Statement by Pieter Stek, Executive Director
Date of Meeting: September 18, 2001

**Croatia - Country Assistance Strategy Progress Report**

The report is clear and comprehensive. It will contribute to the effectiveness of current and future work of the Bank Group in Croatia. Therefore, at the outset, let me express my appreciation for this document on behalf of my Croatian authorities.

**Performance highlights**

Repetition of the document serves no purpose. However, an undiluted concentrate distilled from the report may serve to bring out an inconsistency of the second half of the agreed business plan of the Bank/IFC, as elaborated here: the link between performance and proposed volume of Bank activity.

The opening up to the outside world and international collaboration has been quite remarkable. I shall concentrate here on internal reforms.

The economy pulled out of recession thanks to a courageous structural approach to public finances rather than falling prey to Keynesian siren songs, which can easily dull the senses at times of high unemployment in the face of the popular belief that reform itself is the cause of unemployment. The Government reduced public expenditure by 5% of GDP in 2000 and the general-government deficit from 8% of GDP in 1999 to 5.7% in 2000. In the process a major reduction of public-sector and other arrears was brought about, signifying the serious beginning of a culture change, overdue in so many transition economies. These overall results were achieved while large amounts were being spent on the implementation of the new policy of repatriation of refugees and their settlement as well as that of internally displaced persons - an international priority too. The banking sector has been put on a sound footing and is described in the document as a healthy and increasingly strong player in Croatia's transition to a market economy (para 17). Private-sector development is being boosted among other things by reform of the court system, stricter safeguards of private-property rights, and the introduction of major anti-corruption measures (para 18). Pension and health-sector reforms are gathering pace (para 22). So is the privatization or liquidation of major publicly owned companies, as well as the introduction of necessary complementary legislation in the energy sector (para 20). A National Poverty Reduction Strategy aiming to reallocate misdirected social expenditure to the poor is to be implemented (para 10). A National Environmental Action Plan is being prepared with strong commitment from the relevant ministry and the Government as a whole. Significant environmental projects are underway or being prepared (including the important Karst...
Ecosystem Conservation project (mentioned in Annex B3(2), for which GEF approval has been sought). Finally, portfolio performance and monitoring are now very good.

Summing up, the picture is one of wideranging and deep reform achieved in spite of a bad legacy and a sensitive political environment (the latter, in fact, is being put to constructive use by building consensus before rushing into measures). As stated in para 43, governance and public finance only came within the Bank's purview under this government. Surely, these are essential conditions for the effectiveness of the whole program - conditions so often unmet!

The Bank/IFC business plan
The Bank's non-lending services have been well selected in the past and remain so in the future. They play a constructive role in government planning and programming. The government greatly appreciates this collaborative relationship. The planned SAL and the proposed project loans are also highly relevant. The excellent relationship between Croatia under its new government and the Bank has been fostered by a strong field office (let me here thank Sandor Sipos!) and will be further enhanced by the creation of the three-country hub office in Zagreb under Andy Vorkink's strong leadership.

To cut what could be a long story short, my concerns are the following:

- Bank management I quote intends to process three loans totaling about US$282 million in FY02-03, which is in the low end of the base case envelope end of quote (para 59); i.e. one SAL and only two project loans; to me this appears to be incommensurate with performance;
- the document quite appropriately indicates under what conditions a Low Case would prevail (para 62); also, the requirements for returning to a full Base Case are fairly presented (para 60); in para 61, one finds a plausible explanation why a second SAL can not be prepared before FY03; however, the document does not discuss the possibility of additional project loans; this would be an element of the so-called Comprehensive Adjustment Scenario, the feasibility of which is ruled out in full in para 61; in fact, even the possibility of moving ahead with the additional project loans needed for the full Base Case, assuming the government is ready for them, is questioned by being conditioned on the availability of Bank budget (para 60);
- the risks to Croatia are well described; however, I would have thought that the Bank could do more to reduce external vulnerability with a larger program; precisely at this stage, with relatively low FDI and regional concerns, this would be very helpful.

I can only conclude that the Bank is not encouraging a client as strongly as, I believe, it should, who is demonstrating great seriousness of purpose. A subsidiary but at the same time more general question is whether the budget has not acquired excessive dominance for the ECA region, more than for others.