Statement by Balmiki Prasad Singh  
Date of Meeting: September 18, 2001

Croatia: Country Assistance Strategy Progress Report

We welcome the discussion on the Croatia Country Assistance Strategy. We thank the Management and Staff for the document before us.

Macro-Economic Situation

2. The Government of Croatia is to be commended for some bold steps that it has taken for macro-economic adjustment, such as cutting of top level civil service salaries and introducing a 5% roll-back in public sector wages. However, the overall fiscal position of Croatia is a cause for concern and may impact future growth prospects. We must recall that, at independence, economic conditions in Croatia were favorable; there was no foreign debt; the bureaucracy was small, the deficit was manageable and the tax system was developed and effective. These advantages have been squandered, sovereign foreign debt is now $5.2 billion and the total foreign debt is $11.3 billion or 59% of GDP which is close to the 60% level recognized as the maximum permissible level for the transition states. Public sector wages are 12% of GDP, almost double than that of other transitional economies, and the military and police are greatly over staffed.

3. In this context, we feel the base case triggers for fiscal reforms are adequate and, indeed, quite ambitious.

Banking Sector

4. The Croatian banking sector will need much greater assistance (including avisroy services) from the Bank than has been envisaged by the CAS. The uncertainty over the bid by Italian Bank Unicredito Italiano and Germany’s Allianz to hike their stake in Zagrebacka Banka, the country’s largest bank has left the banking sector’s last phase of transition incomplete. Zagrebacka requires a strategic partner to maintain
its leading role in the domestic market and expand south eastward. Banking is one of the economy’s most successful sectors. However, the sector must still address the four key challenges:

i) **Regional expansion** – Regional integration will be encouraged by an expansion of trade in South East Europe.

ii) **Privatization** – Among the several banks slated for privatization is Dubrovacka Banka and Croatia Banka are the two largest and perhaps the most difficult to privatize. Dubrovacka Banka has been unsuccessfully rehabilitated on three occasions.

iii) **Technical challenges** – In the socialist Yugoslavia, all payments between banks, firms and citizens went through a Central Payment Agency. Croatia faces the technical challenge of putting into place an efficient payment system which prevents abuse and corruption without higher transaction costs.

iv) **Dubrovacka future** – The country’s largest bank is still to find a strategic partner to maintain its leading role and the sector will not be able to achieve stability until it does so.

We would like more details on the Bank’s and IFC’s strategy for the Croatian banking sector.

**Tourism Sector**

5. Tourism remains crucial for the Croatian economy. Income from tourism contributes about one-fifth of the GDP. While the sector showed strong signs of recovery last year, the on-going global recession and the terrorist attacks hitting the travel and leisure industry particularly hard, the outlook for the sector looks gloomy. *How would staff adjust their expectations for the sector in the light of recent developments?* Moreover while we welcome IFC’s involvement in the hotel privatization process, there are a number of other structural deficiencies which curb the tourism sector’s ability to expand – these include poor infrastructure especially flight connections and poor road connections to the coast, damaged hotels etc.. We feel that the sector may benefit by having strategic partnerships with leading international tourism companies. *Does the IFC have any plans to assist the government in this regard?*
6. Subject to the above comments, we are happy to endorse the CAS.