Editor's note

This sixth volume of the *Croatian Economic Survey* comprises a selection of articles originally published in *Privredna kretanja i ekonomska politika* journal (*Economic Trends and Economic Policy*) in 2003. It continues the mission of the *Survey* edition, namely to present to an international audience recent research results originally published in Croatian or even in English, which have remained unnoticed by the broader readership due to the language barrier or limited distribution of the source journal. This volume comes after the two of tri-annual issues and is intended to re-establish the practice of regular annual publications based on contributions originally presented in *Privredna kretanja i ekonomska politika* journal, and potentially in other working paper series during the previous year.

The selection of papers for this issue follows my preference towards contributions that are mostly quantitative in their nature and are of high relevance for the issues they pertain to. I have chosen a total of five papers that cover quite diverse topics. The first one concerns the growth determinants, the second one deals with the financial system comparisons, the third one is about linkages between government revenues and expenditures while the last two deal with regional unemployment and currency disturbances. It is my impression that they represent rather well the issues currently faced by the Croatian economy, as well as recent Croatian economic literature stance.

In 2002-2003, when the papers from this volume originally emerged, the Croatian economy was characterized by rather strong growth accompanied by increasing public and external debt. The expansion was driven mainly by rising domestic demand, especially for investment and personal consumption goods, whereas the trade balance deteriorated. The financial sector experienced unprecedented growth, which caused a headache to monetary authorities due to the possibility of insufficient credit control and rampant external borrowings to fuel the credit boom. Government-sponsored projects of intense highway construction surged up, while their financing put additional pressure upon the already strained fiscal position of the country. Such a performance of the economy was coupled by a shift in the focus of policy makers - from longstanding inflation and exchange rate issues towards the issues of growth and development, unemployment, financial stability and the EU integration. Some of the actual policy priorities are reflected in the papers from the present volume. However, some others are not, such as public and external debt issues or specific EU integration challenges, but I expect them to be echoed in the future volumes.

In spite of the fact that these papers have been selected from a rather narrow sample of Croatian literature, it is my impression that the present volume illustrates recent trends in it rather well. Let me outline two of these. The one is orientation towards empirically-based research and the use of the more advanced econometric techniques. The other is an "internationalization" of the research approach. In that, focus is switched from the examination of individual characteristics of the Croatian economy towards analyzing its experience in the wider context of transition. For example, the paper on growth determinants in transition countries makes no specific reference to the implication of empirical results for Croatia, whereas the paper on currency disturbances discusses the Croatian case as the case of any other transition country subject to research. The paper on fiscal issues that was prepared by three U.S. scholars contributes also to a more internationally-flavored analysis of the Croatian economy.

Let me now draw your attention to the main features of each paper in order of their original publishing. The first paper by *Andrea Mervar* provides panel regression estimates of growth determinants in transition economies. In quest of common factors that can explain growth experience of transition countries, it opens with a comprehensive review of empirical literature and continues with interesting points that stem from the panel regression analysis. Initial conditions, structural reforms, macroeconomic stability and institutional development are shown to have influenced growth in transition countries. The author recognizes the differences in growth patterns between CEEB (Central and Eastern Europe and the Baltics) and CIS (Commonwealth of Independent States) countries, as well as between the initial, recession stage and the following, recovery stage of transition. For example, in the first stage of transition in CEEB countries growth was affected considerably by structural reforms while significance of macroeconomic stability was questioned. In contrast, the experience of CIS countries confirmed the importance of stability for growth, at least if it is approximated by the fiscal deficit, while structural reforms were not proven important at the usual levels of statistical significance. In the recovery stage of transition, the openness begins to play an important role in growth in addition to the institutional development approximated by a corruption index, but the latter is shown to be significant only for the CEEB countries. These findings support the conclusion of the paper that growth in transition countries will be increasingly determined by standard growth factors valid for established market economies, whereas the impact of specific "transition" factors is expected to diminish.

The paper by *Martina Daliæ* compares financial systems in Croatia and advanced transition economies. It shows that the size and activity of the banking system in Croatia is similar to those of Central European transition counties. However, other segments of the financial system, namely non-banking intermediaries and capital market, are relatively weak. In spite of the fact that a relatively well-developed banking sector dominates in financial services to Croatian enterprises, underdevelopment of other segments of the financial sector enables a generally poorer corporate access to resources than in advanced transition countries. The author expects that things are going to change soon due to a development of the capital market resulting from stronger demand of emerging pension and investment funds and a larger supply of higher-quality trading instruments. The paper concludes with the stipulation that further reforms aimed at strengthening the corporate sector, improving the legal system and privatizing the state-owned portfolio through initial public offerings are priorities for fostering financial system development.

James E. Payne, Bradley T. Ewing and *Richard J. Cebula* examine in their paper the temporal relationship between government revenues and expenditures in Croatia. Using unrestricted VAR and Grenger-causality test they found support for a tax-spend hypothesis of the revenue-expenditure nexus. Therefore, it appears that in the Croatian case rising tax revenues might lead to higher government expenditures rather than to a deficit reduction. The conclusion is drawn after an examination of the data from 1994-1999, but it is also instructive for the fiscal policy stance observed afterwards. The stylized fact in my own interpretation goes as follows. The Government wants to reduce excessive public expenditures. Despite having a substantial deficit, it has gradually introduced tax changes that have led to lower revenues. Only after that did the budget preparation process, either through regular budget or its occasional revisions, lead to lowering the expenditures while the deficit remained rather high. It follows that in the current budget process in Croatia it is easier to impose more stringent behavior of numerous government bodies and other beneficiaries if there is clear evidence of limited, even declining government revenues. The deficit seems to be a rather resilient constant in such a set-up. These stylized facts are calling for stronger quantitative tests, which will be possible in further examination in line with Payne-Ewing-Cebula paper.

Relations between unemployment at both the national and regional levels are explored in *Valerija Botriæ's* paper. Apart from the differences in the magnitude of unemployment, Croatian regions diverge in unemployment dynamics, as suggested by the SUR method applied in the paper. It is indicated that this dissonance stems from a regional diversity of economic activities, the depth of war damage and the prevalence of shadow economy. A relatively high product share of agriculture in Eastern Croatia, in addition to the substantial exposure to war destruction, could explain rather autonomous unemployment dynamics in that region. Being cautious in making conclusions due to data problems and method limitations, the paper also argues that specific regional influences on unemployment dynamics in Croatia could be stronger than in the EU candidate countries.

The fifth and the last paper in this edition is the one by *Amina Ahec-Šonje, Ante Babiæ* and *Katarina Baèiæ* which deals with the determinants of currency disturbances. It presents results of the "signals" approach employed to identify early warning indicators of currency disturbances for ten transition economies. As an introduction to the analysis it constructs an interesting analytical measure of currency disturbance - the foreign exchange market pressure index (FEMPI) - aimed at detecting pressures that might lead to a full-blown crisis. Major part of the paper is devoted to a search for early warning indicators of currency disturbances, first for each individual country and then for the transition economies as a whole. The authors conclude that the "signals" approach could be useful in explaining, or even anticipating a rising vulnerability of foreign exchange markets in transition countries.

It is my hope that the collection of papers presented here will contribute to the comprehension of the Croatian economy issues, and stimulate further research in the areas challenged in this volume.

Guest Editor:

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April 2004