THE STATE OF EXTERNAL EQUILIBRIUM IN CROATIA AND ITS LONG TERM STABILITY

Dražen Derado[*]

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From the outset of transition Croatia faces a serious problem of external imbalance as a consequence of unfinished structural and institutional reforms. The external balance crisis can be seen through raising international trade deficit and structural characteristics of trade flows. To these unfavorable characteristics belong export reorientation from developed to less developed countries, increasing number of industries in which Croatia has position of net-importer and export structure in which dominate low-value-added products. Increasing trade deficit in 2001 and 2002 followed by further growth in external indebtedness cause increasing burden of debt service and limit the possibilities for economic growth. Taking all this as well as real limits in further external imbalance growth into consideration it can be said that Croatia realizes high level of external disequilibrium. In contrast, advanced transition countries achieve fairly good and stabile external positions thanks to successful economic restructuring and strong export growth.

1. INTRODUCTION

From the very beginning of transition Croatia faces the problem of external imbalance. Although this problem was also present in other (advanced) reform countries, the case of Croatia deserves special attention due to intensity and duration, as well as the effects of this disequilibrium. Causes of such a situation are deep and some of them can be mentioned - economic policy based on "hard" monetary and exchange rate policy, privatization, slow economic restructuring, modest inflow of foreign direct investments (FDI), unfinished institutional reforms, etc. All these are conditions under which modern company functions and which have to be taken into account in its management.

[*] Dražen Derado, PhD, Research Assistant, Faculty of Economics Split, Matice hrvatske 31, 21000 Split, Croatia, Phone: +385/21/430 681, Fax: +385/21/430 701, E-mail: dderado@efst.hr

This paper analyzes the state of external equilibrium in Croatia and tries to show that dynamic export growth is the most important factor in achieving long-term stability of external position of one country. Therefore it includes the balance of payments analysis for Croatia and seven more transition countries[1]. In that way this paper will also point at specific problems of reform countries in achieving their long-term external stability.

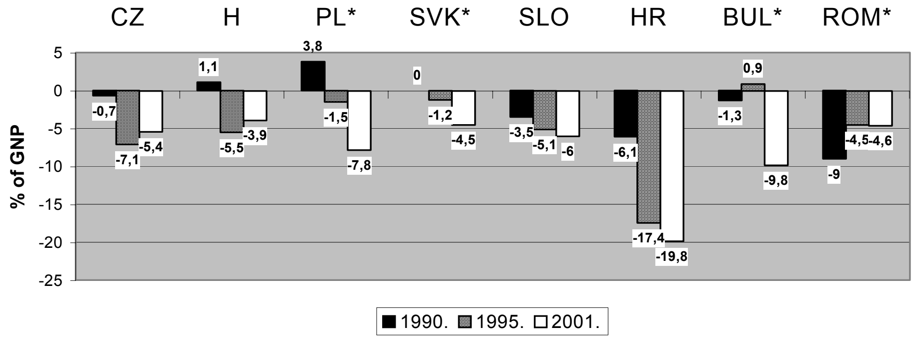
2. FOREIGN TRADE AND CURRENT ACCOUNT

In international comparisons Croatia achieves a relatively low degree of international economic openness (measured by trade volume-to-GDP ratio; trade volume is defined as the sum of exports and imports of goods and services). In 2000 Croatia realizes an international openness degree of 95,9%. Although it has doubled its international openness compared to 1990 (45,2%) and even improved it in relation to previous year (1999: 88,1%), this result is however considerably worse than that of other transition countries. In the Czech Republic, Hungary, the Slovak Republic, Slovenia and Bulgaria trade volume exceeds the value of GDP and they realize international openness indicators in the range of 120-150%. Lesser international openness than Croatia has only Poland (49,7%) and Romania (71,2%) (WIIW- Handbook of Statistics Countries in Transition 2001).

Concerning developments in exports and imports during the 1990s Croatia does not differ much from other transition countries. They all experienced strong increase of trade deficits after 1995 as a consequence of post-recession consolidation and the beginning of economic growth. However, analyzed countries had different success in restraining trade imbalance. The Czech Republic, Hungary and the Slovak Republic were particularly successful in that respect since they managed to reduce their trade deficits during the second half of the 1990s[2], while Hungary (since 1997) and the Slovak Republic (since 1999) show positive balance in trade with EU. During the whole transition period Slovenia kept its trade balance stabile and shows almost negligible balance in its current account. Poland experienced a strong rise in both trade and current account deficit, while similar developments, however with strong fluctuations can be noticed in Bulgaria and Romania (Figures 1 & 2).

[1] The Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia, Bulgaria, Romania.
[2] Between 1995 and 2001 trade deficits rose to -10% of GDP (the Czech Republic) or -12% of GDP (the Slovak Republic).

The Czech Republic, Hungary and Romania reduced their trade deficits while such favorable developments in the case of Hungary and Romania have been additionally confirmed by decreasing negative balance in their current accounts. Despite stabilizing tendencies in international trade the Czech Republic experiences an increasing deficit in the current account. The Slovak Republic and Slovenia register just a modest increase of trade deficit but with one major difference. Slovenia namely achieves almost complete current account balance, while increasing current account deficit can be observed in the Slovak Republic (Figure 2). With pronounced fluctuations in trade and current account balance in the second half of the 1990s, Bulgaria moves towards increasing external imbalance.



* *Poland, Slovakia, Bulgaria, Romania - 2000*

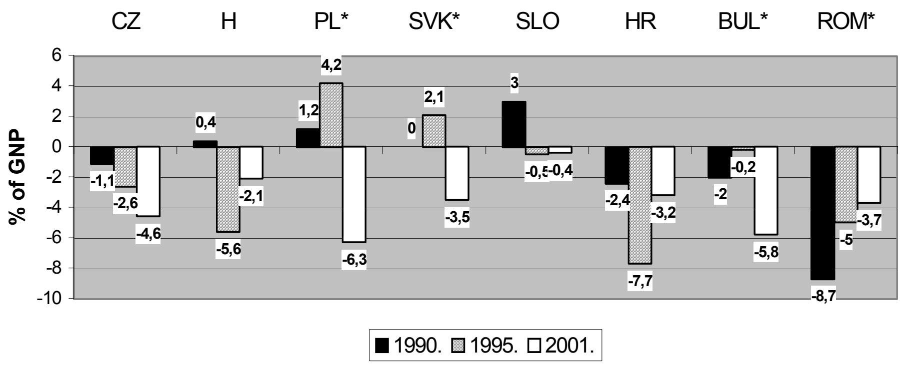
Figure 1. International trade balance of selected transition countries (% of GDP)

Source: *WIIW - Handbook of Statistics Countries in Transition 2001*
IMF - International Financial Statistics, October 2002

In the most difficult situation of all analyzed countries is Croatia, which entered transition with high trade deficit (-6,10% of GDP in 1990); deficit began to rise significantly since 1993. Negative trade balance increased 1995 compared to previous year for almost 10 percentage points (p.p.) and reached -17,4% of GDP (Table 1). With the aim of achieving more dynamic economic growth economic policy in Croatia after 1995 concentrated on increasing components of domestic demand which have been abundantly financed through expensive foreign credits[3]. Without economic restructuring and preferential trade agreements with other countries and with only modest inflow of FDIs, the

[3] Credit rating: BBB- (according to *Standard & Poor's*).

value of Croatian exports fluctuated within a narrow range of 4,2-4,6 bill. USD per year.



** Poland, Slovakia, Bulgaria, Romania - 2000*

Figure 2. Current account balance of selected transition countries (% of GDP)

Source: *WIIW - Handbook of Statistics Countries in Transition 2001*
IMF - International Financial Statistics, October 2002

Strong foreign competition and consumer preferences for imported goods led, under circumstances of dynamic economic growth (5,9-6,8% per year), to strong rise in imports (1994 by 20%, 1995 by 45,5%) and an extremely high international trade deficit. In 1997, the international trade deficit reached almost -26% of GDP (import-fed growth). In the same year, current account balance increased to -12% of GDP (Table 1). After crisis in 1997, Croatia reduced trade deficit to -16,8% of GDP in 2000, as well as the negative current account balance to -2,1% of GDP. The most significant contribution to current account balancing came from export of services (tourism).

However, the data for 2001 and 2002 point at weakening of these stabilizing tendencies and show rising deficit in trade balance. In 2001 Croatia experienced further growth of trade deficit, which tends again towards -20% of GDP. During the first nine months of 2002 Croatia realized trade deficit of -4,17 bill. USD.

Thus, trade deficit exceeded the value of nine-months exports. An increase in exports of 3,6% and imports of 13,6% (January-September 2002), compared to the same period of previous year, gives further explanation for growing deficit and a decreasing export-import ratio. Under such conditions, other items in current account (apart from trade in goods) become more and more important in eliminating international trade imbalance. As a result of income from services (tourism, transport) and transfers, Croatian current account imbalance amounts -3,2% of GDP in 2001.

Table 1. Exports, imports, trade balance, current account balance and export-import ratio of Croatia

YEAR	EXPORTS (bill. USD)	IMPORTS (bill. USD)	Trade balance (% of GDP)	Current account balance (% of GDP)	EX/IM•100 (%)
1990	2.913,0	4.426,0	-6,10	-2,39	65,82
1991	3.292,0	3.828,0	-2,95	-3,24	86,00
1992	4.597,5	4.460,7	1,34	8,04	103,07
1993	3.903,8	4.645,7	-6,82	5,58	84,03
1994	4.260,4	5.432,2	-8,03	5,66	78,42
1995	4.632,7	7.900,7	-17,37	-7,72	58,63
1996	4.545,7	8.235,9	-18,57	-5,77	55,19
1997	4.210,3	9.434,6	-25,98	-11,66	44,63
1998	4.604,5	8.773,4	-19,17	-7,12	52,48
1999	4.371,2	7.671,8	-16,36	-7,27	56,98
2000	4.567,0	7.770,9	-16,79	-2,09	58,77
2001	4.752,1	8.763,8	-19,80	-3,20	54,22
Jan.-Sep. 2002	**3.553,9**	**7.720,3**	**-**	**-**	**46,03**

Source: *WIIW - Handbook of Statistics Countries in Transition 2001*
IMF - International Financial Statistics, October 2002
DZS - Mjesečno statističko izvješće, Vol. 11, 2002.

As Croatian trade balance deteriorated, export-import ratio decreased until 1997 when it dropped below 50% (44,6%). Although its value increased towards the end of the 1990s (to almost 60%), export-import ratio achieved the level of just 46% during the first nine months of 2002.

The value of this indicator in Croatia is unfavorable when compared to achievements of other countries - Poland: 68,2%, Bulgaria: 80,4%, Romania: 86,0%, Slovenia: 89,1%, the Czech Republic: 90,3%, Hungary: 92,3%, the Slovak Republic: 92,8%.

3. REGIONAL AND SECTOR STRUCTURE OF CROATIAN FOREIGN TRADE

Analysis of regional structure of trade flows shows that, among the analyzed countries, only Croatia experienced a negative reorientation of its exports during the 1990s. Croatia, namely, reduced the EU-share in its exports, while increasing exports to other countries[4]. When, e.g. total exports in 1995 rose by 8,7% (compared to previous year), exports to other countries (less developed countries) increased by 16,2%, to CEEC by 11,8%, while exports to EU (5,5%) and developed countries (4,8%) realized a growth below average. Exports to developed countries registered a growth below average also in 1998, when total exports increased by 8,9%, exports to EU by 4,3%, while exports to CEEC realized a negative growth rate (-10%) and that in other countries increased by 16%. In the second half of the 1990s (1995-1999), when (however, with modest fluctuations in absolute amount) total exports decreased by an average annual rate of -1,9%, exports to developed countries realized a negative growth rate (-4%), as well as that to EU (-5,9%) and CEEC (-3,1%). In the same period, exports to other countries grew by an average pace of 2,3% à year. Similar situation can be observed in the first half of the 1990s.

In the years of the balance of payments crisis (1995 and 1997), imports from EU grew intensively. In 1995 total imports increased by 44%, with those from EU growing by 50%, while imports from CEEC increased by 53%. Imports form other countries grew moderately (with regard to increase in total imports) by 24%. Similar situation took place in 1997.

The biggest problem in the regional structure of Croatian external (im)balance occurs in trade with EU; with negative balance of -2,32 bill. USD (2000), -1,95 bill. USD (January-September 2001) and -2,37 bill. USD (January-September 2002) trade with EU makes up app. 65% (2000) of total trade deficit (app. 57% in the analyzed periods of 2001 and 2002). Some 1/3 of Croatian total trade deficit is realized through exchange of goods with less developed countries.

Despite relatively high degree of trade integration with EU at the beginning of the 1990s[5] (60% of total exports and app. 55% of total imports) Croatia is the

[4] Country grouping follows the methodology of Vienna Institute for International Studies (WIIW) according to which one can differentiate between: developed countries, EU 15, CEEC and other countries (see: WIIW - Handbook of Statistics Countries in Transition 2001).
[5] Of all analyzed transition countries it is only Slovenia that at that time realized for app. 5 p.p. higher share of EU in its total trade.

only country that experienced a fall of EU-share in its trade. Compared to 1990, the EU-share in exports decreased for 11 p.p. until 1999 and reached the level of 49%, while, at the same time, the share of other countries in Croatian exports rose from 27% to 40%. The share of exports to other developed countries (8%) and CEEC (3%), as well as complete regional structure of imports, stayed almost the same during the 1990s. There occurred an increase of EU-share in Croatian exports (to 54%) in 2000, while EU-share in imports moderately decreased (from 57% to 55%). These changes can be seen as a positive impact of trade liberalization between Croatia and EU according to the Stabilization and Association Agreement.

European Union represents the most important market for Croatia, whose biggest individual trade partners came from EU - Italy and Germany (Table 2). Italy is the most important export market for Croatian products, while both countries realize equal shares in Croatian imports. Together, they make up to 1/3 of total Croatian international trade and 70% of Croatian exports to EU, as well as some 60% of its imports from EU. Among ten biggest Croatian trade partners, there are only three more from the Union (Table 2). So, with the five best-ranked EU-countries, Croatia realizes 47% of its total exports.

Table 2. The most important Croatian trade partners

COUNTRY		EXPORTS (%)		COUNTRY		IMPORTS (%)	
		2000	**1995**			**2000**	**1995**
1.	*Italy*	22,29	23,63	**1.**	*Italy*	16,63	20,11
2.	*Germany*	14,21	21,58	**2.**	*Germany*	16,45	18,18
3.	*BiH*	11,20	8,27	**3.**	*Russia*	8,57	2,09
4.	*Slovenia*	10,83	13,09	**4.**	*Slovenia*	7,93	10,72
5.	*Austria*	6,60	4,31	**5.**	*Austria*	6,70	7,66
6.	*Liberia*	5,10	-	**6.**	*France*	5,50	2,50
7.	*France*	2,83	2,39	**7.**	*USA*	3,01	2,67
8.	*Yugoslavia*	2,44	0,81	**8.**	*Hungary*	2,33	6,04
9.	*USA*	2,03	1,24	**9.**	*UK*	2,28	2,11
10.	*Greece*	1,94	3,27	**10.**	*Czech Republic*		2,27
TOTAL		**79,47**	**78,59**	**TOTAL**		**71,67**	**74,35**

Source: *WIIW - Handbook of Statistics Countries, in Transition 2001*

Bosnia and Herzegovina, Slovenia and (since 2000) Yugoslavia also belong to the group of important Croatian trade partners. This fact points to possibly still existing strong convergence of economic structures and similar consumer preferences among the countries that until recently constituted a common economic area. In that respect, it is worth to mention the reduction of Croatian exports share to Slovenia, since, according to its macroeconomic indicators, Slovenia converges more to the lower ranked EU-countries. All countries of former Yugoslavia and Russia (the third biggest import market for Croatia) belong to the group of other countries, which realizes a rising share in Croatian international trade.

Concerning sector structure of Croatian international trade, in 2000 manufacturing dominates it, with a share of 96% in exports and 82% in imports (considerable share in imports realize mining and quarrying with 13,3%, which almost entirely relates to imports of crude petroleum and natural gas).

The greatest individual share in exports in 2000 belongs to the other transport equipment (ships), with 14,5% of total exports, followed by chemicals and chemical products (12%) and refined petroleum products (10,2%). For the needs of chemical industry and petroleum manufacturing, Croatia realizes high import shares in these industries (crude petroleum and natural gas: 12,3% and chemical industry products: 12,2% of total imports).

Highly ranked in Croatian exports is also the wearing apparel with a share of 9%. So, the four mentioned industries make up app. 45% of total Croatian exports. Among ten most important Croatian export industries are also food and beverages, wood and leather manufactures, non-metallic mineral products, machinery and equipment and electrical machinery and apparatus (Table 3).

In comparison with 1995, exports of other transport equipment experienced (in 2000) the strongest share growth in total exports (8,7 p.p.); refined petroleum products (2,5 p.p.) and other non-metallic mineral products (1 p.p.) also realized an increase in exports share. Decreasing shares in total exports occurred in: wearing apparel and chemical industry products (each by -4,8 p.p.), while the same (however to a lesser extent) occurred with exports of food and beverages, fabricated metal products and leather products.

Concerning imports, some 1/3 (32,1%) of total Croatian imports in 2000 are realized through chemicals and chemical products, motor vehicles (mostly personal cars) and machinery and equipment. Compared with 1995, imports of motor vehicles realized the strongest share growth (5 p.p.), while more modest growth occurred in the import share of other transport equipment (2,7 p.p.) and chemical products (1,7 p.p.). A slight increase in share was realized in wood manufactures, other non-metallic mineral products, television and communication equipment, as well as metal products (except machinery and equipment).

During the same period (1995-2000), food and beverages (-1,9 p.p.), machinery and equipment (-1,1 p.p.) and, to a slightly lesser extent, electrical machinery apparatus, leather products, medical and optical instruments, metal products and wearing apparel, experienced decreasing import shares (DZS - Statistički ljetopis Republike Hrvatske 2001).

Table 3. Industries with the greatest shares in total exports and total imports in Croatia (NACE-classification), 2000

INDUSTRY	EXPORTS (%)	INDUSTRY	IMPORTS (%)
35 *other transport equipment*	14,50	**24** *chemicals and chemical products*	12,18
24 *chemicals & chemical products*	12,02	**34** *motor vehicles, trailers & semi-trail.*	10,86
23 *coke, refined petroleum prod., nucl. fuel*	10,24	**29** *machinery & equipment, n.e.c.*	9,05
18 *wearing app., dressing & dying of fur*	8,83	**15** *food products & beverages*	6,00
15 *food products & beverages*	5,96	**27** *basic metals*	4,85
20 *wood, wood & cork products*	4,56	**35** *other transport equipment*	4,58
31 *electric. machinery & apparatus, n.e.c.*	4,47	**17** *textiles*	3,81
29 *machinery & equipment, n.e.c.*	4,17	**21** *pulp, paper & paper products*	3,12
26 *other non-metallic mineral products*	3,93	**32** *radio, televis. & commun. Equipment*	3,08
19 *leather, leather products*	3,92	**25** *rubber & plastic products*	3,07
TOTAL	**72,6**	**TOTAL**	**60,6**

Source: *DZS - Statistički ljetopis Republike Hrvatske 2001.*

Comparing trade balance of individual manufacturing industries in 2000 to that of the mid-1990s, one can observe the existence of increasing number of industries in which Croatia realizes a negative balance in international trade.

The greatest contribution to total trade balance in 1995 (-14,97 bill. USD) came from manufacturing, whose negative balance amounted to almost 50% (48,9%) of the country's international trade deficit. One fourth (25,5%) of the total trade deficit has been realized through mining and quarrying (imports of crude petroleum and natural gas).

Positive balance in trade with wearing apparel (2,07 bill. USD) and refined petroleum products (1,6 bill. USD), together with the surplus realized in trade with tobacco, leather and wood products, other transport equipment, furniture and other manufacturing (altogether: 1,63 bill. USD) contributed to deficit reduction in 1995.

However, there were more industries in which Croatia had a position of a net-importer, causing the mentioned deficit. The biggest deficit in manufacturing (42% of the manufacturing industry deficit and 20,4% of the total trade deficit) has been realized in 1995 through imports of machinery and equipment, motor vehicles (13% of total trade deficit), basic metals (8,1%) and food and beverages (6,8%).

Until 2000, Croatia holds the position of net-exporter in trade with refined petroleum products (3,36 bill. USD) and wearing apparel (1,38 bill. USD), while, at the same time, positive balance turned into deficit in trade with leather products, furniture and other products of manufacturing industry. In the group of other non-metallic mineral products, Croatia gained position of a net-exporter.

In 2000, a negative balance in trade with manufactures increased to the level of 65% of total trade deficit (while mining contributes to it with 29%). Motor vehicles realize the greatest individual share in total trade deficit (23% of total trade balance and some 1/3 of manufacturing industry deficit), followed by machinery and equipment (15,3% of total trade deficit) as well as by chemicals and chemical products (12,4% of total trade deficit).

Considerable negative balance is still realized in trade with basic metals, food and beverages and office machines and computers (together 17,7% of total trade deficit). Croatia realizes a strong net-importing position in trade with rubber and plastic products, pulp, paper and paper products, television and communication equipment, textiles and fabricated metal products (except machinery and equipment) - these sectors altogether realize 23,7% of total trade deficit, which in 2000 amounted -28,79 bill. USD.

4. EXTERNAL POSITION OF CROATIA AND OTHER TRANSITION COUNTRIES

In order to find out the external position of a country, not only the export and import flows should be taken into consideration, but also all the other current account items (as sources of foreign exchange revenues), as well as the external indebtedness and the external liquidity (e.g. international reserves). Constantly high trade deficit, followed until 2000 by modest income from services exports and strongly rising external indebtedness[6], indicates possible problems in keeping Croatian external position stable (Figures 3 - 13).

Table 4. shows that in all the analyzed countries the greatest contribution to the current account deficit comes from the trade imbalance. In that respect, the most favorable situation can be observed in Hungary, where all the current account items participate to almost equal extents in the current account balance. Although Croatia realizes the lowest deficit of the current account in 2000 (-2,4% of GDP), it shows an extremely unfavorable structure of the external imbalance.

Table 4. Structure of current account balance of Croatia and selected transition countries (% of GDP), 2000

	CZ	H	PL	SVK	SLO	HR	BUL	ROM
CURRENT ACCOUNT	**-5,23**	**-2,85**	**-6,34**	**-3,52**	**-3,02**	**-2,35**	**-5,85**	**-3,69**
1. Trade balance	-6,02	-3,78	-7,81	-4,53	-6,28	-16,83	-9,81	-4,57
2. Balance of services	2,73	3,81	0,88	2,21	2,48	11,84	4,22	-0,69
3. Balance of income	-2,67	-3,38	-0,93	-1,80	0,14	-2,0	-2,68	-0,76
4. Balance of current transfers	0,73	0,50	1,51	0,61	0,64	4,64	2,42	2,33

Source: IMF - International Financial Statistics, October 2002

In eliminating trade deficit of -16,8% of GDP, it relies heavily upon revenues from services exports (11,8% of GDP) and current transfers (app. 5%

[6] With cumulative trade deficit of -34,86 bill. USD (1990-September 2002) Croatian external debt rose to 13,5 bill. USD. The strongest increase of external debt (almost 100%) occurred during the period 1995-1997.

of GDP). Such a situation, in which trade imbalance is eliminated through current transfers or services income (which can both strongly fluctuate[7]), does not offer the long-term stability of a country's external position. According to the structure of current account imbalance, similar to Croatia is only Bulgaria. In Bulgaria, Romania and Poland current transfers contribute more significantly to external balance than it is the case in other countries.

During the second half of the 1990s, Croatia achieved a very high current account deficit of -8% of GDP on average per year. Together with the Slovak Republic and Romania, Croatia took the "leading" position among transition countries in that respect. However, in 2000, Croatia managed to reduce the average annual current account deficit from -8% or app. -1,6 bill. USD (1996-1999) to -2% of GDP[8] (Figure 3).

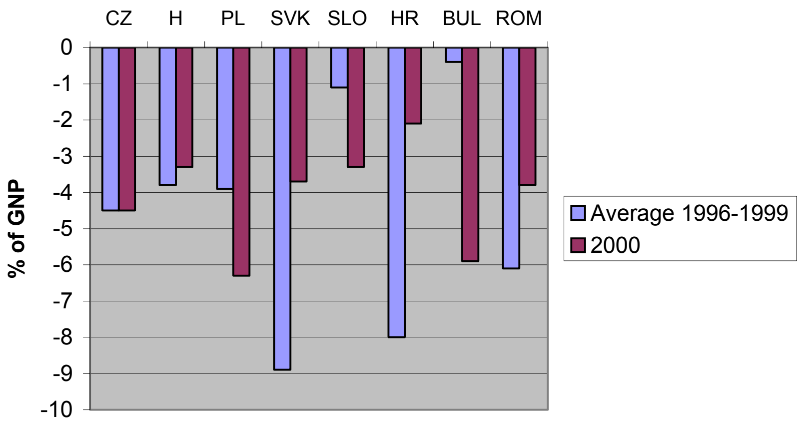


Figure 3. Current account balance (% of GDP) of Croatia and selected transition countries

However, unfavorable situation in exports, during the second half of the 1990s, as exports grew at the average annual rate of only 0,1%, represents the most serious problem in the long-term improvement of Croatian external position.

At the same time, the average annual growth rate of exports in the Czech Republic, the Slovak Republic and Romania did not fall below 7%; Hungary

[7] In 1999 income from exports of services amounted app. 8% of GDP.
[8] In that way, according to EBRD, Croatia left the group of countries with high current account deficit (more than -7% of GDP) and came into the group of countries with moderate deficit (-2 to -7% of GDP) to which also advanced transition countries belong.

realized the highest, two-digit exports growth. When also services are included in exports, the Croatian export dynamics (of goods and services) improves and its average growth rate comes to 2,5% per year. However, even in this case Croatian position in international comparisons does not improve significantly - lower values of this indicator realizes only the Slovak Republic.

Figure 4. shows that, in the analyzed period (1996-2000), only Croatia (and Bulgaria) had a stronger growth in service exports (compared to exports of goods), which confirms the importance of service export revenues in achieving external balance in Croatia.

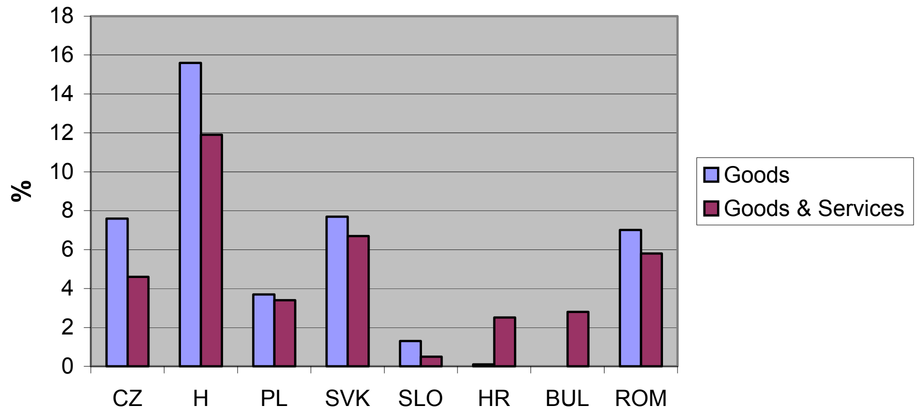


Figure 4. Average exports growth rate (%) of Croatia and selected transition countries, 1996-2000

Income from services eliminates the greatest part of trade deficit in Croatia - up to 70% in 2000. Hungary, which has the greatest export dynamics, also realizes revenues from exports of services sufficient for covering 85% of trade balance net-revenues.

Other countries finance only 40-47% of their trade deficits through income from services. Only Romania has a negative balance in service trade, which makes its external position vulnerable, despite the achieved relatively low trade deficit (Figure 5).

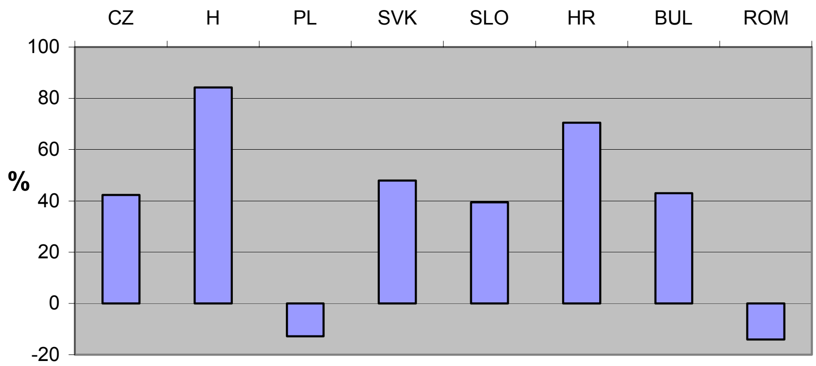


Figure 5. Income from exports of services (% of trade balance net-revenues) of Croatia and selected transition countries, 2000

Financial inflows stemming from foreign investments in Croatia were not sufficient to ease the current account negative balance. Cumulative inflow of foreign direct and portfolio investments in Croatia in the period 1996-2000 covers only app. 85% of cumulative current account deficit from the same period, while in other countries (with the exception of Romania and the Slovak Republic), these inflows exceed the value of cumulative deficit (Figure 6).

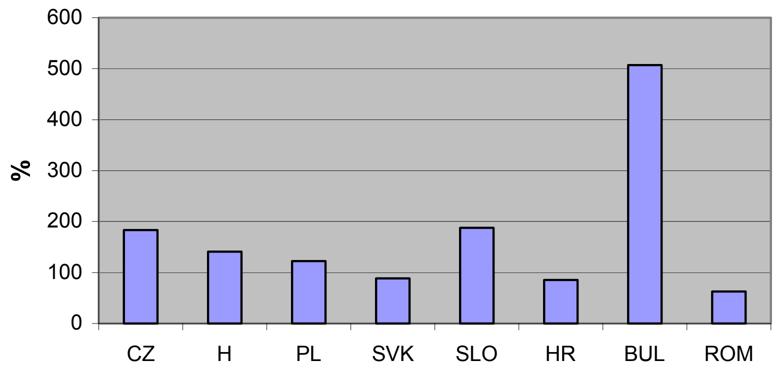


Figure 6. Cumulative investments - portfolio and direct (% of cumulative current account balance) of Croatia and selected transition countries, 1995-2000

As a consequence of slow export growth and foreign exchange revenues insufficient to cover raising trade deficit, Croatian external debt increased and reached, until 2001, almost 60% of GDP (Figure 8). This is very worrying regarding the slow economic growth (estimated GDP-growth of 3% in 2001 and

2002). Namely, Croatian external debt is more than twice bigger than the value of annual exports; the same problem is present in Poland and Bulgaria. External debt-to-exports ratio of Croatia improves significantly only when export of services is included in total exports.

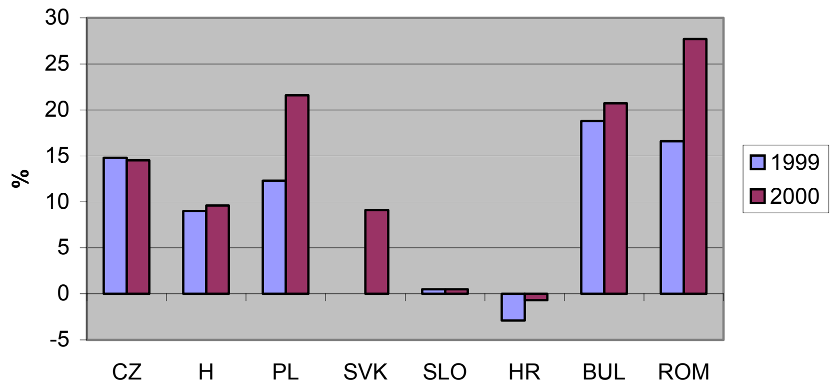
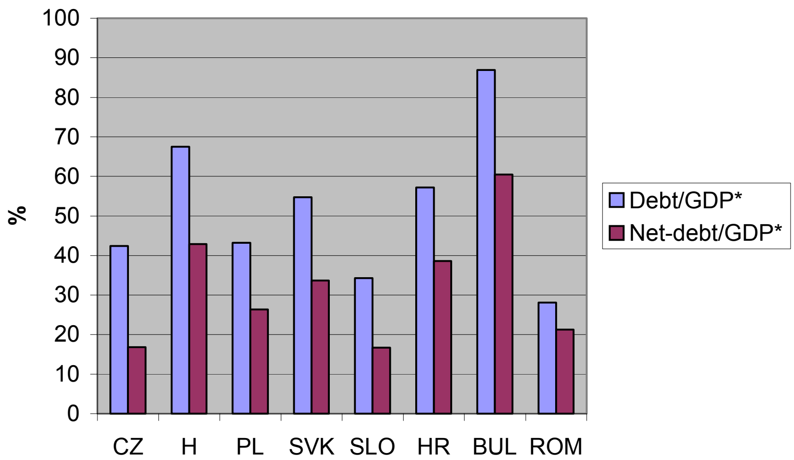


Figure 7. Real exchange rate index (USD) of Croatia and selected transition countries, 1995=100



* *"Debt" represents external indebtedness. "Net-debt" represents net-external debt as a difference between total external debt and international reserves (without gold).*

Figure 8. Total external debt and net-external debt (% of GDP) of Croatia and selected transition countries, 2000

However, even then Croatia realizes unfavorable value of this ratio in international comparisons. While the other countries' value of annual exports is higher than external debt, Croatia belongs to another group of countries, in which the case is exactly opposite - external debt-to-service ratio lies above 100% (Figure 9).

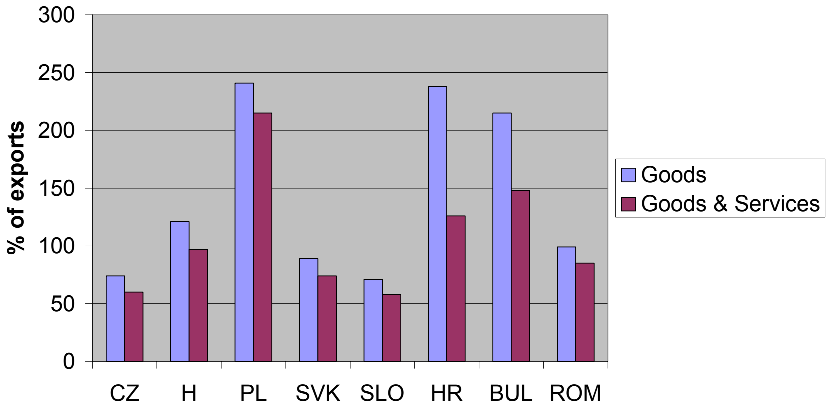


Figure 9. Total external debt (% of exports) of Croatia and selected transition countries, 2000

Similar to Croatia, Poland and Bulgaria, achieve the greatest imbalance between exports and external indebtedness; they are facing serious limitations concerning continuation of financing of imports above real export possibilities of their economies. Income from services appears again in the case of Croatia as an important balancing factor in its external relations.

Debt service, which, in 2000, in Croatia amounted 2,47 bill. USD, absorbs 1/4 of total current account revenues; this points to increased burden of external indebtedness for Croatian economy, since, until 2006, the greatest part of foreign credits will have to be paid back[9].

External liquidity, measured by short-term debt-to-international reserves ratio is rather weak in Croatia, since short-term debt reaches the level of 60% of international reserves. According to this indicator, Croatia appears to be the worst among the analyzed countries (Figure 10).

[9] Source: Croatian National Bank, http://www.hnb.hr

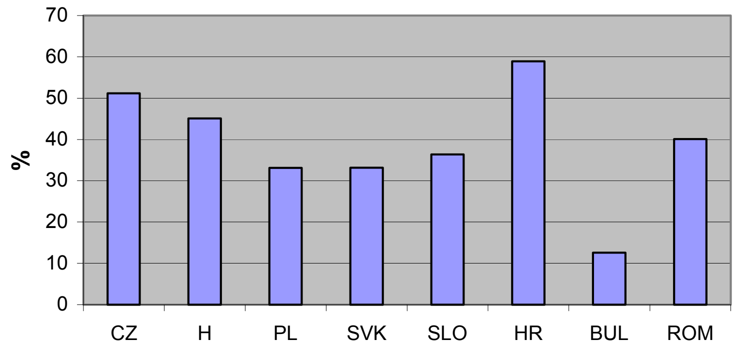


Figure 10. Short-term debt (% of total international reserves, excl. gold) of Croatia and selected transition countries, March 2001

With international reserves sufficient for financing the 4,4-months imports (Figure 11), Croatia meets the minimum criterion (the 3-months imports) like other countries. The only country that does not meet this criterion is Romania. Its international reserves hardly exceed the value of 2-months imports, while this indicator in other countries reaches the average level of 4 months (Poland - almost 7 months).

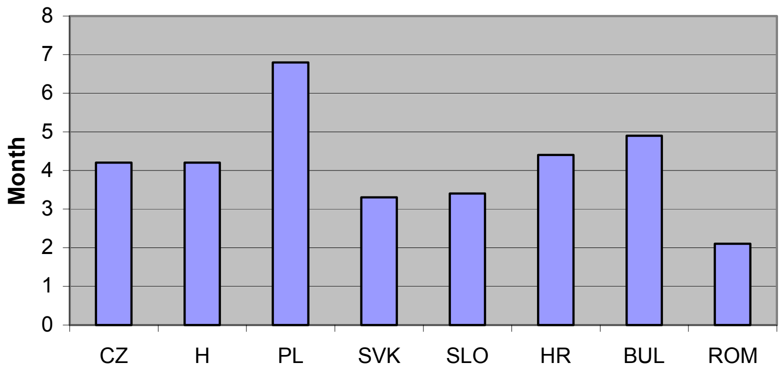


Figure 11. International reserves (months of goods and services imports) of Croatia and selected transition countries, 2000

Debt servicing in Croatia amounts to 15% of annual current account revenues (without transfers), putting Croatia in the middle position among the analyzed countries; the lowest debt service burden, according to this criterion, belongs to Slovenia and Poland (Figure 12). A high debt-service ratio can be observed in Romania and Bulgaria, which could be, in the medium run, exposed to external instability. Concerning strong export growth and economic restructuring in Hungary and the Slovak Republic, their current level of debt service (according to estimations of EBRD) will not endanger their external position.

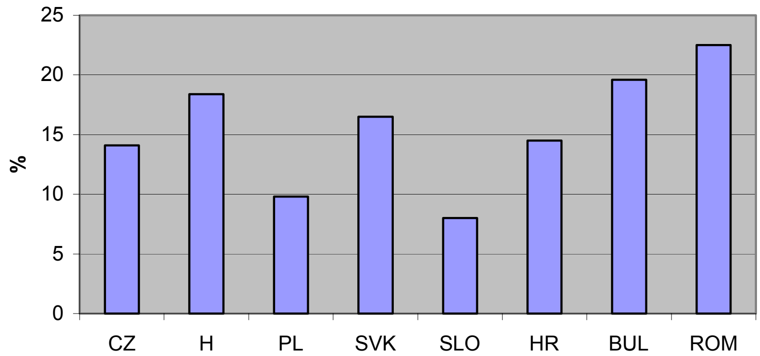


Figure 12. Debt service (% of current account revenues minus transfers) of Croatia and selected transition countries, 1999 (EBRD-estimation)

In the second half of the 1990s, Croatia ran the policy of real exchange rate, so that, in 1999, its currency (HRK) has been exposed to a moderate depreciation (1995=100) towards € (2,4%), while, in 2000, a very small appreciation of 0,3% took place (Figure 13).

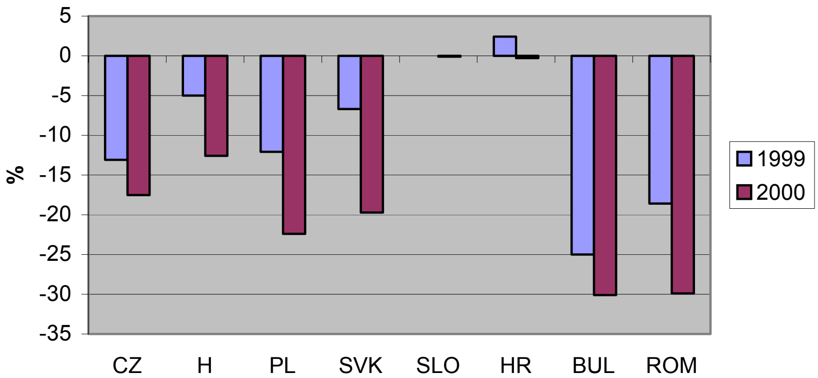


Figure 13. Real exchange rate index (EUR) of Croatia and selected transition countries, 1995=100[10]

[10] ***Sources for Figures 2-13:*** *WIIW - Handbook of Statistics Economies in Transition 2000; IMF - International Financial Statistics, October 2001; EBRD - Transition Report Update, May 2000; IMF - Staff Country Report, February 2000; BIS - Quarterly Review, September 2001*

At the same time, other countries ran policies of real currency appreciation causing real appreciation from 7% (the Slovak Republic, 1999) to 30% (Bulgaria and Romania, 2000).

All the stated indicators show relatively high external vulnerability of Croatia, resulting from weak exports growth and the already very high level of external indebtedness. Apart from sufficient international reserves, Croatia, therefore, faces the growing problem of external liquidity and limitation to a more dynamic economic growth. In contrast, the Czech Republic, Hungary, Slovenia and the Slovak Republic realize much better external positions. All of them (except for Slovenia) have realized, from 1996 to 2000, a strong increase in exports, what helped them either to reduce the current account deficit (the Slovak Republic), or to keep external imbalance low (Hungary).

Slovenia is the only one among them to realize weaker growth of exports and deterioration of the current account. Regarding the values of all other presented indicators, this could not endanger Slovenia's external stability. The Czech Republic, Hungary and Slovenia experienced, despite strong export growth, further increase in their external indebtedness. However, solid economic growth and the export possibilities, particularly to the EU-market, represent a good basis for the long-term stability of their external positions, while relatively abundant international reserves guarantee sufficient liquidity in the medium-run.

Thanks to good exports dynamics, the Slovak Republic has improved its external position. It also does not have too large external debt. However, relatively small international reserves should be increased in order not to endanger its external position, particularly with reference to the level of Slovakia's indebtedness.

A fall in exports and increase in imports have caused a large current account deficit in Poland and led to increasing external indebtedness (app. 40% of GDP). High international reserves (almost 7-months imports) guarantee a sufficient liquidity. However, slow exports growth does not offer a sound basis for a long-term stabile external position.

At the end of the 1990s, Bulgaria considerably deteriorated its external position (in 2000 it experienced export decline and a strong rise in current account deficit). Cumulative inflow of foreign investments in Bulgaria was approximately six times higher than the realized cumulative current account deficit and Bulgaria realized the highest foreign debt (more than 80% of GDP) among the analyzed countries. Despite large international reserves such high indebtedness threatens the country's long-term liquidity. Debt service could cause difficulties in achieving stabile external positions in Bulgaria in medium-run.

Economic stagnation at the end of the 1990s, slow exports growth, but also the reduction of the current account deficit (2000), are the main features of the Romanian economy. Romania realized modest inflow of foreign investments and has the lowest foreign indebtedness at the end of 1990s (26% of GDP). Therefore, Romania's external indebtedness is lower than the annual exports (90%). Despite that, rigid external imbalance during the 1990s and low international reserves (the 1,7-months imports) followed by high debt service ratio pose a serious threat for Romania's stable external position.

5. CONCLUSION

After consolidation at the end of the 1990s, Croatia experiences further deterioration of its external balance in 2001 and 2002. The growing gap between imports and exports becomes obvious through decreasing export-import ratio. Additional problem poses trade reorientation from EU towards less developed countries. Regarding desired economic restructuring and strengthening of international competitiveness, such developments in Croatian international trade are not welcome. Although these export markets should not be neglected, it is necessary to create an economic structure compatible with the EU-countries as a long-term objective. This would contribute to the further economic cooperation, positive spillovers (e.g. technology) and successful economic integration with EU as a precondition for full (institutional and political) integration. Still, increase of the EU-share in Croatian exports speaks of possible positive effects of the realization of the Stabilization and Association Agreement between Croatia and EU.

Sector structure analysis shows that there is a growing number of industries in which Croatia has position of a net-importer what further contributes to trade deficit rigidity. Domination of labor- and resource-intensive industries or capital-intensive industries, which engage low-qualified labor force results in exports of low-value-added products. This cannot contribute to Croatian international competitiveness or a change of unfavorable developments in international trade.

Concerning the presented data, external position of Croatia can be viewed as fairly bad, particularly because of slow export growth and high level of external indebtedness. This confirms the hypothesis that the strong export growth (reflecting restructured and internationally competitive economy) is the most important factor in achieving the long-term external stability. Income from services, or even current transfers, can contribute to it, but, in the longer run, they can undergo significant fluctuations. External indebtedness, leading to increasing debt service ratio and high international reserves, is, of course, not a long-term solution to the problem and can limit the prospects for economic growth.

Slow export growth is a consequence of non-restructured economy, which can be seen through structural characteristics of the country's international trade flows (exports of low-value-added products to the less developed countries). The low competitiveness of such products on international market can explain the stagnating Croatian exports. Concerning external indebtedness, Croatia already achieved the level at which external debt exceeds the total annual exports by 2,5 times and amounts to 60% of GDP. Servicing such a high debt makes use of a considerable part of current account revenues, while high share of short-term loans calls for relatively large international reserves as a guarantee for the country's international liquidity.

Taking into consideration the estimated slow economic growth and restructuring, the continuation of these trends would cause high instability of Croatian external position, i.e. its high external vulnerability. Even in the case of a more dynamic economic growth, which would increase imports, the presented external position of Croatia could not be improved much, at least not in medium-run.

A good economic policy is necessary in order to solve the problem of external imbalance and weak external position of Croatian economy. Experience of other reform countries shows that the most important contribution to stable external position comes from the dynamic export growth. The Czech Republic, Hungary and the Slovak Republic are the best examples for that, as well as Bulgaria, Romania and Poland, whose slow economic restructuring did not contribute to their external long-term stability. Therefore, Croatia should, as soon as possible, carry out economic restructuring, increase labor productivity and improve its international competitiveness, in order to initiate export growth and prevent further external indebtedness. Further efforts in attracting foreign direct investments and trade liberalization can certainly contribute to it; giving impulse to long-term economic growth this could significantly improve external position of Croatian economy.

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STANJE EKSTERNE RAVNOTEŽE HRVATSKE I NJEZINA DUGOROČNA STABILNOST

Sažetak

Hrvatska je od početka '90-ih suočena sa izrazitom eksternom neravnotežom kao posljedicom izostalih strukturnih i institucionalnih reformi u gospodarstvu. Ta se kriza eksterne ravnoteže u slučaju Hrvatske očituje kroz rastući deficit vanjske trgovine, ali i kroz strukturna obilježja vanjskotrgovinskih tijekova. U nepovoljna obilježja spadaju preusmjeravanje izvoza od razvijenih ka manje razvijenim zemljama, porast broja industrija u kojima Hrvatska ostvaruje poziciju neto-uvoznika, te struktura izvoza u kojoj dominiraju proizvodi niske dodane vrijednosti. Rast vanjskotrgovinskog deficita tijekom 2001. i 2002. godine uz daljnji rast eksterne zaduženosti uzrokuje sve veći teret servisiranja duga i time umanjuje mogućnosti gospodarskog rasta. Stoga se, s obzirom na realna ograničenja mogućeg daljnjeg rasta eksterne neravnoteže, može reći da Hrvatska ostvaruje visoki stupanj eksterne neravnoteže. Za razliku od Hrvatske, napredne tranzicijske zemlje ostvaruju vrlo povoljne eksterne pozicije kao posljedicu restrukturiranog gospodarstva i dinamičnog rasta izvoza.