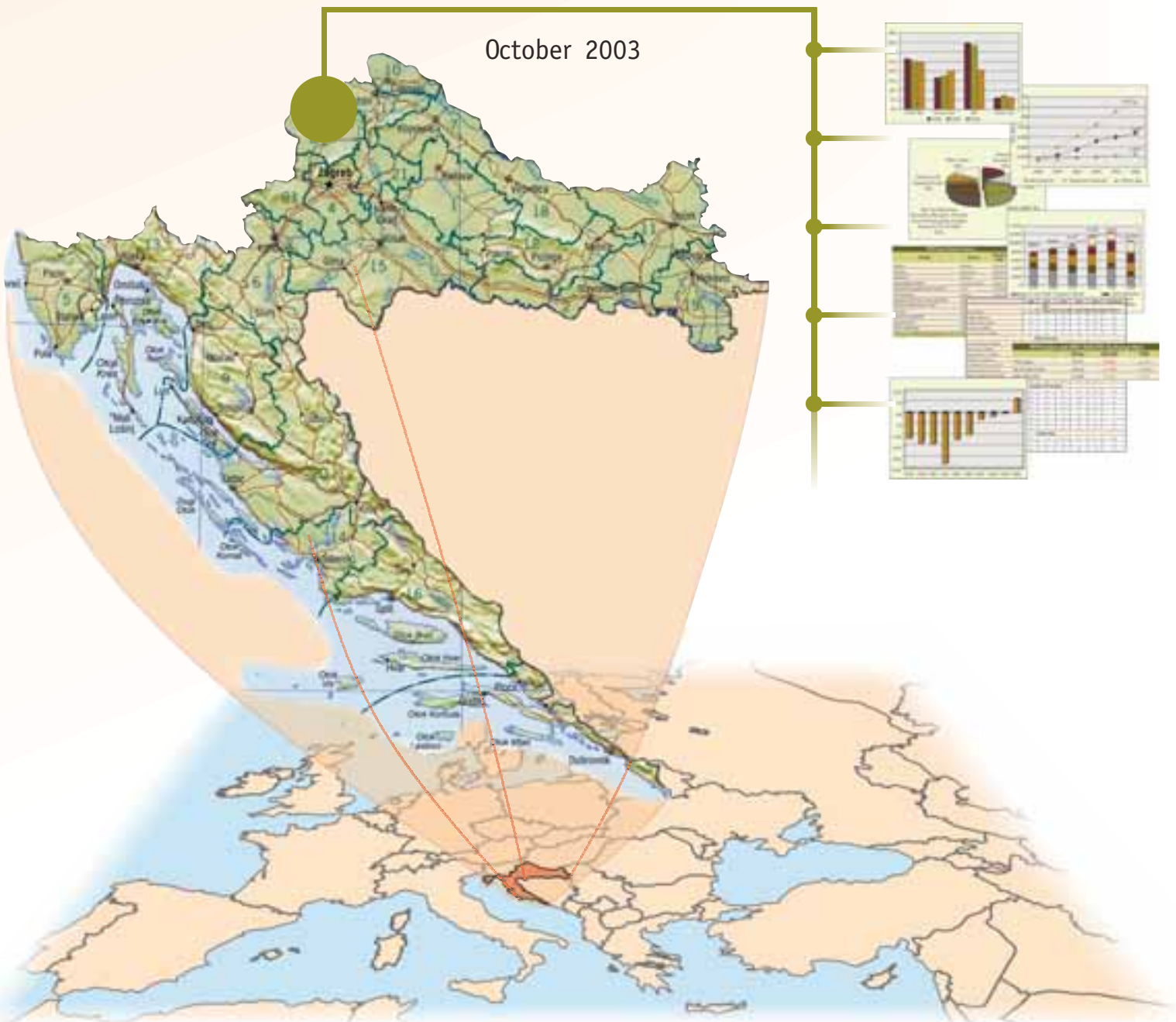


# Croatia: Country Overview





## CROATIA: COUNTRY OVERVIEW



### Background Information

**Official Name:** Republic of Croatia (located in Central Europe in the Adriatic Sea basin)

**Official Language:** Croatian

**Currency:** Kuna (100 lipa)

**Population:** 4.4 million

**Capital:** Zagreb (close to 1 million)

**Administrative Territorial Division:** 20 districts, 121 cities, 416 communities

**Total Area:** 113,700 square kilometers

**Land Area:** 89,800 square kilometers

**Number of Islands:** 1,185

**Sea Territory:** 23,900 square kilometers

**Total Coastline:** 5,835 kilometers, of these 1,777 kilometers continental.

Croatia has almost 2,000 kilometers of Adriatic coastline, as well as 1,185 islands, 66 of which are inhabited. Its coastline is 5,835 kilometers long, of which 4,057 kilometers are islands and sea rocks. On the coast, the Mediterranean climate is hot and very dry in the summer, with wet, humid winters. For several years in a row, the UNESCO committee has awarded Croatia the Blue Flag of excellence for the cleanest water on the Mediterranean coast. Taking into account Croatia's aim to expand reserved areas, the country represents an exceptionally valuable and environmentally clean European region. These resources also give Croatia an exceptional advantage to develop the tourist industry.

Croatia is a country with a well-developed transportation network. In 1997, the total length of railroads was 2,300 kilometers, with 27,800 kilometers of motorways (23,500 kilometers with hard covering, of these 330 kilometers of highways.) Zagreb is connected by highways to Slovenia, Yugoslavia, and Hungary. The Adriatic highway connects all the coastal cities.

The Sava is Croatia's main waterway. Before hostilities, the Sava and the bordering Danube were navigable. To restore shipping on the internal waterways, the Government is cleaning the riverbeds. A number of sea ports are located on the Adriatic Sea coast, ensuring marine transportation to Croatia and former Yugoslavia, as well as a number of other European countries. The largest ports are Rijeka in the Rijeka Bay in the north, and Ploce in the mouth of the Neretva in the south. Other ports are Pula, Split, Sibenik, and Dubrovnik. Croatia's commercial fleet comprises 53 ships, each exceeding 1000 GRT, totaling 631,853 GRT. In 1999, 22 airports operated in the country. In Croatia, there is an oil pipeline 670 kilometers long, an oil products pipeline of 20 kilometers, and a gas pipeline of 310 kilometers.

## EXECUTIVE SUMMARY

Croatia is one of the six republics of what was formerly Yugoslavia. It managed not only to take a leading place among the other republics, but also to preserve a sufficient competitive potential compared to other countries in the Balkan Peninsula. The Croatian economy proved to be among the most adapted to market conditions; however, even with relative economic independence, the country did not manage to avoid all the consequences of the liberation war in the early 90s.

The role and the influence of private businesses on the country's economic policies are increasing. From the point of view of the business environment, this is a positive trend. Under pressure from the political coalition and public resistance, especially on the part of trade unions, the government does not dare to implement measures leading to job cuts or decreases in salaries and social payments. As a result, the growth demonstrated in 2000 has slowed and is now on the decline.

One of the key threats for the target GDP level is the forthcoming election scheduled for the end of the year. Populist decisions and loose fiscal and monetary policies can have negative effects on economic potential, especially as the ruling coalition's position remains unsteady. However, it is possible that the present government will continue its reform policies, even though it may cost them the election. In addition, active economic reforms are required for quick EU accession, which must play a key role in the revision of the reform implementation process.

The analysis of key macroeconomic indices shows latent problems in the Croatian economy, which may lead to a crisis in the near future. On the one hand, GDP continues to grow steadily at 4–5% per year. Consumer inflation has remained safe for a number of years; it has not exceeded 5% since 2001 (4.9% in 2001, 2.6% in 2002, and 2% expected in 2003.) GDP per capita is \$5,107, which is high for the region. On the other hand, the unemployment rate in Croatia persistently remains in the vicinity of 20%, representing a challenging problem for Croatian authorities.

In 2003, the country's foreign debt will greatly exceed the 2002 record high level of \$15 billion, reaching more than \$18 billion (compared to slightly more than \$27 billion in GDP expected in 2003). Croatia manages to serve its foreign debt from its sound international reserves, which are replenished by tourism proceeds and exports, and from domestic borrowing. However, such debt payment should not last long, as it indicates that the safety margin has already been exhausted in Croatia.

An important indicator of the economic situation is the current account balance, whose deficit has remained at 5–6% of GDP for a long period of time. Such a large deficit is explicable in time of war and rehabilitation. However, the situation has not changed much over the last ten years (seven years after the war). Rapid growth of private consumption resulted in substantial acceleration of imports, thus contributing to the large current account deficit. However, a large share of capital goods in total imports suggests that deterioration of Croatia's current account balance may also have positive implications in terms of higher productivity and improved production capacity. Given continuous foreign capital inflow into the country, Croatia's external gap is likely to decrease if capital goods imports are used for development of export capacity that leads to higher competitiveness of Croatian export items. Nevertheless, the Croatian government has to use a prudent mix of monetary and fiscal instruments to bring the external deficit to sustainable levels in order to reduce the country's external vulnerability.

Foreign markets for Croatia's exports are gradually developing. In 2002, export volumes reached \$5.0 billion. Major export commodities are transport equipment, chemical and petrochemical products, textiles, and food products. Croatia's main export partners are Italy, Germany, Bosnia and Herzegovina, Slovenia, and Austria. Imports in 2002 were \$10.3 billion, doubling exports. The key reasons for such excess are lack of raw materials and energy in many sectors of the Croatian economy. Croatia imports machinery, transport and electrical equipment, fuel and lubrication materials, and food products. Science intensive sectors of Croatia's economy are in need of renovation.

Foreign direct investments (FDI) in Croatia have amounted to \$8.4 billion since 1993. However, FDI dynamics also reveal some deterioration, primarily because of the slowdown of privatization. In 2001, FDI amounted to \$1.4 billion, but in 2002 the level was almost half — \$886 million. In 2003, the government expects FDI inflows to increase above the previous years' figures. In the first half of 2003, foreign direct investment inflow reached \$990 million. Sectors with the largest volumes of investment inflow are telecommunications, banking and finance, and pharmaceuticals, while sectors with higher investment needs received less. An interesting trend is an increase in FDI from other Eastern European transition countries (particularly Russia).

Croatian industry continues to rise on the whole. In 2002, industrial growth was 6% (expected at 8%). However, the source of growth has been the extractive industry, which produces little added value (taking into account the depletion of many natural resources reserves). A positive factor in industry growth is the rise in construction (12.8% in 2002). Its qualitative aspect has changed as well — new buildings and structures, motorways, and highways are being built, which may have a positive impact on the country's economic development as a whole and on specific sectors in particular (for example, construction of new tourist complexes).

Despite the fact that services account for more than 50% of Croatia's GDP, the sector remains quite static. An exception here is tourism, which grew by 6% in 2002 and gained another 15% to date in 2003. However, the growth potential of the tourist sector is not used efficiently. Croatia is positioned as a cheap resort with a clean environment (the low cost is due to inadequately organized material base for tourism). But the tourists are prepared to pay more, given that the quality of services improves accordingly. There are a lot of tourist centers in Croatia needing modernization or even complete reconstruction. Russian companies have shown interest in this area of business, as the number of Russian tourists in Croatian resorts grows every year.

The International Monetary Fund (IMF) approved a \$140 million Stand-by Program aimed at strengthening fiscal discipline and structural reforms in the country. The IMF is wary of Croatia's economic development prospects; however, investment leaders such as the European Bank for Reconstruction and Development (EUR 12 billion in investment), Soros Private Fund, and Southeast Europe Equity Fund (\$150 million) continue to operate in the country. The other funds' objectives are similar — to help further restructuring and privatization in the South-Eastern region and ensure ecological safety and energy conservation.

Presently, the Overseas Private Investment Corporation is implementing insurance and financial projects totaling more than \$65 million in Bulgaria, Croatia, and Romania. Small Enterprise Assistance Funds have also created a fund, SEAF-Croatia, which has invested \$141,000 in the company MIT Software (buying a 28% stake). In 2003, the World Bank approved a loan to the Rijeka sea port in the amount of \$156.5 million.

Croatia is presently in the third stage of privatization, but the Croatian Privatization Fund has not managed to privatize any state companies as yet. In 1991, the total assessed value of statutory funds of privatized companies was \$11 billion, which represented around 10% of all companies (approximately 80% in value terms). Since the beginning of the Parliament's present term, 33 companies in the state privatization portfolio were sold. There were two large sales, a 16% stake in Dubrovaeka Bank and 25% stakes in Privredna Bank and Splitska Bank. One third of companies in the early 1990s privatization portfolio still remain in state ownership. The privatization plan includes stakes in 1035 companies to be put up for sale.

With traditional support from Germany and the USA, disposed to cooperate with new democratic leaders in Zagreb, as well as from the majority of EU countries, Croatia has every chance of becoming a regional leader in the Balkans in the future.

## Table of Contents

CROATIA: COUNTRY OVERVIEW	1
Background Information	1
EXECUTIVE SUMMARY	3
POLITICAL SITUATION	7
Political System	7
Key Political Forces and Figures	8
MACROECONOMIC SITUATION	9
Background	9
Economic Growth	11
Fiscal Policies	12
Monetary Policies	12
International Trade	13
International Capital and Debt	15
International Programs	16
INVESTMENT CLIMATE	18
1. Liberalization and Deregulation of Business Activities	19
2. Stability and Predictability of the Legal Environment	20
3. Corporate and Public Governance	20
4. Liberalization of Foreign Trade and Capital Movements	23
5. Financial Sector Development	24
6. Corruption Level	26
7. Political Risks	27
8. Country Promotion and Image	27
9. Targeted Investment Incentives	27
INVESTMENT OPPORTUNITIES	28
Tourism	28
Agriculture	29
Food Industry	29
Construction Industry	30
Shipbuilding	31
Mining and Processing Industry	31
Pharmaceuticals	31
RISKS AND OPPORTUNITIES	33
CONCLUSION	34
REFERENCES	35
APPENDIX	36
A FEW WORDS ABOUT US	38
SigmaBleyzer	38
The Bleyzer Foundation	38

© 2003 SigmaBleyzer. All rights to this analytical report belong to SigmaBleyzer. This report may not be reproduced or re-distributed without the prior written consent of SigmaBleyzer. The report was created for informational purposes only. The information contained herein is based on data believed reliable and was not subject to any audit or special verification. SigmaBleyzer does not make any representation or warranty as to its accuracy or completeness. Correspondingly, SigmaBleyzer refuses to bear any responsibility for any consequences of the use of the present analytical report.

## POLITICAL SITUATION

Currently, the main objective of the political forces in Croatia is to prepare the country for European Union accession in 2007. Croatia already has the support of the majority of EU countries. Romano Prodi, President of the European Commission, welcomes Croatia's accession and believes that it will help strengthen stability in the Balkans.

Under favorable conditions, Croatia may begin negotiating its EU accession in 2004, when most of the present candidates join the Union. Croatia wishes to join the EU in 2007 together with Romania and Bulgaria, which are already officially negotiating with Brussels and have received an extension.

At the same time, the EU countries criticize Zagreb for its inability or unwillingness to actively cooperate with the International Tribunal for the former Yugoslavia, protracted negotiations in the return of Serbian refugees driven out of Croatia's territories during the war, and slow reforms of state TV and radio channels.

### Political System

Croatia is a parliamentary republic. The Sabor, Croatia's two-chamber Parliament, is the highest legislative body in the country. The term for both chambers, the House of Representatives and the House of Counties (Zupanije), is four years.

According to the law, the number of seats in the House of Representatives may vary from 100 to 160. Deputies are elected by hidden vote at free elections (voting citizens are 18 and older, or 16 and older if working). In 1999, amendments were made to the law on elections, according to which the number of seats of the Croatian diaspora depends on the number of Croatians living abroad that take part in elections. The House of Representatives includes parties and coalitions that have received at least 5% of votes. It is responsible for adopting the Constitution and amendments, approving the state budget, passing laws, calling referendums, and monitoring government activities. The House of Counties has 68 seats: three deputies for each of the 21 counties are chosen by national vote, and another five are appointed by the President.

The head of state is the President, elected by nation-wide hidden voting for five years, with a limit of two terms. The President is the Supreme Commander; he appoints and relieves the Prime Minister and vice prime ministers, other ministers, and government officials, calls parliamentary elections and referendums, appoints and relieves diplomatic representatives of Croatia abroad, and represents the country in international relations. Today, the President of Croatia is Stipe Mesic.

The highest executive body in Croatia is the Cabinet of Ministers, formed by the Prime Minister and approved by Parliament.

## Key Political Forces and Figures

---

There are around 60 political parties in Croatia. One-fourth of the parties play leading roles in the country's political life. Nine parties are represented in Parliament and six in the government.

The Social Democratic Party of Croatia, founded in 1990, is the successor of the Communist Union of Croatia. It is the largest party in the country. Together with the Social Liberal Party of Croatia, they comprise the ruling coalition. The leader of the Social Democratic Party, Iвица Račan, has been head of the government since 2000.

The Croatian Social Liberal Party is a moderate center-right party, created in 1989. Initially, its program combined liberal, democratic, and nationalist demands. Later it moved away from nationalism and came to support the right of Croatian Serbs for autonomy within Croatia. In 1992–1995, it was the most powerful opposing party in the country; since 1999, it is part of the ruling coalition.

The Croatian Peasant Party was created in 1990 as a successor of the largest prewar Yugoslavian party, founded in 1904. It is a moderate conservative party, advocating traditional family values and social and economic stability.

The Istrian Democratic Sabor is a regional party advocating Croatia's federalization and liberal values. It has an overwhelming majority of seats in the regional parliament of Istria.

The Croatian People's Party is a centrist party, which strengthened its positions in 1997, when Stipe Mešić, the future President of Croatia, joined the party, leaving the Croatian Independent Democrats. It advocates EU accession and peaceful solution of national conflicts.

The Croatian Christian Democratic Union is a conservative party adhering to Christian values.

The Croatian Democratic Union was founded in 1989. Over time, it transformed into the nationalist movement. The party was at power in 1990–1999.

The Croatian Party of Rights was founded in 1990, basing on nationalist views. The Liberal Party was created in 1997, resulting from the split of the Social Democratic Party.

The following parties play less important roles in the country's politics: the Croatian Independent Democrats, a centrist party; the Social Democratic Action of Croatia, for a multinational Croatia and EU integration; the Social Democratic Union, which advocates social justice and is against military solutions to national problems; the Serb People's Party, the party of Serbs living in Croatia; and the Independent Serb Democratic Party.

## MACROECONOMIC SITUATION

### Background

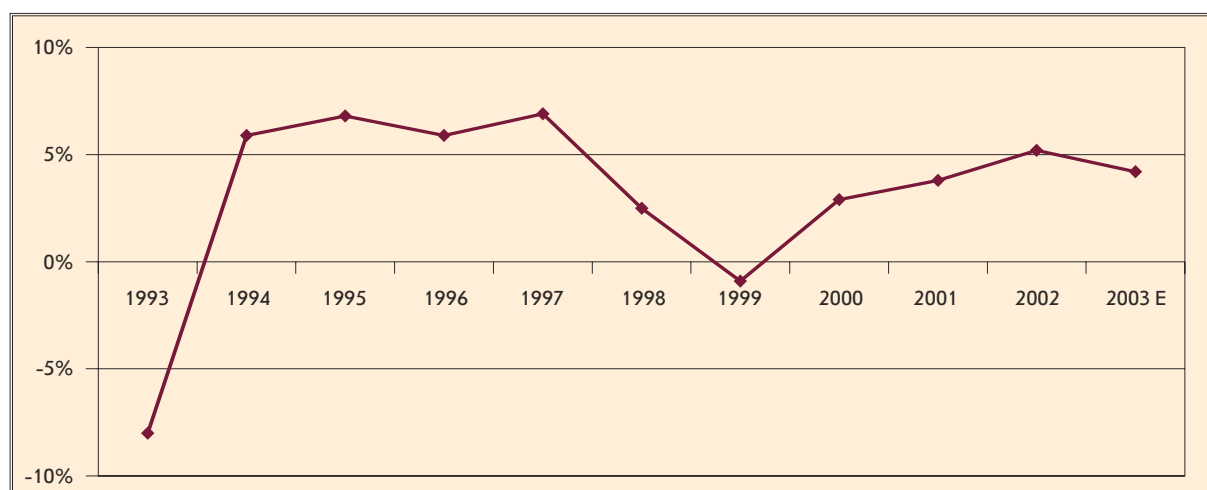
During the last decade, the Republic of Croatia was subject to two opposing forces. On the one hand, its initial economic conditions of transition to market economy were quite favourable relative to other countries of the region. Out of former Yugoslavian republics, Croatia ranked second after Slovenia in industrial development and living standards. As measured by GDP per capita, the Croatian economy is similar to advanced transition economies like the Czech Republic and Hungary. On the other hand, the country suffered the hardships of a wartime economy because of the liberation war of 1991–1995, after which the Republic of Croatia gained independence. The signs of economic stabilization became apparent late in 1993, following the end of the first wave of privatization.

The liberation war of 1991–1995 caused hyperinflation and economic decline. From 1990 to 1994, economic output dropped by almost 40% cumulative. The end of the war and political stabilization in the region has brought about positive economic results. The improvement was mainly due to the quickly recovering tourist business and industrial output growth. After 8% GDP decline in 1993, Croatia's economy demonstrated rapid recovery in 1994 when 5.9% growth was registered. Consumer prices growth dropped from 98% year-on-year (yoy) in 1993 to 2% in 1994. However, imprudent fiscal policies implemented by the Croatian government and a widening external gap in the period of 1994–1997 resulted in a sharp decline of economic output in 1999. Consumer inflation increased to 7.4% yoy in 1999. Excessive defense expenditures of the government caused persistent fiscal deficits that reached a high 7.4% of GDP. In addition, the current account deficit in Croatia remained persistently high (averaged about 8% of GDP) during the post-war period. Croatia's current account deficit peaked in 1997 due to a trade deficit of \$5.2 billion. Although Croatia's external position improved slightly in 1999, the external gap stayed at a still high 7% of GDP that year. The current account gap, however, was financed by solid foreign investment inflow and external borrowing. Relatively high foreign direct investment (FDI) inflows came mainly from the privatization of state property. In 1999, FDI inflows reached a record high \$1.46 billion following the successful sale of the state telecommunications company to a foreign investor. At the same time, Croatia was gradually accumulating its external debt stock during 1994–1999. By 1999, the country's foreign debt stock approached the sustainability benchmark of 50% of GDP.

Croatia was on the eve of fiscal crisis when the new coalition government was elected in early 2000. To restore macroeconomic and financial stability, the newly elected government started pursuing a course of economic reforms and a relatively transparent privatization program. The reform intentions of the Croatian government were supported by the international financial institutions. In March 2001, Croatia signed a precautionary Stand-By Agreement with the IMF, which it successfully concluded in May 2002. The World Bank also launched a number of economic development projects during that period.

Since 2000, there has been considerable economic progress in Croatia. After the 1999 recession, GDP growth resumed in 2000, initially triggered by the fast recovery of the tourist sector following the end of armed conflict in Kosovo and then supported by increases in private consumption and investment. In 2001 and 2002, Croatia witnessed 3.8% and 5.2% yoy growth respectively.

### GDP Growth



Source: Croatian National Bank

The country's fiscal performance has improved as the deficit dropped to 5.4% and 4.3% of GDP in 2001 and 2002, respectively, following the implementation of needed public sector reforms. After a short spike to 6.2% yoy in 2000, consumer prices growth slowed to 4.9% yoy in 2001 and 2.6% in 2002. Reduction of interest rates and steady wage growth have boosted bank lending. The Croatian National Bank kept the exchange rate of the kuna stable against the Euro through a managed float regime. Foreign exchange inflow, especially during tourist season, allowed Croatia to build up its international reserves to sustainable levels. In 2003, gross international reserves reached \$6.6 billion or 6 months of imports.

### Key Macroeconomic Indicators for Croatia

Index	1997	1998	1999	2000	2001	2002	2003 E
GDP, \$ billion	\$20.2	\$21.6	\$19.9	\$18.4	\$19.5	\$22.4	\$27.4
GDP Growth, %	6.8%	2.5%	-0.9%	2.9%	3.8%	5.2%	4.2%
Consumer Prices Growth, %	3.6%	5.9%	4.3%	6.2%	4.9%	2.6%	2.0%
Unemployment, % of labor force	17.0%	17.4%	18.8%	21.0%	22.6%	23.8%	18.5%
Fiscal Balance, % of GDP	-1.9%	-3.0%	-7.4%	-5.7%	-5.4%	-4.3%	-4.6%
Current Account Balance, % of GDP	-11.6%	-7.1%	-6.9%	-2.3%	-3.1%	-6.9%	-5.5%
Gross International Reserves, \$ billion	\$2.54	\$2.82	\$3.03	\$3.53	\$4.70	\$5.89	\$6.64
External Debt, \$ billion	\$7.45	\$9.59	\$9.87	\$11.00	\$11.32	\$15.28	\$18.45

Source: IMF, Croatian National Bank

Despite reasonable economic policies, high unemployment has persisted in Croatia. Restructuring of large state enterprises required reduction of jobs, while growth of small and medium enterprises, though rapid, was insufficient to absorb the losses. Therefore, unemployment in Croatia increased from 18.8% in 1999 to 24% in 2002. Another source of concern was the gradual increase of external debt stock. In 2000, public debt stock exceeded the sustainability benchmark and reached 51.1% of GDP. Despite accelerated economic growth in 2001 and 2002, external debt accumulation provided for an increase of public debt to GDP ratio to over 50%. Although accumulation of external debt is a worrying development, Croatia has managed to service its debt without any problems so far, primarily due to healthy rates of economic growth and the reduction of the fiscal deficits, and the inflows of foreign capital. Since the outlook for Croatian economic

development remains positive, its high external debt obligation should not raise concerns over the country's solvency.

## Economic Growth

---

The Croatian economy continued to demonstrate solid growth in 2002 when GDP expanded by an impressive 5.2% yoy. Economic growth has largely been driven by strong private consumption and the quick upturn in investments. Robust growth of private consumption, which accounted for nearly half of total GDP, was triggered by the consumer lending boom (the volume of consumer loans grew by about 40% yoy in 2002). Internal investment dynamics in Croatia are similar to changes in GDP. In 2002, domestic investment grew by about 3.5% yoy. This investment growth was primarily on account of the widespread construction activities around the country, with the construction of the Zagreb-Split motorway being the largest project under implementation in 2002. In addition to the rapidly growing services sector, industry made a large contribution to overall GDP in 2002. Industrial production, which provides approximately one-third of GDP, expanded by 6% yoy during the year. The leading sectors in the country are chemical, petrochemical, machine-building, food, textile, wood processing, and pharmaceutical. Croatia's heavy industry includes metallurgical and steel-rolling companies, hydroelectric power plants, shipyards, and cement and reinforced concrete production plants.

Agriculture in Croatia accounts for around 10% of GDP. The northwest plains of Croatia are the country's main breadbasket. Among the most popular agricultural items in Croatia are grain, sugar beets, soy, hemp, flax, sunflower, potatoes, and fodder crops; cattle-breeding is also popular. Gardening (plums and apples) and winegrowing are traditional on slopes of the hills and low mountains. The major items for the mountainous regions are barley and potatoes. In Istria and Dalmatia, winemaking is common, as well as growing early vegetables and southern fruits (citrus plants and olives). However, agriculture demonstrated relatively modest growth rates. In 2002, less than 2% yoy growth was recorded in agriculture.

Croatia's economic performance remained robust in 2003 due to strong domestic demand. In the second quarter of 2003, Croatian GDP rose by 5% yoy, primarily on account of strong investment demand and robust private consumption. Among the largest contributors to GDP were construction and tourism, value added growth in which made up 24% yoy and 11% yoy respectively. Industries related to these two sectors also demonstrated high rates of growth. However, export-oriented textiles, chemicals and machine building revealed signs of stagnation in 2003. On the demand side, continuing growth of private consumption and the rise in investments may bring real GDP growth to 4.3% yoy in 2003. On the eve of parliamentary elections, the government is also likely to increase its consumption, thus contributing to GDP growth as well.

The high unemployment rate still remains a major negative factor for the Croatian economy. Over 2001–2002, unemployment was at a high 22–24%. Under pressure from various political groups and also general public resistance, the government's intentions to pursue public sector reform were weakened, particularly its plans to implement measures leading to job cuts and decrease in salaries and social security benefits. Nevertheless, the government has managed to reduce the number of employees in the public administration by 3.5% yoy in the first half of 2003. Following the introduction of new procedures for registering the unemployed, official unemployment rate declined to 18.2% in August 2003. Over recent years, average wage growth has

remained persistently high in Croatia, although wage dynamics revealed a decelerating trend, thus mirroring GDP dynamics. In January–July 2003, growth of average wage reached 4.9% yoy in real terms.

## Fiscal Policies

---

In 2002, the Croatian government managed to significantly improve its fiscal performance. The general government budget deficit was cut from 5.7% of GDP in 2000 to 4.3% of GDP in 2002, due to the reduction in recurrent expenditures and rising tax revenue as recommended by the IMF under the stand-by arrangement. However, this fiscal deficit is still large, exceeding the Euro Area limit of 3% of GDP. The main reason for the sizeable fiscal deficit in Croatia is the high wage cost of the public sector, social security payments, and repayment of public debt. Also, the Croatian government has been investing heavily into public infrastructure (e.g. highway construction program.)

In 2003, fiscal performance has remained at the same level. The Croatian government kept restraining expenditures primarily through cutting employment in the health care and defense sectors, and through progress with pension reform. In the first half of 2003, the fiscal deficit reached about \$680 million, which was partly financed out of domestic sources and partly through the issuance of sovereign Eurobonds. Robust economic growth allowed fiscal authorities to collect more tax revenue in the first half of the year than was targeted for the period. However, expenditure cuts are unlikely to be large in 2003 because of the political pressures of the pre-election period. In addition, the government still allocates substantial budget resources to public investment projects in 2003 (continuation of highway construction). Therefore, the fiscal deficit is expected to be 4.6% of GDP in 2003, a percentage similar to the one in 2002. In early 2003, the IMF approved a new stand-by lending program for Croatia emphasizing further fiscal consolidation and stabilization of the public debt ratio. Over the longer term, further reductions in the fiscal deficit will be necessary for sustainability.

## Monetary Policies

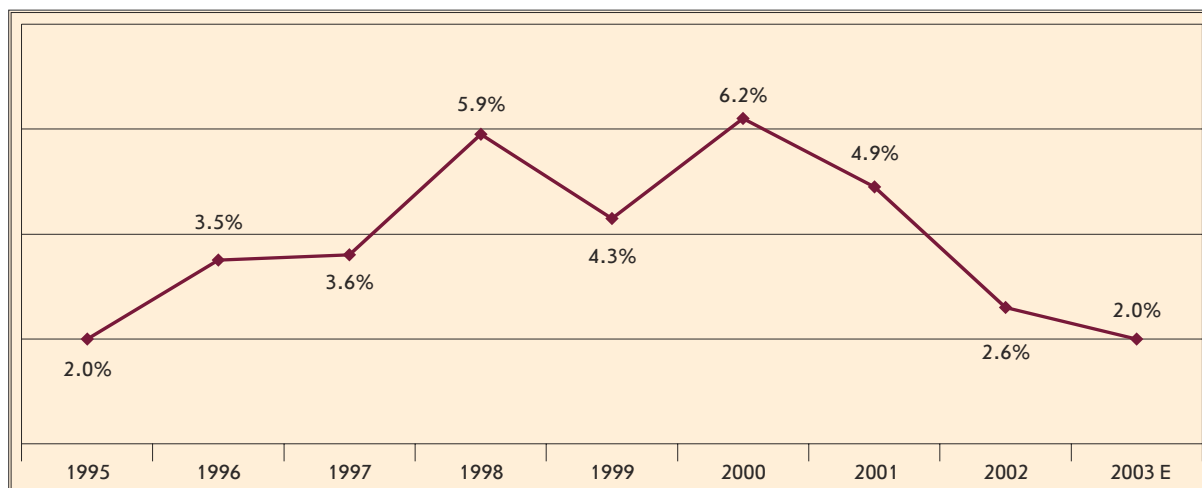
---

The inflation level in Croatia has remained safe since the end of the liberation war. Since 1995, it has never exceeded 7%, while during the last three years inflation has been gradually declining due to the tight monetary policy pursued by Croatian government. In 2002, consumer prices picked up by 2.6% yoy. Throughout 2003, consumer inflation has remained low due to favorable oil prices and the strength of the kuna against the US dollar. Over the first eight months of 2003, the cumulative increase of consumer prices made up a low 1.4% yoy. According to official forecasts, end-of-period inflation is expected at a low 2% in 2003. Such inflation dynamics is likely to support further growth of real disposable incomes, thus helping to maintain high private consumption.

The Croatian National Bank (CNB) is responsible for monetary policy conduct. Since 1994 when the national currency, the kuna, was introduced, the CNB's monetary policy targeted exchange rate stability. According to the IMF reports, such monetary policy has served Croatia well as it helped to keep inflation low and export competitiveness relatively high. However, the CNB is limited in the choice of monetary instruments because of widespread currency substitution. About 70% of bank deposits and almost 50% of loans are made in foreign currency or indexed to it. In 2002, money

aggregates (M4) growth decelerated from 45.2% to 9.4%. High liquidity of the banking system made banks intensify their lending activity in 2002. In 2002, credit activities of the banks gained approximately 30% through expansion of consumer lending programs. The CNB's discount rate was 4.5% annually. Over 2002, international reserves of the CNB increased to \$5.9 billion.

### Inflation Rate, %



Source: Croatian National Bank

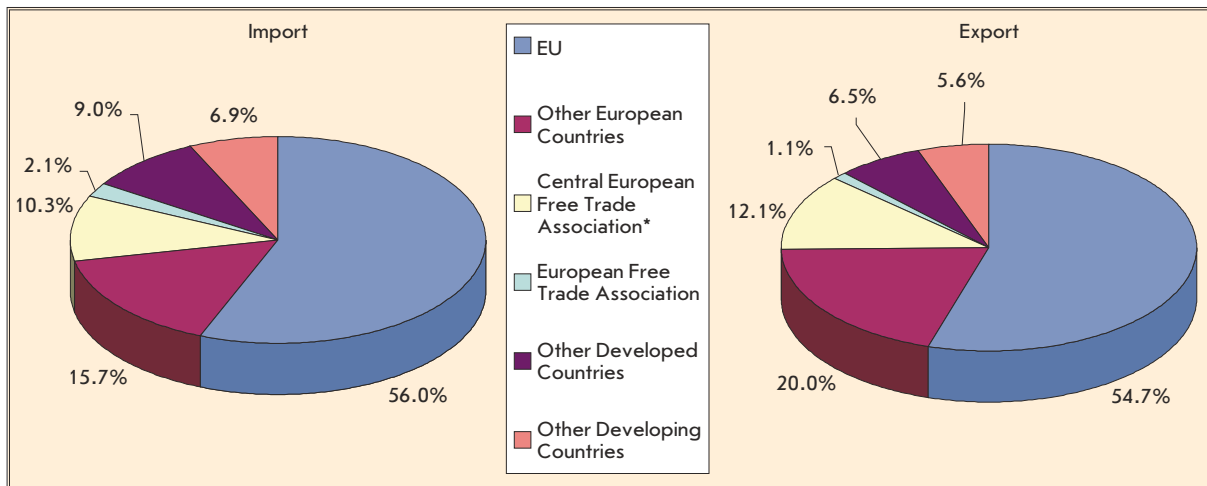
Rapid growth of commercial banks' lending to households resulted in substantial acceleration of imports, thus contributing to the large current account deficit. In 2002, total domestic credit grew by 30% yoy with consumer and corporate lending increasing by 43% yoy and 22.7% yoy respectively. In 2003, the CNB introduced specific measures to curb credit growth (in particular, 16% cap on credit growth for commercial banks, and an increase of the foreign exchange reserve requirement from 25% to 35%.) However, these measures resulted in a marked deceleration of lending growth to enterprises (3.3% yoy), while consumer lending growth remained at rather high levels (13% yoy in the first half of 2003.) Interest rates showed an increase in 2003 due to active interventions of the CNB on the foreign exchange market and recently introduced credit growth restrictions. In the first quarter of 2003, the Croatian kuna depreciated against the euro, reflecting increased demand for foreign exchange in the off-season. However, the kuna appreciated against the euro in the second quarter, reflecting the inflow of tourist-related foreign exchange. This allowed the CNB to replenish its international reserves. Despite the IMF recommendation to allow for greater exchange rate volatility, the CNB kept intervening on the forex market to maintain stability of the kuna and preserve export competitiveness.

### International Trade

Since 1995, the current account balance has been persistently negative at 5–6% of GDP. Such external imbalance is explicable in wartime and in the rehabilitation period, but the situation has seen only temporary improvements over recent years. After a substantial reduction in the current account deficit in 2000–2001, it widened to 7% of GDP in 2002. Although Croatian authorities had no significant problems with financing such a deficit, the associated buildup of the country's external debt contributes to external vulnerability of the economy. The main reason for large current account deficits remained the persistently growing merchandise trade deficit. Excessive

absorption is due in great part to the persistent fiscal deficits incurred by the Government. In 2002, the trade of goods balance showed a \$5.3 billion deficit, or almost 25% of GDP, due to rapidly growing imports. Croatian imports were twice as high as exports in 2002. Imports were equal to more than a half of the country's GDP. Rapid growth of imports is attributed to strong domestic demand for imported goods (also a reflection of high fiscal deficits).

**Croatian Import and Export by Country**



\*— includes Poland, Hungary, Slovakia, and Czech Republic  
 Source: ISI Securities

Croatia has had a very liberal international trade regime after it become a member of the World Trade Organization (WTO) and concluded a number of free trade agreements. Because most import restrictions were lifted, the flow of imported goods and services became quite sensitive to changes in domestic demand. Robust imports growth coupled with much slower exports increase put severe strain on the external balance of the country. However, the goods composition of Croatian foreign trade provides evidence of intense investment activity in the country. Out of total imports, 17.4% is transport equipment, 13.3% is petrochemicals, and 1.6% is metallurgical products, as well as spare parts and electric power. In the structure of exports, machinery and equipment accounted for 20.7% of the total, raw materials, fuel, and chemicals — 16.1%, clothes and footwear — 9.9%, lumber and furniture — 3.2%, and tobacco — 1.7%. However, large services surpluses, primarily caused by tourist services, helped to cover continuous trade of goods deficits.

**Croatian Foreign Trade in 1996–2003**

Volume, \$ billion	1996	1997	1998	1999	2000	2001	2002	2003 E
Exports	\$4.55	\$4.21	\$4.60	4.39	\$4.57	\$4.75	\$4.99	\$5.86
Imports	\$8.17	\$9.41	\$8.75	\$7.69	\$7.77	\$8.76	\$10.27	\$11.88

Source: IMF, Croatian Bureau of Statistics

Foreign trade performance remained almost unchanged in 2003, with exports growing much slower than imports. Imports growth remained strong in 2003 due to strengthening domestic demand for both consumer and capital goods. According to IMF estimates, the current account deficit is anticipated to remain high at 5.5% of GDP in 2003. Over the first half of 2003, the current account deficit saw more than a twofold increase yoy to \$2.45 billion. This figure represents about

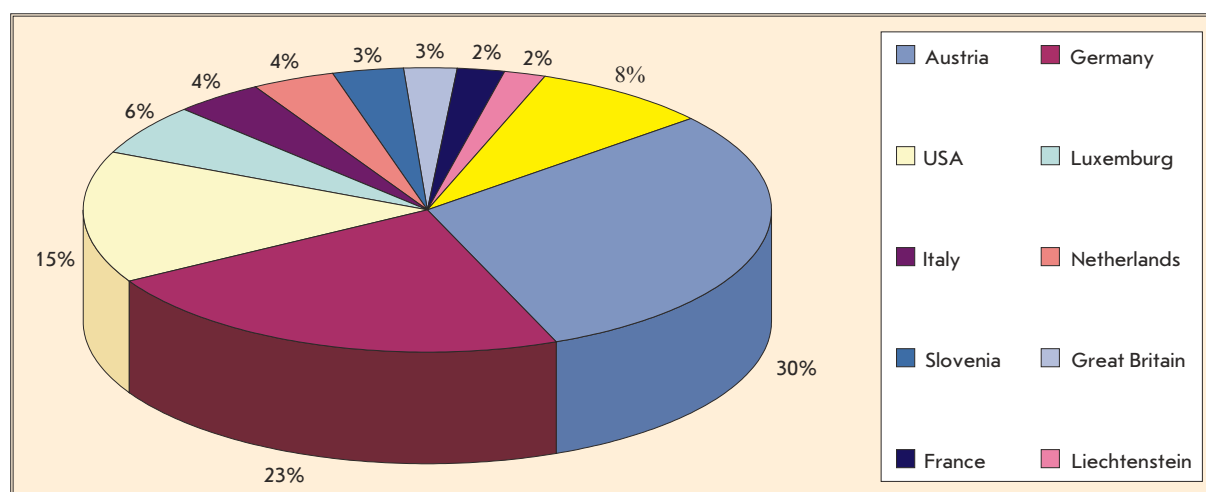
8.5% of projected GDP, which is a worrying development indicating that increases in tourist service revenue, net income and transfers only partly compensated for the merchandise trade deficit. However, high growth of capital goods imports suggests that deterioration of Croatia's current account balance may also have positive implications in terms of higher productivity and improved production capacity. Given continuous foreign capital inflow into the country, Croatia's external gap is likely to decrease if capital goods imports are used for development of export capacity and lead to higher competitiveness of Croatian export items. However, the Croatian government has to use a prudent mix of monetary and fiscal instruments to bring the external deficit to sustainable levels in order to reduce the country's external vulnerability.

### International Capital and Debt

Strong economic growth and progress with market reforms brought robust capital inflows into the country. Capital inflows helped cover the large current account deficit, although a large part of it represented private sector borrowing from abroad, which contributed to rapid growth of the country's foreign debt stock.

During recent years, Croatia has remained among the leaders in terms of foreign direct investment (FDI) inflow. In FDI per capita, Croatia ranks sixth in Central and Eastern Europe (\$1,711). Since 1993, the Croatian economy attracted more than \$8.4 billion of FDI. After a record high foreign capital inflow in 2001, FDI inflows declined to \$886 million in 2002, which is a result of the overall economic slowdown in the country and the slowdown of the privatization process. During 1993–2002, the largest volume of investments went to telecommunications (30%), banking and other financial institutions (17%), pharmaceuticals (15%), and cement production (5%). In 2003, the government expects FDI inflows to increase above the previous years' figures. In the first half of 2003, foreign direct investment inflow reached \$990 million. In addition, substantial capital inflow is expected to arrive as a result of partial privatization of national oil and gas company INA, which yielded \$505 million.

#### FDI to Croatia



Sources: ISI Securities, SigmaBleyzer

More than 60% of foreign investments to Croatia came from the European Union; the rest were investments of the Organization for Economic Cooperation and Development (OECD). Recently, there has been a rise in investments from Eastern European transition countries (5% in 2001).

Among the companies that have invested in Croatia are Ericsson, Siemens, Tuborg, and others.

### Selected Foreign Investors in Croatia

Sector	Investor	Country	Company
Electric Equipment	Telefonaktibolaget LM Ericsson	Sweden	Tesla d. d.
Non-Metal Products	Hofmann&Pankl Beteiligungsgesellschaft	Austria	Straza d. d.
Cement	Societe Suisse de Ciment Portland S.A.	Switzerland	Tvornica cement Koromacno d. d.
	RMC Group	United Kingdom	Dalmacija-cement d. d.
Brewing	Interbrew S.A.	Belgium	Zagrebacka pivovara d. d.
	Southern Breweries Establishment	Lichtenstein	Karlovacka pivovara d.d.
Chemicals	Messer Griesheim	Austria	Monetkemija d. d. Tehnicki plinovi

Source: [www.nekretine.org](http://www.nekretine.org)

Croatia's persistent external deficit has led to a significant buildup of external debt stock. So far, sufficient volumes of international reserves allow for diligent service of Croatia's external debt. However, the public debt to GDP ratio worsened significantly in 2002 despite strong economic growth. During the year, external debt stock grew by 35% yoy in dollar terms to \$15.3 billion. As a result, the foreign debt ratio picked up to a worrying 68% of GDP. External debt service amounted to \$2.88 billion in 2002, which represents 27.3% of Croatian exports for the period. Croatian external debt figures exceed the safety margins as defined by international financial organizations. Thus, the country's vulnerability to external shocks remains rather high. Therefore, the IMF recommends that the Croatian government revise its priority targets in order to stabilize the public debt ratio.

According to IMF projections, Croatia's external debt may increase to \$18.45 billion in 2003, but the external debt ratio is expected to improve slightly (67.3% of GDP). In 2003, external debt service will decline to \$2.57 billion or 20.5% of Croatian exports. However, recent CNB data suggests that Croatia's foreign debt grew to an unexpectedly high \$19.2 billion in July 2003. The main reason for this marked increase was, again, expansion of commercial banks' borrowing, a large part of which were short-term loans. It remains to be seen whether the CNB will further tighten its monetary policy in 2003. Also, the government issued a third tranche of Eurobonds (\$540 million) in January 2003 to cover the existing debt and the expected deficit in financing of highway construction.

### International Programs

In February 2003, the IMF decided to approve a new Stand-By Arrangement for SDR 105.9 million (about \$146 million) to support the country's fiscal discipline and structural reforms through April 2004. The reserve will be used as a guarantee of liabilities, particularly to stabilize the public debt, as well as to help adapt the labor market and propel the privatization process. The Program will be carried out only if Croatia meets six basic conditions, including legislation development and structural reforms.

The World Bank has already implemented eight projects in Croatia, 13 more are under way. Their total amount exceeds \$1 billion. In addition, another four projects for a total of \$316 million were prepared for implementation in 2003. The aims of the World Bank's projects are as follows: technical assistance, structural reforms, reform of the pension system, stock market development, investment climate improvement, development of judiciary, introduction of bankruptcy procedures, development of agriculture, and reconstruction and upgrade of railroads.

In 2003, the World Bank approved a \$156.5 million loan to Rijeka port. The project is aimed at extension of the port and its infrastructure (including construction of new roads connecting the port with other places). The loan is to be divided between Rijeka port management, Croatian highways, and Croatian Road Company. The total project value is \$264 million.

The European Bank for Reconstruction and Development operates very actively in Croatia. At the end of 2001, the total sum of projects approved was more than \$930 million. Most of the projects are implemented in the private sector.

## INVESTMENT CLIMATE

The business environment in Croatia is more favorable than the ones of other transition economies of Southeast Europe. Croatia has made substantial progress in improving its business environment since 2000. Steady foreign direct investment inflow also supports the view that the investment climate in Croatia improved significantly during recent years. Since coming to power in January 2000, the government took active measures to improve the Croatian business environment and to attract foreign investments. Among the major achievements of the current Croatian government in this field were:

- establishment of an Agency for Trade and Investment Promotion
- liberalization of international trade
- introduction of greater transparency of the privatization process
- development of investment incentives legislation
- improvement of taxation regime
- implementation of anti-corruption program
- introduction of effective banking and foreign exchange legislation

A study by SigmaBleyzer identified the most important measures that a Government can take to improve the business environment and attract foreign direct investments. The study reviewed 50 countries around the world and carried out statistical analyses to identify the policy measures that could have the greatest impact on the flows of FDI. Through benchmarking, it also identified best practices in economic reforms in a number of successful developing countries. Also, a model was built to predict the flows of foreign direct investments that a country could receive based on the implementation of these key "policy" investment drivers. The study concluded that "first generation" reforms — macroeconomic stabilization, achieved by sound fiscal and monetary policies — are essential pre-conditions to achieving a favorable business climate and attracting foreign direct investments. But they alone are not sufficient to improve the business environment and achieve increases in international capital inflows. Within this macroeconomic framework, a number of "second generation" reforms are needed. Our benchmarking, statistical analyses and business surveys indicated that a significant portion of the variations in foreign direct investments in a group of 50 developing countries could be explained by nine economic policy drivers. Furthermore, studies showed that whereas there was a high correlation between the nine policy drivers and the flows of FDI, there was also a low correlation between FDI flows and the "natural characteristics" of a country (e.g., geographical location, country size, population, etc.) These key investment drivers were the following, in order of priority:

- (i) **Business liberalization and de-regulation policies** to permit firms to operate freely by removing barriers to market entry, barriers to operations and barriers to exit.
- (ii) Policies to **create a stable and predictable legal environment** with well-defined "rules of the game" for all businesses, without discrimination or preferential treatment and with capacity to enforce business contracts.
- (iii) Policies to develop sound **Corporate and Public Governance** that would protect ownership rights and shareholders, and avoid excesses of power by Government agencies.
- (iv) Policies to **liberalize foreign trade and international capital movements** to facilitate the exports and imports of goods and the transfer of capital internationally.

- (v) Policies to **create a healthy financial sector** capable of meeting the financing needs of growing businesses.
- (vi) Actions to **minimize corruption** and protect businesses from abuse of power by government officials.
- (vii) Actions to minimize the effects of **political uncertainties** on business activities.
- (viii) Actions to **promote and inform investors** about business opportunities in the country.
- (ix) Actions to avoid distortions in incentives by **eliminating preferential targeted investment incentives** to companies, regions or sectors.

The performance of Croatia regarding the above nine investment drivers is discussed below:

## **1. Liberalization and Deregulation of Business Activities**

The Croatian government has made substantial progress in liberalizing and deregulating its business environment over the last two years. For this work, the Croatian authorities benefited greatly from a comprehensive report on administrative barriers to investment prepared by the Foreign Investment Advisory Service (FIAS) of the World Bank Group in early 2001. In June 2001, the government established a high-level coordinating group to address problems identified in the FIAS study. The group developed a detailed action plan, which is currently being implemented. In February 2003, Croatia submitted a formal application for EU membership and is now working diligently on adjusting its entire legislative and administrative system in accordance with EU requirements.

A liberal business environment is usually characterized by easy entry and exit procedures. In Croatia, the company registration process is relatively straightforward and requires less time than in other countries of the region. The basic registration requirements are in line with standard practice throughout the EU. However, the entry procedure remains costly as compared with EU standards. This concerns primarily acquiring visas and work permits. There is a fairly complicated system for expatriate employees to be formally registered for work in Croatia. At the same time, Croatian authorities created one-stop-shops for obtaining licenses and permits, and eased the access to all needed utilities for greenfield investors. In September 2003, the new bankruptcy law came into effect in Croatia, with retroactive implementation. It introduced changes into the bankruptcy legislation to speed up company liquidation and restructuring procedures. At the same time, the new law envisages changes in the sequence of dues payment. A significant part of payments to the workers (like severance pay) were shifted from the first class payment level to the lower payment levels. Such provisions provoked hot public debates. In particular, trade unions demanded urgent changes to the law. In 2003, Parliament also enacted amendments to the Croatian Labor Act. The amended labor legislation introduces more flexibility to labor market regulations. In particular, it envisages easier dismissal procedures, stricter rules for unemployment benefit applications, lower severance pay, etc. Although the new labor legislation has been fully adapted to EU standards, it spurred active protests of trade unions.

The level of taxation in Croatia compares well with that of other transition economies in the region. Soon after being elected in 2000, the government developed new tax legislation that introduced reductions of the main taxes. In December 2000, five major tax laws were adopted. These laws envisaged expansion of the tax base and reduction of some tax rates. In particular, corporate income tax has been reduced from 35% to 20%, which was quite a progressive change of the tax

legislation. The new tax legislation also introduced a 15% tax on interest revenue and dividends. The level of payroll taxes is quite modest in Croatia if compare with other CEE countries. The average payroll tax rate constitutes 37.67%, compared to a 45% average rate in peer transition countries. Value added tax was introduced in 1998 at 22%, while the top personal income tax rate is 35%. Therefore, the taxation regime in Croatia looks rather favorable, and the moderate tax burden can not be considered as a significant barrier to business activity.

## **2. Stability and Predictability of the Legal Environment**

---

Since 2000, the Croatian government has made substantial progress in reforming its legal system. Many Croatian laws were developed taking into account western European standards. During Croatia's accession to the WTO, commercial and trade legislation became more transparent and predictable. Although Croatian authorities have yet to do a lot of legislative work within the framework of European integration, the current legislative framework looks favorable for business conduct.

Among the most challenging tasks for the government remains reform of judiciary. The present judicial system in Croatia lacks modern case management practices and court administration, and suffers from overly politicized and inadequately trained lawyers and judges. In March 2003, a comprehensive judicial reform plan was adopted, implementation of which should increase efficiency of the judiciary, reduce case-backlogs and improve enforcement of court rulings. In its recent review, the EU Commission highlighted judicial reform that reduces political influence over the courts and improves their institutional capacity as one of the central issues in Croatia's attempt to meet EU membership criteria.

## **3. Corporate and Public Governance**

---

### **Corporate Governance**

Croatia's corporate governance system has been gradually changing to conform with internationally recognized standards. Croatia is one of the first countries in the CEE region where international standards of accounting and auditing were fully adopted. Croatia has no unified commercial code. Laws that govern investments apply equally to domestic and foreign investors. A law on commercial companies is based on German and Austrian company laws and defines the forms of legal organization for all entrepreneurs disregarding their residence status.

At the same time, there are a number of areas where Croatia's corporate governance system can be strengthened. Company ownership information remains significantly limited even though government regulations on information disclosure and transparency are fairly strong. Auditing practices are still weak because the levels of potential financial liability of an auditor are relatively low. This substantially deteriorates the quality of audited financial statements. There are no specific provisions to protect minority shareholders, thus there is an urgent need to introduce effective forms of redress for minority stakeholders or review voting rules to avoid oppression of minority shareholders by majorities.

Croatian corporate governance has benefited greatly from foreign direct investment inflow because foreign investors usually introduce the best corporate governance practices in enterprises with their participation. As part of the EU association process, Croatia will gradually adapt its corporate governance laws to conform with European standards, but the extent of changes and the timeframe for adoption have not yet been established.

### Public Governance

In order to meet EU accession requirements and successfully implement market reforms, Croatia has to improve institutional capacity of its public administration. Public administration reform is an integral part of the Stabilization and Association Agreement with the EU. In November 2002, the European Commission launched the public administration reform project with the objective of promoting modern and professional public service, capable of meeting the EU administrative standards and practices. The EU Commission intends to spend EUR 1.5 million for implementation of the project. Presently, the Croatian government operates in a markedly sectoral manner, with poor central coordination. There is insufficient cooperation within and between different government agencies and other parties involved (non-governmental organizations, business groups and citizens etc.) in the preparation and implementation of strategic documents, regulations and important decisions. Croatia may benefit greatly from the EU's assistance in modernization of its civil service through improved legislation and procedures for human resource management, remuneration and recruitment system; improvement of functioning and coherence of central civil service management.

### Privatization

Since 2000, the Croatian government has made substantial progress in privatization of state property, thus meeting its pre-election commitment of making privatization an integral part of Croatia's transition to a market economy. Although large-scale privatization progressed only gradually, transparency of the privatization process has been greatly improved over recent years.

The privatization process started in Croatia in the early 1990s. The privatization portfolio included approximately 3,000 formerly socially owned enterprises. In 1991, the total assessed value of privatized companies' statutory funds was close to \$11 billion. That was around 10% of all companies and 80% in value terms. One third of companies in the privatization portfolio of the early 1990s still remain in state ownership.

### Selected Large Sales

Year	Company	Stake, %	Amount, million	Buyer
1999–2001	Hrvatski Telekom	51.0%	\$1,272	Deutsche Telecom
1999–2002	Privredna Banka Zagreb	66.7% +10%	EUR 350	Banca Commerciale Italiana SpA
2000	Splitska Banka	63.0%	EUR 48	Unicredito Italiano
2000	Rijecka Banka	60.0%	\$76	Bayerische Landesbank
2002	Zagrebacka Banka	96.0%	EUR 250	Unicredito Italiano

Source: *Croatian Privatization Fund*

## Croatian Privatization Fund

Croatia's privatization portfolio contains assets (shares and interests) owned by the following government agencies:

- HFP — the Croatian Privatization Fund
- DAB — the State Agency for Deposit Insurance and Bank Rehabilitation
- HZMO — the Croatian Pension Insurance Institute
- HZZO — the Croatian Institute of Health Insurance
- HEP — the Croatian energy company
- INA — the Croatian oil and gas company
- HBOR — the Croatian Bank for Reconstruction and Development

The Croatian Privatization Fund was created as a legal entity according to the law. Its key functions are privatization of state enterprises and assets (stakes, interests, rights, and property) from the Fund's portfolio and management of government stakes and other assets.

The Supervisory Board monitors the lawfulness of the Fund's activities and is accountable to the Parliament of Croatia. Presently, the Board consists of 8 members appointed by Parliament. The Fund's Management Board decides on the policies, prepares financial plans for the Fund, makes key decisions on privatization, and is accountable to the government. The Management Board includes 5 members appointed by the government.

The Collegium of Department Heads is composed of the President and Vice-Presidents of the Fund (presently five). The Collegium makes decisions on privatization of assets of companies with registered capital up to HRK 10 million (some \$1.35 million). The President and the Deputy President of the Fund are appointed by the government. The Vice-Presidents are appointed by the President of the Fund and are approved and relieved by the Management Board. Vice-Presidents report to the President and the Management Board of the Fund. Presently, acting President is Kresimir Starcevic, one of the Vice-Presidents.

## Privatization Legislation

The legal framework for privatization in Croatia is the Privatization Act (latest version in 2000), setting criteria and regulating privatization procedures for state assets. There are also a number of supplementary regulations, among which:

- Regulations on the types of documents the buyers of shares, interests, property, and rights must submit to the Croatian Privatization Fund when concluding purchase agreement (1996)
- Regulations on the sale of shares, interests, property, and rights at public tenders (1996)

There are two privatization methods that the HFP uses: public tenders and public auctions.

The Croatian Privatization Fund privatizes large stakes or strategic enterprises through public tenders. The tender process includes the following steps:

- The Fund publicizes an invitation to the public tender in the media, on its website, and sends it through email to various embassies, chambers of commerce, and potential investors (interested bidders may purchase tender documentation from the Fund and conduct due diligence);
- Bids are made by the interested participants and evaluated by the Fund based on specified criteria;
- Contracts are signed.

The Fund sells companies in which it holds minority stakes at the Zagreb Stock Exchange (in special cases at the Varazdin Stock Exchange). Only registered members of the stock exchange can represent potential buyers.

### **Privatization Plan**

On November 14, 2002, the government of Croatia approved a plan for privatization of the state portfolio. In the following 18 months, the Croatian Privatization Fund should sell all state shares in companies. On the whole, the plan provides for sale of stakes in 1035 companies in the following sectors: agriculture (85), fishing (7), mining (5), processing (342), shipbuilding (95), trade (176), tourism (145), transport (56), and others. The total registered capital of these companies reaches \$8.3 billion; the state share is \$3 billion. Of the total number of companies in the state portfolio, 65 companies will be sold at public tenders, including:

- 23 tourist companies (mostly hotels)
- 13 companies in the agroindustrial sector
- two ports and one shipbuilding company
- 26 industrial companies

In July 2003, a 25%+1 share of the state oil enterprise (INA) was sold to MOL of Hungary, but the purchase agreement will be finalized after approval of the sale by the Slovenian antimonopoly committee (because INA and MOL together hold a substantial share of Slovenian market.) According to special laws, HEP (Croatian energy company) and JANAF (Croatian oil pipelines) will be privatized presumably in 2004. Secondary businesses of these companies will be sold separately. Two banks and a large insurance company remaining in state ownership will also be privatized.

In 2003, the government of Croatia revealed its intentions to transform the Croatian Privatization Fund into a property management fund. In addition to managing the state portfolio and carrying out its privatization, the new fund will be authorized to restructure companies prior to privatization.

## **4. Liberalization of Foreign Trade and Capital Movements**

---

Croatia has a very liberal foreign trade regime. The average tariff protection constitutes a low 6% in Croatia, which is much lower than in other countries of the region. In November 2000, Croatia became a full member of the WTO. The major changes to the trade regime in the country were made prior to WTO accession. Under the WTO accession agreement, Croatia undertook commitments to gradually reduce tariffs on goods over a period of 5–7 years. In 2001, customs duties and quality

restrictions for export of Croatian textiles to EU were removed. Customs duties exist only for manufactured goods, with rates from 0% to 18.8%. A major reduction of customs tariffs on industrial goods has been introduced in 2002. Between 1997 and 2002, Croatia signed bilateral free trade agreements with the majority of Central and Eastern European countries, thus considerably improving the access to foreign markets for its exports. In particular, Croatia has free trade agreements with the EU, EFTA countries (Norway, Iceland, Liechtenstein, and Switzerland), and CEFTA countries (Slovenia, Poland, Czech Republic, Slovakia, Hungary, Romania, and Bulgaria). Also, Croatia concluded free trade agreements with Albania, Bosnia and Herzegovina, Serbia and Montenegro, Lithuania, Macedonia, and Turkey. The only important issue that needs to be addressed is joining the Pan European System of Cumulation of Origin that establishes a single ruler of origin among participating countries. Being a member of the System may significantly ease the terms of exports for textiles, which remain the most sensitive export category for Croatia.

Croatian legislation is also fairly liberal in terms of capital movements and international payments. The Croatian Constitution guarantees the free transfer and repatriation of profits and invested capital for foreign investors. In June 2003, the Croatian government passed a new foreign exchange law that permits non-residents to maintain foreign currency accounts and to make external payments. However, the new law envisages the right for both the Croatian National Bank and the Cabinet of Ministers to impose capital controls if they believe that outflows or inflows of capital could cause significant problems to conducting monetary policy or carrying out foreign exchange policy. This provision is a step back in capital movements liberalization, but it is likely to be only a temporary measure necessary to address the current external vulnerability of the country.

## 5. Financial Sector Development

---

The banking system in Croatia is well developed. The banking crisis in 1998–1999 led to the privatization of major troubled banks of Croatia and development of the new banking regulations. Presently, there are 46 banks operating in Croatia, and more than 90% of their total assets are now foreign-owned. The first bank with 100% foreign capital, Raiffeisen Bank, started its operation in Croatia in 1995. Today, there are six more banks with 100% foreign capital. The most active banks with foreign capital are Bank Austria and Raiffeisenbank. The largest national banks are Zagrebacka Banka, Splitska Banka, and Privredna Banka. Rijecka Banka, Varazdinska Banka, Slavonska Banka, Istarska Banka, and Bjelovarska Banka are among the regional banks. The Croatian banking system is characterized by a high degree of consolidation as the five largest banks of the country control about 65% of total bank assets. Foreign owners of Croatian banks brought the best banking practices into the country. As a result, the Croatian private sector gained access to financial resources for investment and operational needs. Also, consumer-lending programs actively promoted by commercial banks have spurred private consumption in recent years, which in turn encouraged economic recovery in the country. The Croatian National Bank (CNB) is the main regulatory authority for Croatian banking institutions. The CNB develops and implements monetary and foreign exchange policy, manages international reserves and supervises banking system operation. An unexpectedly high current account deficit and larger-than-expected GDP growth in 2002 led the CNB to introduce measures to restrain lending in an effort to prevent an overextension of credit and to slow the growth of imports.

Insurance and stock markets in Croatia are much less developed than the market for banking services. However, insurance and stock market activity has been growing rapidly over recent years.

In 2001, insurance services contributed to only 3% of the country's GDP. The lax insurance activity in Croatia can be explained by delays in privatization of Croatia's largest state-owned insurance company, which holds 52% of the market share. Privatization of this enterprise is expected to provide an impetus to competitiveness and development of financial services in Croatia. Also, more active development of the insurance sector in Croatia is expected with progress in pension and healthcare system reform, which is currently underway.

### Stock Exchange

There are two stock exchanges operating in Croatia — in Zagreb and Varazdin. The Zagreb Stock Exchange is the main stock exchange in the country. The recent Zagreb stock exchange performance indices provide evidence of positive trends in the country's stock market development. The market has improved in both quality and performance indices. Over the last two years, stock market liquidity has increased considerably. Some Zagreb stock exchange performance indices are given in the table below.

Zagreb Stock Exchange	2001	2002	Change, %
Transactions Turnover, \$ million:			
Shares	\$135.0	\$163.4	21%
Bonds	\$99.0	\$653.0	559%
Certificates	\$0.8	\$1.1	37%
Rights	\$0.0	\$4.2	—
<b>Total, \$ million</b>	<b>\$234.8</b>	<b>\$816.4</b>	<b>248%</b>
Traded Securities	60	66	10%
Listed Securities	66	73	11%
Market Capitalization, \$ million:			
Shares	\$3, 585.5	\$3, 933.3	10%
Bonds	\$1, 000.0	\$1, 407.1	41%
<b>Total, \$ million</b>	<b>\$4, 585.5</b>	<b>\$5, 340.4</b>	<b>16%</b>

Source: Zagreb Stock Exchange

The 2003 expected market capitalization is \$7 billion, which will exceed the 2002 growth rate. A number of listed companies are expected to increase in 2003.

Croatia has a rather well developed market infrastructure (consulting, brokerage, auditing, and law firms) able to provide quality services to investment businesses.

### Funds and Investors

There are closed-end and pension funds in Croatia that invest not only in the country, but also abroad. Thus, Raiffeisen PIF net assets recently exceeded \$90 million. The fund has a 30% share of the market. Data on some funds is given in the table below.

The European Bank for Reconstruction and Development (EBRD) participated in a large number of projects in Croatia. From 1995 to 2002, the total value of projects was over EUR 3.5 billion, and EBRD contribution is estimated at EUR 1.2 billion. The projects were aimed at providing loans for infrastructure recovery (transport and communications), agriculture and industry, namely the shipbuilding, and electricity sector.

**Data on Some Croatian Funds**

Fund	Market Capitalization, \$ million (January 31, 2003)	Stakes in Portfolio	Managing Company
Dom Fond ZIF*	\$64.2	38	I.C.F.-Invest d.o.o.
Expandia Fond ZIF	\$22.5	11	Expandia Invest d.o.o.
Velebit ZIF	\$29.4	15	Dalbank Invest d.o.o.
SN Holding	\$20.4	26	E-Invest d.o.o.
Slavonsky ZIF	\$13.1	36	Hypo Alpe-Adria-Invest
Pleter PIF**	\$12.5	52	Fima Invest d.o.o.
Sunce PIF	\$10.5	38	Sunce Invest d.o.o.
Breza Invest ZIF	\$0.4	n/a	Fima Invest d.o.o.

\*— closed end fund, \*\*— pension fund

Source: Fima Invest

Other funds also actively operate in Croatia and in the region. The Overseas Private Investment Corporation (OPIC), and the Soros Private Funds Management (SPFM), have established the \$150 million Southeast Europe Equity Fund (SEEF) to facilitate further restructuring and privatization in the southeastern region.

OPIC opened a regional (southeastern Europe) office in Zagreb in February 2002 to establish partner relationship between American and regional businessmen. Today, OPIC implements insurance and financial projects for over \$65 million in Bulgaria, Croatia, and Romania.

## 6. Corruption Level

As in many transition economies, corruption in the public sector represents a problem in Croatia. Although the West perceives bribery and corruption to be widespread in Croatia, the scope of this problem is much smaller than it is in former Soviet Union countries. Moreover, the situation has seen substantial improvement since its independence. According to reports of Transparency International (TI), the international corruption monitoring organization, Croatia's rating of public perception of corruption improved from 74th (during the Tudjman regime) on its rank-ordered list of corrupt countries to 51st in 2002, although the country still remained in the group of "very corrupt" countries.

Restrictive labor legislation and overly bureaucratic procedures in a number of government agencies still create favourable conditions for corruption in Croatia. However, the Croatian government took active measures to reduce corruption in the country, viewing it as a serious impediment to business activities. In December 2000, Croatia joined GRECO (the Group of States Against Corruption), a monitoring organization assessing anticorruption efforts of the government on a continuing basis in member countries. In 2001, the Croatian Parliament ratified the Council of Europe Civil Law Convention on Corruption as well as two related protocols and United Nations anticorruption and transnational criminal conventions. In 2002, the government developed a comprehensive anti-corruption program, which was positively assessed by international organizations. In March 2002, the Croatian Parliament adopted an action plan and national program for combating corruption.

## 7. Political Risks

---

Election of the coalition government in 2000 and its substantial progress in implementing market reforms contributed greatly to the reduction of political risks in Croatia. In May 2002, Croatia was accepted into NATO's Membership Action Plan, underscoring the improved relationship between Croatia and the international community. Presently, the political situation in Croatia remains stable and democratic developments are being consolidated. However, parliamentary elections scheduled for late 2003 — early 2004 add to political uncertainty. Although the ruling coalition has a good chance to win the forthcoming elections based on public opinion polls, consolidation efforts of opposition parties may have negative implications for ruling coalition. In addition, the tight parliamentary election race could diminish the country's chances to meet political criteria set by the EU to get candidate status in spring 2004.

## 8. Country Promotion and Image

---

Croatia's international image was severely damaged by the hostilities of 1991–1995 taking place on Croatian territory. Return of political stability and rapid economic recovery over the last three years significantly improved the international image of the country. The government of Croatia has shown a strong commitment to implementation of the EU integration plan. To promote export and investment activity, the government established the Agency for Trade and Investment Promotion in January 2003. However, the Agency had not started its operations as of July. Although the Agency's establishment progresses slowly, its effective work may soon bring positive results in terms of foreign capital inflow. According to the leading rating agencies, Croatia's credit rating in 2003 remained unchanged as an investment-grade: BBB- by Standard & Poor's and Fitch, and Baa3 stable by Moody's. These sovereign ratings are supported by the government's intentions to reduce the budget deficit to sustainable levels, and accelerate privatization and reforms of the pension and health care system.

## 9. Targeted Investment Incentives

---

The main law regulating foreign investments in Croatia came into effect in January 1995. According to the law, foreign investors have equal rights, responsibilities, and status with resident investors. However, foreign investors can receive extra guarantees. Under the Croatian Constitution, the rights obtained as a result of capital investment cannot be alienated by any legal act. In addition, free investment profit expatriation and investment withdrawal is possible.

In July 2000, the Investment Promotion Law was adopted. The law envisages significant relief (even tax holidays in some cases) for greenfield investments. It also provides for limited employee subsidies and assistance for re-training, as well as customs relief for import of capital equipment. The law also offers investor access to government-owned real estate and construction rights on preferential terms.

## INVESTMENT OPPORTUNITIES

The Croatian economy is well diversified and is not dependant on any sector, though tourism has always been one of the most important components of the economy. In 1990, the share of tourism in GDP was 12%. The current government is aware of the fact that tourism is also one of the major factors in the process of restoring Croatia's post-war economy. It helps attract investments, generating hard currency earnings for the country, and creates jobs.

### Growth Rates in Some Industrial Sectors

Sector	Change 2002/2001, %	Sector	Change 2002/2001, %
Mining Industry	+17.0%	Chemical Industry	+6.6%
Food Industry	+6.8%	Metallurgy	+6.7%
Light Industry	-13.6%	Electricity Sector	+1.7%
Publishing	+19.6%		

Source: ISI Securities

Services account for over 50% of GDP, while production and mining account for almost 20% of GDP. The largest production sectors are the electricity sector, light industry, food industry, chemical industry, and shipbuilding. In 2002, the industrial production growth rate in Croatia was 6%. From 1998 to 2001, average industrial production growth was 2.1% per year.

Tourism, agricultural business (growth and trade), the food industry, and pharmaceuticals are the most attractive sectors in the Croatian economy.

### Tourism

Tourism is an important sector, providing 6% of full employment and encouraging development in other industrial sectors. Tourism direct revenues in 2002 are estimated at \$7.9 billion, which is a 6% increase over 2001. Tourism continues to play a key role in Croatia's current account balance, accounting for over a third of goods and services export. The war deterred almost all foreign tourists. This sector has, however, completely recovered by now. In 2002, 8.3 million tourists visited Croatia.

In 1998, tourism revenues exceeded \$2.5 billion, reaching a 5% increase over 1997. In 1999, however, due to the Kosovo crisis, revenues from tourism decreased by 10% compared to the previous year. Yet, tourism in Croatia still has great potential, possessing a long and developed Adriatic coastline and a large number of offshore islands.

Croatia has almost 2,000 kilometers of Adriatic coast and 1,185 islands, 66 of them are populated. The coast length is 5,835 kilometers, 4,057 of these with islands and cliffs. On the seacoast has a Mediterranean climate, with hot and dry summers and warm, damp winters. For several years, the UNESCO commission has awarded Croatia the Blue Flag for the excellent pure waters of the Mediterranean coast. Taking into account Croatia's aspiration to increase the number of such territories, the country can be considered a valuable pollution free European region.

## Agriculture

Agriculture, wood industry, and fishery account for about 10% of GDP. Over 80% of 3 million hectares of agricultural land is in private ownership. The remaining agricultural land the government grants on lease to private farmers either for free or for a small charge. Today, Croatia is bringing its agricultural sector into conformity with WTO norms and the EU Common Agricultural Policy. Forestland in Croatia is over 2 million hectares, planted mainly with quality trees including beech and oak.

## Food Industry

### Major Products Output, 1998–2002

Product	1998	1999	2000	2001	2002
Wheat Flour, thousand tons	298	297	276	279	299
Bread, thousand tons	140	125	124	124	129
Pasta, thousand tons	7	6	7	7	8
Fruit Juice, thousand tons	12	11	26	30	28
Canned Fruit/Vegetables, thousand tons	23	17	16	17	27
Flavorings, thousand tons	25	23	17	16	19
Fresh Meat, thousand tons	91	87	91	100	105
Sausages, thousand tons	34	32	35	40	44
Canned Meat, thousand tons	16	17	13	12	15
Infant Food, thousand tons	4	4	4	4	4
Butter, thousand tons	2	2	2	3	3
Cheese, thousand tons	19	18	21	23	22
Sugar, thousand tons	139	114	57	131	172
Confectionery Products, thousand tons	20	20	20	22	24
Biscuits and Other Baked Goods, thousand tons	23	23	22	25	27
Canned Fish, thousand tons	12	10	11	11	13
Vegetable Oil, thousand tons	41	38	35	40	41
Margarine, thousand tons	15	16	16	16	18
Yeast, thousand tons	11	11	11	12	12
Refined Spirit, million liters	7	12	13	9	11
Alcoholic Drinks, thousand hl	241	208	177	163	151
Beer, thousand hl	3,759	3,663	3,847	3,799	3,624
Wine, thousand hl	577	426	472	501	435
Soft Drinks, thousand hl	1,919	1,576	1,471	1,657	1,949
Forage, thousand tons	500	472	484	524	524
Tobacco, thousand tons	9	12	8	11	8
Cigarettes, million units	11,987	12,785	13,692	14,716	15,047

Sources: Croatian Chamber of Economy, ISI-Securities

The food industry generates 17.9% of the country's GDP (the tobacco sector accounts for 2.6% of GDP) and consists of 842 companies. The sector's output started increasing after the liberation war was over. A gradual recovery of food and beverage production began in 1993. The food industry has a number of sub-sectors, such as fish products and seafood, production of spices, flavorings, fast food, tobacco products, brewing sector, dairy sector, tea, coffee, and other beverages

production, etc. These sub-sectors attract a large volume of foreign investments. Among the most successful companies are the following:

1. VINDIJA d.d. ([www.vindija.hr](http://www.vindija.hr))
2. TVORNICA DUHANA ROVINJ d.d. ([www.tdr.hr](http://www.tdr.hr))
3. PODRAVKA d.d. ([www.podravka.com](http://www.podravka.com))
4. LURA d.d. ([www.lura.hr](http://www.lura.hr))
5. COCA-COLA BEVERAGES HRVATSKA d.d.
6. ZAGREBACKA PIVOVARA d.d. ([www.ozujsko.com](http://www.ozujsko.com))
7. KRAS d.d. ([www.kras.hr](http://www.kras.hr))
8. FRANCK d.d. ([www.franck.hr](http://www.franck.hr))
9. LEDO d.d. ([www.ledo.hr](http://www.ledo.hr))
10. ZVIJEZDA d.d. ([www.zvijezda.hr](http://www.zvijezda.hr))

Though the Croatian food industry possesses vast potential, imports of food products exceed their exports. The neighboring Bosnia and Herzegovina, Italy, and Slovenia are the most important Croatian markets. Major exported products include cigarettes, sugar, flavorings (Vegeta), dry soup mixes, confectionery products, canned fish, canned ham, beer, and other alcoholic drinks. Some of the imported products are milk, meat, chewing gum, soft drinks, malt, etc. Agricultural and food products account for 18% of total exports and imports. Croatia sells a number of recognizable products on the world market, such as Postup and Dingac wines, cheese from the Island of Pag, salami under the trademark Slavonski Kulen, and Slavonski plum brandy.

## Construction Industry

---

Construction is one of the most important Croatian sectors. There are 11,762 companies in the industry and 62,773 employees.

The sector dynamics have been irregular, yet a growth trend was common for postwar construction. The physical damage caused by the war of 1991–1995 is estimated at \$27 billion. The territories along the front line (Slavonia, the Dalmatian coastline, and the Dubrovnik region) took the largest damage. These events generated a need for extensive reconstruction, which was the major factor in the growth of the construction industry. It reached 18.8% in 1996 and 13% in 1997. However, growth rate decreased to 0.5% in 1998, despite the fact that the government headed by the Croatian Democratic Union (HDZ) extended road building programs. In 1999, the sector kept growing (10.1%); in 2000 the growth decreased to 4.5%, since the new government had to reduce allocations to the sector and most private companies halted investment projects. Growing unemployment and political instability in the country also contributed to a decline in construction activities.

In 2002, the growth in the construction industry was 12.8%. In addition, the sector saw some serious changes. Most work was now connected with construction of new buildings, while earlier it was mostly old buildings undergoing reconstruction. Investments in road construction, as well as in rebuilding the Croatian infrastructure, increased. Currently, the Croatian capital is being linked with Split on the southern coast and with Rijeka on the Istria Peninsula.

In Croatia, purchase of apartments is promoted by introducing credit purchase schemes. A new model of social incentives for apartment construction is aimed at considerably promoting construction and helping to meet the population's needs with assistance from social funds.

Know-how and international experience of Croatian engineers in construction of industrial and power generating units, roads, tunnels, and bridges suggest opportunities available for implementing sophisticated construction projects both in Croatia and abroad. The development strategy of the Croatian transport sector includes construction of 700 kilometers of new roads by 2011. Together with existing roads, they will make 1,220 kilometers of highways. Large foreign companies already operate in the Croatian construction sector.

## **Shipbuilding**

---

Nearly the entire shipbuilding sector is in government ownership. The sector consists of the following major companies: Uljanik, Kraljevica Shipyard, 3 Maj, Brodotrogir, and Brodosplit. They produce mostly tankers and merchant vessels, whose manufacture requires financing guarantees. Though there are orders in portfolios, most shipyards keep posting losses, which considerably deteriorate their financial position. Uljanik and Brodosplit are the only ports that were profitable in 2002. Despite government support, the sector import volumes exceed export. The Uljanik shipyard is an exception. It is partially owned by its employees and was able to receive 65% of its orders from domestic consumers.

## **Mining and Processing Industry**

---

Croatia possesses various mineral resources, except for oil and gas. Coal production ceased in August 1999. Production of aluminous and silicic sand, which were the most important minerals before Croatian independence, has also stopped. Yet the mining sector continues growing rapidly. In 2002, its growth rate was 17%, reacting to growing demand in the construction sector. Particularly, it is connected with the implementation of the government program on highway repair.

Croatian oil reserves are depleted, yet oil processing and refining remains an important part of industrial activity. Refineries in Sisak and Rijeka supply not only the domestic market, they also export their products to Bosnia and Herzegovina, Slovenia, and Serbia and Montenegro. Related industries include fertilizer production, production of petrochemicals, and plastic production in Dalmacia. In 2002, the government began the privatization of oil and gas company INA by selling a 25% stake plus one share. The company's privatization is expected to be completed in 2003.

## **Pharmaceutics**

---

The pharmaceutical industry is the second export-oriented sector by importance after oil refining. The industry leader is Pliva. The advantageous position of the company is strengthened by the fact that it has its own patent for producing Azithromycin (antibiotic), sold all over the world. Pliva is listed on the London Stock Exchange and has started to expand to Europe by purchasing production capacities in Germany and Poland. Pliva also conducts scientific research in Great Britain. The company has already stopped performing secondary types of commercial activities

(like production of yeast and makeup), which boosted its competitive capacity on international market. Pliva is implementing an aggressive international expansion strategy. In 2002, the company opened a sales branch in Italy. The rest of the companies in the sector are focused mostly on the CIS and domestic markets. On the whole, the industry requires considerable investments to improve product quality and competitive strength.

## RISKS AND OPPORTUNITIES

### Risks:

- Slow reforms or total rejection of reforms can cause a structural crisis in the Croatian economy. The Government's fear of making unpopular decisions (salary/benefit decrease) is the key risk.
- Low competitive strength of separate Croatian industries compared to the EU countries can lead to their collapse after EU accession.
- Great dependence of a number of leading Croatian industries on raw materials imports can lead to economic dependence of the country.
- A decrease in foreign investments inflow creates a risk of a lack of funds to implement important economic projects, which will be made up for by diverting internal reserves.

### Opportunities:

- Croatia has vast staff resources.
- The EU accession opens new markets for successful Croatian manufacturers (export of wine, food products, and pharmaceutical products).
- Tourist business is promising and will attract FDI to Croatia. This can boost the development of related sectors (construction, food industry, catering and hotel business).
- Incomplete privatization process provides additional opportunities for investors.
- Croatia's EU accession should accelerate capitalization growth of Croatian stock market and Croatian companies.

## CONCLUSION

Since independence twelve years ago, Croatia has achieved significant progress in developing a market economy. The return of political stability to the region contributed to improving the climate for economic development. In 2000, the newly elected coalition government began implementing needed economic reforms to restore macroeconomic and financial stability, and developed a transparent privatization program. The government has made good progress in reducing inflation, restraining the fiscal deficit and achieving sustained economic growth. Among major accomplishments of Croatia over the recent years are accession to the World Trade Organization, signing a Stabilization and Association Agreement (SAA) with the European Union, entry into NATO's Membership Action Plan, and also submitting a formal membership application to the European Union.

Although Croatia has yet to implement important economic reforms, including reform of judiciary and social sector reforms, the country stands firmly on the way to building efficient market economy with favorable business environment. Also, the Croatian government has to manage the current macroeconomic problems in a prudent manner. The Croatian government acknowledges that further implementation of market reforms will bring better living standards for Croatian citizens.

## REFERENCES

Croatian National Bank, *Annual Report 2002*, Zagreb, 2003

EBRD, *Croatia: Investment Profile 2001*, London, 2001

FIAS, *Croatia: Administrative Barriers to Foreign Investment*, Washington DC, January 2001.

IMF, *Republic of Croatia: First Review Under the Stand-By Arrangement — Staff Report*.  
IMF Country Report No. 03/252. Washington DC, August 2003.

IMF, *Republic of Croatia: Article IV Consultation — Staff Report*.  
IMF Country Report No. 02/178. Washington DC, August 2002.

Intellinews, *Croatia: Monthly Macroeconomic Report*, various issues

O'Driscoll Gerald et al. *2003 Index of Economic Freedom*. The Heritage Foundation,  
Washington DC, September 2002.

OECD, *Corporate Governance Country Assessment: Republic of Croatia*, Paris, 2001

Podkaminer Leon et al. *Transition Countries Resist Global Slowdown: Productivity Gains Offset  
Effects of Appreciation*. WIIW Research Report No. 293. The Vienna Institute for International  
Economic Studies, Vienna, February 2003

SigmaBleyzer, *Accelerating the Flow of International Private Capital to Ukraine*,  
Houston, April 2001

World Bank. *Memorandum on Country Assistance Strategy of the World Bank Group for Croatia*.  
September 1999

## APPENDIX

## Croatia: Key Economic Indicators

	Unit of measurement	1996	1997	1998	1999	2000	2001	2002	2003 (est.)
Population	mn, eop	4.5	4.67	4.5	4.55	4.38	4.43	4.39	4.43
Unemployment Rate	%, eop	15.6	17	17.4	18.8	21	22.6	23.8	18.5
Average monthly Salary (net)	US\$	374	386	421	430	402	425	442	n/a
Real Sector									
Nominal GDP	US\$ bn	19.87	20.2	21.6	19.9	18.4	19.5	22.4	27.4
GDP per capita	US\$	4,422	4,478	4,702	4,524	4,188	4,433	5,107	6,189
Real GDP Growth	% yoy	n/a	6.8	2.5	-0.9	2.9	3.8	5.2	4.2
Industry Share in GDP	%	21.6	21.9	21.1	21.6	22.3	22.5	23.4	20.7
Agriculture Share in GDP	%	8.4	7.8	7.9	8	7.9	7.8	7.9	6.8
Gross Domestic Investments/GDP	%	n/a	n/a	n/a	25.7	21.8	23.6	28.7	27.8
Domestic Savings/GDP	%	19.5	13.2	3.9	7.1	5.8	7	4.8	2.7
Public Finances									
Fiscal Balance (IMF method)	% of GDP	-1	-1.9	-3	-7.4	-5.7	-5.4	-4.3	-4.6
Fiscal Revenues	% of GDP	44.3	42.5	45.6	42.8	39.9	38.7	40.9	44.9
Fiscal Expenditures	% of GDP	45.3	44.4	48.5	50.2	45.5	44.2	45.2	49.5
Monetary Statistics									
Consumer prices	% yoy, aop	3.5	3.6	5.9	4.3	6.2	4.9	2.6	2.0
Currency in Circulation	% yoy, eop	n/a	20.8	-1.0	2.0	30.1	31.4	30.2	21.1
Money Supply-M4	% yoy, eop	49.1	38.3	11.7	-1.2	28.9	45.2	9.4	8.3
Net Domestic Credit to Private Sct	US\$ mn	6.2	7.9	9.4	7.8	7.3	8.9	9.5	12.2
Exchange Rate HRK/USD	aop	5.43	6.16	6.36	7.11	8.28	8.35	7.86	7.07
Exchange Rate HRK/EUR	aop	7.02	6.98	7.13	7.59	7.65	7.48	7.41	7.58
Balance of Payments									
Exports of goods	US\$ mn	4,546	4,210	4,604	4,395	4,567	4,752	4,995	5,861
Imports of goods	US\$ mn	-8,169	-9,407	-8,752	-7,693	-7,771	-8,764	-10,274	-11,883
Trade Balance	US\$ mn	-3,623	-5,197	-4,148	-3,298	-3,204	-4,012	-5,279	-6,022
Trade Balance/GDP	%	-18.2	-25.8	-19.2	-16.6	-17.4	-20.6	-23.5	-22.0
Net Services, Income & Transfers	US\$ bn	2,532	2,872	2,617	1,908	2,771	3,389	3,732	4,629
Current Account Balance	US\$ mn	-1,091	-2,325	-1,531	-1,390	-433	-623	-1,547	-1,502
Current Account/GDP	%	-5.5	-11.6	-7.1	-6.9	-2.3	-3.1	-6.9	-5.5
Net Foreign Direct Investment Inflow	US\$ mn	482	344	835	1,445	1,086	1,407	886	895
Overall B/P Balance	US\$ mn	413	391	160	410	611	1344	567	599
Gross International Reserves	US\$ bn eop	2,314	2,539	2,816	3,025	3,525	4,704	5,886	6,639
Public and Private Debt									
Total External Debt	US\$ mn eop	5,308	7,452	9,856	9,872	11,002	11,317	15,284	18,446
Total External Debt	% of GDP	23.2	31.9	40.3	44.5	59.7	58.0	68.2	67.3
Private External Debt	US\$ mn eop	1,456	2,840	4,716	4,601	5,136	4,780	8,928	n/a
Public External Debt	US\$ bn eop	2,935	4,168	6,249	6,222	6,725	6,537	6,356	n/a



## A FEW WORDS ABOUT US

### SigmaBleyzer

---

*SigmaBleyzer, an international investment company, was established in 1993. Founded by the Bleyzers, an American family from Houston, Texas, with Ukrainian heritage, the company is committed to providing a comprehensive range of financial services for those that do business in countries with transition economies, including Eastern Europe and the CIS region. SigmaBleyzer's worldwide network of industrial and financial contacts has ensured a strong investor base and strategic industry partners in the West. The main areas of activities of the company include investment banking, asset management, corporate finance and consulting services.*

*Michael Bleyzer, President and CEO of SigmaBleyzer, is a respected expert on developing countries and transition economies. Before co-founding SigmaBleyzer, he had a 15-year career with Exxon Corporation and Ernst & Young, which provided him with opportunities to work in management positions in Belgium, France, Germany, United Kingdom, Netherlands, and other countries in Europe as well as in Asia Pacific. He has the vision and drive that continues to propel the company ahead of the competition.*

*With the strength of the company's local infrastructure, implementation of western-style management and intimate knowledge of local market conditions, SigmaBleyzer has created one of the best investment banking organizations in Ukraine. Today, SigmaBleyzer's Ukrainian Growth Fund (UGF) portfolio consists of about 60 companies with estimated value of \$150 million. The most successful among them are Volia Cable — the largest TV-cable operator in Ukraine and one of the largest in the FSU, Softline — the leading Ukrainian software development company, Sevastopol Shipyard — a commercial shipbuilding, ship-repair and machine engineering facility, Poltava Confectionery — one of the largest and fastest growing companies in the industry, and many others.*

### The Bleyzer Foundation

---

*The Bleyzer Foundation is an international non-government organization established in 2001. The Foundation was created by the Bleyzers, an American family with Ukrainian heritage. The President of the Foundation is Mr. Michael Bleyzer, President and CEO of multinational company, "SigmaBleyzer".*

*The Foundation's Managing Director is Mr. Victor Gekker, who is supported by a team of economists and business analysts. The Advisory Board of The Bleyzer Foundation is chaired by Dr. Edilberto Segura and provides advice and guidance to the activities of the Foundation.*

*The aim of the Bleyzer Foundation is to support the successful transition of developing countries and transition economies into healthy, democratic market economies. The Foundation provides informational and consultative assistance to developing countries on creating favorable market conditions, improving the investment climate, and ensuring sustainable economic growth. The Foundation helps these countries complete the transition process and become successful, prosperous nations, fully integrated into the global economic community.*

*The mission of The Bleyzer Foundation is to promote the development of the private sector and the use of best practices in government policies, which create capital-friendly environments and deliver improved quality of life through economic transformation and sustainable growth. The Foundation advocates open market economies, transparency, business liberalization, and the formation of honest partnerships between the government, business, and the community. It actively supports the creation of a stable, predictable and level playing field, which provides conditions for private-sector-led economic growth and development of international economic relationships.*

*A large portion of the world is in an unstable state of transition. The main goal of these countries is to successfully complete transitions and achieve stability, based on market economy, private business development and democracy. The developed countries hold the keys to this transition and must lead the effort.*

*There are three alternatives to consider.*

**Standoff** — *basically where we are today, the status quo. The developed countries enjoy relative stability and prosperity, but attempt to isolate their economies. They mostly keep their wealth and their market economy know-how to themselves. The developing countries struggle to develop, but continue to be immersed in poverty, inequality, instability, and envy.*

**Payoff** — *the idea of "wealth redistribution" on a global scale. This would be accomplished through substantial increases in foreign aid, in order to avert possible future troubles in the world. While some believe you can simply pay your way to world stability, this approach will likely produce a global welfare system. Donors and recipients will be equally dependent on each other and motivated to maintain this dependency in perpetuity.*

**Tradeoff** — *joint application of best practices to manage changes in developing countries. On the one hand, the developed countries provide know-how and experience in building a market economy, better access to their markets, foreign direct investments, and precisely targeted aid. On the other hand, the developing countries fully implement necessary changes to make the business environment more attractive and trade in their commitment to build a market system, the rule of law, and a transparent and democratic society.*

*The Bleyzer Foundation believes that only the last alternative — tradeoff — will achieve real, long-term results. The Foundation attempts to help refocus multilateral and bilateral assistance to developing countries on the creation of private business and market economies. Economic research on transition economies carried out by the Foundation help to identify best practices in government policies, which must be used in these countries.*

*To achieve these goals and to realize its mission, the Foundation's activities include:*

- *Engaging governments in dialogue to influence economic policy in areas related to improving the business climate*
- *Monitoring and reporting on the evolution of key economic reforms and policies that affect the investment climate*

- *Assisting the activity of associations and alliances of businesses and non-government organizations that share the Foundation's goals*
- *Establishing cooperation with national associations and international organizations whose activities are similar to those of the Foundation*
- *Providing informational and advisory support to businesses in developing countries*
- *Advocating and promoting campaigns to create positive images of developing countries and strengthen their international reputations*
- *Promoting education and implementation of best practices in government policies, and building consensus on the major issues of economic development for transition economies*
- *Promoting the necessity of legal, administrative, economic, and other reforms in order to ensure the sustainable economic growth of developing countries*
- *Informing the community about the Foundation's activities, and advocating its ideas and objectives through the media*