Statement by the Hon. BORIS VUJCIC,
Alternate Governor of the Fund for THE REPUBLIC OF CROATIA,
at the Joint Annual Discussion
Mr. Chairman, honorable delegates, ladies and gentlemen,

It is my pleasure and privilege to address the 2006 Annual Meetings of the Boards of Governors of the World Bank and the Fund here in Singapore, a country in East Asia which took advantage of globalization in the early days, and a country which could serve as a prime example of how globalization and free trade can bring prosperity. We are aware, however, that universal sense of global economy working for all is not entirely there yet. Moreover, we are witnessing these days rising protectionism in some of the countries previously known to promote globalization. In addition to that we observe continued existence of global imbalances which remain a key risk factor for the world economy. These lead us to a simple conclusion – promoting international economic cooperation remains a challenging task. Given the importance of Bretton Woods institutions in promoting international cooperation, my warm appreciation goes to Messrs. de Rato and Wolfowitz for their dedicated service to our institutions, and I wish them much success and wisdom in steering the institutions in years to come.

In my statement, allow me first to outline the major economic developments related to Croatia. Thereafter, I will touch on Croatia’s relations with the Fund and the Bank, and finally I intend to discuss a couple of policy issues relevant for the Bank/Fund business.

To start with economic developments, let me note at the outset that the Croatian economy has been doing fairly well despite adverse external developments over the past two years (oil hikes and rising interest rates). The economy is expected to grow by 4.5% this year, which is slightly better performance in comparison to 2005, unemployment is heading down to below 13% (the lowest level in the recent history), and inflation is to remain within last year's range of 3.3% to 3.5%, given persistent increases in energy prices. Budget deficit is expected to come down to 3.0% of GDP in 2006, following its July's revision, thanks to continued consolidation efforts and better than expected revenue performance. Nonetheless, large fiscal contraction (approx. 1.2 percentage points of GDP) that is envisaged this year will not have such a large impact on broader economy, given a partial counter effect of a start-up of pensioner's debt repayment (not included in fiscal accounts). Given the higher energy prices and strong credit growth, current account deficit is likely to deteriorate to about 6.8% of GDP in 2006, despite strong export performance. And in the similar vein, external debt is to deteriorate further to about 85% of GDP (from 82% of GDP in 2005), mainly thanks to continued and strong private sector borrowing.

No doubt, macroeconomic policies have limited impact on private sector borrowing. Hence, narrowing the domestic savings-investment gap (in order to stabilize foreign debt) through stronger fiscal consolidation continues to be the objective of the current policy stance. This policy is supported by ambitious privatization plan, as well as by several
central bank measures aimed at curbing credit growth. In particular, the central bank has already strengthened existing measure – marginal reserve requirement – which is increasing the cost of commercial banks' foreign borrowing. At the same time, the central bank has introduced a set of supervisory measures that should encourage prudent lending practices of commercial banks. However, curbing credit growth in an environment characterized by major foreign ownership of banks is more than a challenging task, especially if "parent" banks are trying to earn extra dividend through their "daughter" banks (given the existence of interest rate differentials). Hence, although central bank stands ready to introduce additional measures to curb credit growth, one should underline again only the supportive role of central bank's measures to curb credit growth in the context of the country's overall ambition to improve external imbalances.

In linking Croatian credit growth experience with recent GFSR discussion, I fully share the majority of concerns that GFSR raises while discussing the rapid growth of household credit in emerging markets. Nonetheless, in my view, one should be more cautious when expressing desirability of recent credit expansion in EM in light of the fact that credits are not starting from a low base in all EM economies. In addition to that, it is uncertain whether reforms in the area of securitization can help mitigate risks arising from high credit growth, as securitization brings additional liquidity that could be used for "new" loans, and hence increase household's debt exposure further on.

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. The Stand-by Arrangement, which has been supporting our macroeconomic policies over the past two years, is about to successfully end in mid-November. Following its expiration, the authorities' plan is to switch only to Article IV Consultations, which should send an additional signal of maturing on the way towards the EU. Fulfillment of EU accession criteria and successful EU integration have been calling for intensive structural and institutional reforms especially over the last couple of years, and the Bank’s Programmatic Adjustment Loans (PALs) have been supporting Croatia in that effort. The First PAL was successfully approved in fall 2005, and Croatia is committed to fulfill all the prior actions under the Second PAL before end 2006. The main aim of the PALs is to support Croatia in improving its investment climate and reducing the size as well as improving the efficiency of its public sector. In addition, Croatia has still been benefiting from the Bank’s investment lending focused primarily towards the improvement of social welfare, enhancement of economic competitiveness, protection of the environment, improvement of trade and transport infrastructure, and advancement of Croatia’s knowledge-based economy.

Besides program arrangements, Croatia has been participating in a number of the Fund/Bank initiatives aimed at strengthening the architecture of the international
financial system. I may quote Financial Sector Assessment Program and Financial Soundness Indicators Coordinated Compilation Exercise for instance. Also, in light of the still existing precautionary Stand-by Arrangement, the Fund staff has recently completed an updated Safeguards Assessment, which confirmed previous positive findings. In close cooperation with the authorities, the Bank is about to finalize Living Standards Assessment and Public Finance Review. In addition, I wish to thank both the Fund and the Bank for providing us with expertise technical assistance, which is very much appreciated.

Finally, let me touch on a couple of policy issues relevant for the Fund/Bank business. First, regarding the Fund's reform package, I support the ad hoc quota increase for the most underrepresented countries (China, Korea, Mexico and Turkey). Also, I believe that Executive Board will come up with a new quota formula in due time, which would adequately take into account both the size of countries and their openness. And with regard to the issue of the voice, it is somewhat unfortunate that there has been insufficient support for doubling of the basic votes already now at the first stage of the reform. Second, I welcome the multilateral consultation on global imbalances that the Fund is currently undertaking with the US, Japan, China, Saudi-Arabia and the Euro area. This exercise should help pave the way to orderly unwinding of global external imbalances, which is particularly important for emerging market economies, as they tend to be the most vulnerable to changes in investor sentiment. Third, regarding the Bank, Croatia, as an upper middle-income country, has made extensive progress in transforming its economy, achieving economic growth and moving toward the EU, also in collaboration with the Bank. Therefore, Croatia welcomes the continued Bank’s presence in middle-income countries, both in investment and adjustment lending as well as in technical assistance. However, the Bank’s presence is to be purely demand-based, and is to focus more on transferring knowledge and ideas, especially in helping find solutions for specific problems that are to be addressed in a custom and country fit format. In order to be able to provide such advice, the Bank needs to strengthen its local capacity and to cooperate more with local experts and institutes, especially in countries like Croatia, where EU accession continues to be the main goal over the medium term. Fourth, Croatia, like all EU countries, also fully supports strengthening the Bank’s strategy on governance and fighting corruption that should be addressed from a development perspective and within the Bank’s mandate. The principal objective of the Bank’s governance work should be to help build capable, accountable and responsive states that deliver services to the needy, promote private sector-led growth and tackle corruption effectively and firmly.

Mr. Chairman, dear guests, allow me in concluding to thank our hosts for their warm hospitality and outstanding organization of these meetings. We will definitely remember a sincere smile citizens of Singapore welcomed us with. I wish the Fund and the Bank
well in their future undertakings and thank them for the assistance provided to my country.