2,55 billions USD, which surpasses the money supply. The current level of Croatian National Bank foreign exchange reserves covers 2.7 months of imports of goods and services. It is expected that the foreign exchange reserves will continue to grow in the future.

I would briefly like to touch more upon one issue - balance of payments. The 1997 current account deficit of around 12,6 percent of the estimated GDP has been the main topic of numerous discussions. However, it is important to note that this deficit was a result of the increase of both imports and exports.
Nevertheless, we should keep in mind that in conditions of relatively low domestic savings, real growth could be financed only from foreign sources.

At the end of the short overview of Croatian achievements it is worth mentioning that Croatia has regularised all its relations with foreign creditors, including the Paris and the London Club and that the foreign debt remained at about 28% of GDP at the end of 1997.

Since the beginning of 1997 the Republic of Croatia received an investment grade rating (from Moody's, S&P and IBCA) which was instrumental for a successful approach to the international financial markets. By mid of 1998, all agencies confirmed the credit rating. Internationalisation and the drive to the foreign capital markets can also be seen at the corporate level.

After 6,5% GDP growth in real terms in 1997, economic activity in Croatia in 1998 is estimated to be 7% by the end of the year. While progress with structural reform has been made in several areas, further efforts are needed in key areas (notably improving banking system operations, privatisation of state-owned banks and large public enterprises, and completing trade reform consistent with the requirements for accession to the WTO).

How do we see future developments? The Croatian industry and tourism is picking up and also export industries are becoming a driving force of economic growth. Still we are well aware of the challenges facing the Croatian economy. There is much yet to be done in the restructuring and privatisation of large public sector economy, as well as in the banking sector. The Croatian economy is small and future development is possible through the adjustments of an open and export-oriented policy. Longer term, the potential of the Croatian economy lies in its integration into the European Union and other institutions such as the World Trade Organisation and NATO.

I would emphasise the importance of foreign market access and the process of integration into the international economy. But, the high level of financial integration in the world today - and extremely dynamic capital flows - means that all countries have to be much more careful. Over the last 18 months, events in Asia and elsewhere (including most recently Russia) have vividly illustrated the consequences of the combination of a weak financial system and inadequate macroeconomics policies.

What does globalisation imply for small member countries of the Bretton Woods institutions like Croatia? We are fully aware that we are a part of the global family, and we accept that there is really no other viable alternative but for us to find our niche in the world marketplace. But, every country has its own specific features. Therefore, because of our size and location, it is unlikely that we can compete for private capital flows in unrealistic high amounts, so we would rely also on official capital flows from the international financial institutions. At the same time, the needs of other developing countries, particularly the transition economies (especially Central and Eastern European) are significantly larger than ours. I therefore fully share the concern that the expected financial requirements of members may impose severe strains on the future resources of the Fund and the Bank.

I feel that one of the major challenges that faces the Fund and the Bank today is to ensure that the allocation of funds and the modalities of their facilities are constantly aligned to the real needs of member countries. This would go a long way to lifting the effectiveness of the twin institutions and improving the economic well being of its members. The special needs of member countries like those in transition and the heavily indebted call for bold and innovative approaches. I am therefore pleased to support the continuation of the Enhanced Structural Adjustment Facility (ESAF) as a permanent feature of the Fund's facilities. In my view, the temporary and monetary features of the Fund' s mandate are not being compromised by ESAF. The Fund' s role is constantly being frustrated by the lack of adjustment and reforms that are prerequisites to the achievement of the Fund's wider and, I believe, more strategic objectives of growth and prosperity. I therefore propose the Bank and the Fund to work very closely together to address the special structural needs of member countries.

There is also a need to expand the flow of resources from the World Bank. The level of the World Bank lending remains almost unchanged and this despite the fact that a large number of new members have joined the Bank in the past few years. The Bank has the headroom necessary for new lending. There is a case for increasing the flow of lending from the World Bank to support critical areas, including especially infrastructure. Private sector and commercial banks have to take a larger share as well. This is an area in which we are trying to increase both public and private investment. I believe the World Bank can help support this effort through a combination of direct lending and play a catalytic role in using its other instruments to facilitate new investments (e.i. partial guarantees etc.).

I have already welcomed the World Bank role in the joint initiative to alleviate the debt problems of the heavily indebted poor countries. However, I should like to emphasise the paramount importance of preserving the financial integrity and preferred creditor status of multilateral creditors. The present debt initiative must therefore be a one-time initiative, with clear boundaries.

The IMF initiative to strengthen the architecture of the international monetary system has been perceived as the right response to current challenges. In this regard, let me emphasise that Croatia, although being a small country, has been determined to become a productive participant/player in the global economy. It' s not just about its support to the XI Increase of Quota as to ensure resources for proper functioning of the IMF or acceptance of the Amendment of the IMF Articles of Agreement regarding SDR allocation as to achieve greater equity, or regular provision of the data to the Fund.

It is also, among other things, about Croatia's effort to enhance effective financial surveillance, as well as the accountability and credibility of its macroeconomics policies. In this regard, I must stress how greatly Croatia has benefited from the IMF's technical assistance and close dialogue with Fund staff also in this year.

Let me just mention close collaboration on improving the quality of a database in view of our commitment to SDDS (Special Data Dissemination Standard). Recognising the key importance of transparency, Croatian authorities also have consented to publishing the Press Information Notice for Croatia this year. We are also carefully following other IMF initiatives as for example its work on liberalisation of capital movements. In this respect, we welcome the IMF approach to orderly liberalisation.

Allow me at the end to make a final comment that the co-operation between the Bank, as well as the Fund with the Republic of Croatia is good and supportive and we are sure that further Bank and Fund activities in the Republic of Croatia would be performed in accordance with our positive and co-operative achievements.
I conclude by wishing the Bank and the Fund well in their next year of operation.