Statement by Lewis D. Holden, Alternate Executive Director
Date of Meeting: June 3, 1999

**Croatia: Country Assistance Strategy**

We welcome this opportunity to consider the Country Assistance Strategy for Croatia.

Staff should be complimented on the preparation of a well-written and informative document that clearly identifies the key policy issues and challenges facing the Croatian authorities. These can be summarised as the need for structural fiscal adjustments, the importance of extensive reform of the banking and judicial systems and a reversal of the rather inward looking approach that has characterized development to date.

A key message in the document is that the current structural shortcomings (e.g. the distorted and unsustainable pattern of public expenditures, and the weaknesses associated with the initial approach to privatisation) partly stem from the failure of the Bank and other development partners effectively to underscore the need to use initial reconstruction efforts as a spring board for longer term structural reform. Moreover, the Croatian experience highlights the difficulties for the Bank in forging an effective policy dialogue with members who enjoy relatively easy (albeit temporary) access to significant alternative sources of external assistance.

The paper also draws out very clearly the deleterious impact on Croatia’s transition of regional conflict and security tensions over much of the last decade, most recently in Kosovo. There remains, however, much that could be done within the authorities’ control to buttress the Croatian economy against the impact of the Kosovo crisis and lay the foundation for sustainable development. It is therefore crucial that, this time, the authorities and their development partners effectively focus on the longer-term agenda.

With this in mind, the Comprehensive Adjustment Scenario is arguably the minimum necessary to avoid the ‘stop-go’ approach to the transition process. Yet staff rightly raise questions about the sustainability of the authorities’ commitment to the Base Case adjustment.
path. In this context, we are not fully convinced as to the merit of the considerable front loading of financial assistance being proposed under the base case. We note that in FY00, the extent of financial assistance is no different than would apply under the high case lending scenario.

In view of the political uncertainties pertaining beyond FY00, we support the need for a CAS progress report early in FY01. However, one implication of this is that what we are today discussing is, in effect, an interim one year CAS. In these circumstances, we consider a case can be made for greater caution on the Bank’s part and a more gradual approach to ensure sustained ownership by the authorities.

The envisaged front-loading is, of course, driven by the inclusion of the $200 million SAL in FY00. This appears to be a remarkably large operation in the context of the Croatian economy, and we will look closely at its tranching structure and conditions when it is brought to the Board. In this connection, we would appreciate some further detail from staff on the scope and timetable for the foreshadowed IMF stand-by agreement, which we would expect to bear the bulk of the short-term external funding needs.

The CAS also raises for us some questions of sequencing. We would be interested in staff’s comments as to why, for example, the proposed judicial/regulatory reform project is not to proceed until FY01, notwithstanding the recognition that judicial reform, and its link to the effective operation of markets, is essential even to the immediate banking sector reforms highlighted in paragraph 57. On the face of it, judicial reform should attract a higher priority than, say, the Kastela Bay Cultural Heritage project foreshadowed for FY00.

Our final comment relates to the treatment of donor coordination issues in the CAS. While paragraph 55 briefly alludes to the many other partners involved in assisting Croatia, there is little or no detail on the scope and focus of their activities. From other sources, for example, we are aware that the EBRD has been giving much thought to its strategy for assisting the Balkans region and, in the spirit of the CDF, it would be helpful if CASs could be more forthcoming on this front. Within the Bank Group, while we welcome the collaboration evident between the Bank and the IFC, we were struck by the absence of any reference to MIGA, notwithstanding the attention given to the high political risks perceived by foreign investors.