

Editor's Note

I would like to draw your attention to the seventh volume of the *Croatian Economic Survey*. It comprises a selection of articles that originally appeared in *Privredna kretanja i ekonomska politika* journal (*Economic Trends and Economic Policy*) in 2004, the year in which this quarterly journal celebrated its 100th issue. As was the case with the preceding volumes of the *Croatian Economic Survey*, the main purpose is to bring the recently published research articles that were originally available only in Croatian or in English to a broader international audience.

The first volume of the *Croatian Economic Survey* was issued twelve years ago, in 1993. The following three volumes appeared on a rather non-regular basis due to a number of difficulties. Since 2002, the regularity of the annual publication has been re-established and we hope to continue with that practice in the future. In order to afford greater flexibility and wider accessibility in reading the *Survey*, every issue from now on will be available via the Institute of Economics' website, www.eizg.hr.

Five articles have been selected for this volume of the *Croatian Economic Survey*. They cover a wide range of topics and appear in the chronological order in which they were published in the source journal. The first two articles deal with the "hot" issues of fiscal and external vulnerability faced by the Croatian economy. The next article introduces the reader to the internationally appealing topic of hedonic regressions. The following article takes on the topic of environmental issues and the European Union accession as Croatia approaches the start of negotiations with the EU on full membership. The final article reports some intriguing results on the innovation development in the leading Croatian enterprises. In a way, this volume starts with the current problems faced by the Croatian economy and then leads towards topics that are more future-oriented.

The first two articles of this volume address the topic of public debt management in Croatia, the first from a perspective of static indicators and the second involving dynamic sustainability analysis. It should be mentioned that both articles were originally prepared in 2003 for the "Public Debt in the Republic of

Croatia: Measurement, Limits and Sustainability” project.¹ The objective of the project was to give fiscal authorities analytical tools for improved public debt management. In the first article “Sustainability of Croatia’s Public and External Debt” *Dubravko Mihaljek* undertakes the analysis of standard financial indicators in order to assess Croatia’s public and foreign debt sustainability. Recognizing that only two summary measures: total amount of debt (public and foreign) and share of debt (public and foreign) in GDP are usually used in discussions in Croatia, *Mihaljek* suggests that it is not enough and, more importantly, that it may lead to wrong conclusions and inappropriate fiscal and monetary policy decisions. Therefore, the author advocates determining the actual debt level on the basis of systematic analysis of much larger number of macroeconomic and financial indicators. In addition, he provides a wide range of debt indicators for the Croatian case, compares them with the indicators for new EU member states as well as candidate countries, and discusses the sustainability issues. A threshold level at which debt sustainability becomes a problem may differ across periods and countries, and depends on the perceptions and expectations of financial market participants. Continuous monitoring of various debt indicators, as author suggests, ensures that negative trends will be discovered early enough to allow for timely and appropriate economic policy measures.

A group of authors including *Ante Babić, Ivo Krznar, Danijel Nestić and Sandra Švaljek*, prepared the second article of this volume, “Dynamic Analysis of Public and Foreign Debt Sustainability”. Basing their approach to analyzing debt sustainability on the framework originally developed by the International Monetary Fund,² the authors undertake three major steps. The first step involves projections of key macroeconomic variables and projections of debt developments. The second step relates to the examination of the sensitivity of projected debt developments to various macroeconomic shocks. Consequently, these results are used in the third step to make qualitative judgments on debt sustainability in order to recognize major risks involved in borrowing. In spite of the fact that this approach does not allow authors to answer the question of debt sustainability thresholds, it provides a number of indicators, information and implications for alternative scenarios that may serve as the basis for a professional assessment of

¹ “*Javni dug u Republici Hrvatskoj: mjerenje, granice i održivost*” (*Public Debt in the Republic of Croatia: Measurement, Limits, and Sustainability*), 2003, *Ekonomski institut, Zagreb*.

² “*Assessing Sustainability*”, 2002, *Prepared by the Policy Development and Review Department, IMF*, <http://www.imf.org/external/np/pdr/sus/2002/eng/052802.htm>.

Croatian companies in spring 2002. In spite of much talk about the capability of Croatian companies to innovate and thereby improve competitiveness of the national economy, there has been a lack of systematic studies on innovations development that this paper tries to make up for. The purpose of the study was to explore several issues related to the innovations development. It addresses the structure of innovations and examines the novelty level of new products and processes. It explores whether firms of different sizes differ in their innovation output, and whether the continuity with which firms perform research activities has any impact on their innovation output. The sources of new product ideas are explored, as well as some preconditions for new product success. This paper also examines the prevalence of new product development processes in Croatian companies. In order to mention just a few results, let us say the study shows that most leading firms in Croatia had innovated in the three-year period prior to spring 2002. However, the majority of product and process innovations are recorded as being of low level of innovativeness. In addition, large enterprises in Croatia do not use their existing resources efficiently and effectively in innovation development and commercialization, although they do develop a significantly larger number of new products of high novelty than smaller firms. Although more than half of the companies in the Croatian sample have some type of formally documented “new product development” process in place, these processes have failed to produce a statistically significant difference in comparison to the firms that employ less sophisticated practices. This contradictory result will surely be further explored in the future.

Finally, I would like to take the opportunity to thank everyone who has contributed to this volume of the *Croatian Economic Survey* in various capacities.

I invite you now to take a glance at the selected articles. It is my hope that some will catch your attention.

Guest Editor:

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