

INTERNATIONAL MONETARY FUND

WORLD BANK GROUP

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

J

Press Release No. 18

October 3, 2004

Statement by the Hon. **ZELJKO ROHATINSKI**
Governor of the Fund for the **REPUBLIC OF CROATIA**,
at the Joint Annual Discussion

**Statement by the Hon. Zeljko Rohatinski,
Governor of the Fund for the Republic of Croatia,
at the Joint Annual Discussion**

Mr. Chairman, honorable delegates, ladies and gentlemen,

It is a great pleasure and privilege to address the 2004 Annual Meetings of the Boards of Governors of the World Bank and the Fund here in Washington D.C., the place close to Bretton Woods where our sister institutions were founded 60 years ago. Over the past six decades the global economy has changed quite a bit, it has become far more integrated to say the least. Both the Bank and the Fund made an important contribution in there, as their role in promoting international economic cooperation was indispensable. Looking forward, this role of Bretton Woods institutions will continue to be a cornerstone of prosperous global economy, but at the same time, this role will also present the main challenge, since universal sense of the global economy working for all is not entirely there yet. Having said that, I would like to express my warm appreciation to Messers. Rato and Wolfensohn for their dedicated service to our institutions, and I wish them much success and wisdom in steering the institutions in years to come. Also, my gratitude goes to former Managing Director of the Fund, Mr. Köhler.

In remainder of my statement, allow me first to cover major economic developments related to Croatia. Thereafter, I will say a few words about Croatia's relations with the Fund and the Bank. And finally, I intend to touch on a couple of policy issues relevant for the Bank/Fund business.

To start with the major Croatia's economic developments, I cannot resist mentioning first a big political event, obtaining a candidacy status for EU membership in June this year, the event everybody in Croatia had waited for. We expect accession negotiations to commence early next year. Without doubt, the accession process will anchor future reforms and economic policies, hence helping us to preserve macroeconomic stability and to deal effectively with some of the challenges our economic policy faces.

Having mentioned challenges, it should be noted that relatively high and increasing foreign debt represents a major challenge at present. Foreign debt almost doubled over the past few years (it accounts to approx. 80 percent of GDP at present), and roots for such a debt dynamics could be found both in lack of government's will to consolidate public finances more decisively, and in low interest rates, which in combination with relatively easy access to credit spurred private consumption too. On one hand, such a strong domestic demand helped Croatia to weather the global downturn after 2000/01. In fact, Croatia hardly felt global downturn, it achieved relatively high growth rates in both 2002 and 2003 (5.2 percent and 4.3 percent, respectively) at low single-digit inflation. However,

on other hand, strong domestic demand came at the cost of strongly increasing foreign debt, high budget and current account deficits.

Against this background, the main objective of the current policy stance is to narrow the domestic savings-investment gap in order to stabilize foreign debt. Strong fiscal consolidation (together with a shift in budget deficit financing to domestic resources) is seen as a main vehicle to achieve the aim. Only this year budget deficit is projected to be cut by 1.8 percentage points of GDP. And in the following two years by additional 1.6 percentage points of GDP, notwithstanding the expenditure pressures related to EU accession. All this should bring down the budget deficit to 2.9 percent of GDP by 2007. At the same time, monetary policy will continue to be geared towards low inflation and exchange rate stability, which is entirely consistent with Croatia's EMU aspirations. Though such a monetary policy itself should not necessarily help curbing domestic demand, the central bank will continue to assist the efforts of fiscal policy to stabilize overall external debt. That said, it is noteworthy that the central bank implemented temporary measures to limit credit growth already last year. And this year, it introduced a temporary measure to discourage commercial banks' borrowing abroad. From a somewhat longer-term perspective, the central bank has been continuously improving banking supervision, which paid-off, as recent credit boom has not been reflected in a deterioration of portfolio quality. On the contrary, commercial banks' portfolio quality continued to improve and profitability remained high. (NPLs account to some 5 percent of total loans at present).

This overall macroeconomic policy will be supported, no doubt, with a number of structural measures. Some of the major measures involve enhancing fiscal transparency, improving expenditure and debt management, and perhaps most importantly judicial and public administration reforms. These reforms should have a positive impact on business environment, hence helping to attract non-privatization related FDI and facilitating private sector activity in the medium term. After all, these reforms, together with before mentioned economic policies, should pave the way to EU accession.

In turning to my second point - Croatia's relations with the Fund and the Bank – I want to stress first that Croatia continues to have open and fruitful discussions with the Fund/Bank staff. That said, just outlined economic policies and structural reforms are supported by the Fund's precautionary Stand-by arrangement signed two months ago. They are also to be supported by the World Bank too. In fact, a World Bank Programmatic Adjustment Loan (PAL) is currently under preparation, and it is expected to come on-board early next year.

Besides program arrangements with the Bank/Fund, Croatia is participating in a number of initiatives aimed at strengthening architecture of the international financial system. To quote some of them, I may start with quoting a joint IMF/WB's initiative - Financial Sector Assessment Program (FSAP). Croatia is one of the 70 countries for which FSAP has been already completed. Based on the FSAP mission report, a couple of The Reports on the Observance of Standards and Codes (ROSC) were made, and some of them have

already been updated. In addition to that, an assessment of the legal and institutional framework for anti-money laundering and combating the financing of terrorism was also undertaken. By making this step, Croatia tried to make its contribution to the worldwide efforts aimed at resolution and prevention of the most terrifying global threat we all witness these days. Separately, but still on strengthening the global financial system, Croatia has recently welcomed a comprehensive Financial Soundness Indicators (FSI) Coordinated Compilation Exercise project. As one of about 60 countries, we are participating in the project, hence actively supporting development of efficient tools for assessing the strengths and vulnerabilities of financial system.

Before turning to my third and final point, let me note a few more “assessments” completed for Croatia. In particular, Safeguard Assessment was completed early last year, and the subsequent one is currently underway. Then, the World Bank has done recently a Country Financial Accountability Assessment study in which it helps us identify weaknesses of our public financial management system. A fiscal ROSC was also completed a few months ago. All in all, through all these assessments Croatia is actively supporting a number of the Bank/Fund’s initiatives, but at the very same time it is receiving an increasingly valuable advice for which we are very much grateful. To this end, I wish to thank both the Fund and the Bank for providing us with expertise technical assistance, which is very much appreciated.

Finally, I wish to touch on a couple of policy issues relevant for the Bank/Fund business. First, as Croatia is now the EU candidate country, and currently in the process of the Bank country assistance strategy preparation, I would like to highlight the importance of the Bank’s assistance not only for our country but also for all other countries in the similar status, to have an operational focus with clear strategic fields of intervention defined in the present context of need for EU alignment. Second, I support wider application of the sector wide approaches as they support country-led programs for a coherent sector in a comprehensive and coordinated manner. As they are characterized, among other things, by country-owned sector policies and strategies and by a common program and an expenditure framework based on agreed priorities and strategies, a setting up such sector programs through adjustment financing instruments should promote easier future inclusion of the EU pre-accession and later structural funds. Third, I very much support the idea that all decentralized Bank offices should be able to really represent the Bank at whole, meaning the IFC and the MIGA as well. Recipient country sees the Bank’s presence through a country or a regional office, and it is difficult to understand constant excuses that the IFC and the MIGA are represented through their separate office in other countries. Cooperation among all institutions of the Bank group, not only at the country assistance strategy level, but also in the field, is of utmost importance for an improved effectiveness of the Bank as a whole. Fourth, as Croatia is a middle-income country, and all of the above issues are closely correlated, let me kindly ask for future support to the Middle Income Countries Strategy as well as for a promotion of the country systems adoption, especially for EU candidate countries. Such approach will further decrease the cost of doing business whereas letting us stay involved with the Bank in order to perform crucial structural adjustment within a joint effort. Finally, regarding the Fund business, I wish to

underscore that Croatia attaches a great importance to the Fund's transparency policy, especially given its general role in supporting strengthened domestic economic discussions and market assessment. I am pleased to see the country staff reports' publication rate standing at 76 percent now and I welcome a recent step forward in this area – presumed publication of all staff reports. I would like to point out that Croatia has supported the initiative to publish country reports from its early days, when report publishing used to be very voluntary. Thus, it is indeed a pleasure to see the initiative progress, achieving its aim.

Mr. Chairman, dear guests, allow me in concluding to thank our hosts for their warm hospitality and outstanding organization of these meetings. I wish the Fund and the Bank well in their future undertakings and thank them for the help provided to my country.