

## **CROATIA IN 1993**

### **- BETWEEN HYPERINFLATION AND STABILIZATION**

**Željko Rohatinski**

Taken as a whole, 1993 was a year in which the problems of the Croatian economy, caused by the war and the transitional crisis, and further aggravated by the impossibility of finding optimal solutions, or by an earlier delay of such a solution, culminated in high inflation which additionally worsened the overall economic performance both in the real and especially in financial and monetary spheres.

Industrial production, which due to the sectoral asymmetry of the war depression increased its share in the structure of the social product from the prewar 33.2% to 41.9% in 1992, decreased during 1993 by 5.9%, coming down in such a way to the level of 42.5% lower than in 1990, or by 50.1 % lower than the highest level achieved in 1987. Production decreased in all three main destination groups with the largest fall in the group of the equipment (- 11.9%), where on the average it was lower by 55.1 % than before the war with the variation by branches ranging from -40.1 % (production of electrical machinery and instruments) to -72.9% (machine building). The production level in shipbuilding which is traditionally the biggest exporter, decreased in 1993 by 21.7% In relation to 1990 it is lower by 53.4% with very negative implications on the financial situation within the reproductive chain and on the operations of regional banks. In the conditions of notable disinvestments in the country, where the realized investments reached not more than 80% of the amortization (1992), this was essentially induced in 1993 by the decline in equipment exports to the convertible currency market by 45.6% (decline in relation to 1990 by 56.8%). As a result this relatively biggest net exporting sector in the industry, which even in the war conditions achieved an annual surplus of about 170 million dollars (coverage of imports by exports of 139%), suffered in 1993 a deficit of 389 million dollars with the level of

coverage of imports by exports of only 46%.

Such developments in industrial production and the situation in investments resulted in a decrease in the transport activity (-8.9%) and in construction (-10.4%), which determined an overall fall in the economic activity of about 6% in relation to the previous year. Different rates of exchange in particular activities depending on the intensity of specific character of individual factors, varied from -28.1 % in retail trade to +20.3% in the number of tourist overnights. In this way, the general level of economic activity in Croatia was cut by half in relation to its prewar amount.

A decline in the economic activity was also accompanied during 1993 by a decrease in total employment of 4.1 %, with the transitional tendency of the increase in the number of employed in the private sector (22.1 %) and the decrease in the social sector (-6.3%). Since the registered unemployment simultaneously decreased in relation to 1992 by 4%, the unemployment rate remained unchanged (17.8%) being almost twice as big as in the prewar and pretransitional period (9.3%). In the same period the labour productivity decreased by 33%. In such a way, the economic activity in 1993 proceeded with a relatively low level of employment of economically active population and with low labour productivity, which means with high gross costs (without regard to the fact that the unit net price of labour decreased in relation to the prewar by 63%). All this, together with other factors, caused a low price competitiveness of the economy both in exports and in the domestic market, exerting in this way a constant pressure on the exchange rate policy.

However, even in the conditions of the indexed exchange rate, due to the decline in the sales on the markets of ex-Yugoslavia by 51.8%, and to the increased problems in the marketing on convertible currency areas (with the exception of the finishing sector), the exports of goods as the essential segment of the aggregate demand decreased in 1993 by 15.1 %, expanding the problem of production realization to the agriculture sector as well (decrease in exports by 33.8%). But owing to

the relatively good results in tourism and to the corresponding increase in the export of services by 19.6% the total exports of goods and services dropped by 6.5% in relation to 1992, absorbing about 68.7% of the supply from the domestic sources.

At the same time, the import of goods increased by 4.6%. If the import of services is taken into account, total imports increased by 6.5%. As a result, in 1993 a foreign trade deficit amounted to about US\$ 200 mil. It was mostly financed by the current transfers from abroad. Despite a fall in production in 1993 this made it possible to prevent a decline in goods and services available for final consumption in the country.

However, there was no a real income to finance such a volume of consumption. Because of the high inflation, the real purchasing power of money receipts in the business sector, reduced by the outlays for the material expenditures (which category is approximately 95% of the social product of the state sector) has been namely decreased by 13.1 % (from 1992 to 1993) inducing as a consequence (through the increase in the average annual tax rates, the "escape" of wages into lower brackets of income taxation, and the general tax evasion) a real drop in basic categories of the distribution of the social product - in the volume of wages and salaries by 19.1 %, taxes (gross) by 10.5%, and, through them in the registered effective demand in the domestic market by 18.7%. As a consequence, about 14% of the aggregate demand in 1993 was covered by different forms of deficit financing, i.e., by the increase in the internal debt. This also corresponds to the relation between money supply increase and the nominal social product (in this case: net income of the economy) which amounts to 14.4%, and which is usually taken as a measure of the monetization of the budget deficit.

Consequently, money supply was growing during 1993 at an average monthly rate of 21 %, and base money (having a real basis in the increase in currency reserves of the central bank of 452 million dollars) at the rate of 22.0%, making up a monetary basis for high inflation, to which inflationary expectations were added, generating in this way up

## MAIN ECONOMIC INDICATORS IN CROATIA

- indexes in real terms

	1991 1990	1992 1991	1993 1992	1993 1990
GROSS DOMESTIC PRODUCT	71.3	76.4	94.0*	51.2
INDUSTRIAL PRODUCTION	71.5	85.4	94.1	57.5
- equipment	64.9	78.6	88.1	44.9
- reproduction materials	72.2	86.3	95.1	59.3
- consumer goods	74.0	86.6	95.2	61.0
FINISHED GOODS INVENTORIES	88.4	84.7	101.4	75.9
EMPLOYMENT	88.4	88.7	95.9	75.2
- state sector	87.0	87.5	93.7	71.3
- private sector	136.1	108.8	122.1	180.9
UNEMPLOYMENT	157.9	105.1	96.0	159.3
COMMODITY EXPORTS	81.9 <sup>1</sup>	104.3 <sup>1</sup>	84.9	-
COMMODITY IMPORTS	73.8 <sup>1</sup>	91.9 <sup>1</sup>	104.6	-
RETAIL TRADE	78.9	61.1	71.9	34.7
NET WAGES AMOUNT	72.6	47.3	80.9	27.5
HOUSEHOLDS INCOME	72.3	54.5	78.1	30.8
PUBLIC REVENUES	65.9	75.8	89.5	44.7
HOUSEHOLDS EXPENDITURES	76.8	70.5	81.1	43.9
INVESTMENT PAYMENTS	60.0	40.9	68.0	16.7
MATERIAL EXPENDITURES OF PUBLIC SECTOR	81.9	88.6	84.4	61.2
PRODUCER PRICES IN INDUSTRY	246.3	925.2	1612.4	36742.8
RETAIL PRICES	223.0	765.5	1617.5	27611.8

\* estimate

<sup>1</sup> without countries of ex-Yugoslavia

to October a monthly price growth of 28.6%. That circle: budget deficit - monetary expansion - inflation, was a key determining factor of the monetary and financial trends in Croatian economy during 1993. Since the relations between these categories are not (in the conditions of undisturbed flows) dynamically proportionate but progressive, they simultaneously resulted in a decrease in the real stock of money (by 20.9% during 1993, and even by 46% in 1993 over 1992) as well as in real income decrease, which caused bigger and bigger problems in deficit financing. The situation could not be relieved by the fact that the current deficit in 1993 (14.4%) was as a matter of fact by 22% smaller than in 1992, when under the direct influence of the war it attained 18.4%, because at the same time the volume of the real money (measured by the share of the average money supply in the realized social product) decreased from 12.9% to 8.8%, or by 32%.

In October, the Government of the Republic of Croatia decided to undertake radical measures of the antiinflationary policy within a scope of broader activities for the stabilization of the economy and intensification of transitional processes. That was preceded by three elements.

The first refers to the acceleration of the inflation at the beginning of the autumn to the level higher than 30% monthly, what "broke" the syndrome which had been quite present till then in the part of the economic and political public, and which represented a thesis that the inflation could be reduced even without direct radical antiinflationary measures - and, what is even worse - that such measures are not at all applicable to the current situation in Croatia. It became namely evident that the acceleration of inflation is not just a temporary result of an additional accomodation in the movement of its basic determinants, but one more in the series of logical consequences of the indexation strengthening at a permanently high inflation. Consequently, there could be no doubt that the reproduction of that mechanism simply could not slow down the inflation - but it could accelerate it to the levels which could not be justified by any economic, political or other reasons.

The second element lies in a political evaluation of the appropriate moment, in the development of economic and political conditions in the country, which would allow: (a) to reduce essentially the financing by money emission of the growth of foreign currency reserves as a potential source for defense financing (b) to stabilize the material expenses of the state budget and funds, and to eliminate the shock-components in their structure; and (c) to increase the financial discipline in public enterprises and in the enterprises in predominant state ownership, especially after the harmonization of relative prices.

Finally, the third element is connected with the fact that at the end of September foreign currency reserves reached the amount of 1222 million dollars, what enabled the approach to the realization of the antiinflationary policy even without usual arrangements on international financial support. These reserves became sufficient for a three-month financing of commodity imports or for almost a two-month financing of total expenditures for current transactions with foreign countries, but in the first place, combined with the simultaneous decrease in the real money balance, they became a key component in the structure of the total money supply.

Antiinflationary measures, which were undertaken, belong to the standard heterodox shock-therapy, applied already with a relative success in individual countries. It implies a direct attack on the mechanisms of self-generating inflation (limitation of base money and, depending on that, determination of the discount rate and the intervention exchange rate of national currency), and then, within a priori restricted monetary framework, introduction of the instruments of the control of incomes, in order to distribute evenly the effects of monetary restriction.

The beginning of the application of the program with a delay of one month, orientation on the dynamic instead of static fixing of the anchors, the avoidance of an absolute limitation of the public sector expenditures, and a prompt integration and consolidation of the total budget, lowering of the discount rate to only 3%, as well as refraining

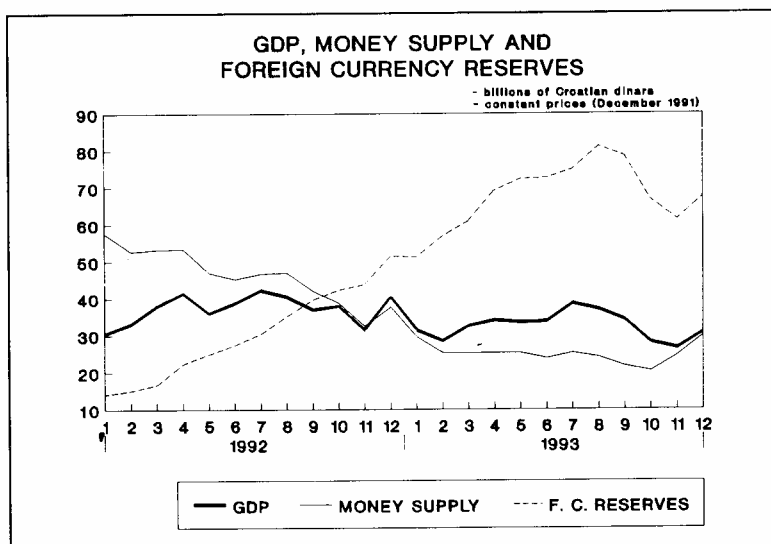
from some other measures which often help the realization of a radical antiinflationary policy, were only " little concessions " which temporally dispersed the effects of the shock - therapy but which didn't change its basic character.

The effects of the antiinflationary policy measures quickly contributed to the realization of its primary objectives. After a jump in retail prices in October in relation to September by 38.7% - which was expected as a result of the prompt exchange rate depreciation at the start of the program - market decrease in the effective exchange rate, lowering of sales tax rates, reducing interest rates by prohibitive taxation, limitation of the mass of wages and a restrictive break in monetary policy, all this resulted in the second half of October in a sudden interrupting in all relevant generators of high inflation. That was accompanied by the application of nominally non inert anchors for November, what reduced inflationary expectations and gave an impulse to squeezing out the anticipative component from the structure of prices.

The key role in that was played by the changes in the policy of creation money and the formation of its price. On the other side, owing to the monetary character of the inflationary processes, such a policy essentially contributed to the very appearance of the high inflation. This is in fact a source of the starting success of the antiinflationary measures: high inflation has been basically stopped by the interruption of the mechanisms of its monetary feeding. This caused the essential imbalances (whether inflation generated or concealed) to come to light, imbalances between real money, production level and foreign currency reserves which stopped the indexation of the key indicator of inflationary expectations - national currency exchange rate.

To comprehend the whole question, it is necessary to keep in mind that at the end of the third quarter of 1992, when the inflation for the first time reached the level of over 28%, mutually inverse functions of the decrease in the stock of real money, and the growth of real dinar countervalue of foreign currency reserves, came to the equilibrium point at the level of the one-month social product, so that the money

supply in this point was completely covered by foreign currency reserves and by the fund of the produced commodities and services at the given level of prices and exchange rate. It was technically a very convenient moment to undertake the measures of the antiinflationary policy and to avoid in such a way a part of the problems which will later arise. But as it was not done, it came to the accelerated opening of the other part of the scissors between the development of foreign currency reserves and money.



As a result, at the end of September 1993, the real dinar countervalue of foreign currency reserves increased by 98%, while the money supply declined by 49%, leading to the increase in the coefficient of the coverage of local money by foreign currency reserves from 100 to 363%. Simultaneously, the realized social product decreased in that period by about 8%, so that such movements in the sphere of monetary aggregates resulted in a decrease in real money supply in circulation of 44% on the one side, and in the increase in foreign



currency savings of 115% on the other. This points to the high intensity of the underestimation of the total money supply reducing its use only on current transactions. That of course significantly reduced inflationary taxation revenues and thereby the reallocative mobility of money.

In such conditions, in mutual interaction with high inflation, a system of three " hard " relations between production, money supply and foreign currency reserves was formed, whose structural characteristics finally enabled a fast halt of the high inflation.

The first of them refers to the increased ratio of foreign currency reserves and the social product, which was accompanied in the situation of the deficit in the trade in commodities and services with foreign countries, primarily on the basis of the transfer, property sales and foreign currency transactions with the population. The increase in this ratio in the conditions of production decline and high inflation, points out to the intensity of local capital conversion (because of opportunity costs) and its immobility in the banking system, from where it only partially and indirectly influenced through the real economic activity (money issue on the basis of foreign currency buying, imports credit financing or " financial rehabilitation " of commercial banks assets).

As the increase in the currency reserves of the central bank absorbed in that period 54% of the increase in total reserves, it was a basic, and after the abolition of selective credits, practically the only source of creation of base money whose quantity nominally grew at an average monthly rate of 23%, inducing at a relatively stable multiplier, the growth of the money supply at the rate of 21 %. That represented the monetary basis of a high inflation, which reversely resulted in the decline with real quantity of money and in that manner, in forming the second " hard " relation which refers to the rise in the velocity of money, from 1 to 1.6 times a month. This phenomenon, normal in every high inflation, alleviated the negative influence of really decreased liquidity on the realization of the social product, but it could not completely remove it because of the constraints existing in the

sphere of the increase in the velocity of money.

In this way, a real level of social product (Y/P) was determined as a sublinearly falling function of the increasing negative difference between the nominal level of the money (M) and the level of prices (P):

$$\ln \frac{Y}{P} = \underset{(13.3180)}{3.3970} + \underset{(6.5267)}{1.2106 \ln M} - \underset{(6.4624)}{0.9373 \ln P}$$

$$DW = 1.7598 \quad F = 397.2280 \quad R^2 = 0.9815 \quad n = 21$$

while its relative changes (y/p) were determined by the expression:

$$y/p = \underset{(1.3708)}{8.2200} + \underset{(7.2592)}{1.0443 m} - \underset{(4.6030)}{1.1107 p}$$

$$DW = 1.9865 \quad F = 30.8603 \quad R^2 = 0.7491 \quad n = 21$$

That's why, a high intensity of the creation of money on the basis of the foreign currency buying, primarily influenced the inflation, while its impact on production was only indirect, and by intensity relatively small or even negative. That of course does not mean that the process of the increase in foreign currency reserves in the existing conditions was not necessary or that it did not have and still has a series of positive effects, nor that the creation of money on the basis of foreign currency buying did not enable the maintenance of a given degree of the smooth viability of the financial system, but the way how it was carried out brought about a third key imbalance in Croatian economy.

This imbalance is determined by the relation between the growing real dinar countervalue of foreign currency reserves and the falling quantity of the real money, which resulted in the marginalization of the latter. The consequence was the actual effective introduction of foreign currency as the accounting unit, and of the exchange rate as the basic indicator of all prices in the domestic market. In this respect, however, because of the growing disproportion between the potential foreign

currency supply and demand, it was more and more difficult for the exchange rate to be formed on the market basis. In fact, it was indexed, and its credibility was defended by the central bank as the largest net buyer. As a result, the effective exchange rate in the market varied only relatively little around it. That rate was convenient for exporters (especially in the context of a decreased selling on the domestic market), for commercial banks, and generally for all the owners of foreign currency, because it protected the real dinar countervalue of foreign currency deposits (the basic motive for savings in foreign currency), and stimulated the foreign currency conversion from the domestic "stocking". The problem was, however, that in the conditions of the proinflationary character of the whole economic policy, the indexation was calculated "in advance", on the basis of high inflationary expectations, what was transformed then into real inflation. The condition for the reproduction of that mechanism was the continuity of the expansive monetary policy and, consequently, the high inflation.

It was in this way, how the circle of modalities in the functioning of the Croatian economy was closed before embarking on the antiinflationary policy measures: substitution of local money by foreign currency and its immobilization with the reflection on production decline, and all that with the indexed exchange rate and expansive monetary policy as the leading substance of that process, and, as a consequence, a moderator of inflation.

Therefore, it is quite logical that the initial effects of the antiinflationary policy implementation were first seen in the relation: foreign currency reserves - local money. When namely in the middle of October the central bank, after using up the foreseen quota, stopped buying foreign currency, their price (rate) could not be maintained on the basis of the nominal increase in local money, but it was completely influenced by the existing absolute relation between the available quantities of local money and foreign currency reserves in commercial banks, what caused the rapid fall in the price of foreign currency.

There was in this, without doubt, a contribution of some speculative elements connected with the question of the initial credibility of the program, which increased the realized foreign currency offer in the period immediately after the initial depreciation of the national currency, and then, when its appreciation started, they slowed down foreign currency demand in the conditions of the internal convertibility. That significantly reduced the dinar liquidity of commercial banks, influencing a further rate appreciation, in spite of the use of the secondary sources of liquidity which have now become expensive in real terms.

In such a manner, the action of the exchange rate as the leading indicator of inflation was interrupted in a very short time, which contributed to the gradual break-down of the entire previously described mechanism of functioning of the economy in the conditions of high inflation.

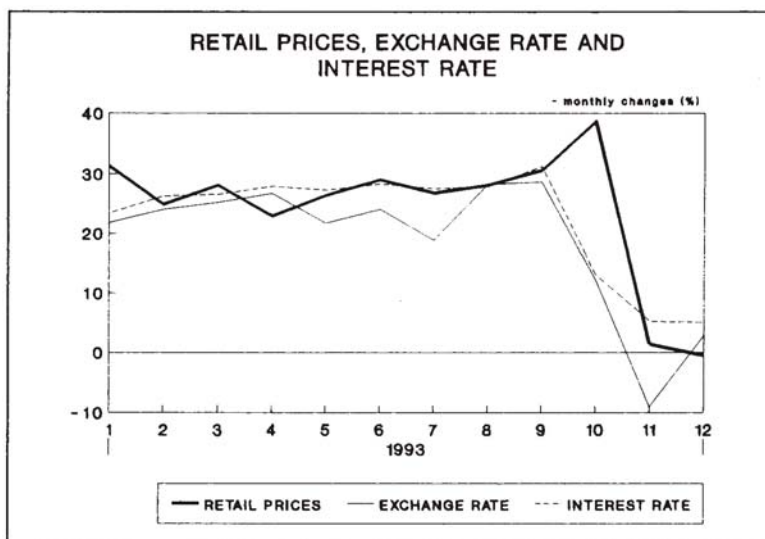
Simultaneously, a progressive taxation of the above the interest rate of 6% prevented the local money price to induce from the cost side high inflationary expectations, i.e. to take over such role from the exchange rate, what could happen in the beginning of the antiinflationary measures in the conditions when demand for dinar on the money market was much higher than its supply.

Such effects of the antiinflationary measures during the second half of October and in November, slowed down to a greater extent the dynamics of money flows in Croatian economy - while the heterodox character of these measures dispersed their effects on prices and incomes of all factors. The inertia of high inflation was in such a way transformed " overnight " in the condition of a relative nominal stagnation.

In an analogous way, similar programmes in other countries, produced the first basic effect in the sphere of the rate stabilization, stopping thereby the process of the "dollarization of domestic prices", in the sense of their quotation in the expression of the given foreign currency,

which then converted in national currency using the rate of forward indexation. This is actually taken as the basic prerequisite for the fast stopping of high inflation. While during the first nine months of 1993 the exchange rate depreciated at an average monthly rate of 25% (with inflation of 27.5%), and in October - going below the upper intervention point of the central bank - for a further 12.2% , in November its value in the market appreciated by 9.1 % , at which level it approximately stayed also during December (depreciation by 2.2%).

At the same time the average interest rate in the money market decreased from 27.4% in the period January - September, to 13.1 % in October, 5.2% in November, and in spite (in the meantime) of the abolition of the interest taxation decree, to 5.4% in December, following the tendency of the discount rate decrease. With one month delay, stabilization of money price was accompanied by a relative stabilization of labour price through slowing down the nominal dynamics of net wages from the average of 27.4% monthly in the first ten months, to 3.5% in November. Finally, as the lagged effect of the rate appreciation, the prices of petroleum products were lowered by 4.2% in November and by additional 4.4% in December. In totality, that resulted in lowering down the inflation rate to 1.4% in November, and in the deflation of 0.5% in December. On the whole, producer prices of industrial products fell during both months: by 4.6% in November and 1.5% in December. In this way, practically all relevant tasks of the first phase of the stabilization program were fulfilled, much faster and more efficiently than generally expected, with almost negligible initial costs, and, what is especially important, with a very low level of administration, which would act contrary to the market mechanisms. Although namely the four initial nominal anchors representing the essence of the program of stopping high inflation, seemed rigorously restrictive, the effective course of the implementation of the whole program and its effects proved that this restrictiveness was only of a relative nature.



In such conditions, the anchor on the exchange rate in the sense of the upper intervention point which the central bank defends by selling its foreign currency reserves has not been practically used. On the contrary, by opening the foreign exchange market and introducing internal convertibility of the national currency, the exchange rate in relation to the upper intervention point appreciated during the last three months of 1993 by 14.4%, so that in actual practice it arose a problem of, formally not specified, lower intervention point, for the partial defense of which the central bank purchased about 130 million dollars in that period.

At the same time, owing to the fast stopping of inflation, the anchor on the discount rate and on the market interest rates (which is connected with the initial effects of the decree on interest taxation) did not result in their real negative values (except in a very short period in the middle of October) that would not correspond to the essence of this type of the antiinflationary program. Just on the contrary, while in the conditions of high inflation, the market interest rate on the average

hardly reached the monthly dynamics of price exchanges so that real income from the interest could be attained only on the basis of high circulation velocity, real interest rate amounted in November to 3.7% and in December 5.9% monthly, what on the average gives a yearly real interest of even 76%.

It is also similar with the anchor in the sphere of net wages. Consequently, all three anchors, essential for breaking inflationary expectations, became fairly accommodating at the moment when the inflation was stopped.

On the other hand, anchors in the sphere of base money - first playing a decisive role in the rate appreciation - more and more redirected its function to the improvement in the banking system liquidity, and consequently to the stabilization of the exchange rate, which due to the intensity of imbalances in foreign currency and money markets resulted in a growth of base money in November of even 33.4% and in December for 12.2%. In such a way - by the intensity not characteristic for the antiinflationary programmes - the real base money supply increased in the conditions of the interrupted inflation by fully 48%.

As the greatest part of the primary money was created by foreign currency transactions at an appreciating rate while the interruption of inflation essentially reduced the opportunity of keeping not - interest - bearing local money, such movements primarily originated from huge changes in the structure of total liquid resources means (M3) of the national economy. While namely, on the top of the inflationary wave at the end of September the share of tied dinar deposits in the structure of total liquid resources amounted to 25%, by the end of December that share decreased to 14.3%, together with the stagnation of dinar countervalue share of foreign currency deposits (49%) which was caused by the appreciation of the rate. In such a way, a combination of initially decreased current liquidity and the price change of individual components of total liquid resources resulted in an increase in the share of money cash in their structure, from 7.5 to 13% and of current

deposits from 17.9 to 23.7%. All that happened in the conditions of the slow down of the nominal growth of those resources from the average of 25.7% in the first ten months to 4.6% in November and December.

This phenomenon points out to the gradual change of the gravity centre in the manner of action of the antiinflationary program itself; while in the phase of the sudden stopping of high inflation the gravity center lied predominantly in the absolute monetary restrictions, in the phase of consolidation of the initial results it moved towards the stabilization of relative prices.

By such action, the antiinflationary program " broke " a circle which during 1993 reproduced the increase in the nominal deficit, generated by inflation and transformed the monetization of its already existing nominal level in new inflation. But of course such action by itself does not solve (but only offers the possibility of solving) the problem of the deficit as such and of its monetization. It can even less solve the problem of nonliquidity with which a period of high inflation ended - and which in the conditions of the slowed down speed of the domestic money circulation and of the restricted possibility of foreign currency conversion - partly exists independently of the budget deficit problem. Therefore, until the solution of these problems does not start giving macroeconomically significant results, and the problems are not of the short-term character, it will exist a permanent pressure from the side of the monetization of the deficit and of the liquidity on the mechanisms which keep inflation on the low level. Since a foreign currency component prevails in these mechanisms, they are still able to resist these pressures for some time, but their possibilities of neutralizing the pressures have objective limits. The more so because the increasing pressures open also the question of the structure and the sources of foreign currency reserves.

Therefore, and that is the essence of the heterodox programs and policies, the low inflation level must be defended in all parts of the circle of generating inflationary pressures , and not only in one of its points.



In this connection, the economic policy of Croatia in 1994 must respect the general experiences of the implementation of the heterodox type of the antiinflationary program, which clearly shows that for a successful realization of such programs it is necessary to fulfill at least three social-political and economic conditions: 1) the establishment and maintenance of the consensus of the dominant social and political structures of the society during the whole period of the program implementation, 2) the existence or the establishment of the mechanisms and instruments of economic policy necessary for the implementation of the program and their consistent application by economic policy decision-makers, and 3) resoluteness in the implementation of the program until an economic equilibrium has been established, when the generators of high inflation have been eliminated and the possibilities of their renewal in a short term removed.

If it is not the case, it comes during the program realization to the reduction of the number and kinds of effectively used instruments, to the decrease in their efficiency and to the appearance of an essential asymmetry in the degree of utilization of particular instruments, with the reflection on the possibility of maintaining their objective values, which disturbs the consistency of the program and gradually weakens its credibility. If the program is technically well conceived, taking into account that it will not be implemented in " ideal " conditions, and the beginning of the implementation psychologically well chosen, the above problems should not represent the essential restriction in accomplishing primary goals in the initial phases of the program, but unavoidably at a later phase they become so. That's why it often happens, that even well initiated programs " evaporate " as the time passes, not achieving their integral goals - and, moreover, start reproducing results which are counterproductive from the aspect of those goals.

It usually comes to that because the consensus (if established) about the necessity to stop the high or the hyperinflation, does not always mean in practice a real consensus concerning all implications for the functioning of the national economy in conditions of low inflation,

which also includes corresponding structural changes, and the consequent differentiation of economic subjects which is not equal as in the conditions of high inflation. It is essential therefore that economic policy-makers have at their disposal efficient policy instruments by which they will neutralize partial attempts to maintain or renew the economic behaviour which would again generate high inflation. That is especially significant in the countries in transition, like Croatia, in which the predominant part of the economy is still in state property, which along with the relative underdevelopment of market institutions (especially in the sphere of financial markets) makes it objectively difficult to remove quickly the " soft " budget constraints and high monetization of the deficit only on the basis of the function of market mechanisms.

On the other hand, the effectiveness of these mechanisms cannot be intensified in the perspective, until the inflationary taxation enables a high degree of socialization of consequences of the irrational economic decisions on all levels of the decision-making. Therefore, the current economic situation in Croatia and consequently a manner and level of efficiency of antiinflationary program realization have much broader dimensions than the technical stopping of high inflation. They will in the final analysis influence the speed of the transitional processes and of the establishment of firm material and financial bases of a new revival of economic activity.