

CENTRAL EUROPE AND CROATIAN FOREIGN TRADE POLICY¹

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1. Main Strategic Issues of the Croatian Economy

1. The present state of Croatian economy is the result of the dissolution of the former Yugoslav federation and the disintegration of its pertinent and East-European and Middle-European markets; at the root of all this was the crisis and collapse of the socialist socioeconomic system of historic significance. A drastic consequence of all these historical developments is the war on the territory of Croatia and Bosnia-Herzegovina. All these factors manifested themselves in the low indices of growth of the gross domestic product, employment, investment, consumption, exports, imports, the level of utilization of economic potentials, a high monthly rate of inflation, and especially the adverse social situation and problems as early as 1990, which flared up in the second half of 1991 and throughout 1992, to continue in 1993. Under such conditions a distinction must be made in current economic policy between war structural problems (transport, tourism, electricity generation, parts of agriculture and industry, certain banks) and ordinary structural problems created by insufficient competitiveness on the world market. Recovery of production is connected with the war structural problems, but also with a reorientation in exports of goods and services to new markets, i.e. in great measure to the replacement of the former East-European and Yugoslav markets. The fundamental objective of the policy of recovery is to raise the level of utilization of

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the country's economic potentials and to reconstruct part of physical facilities destroyed during the war. Stabilization policy must take into account the objectives of recovery and these will for some time act as limiting factors. Recovery should at the same time proceed from the objectives of the stabilization policy.

In determining the development strategy of the Croatian economy it is necessary to distinguish two strategic stages and the substage of recovery as the initial step in the first stage. The basic characteristic of the first stage is a relative autonomy of monetary and credit policy associated with the policy of the foreign exchange rate and foreign exchange reserves, with the aim of achieving full employment and reconstruction of productive facilities, which are not markedly structural problems. It should be expected that the inflow of capital into the country will predominantly evolve for the purpose of financing the current balance of trade deficit, especially in the stage of recovery. Since the instruments and mechanisms of the financial market are underdeveloped, macro-economic regulation will have up to some level an administrative character.

The second stage in development strategy will be characterized by opening up towards the world capital market on the basis of market mechanisms. This stage will presuppose an appropriate development level of financial institutions and mechanisms, such as: a securities market, central bank open-market operations, full convertibility of the domestic currency, automatic equilibration of the balance of payments through the functioning of the capital market and the sale of goods and services by a competitive economy.

The integration of the financial market into the world (European) financial market will demand coordination of monetary and fiscal policies and the exchange and interest rate policies with partner countries (DECD, EEZ, EFTA, for example). This means that Croatia should be ready and prepared to join these economic communities.

The need to distinguish stages in the country's development strategy is imposed by the inherited social economic system, the inertia and non-competitiveness of part of the economic structure, the way of allocation of high-powered money, a low self-financing ability of economic entities and the inability to provide funds for current operations and development on the financial market. The situation calls for the establishment of a "mixed" strategy with elements of policies of a the various development stages and strategic options.

2. In the substage of the production recovery two scenarios are possible: according to the first the inflow of foreign exchange, growth of production and formation of savings for financing working capital would be only based on merchandise exports and a gradual increase in invisible exports and, in addition, on gradual revival of domestic market; current economic policy and economic development would, owing to the external circumstances, for the time being evolve according to the first scenario.

The second scenario of the production recovery would be based on the additional inflow of funds for financing working capital from abroad, but also on an additional inflow of funds from domestic sources; the second scenario would entail a much faster process of production recovery, but also a faster process of the expansion of the domestic market and a rise in living standards.

The second scenario would evolve on a commercial level (short-term credit lines, advance-money, commodity credits in the form of raw and intermediate materials, spare parts and equipment, materials for the reconstruction of houses, infrastructure) and at the level of financial institutions (humanitarian help, donations, the World Bank and the European Bank for Reconstruction and Development, deferment of the repayment of external debts).

The objective of economic policy is to realize the second scenario. In this connection especially interesting and instructive is the experience

of the European countries after the Second World War with the Marshall plan, by means of which the USA helped recovery of production in Europe. Croatia's economic policy concerning recovery of production and reconstruction of production units should make use of some mechanisms and instruments in the implementation of the first strategic option (stage), but also instruments of the second strategic option (stage). This primarily relates to direct investments by foreign investors on the basis of privatization in the form of additional capitalization. Government bonds, bonds of large corporations and of investments funds are instruments of a developed capital market and would belong to the second strategic stage. Since, however, the elements of individual stages (or options) interweave, it is necessary to develop a legal regulation and pursue a stabilization policy in order to make it possible to combine several instruments from individual stages to ensure inflow of capital into the country.

3. The banking-monetary system has a central place in the recovery and development strategy. In order for the banking system to be able to function as a mediator in the collection and investment of real sources of savings, it is necessary to carry out a credible stabilization programme. The preconditions for the successfulness of this programme are as follows:

- financial rehabilitation of banks and infrastructural public enterprises and the solution of major "structural problems" in the remaining part of the economy; in the procedure for overall rehabilitation the Government should take over banks' "bad assets" and obligations of public enterprises that can be rescheduled, balance current budget expenditures and revenues, maximally avoid monetization of the current deficit, and reschedule external debts; the fulfillment of these preconditions is already built into the Government's programme;
- Proceeding from the foregoing, it will be possible to implement stabilization monetary policy in a way that will ensure that credits granted by commercial banks are based on real deposits

of households and the economy; in this connection it is necessary to examine possibilities for changing the mechanism of high-powered money. Credit supply should correspond to credit demand which is able to pay real positive interest rate on deposits of varied term-structure should be attractive to depositors. Credit supply for the economy on the basis of real sources should be such as to ensure a positive real growth rate of gross domestic product. This would in view of the level of economic activities in the current period only be possible with foreign financial support. If the Government is to obtain this support, its stabilization programme should be credible. The said mechanism is an argument for obtaining financial support. The aim of stabilization programme is not only to lower the inflation rate, but also to ensure economic growth. Under our conditions this should have a pronounced development character. This could be ensured by a new approach in monetary policy, whose basic aim would be to place banks in a competitive setting; banks should strive to collect real sources for deposits (from the economy and households) rather than rely and depend on the central bank within the system of quotas and similar instruments.

In the transitional period it will be in particular necessary to solve such great problems as food and exports. However, they should not be a basis upon which the banks would be using direct credits from the central bank earn interest and would therefore not be interested in collecting deposits from other sectors, primarily households. To finance working capital for such activities many countries have special financial institutions, but that they do this so that their sources of financing also rely on real deposits of commercial banks through the reserves deposited at the central bank.

4. Privatization as a source for financing reconstruction and development and financing working capital will under Croatian circumstances not yield good results, save exceptionally and in cases

where additional capitalization that must be approved by a government body is involved. The financial goal of privatization is to increase budget revenues and thus also possibly help finance the reconstruction of destroyed and damaged physical capital. The role of stock exchanges, primarily of those dealing in shares, is also in developed countries to change the owners of, rather than to finance the development of corporations. Stock exchanges were in the past an important mechanism for collecting funds for development in the form of primary share issue. Similarly to the developed countries now, our stock exchanges function as a secondary shares market, consequently as a mechanism for seeking new owners to replace the state. Financial resources derived therefrom go into budget. This means that the new owners will be impelled to seek credits from banks to finance their working capital needs. In view of the foregoing analyses, the question is whether or not this will result in increased pressure on high-powered money, which would be contrary to the stabilization objectives.

2. Institutional Transformation and Regulation of Foreign Trade System²

1. The main characteristic of the foreign trade policy is the liberalization in spite of the war and related risky environment. Now, war environment has been changing and prospective economic climate has been improving. Modern liberal laws have been stipulating:

- the Company law passed the Parliament in November 1993; Law on foreign trade operations has been approved and liberalized;
- free entry into the foreign trade activity is guaranteed;
- foreign companies and traders are the subject to the same legal treatment as domestic ones;
- foreign investor has the same legal status as domestic one, and the transfer of profit and unrestricted repatriation of capital are guaranteed to him.

² See quoted literature under (4)

Foreign investor can establish equity joint ventures, joint stock company wholly owned by a foreigner, etc. Foreign exchange operations are very liberal and they are founded on the Law adopted in October 1993. In the fiscal field, Croatian Parliament has adopted the set of new laws defining the whole fiscal and customs system:

- tax administration law;
- personal income tax law; profit tax law and sales tax law; VAT system will be introduced approximately in one or two years.

Customs system has regulated by the Customs Law, the Law on the Customs Tariffs and the Law on the Customs Administration. Very important is the Law on Free Zones. It defines a free zone offering special conditions for doing business. Free zone policy intends to attract foreigners to use harbour and transit services of Croatian companies. The Republic of Croatia follows the guidelines established by GATT. So up to now, Croatia ratified Agreements on trade and economic cooperation with countries as e.g. Austria, Hungary, Poland, Bulgaria, Russia, etc. Similar agreements have been under negotiations with many other countries.

Customs protection is not high due to the fact that 75% of imports consists of raw materials for further reproduction, 15% of equipment, and about 5% of consumer goods. The protection rates are for consumer goods approximately 17%, for equipment about 13% and for raw material cca 8%. The intention is further decreasing of tariff rates. But still, import policy uses instruments like import quotas, additional customs duties, seasonal duties, customs refund instruments. All these measures are going to follow GATT rules and criteria. All system of quotas includes no more than 6% of total yearly import by value. Operations like customs valuation rules of origin, standards, certification, inspection services at border crossings and all the customs formalities, are regulated according to international rules.

Up to now Croatia has become a member of many international organizations, especially financial institutions like IMF, IBRD, EBRD,

UNIDO, UNDP; observer status was granted to Croatia in GATT, special guest status in Council of Europe, and alike.

2. Regulations of financial system in Croatia are given by laws which already passed the Parliament in 1993:

- the law on National Bank of Croatia;
- the banking law regulating commercial banks activities;
- the law on the foreign exchange systems, operations and gold trading.

According to the law, NBC is responsible for the stability of the domestic currency, liquidity of payments (foreign and domestic); it is responsible for national monetary policy, like interest rate and foreign exchange rate policy, monetary aggregate regulations; it is obliged to audit and supervise commercial bank operations and to control their solvency and liquidity, capital adequacy and other internal controls.

Very important financial institutions in Croatia are Insurance Company, Croatian Credit Bank for Reconstruction and savings banks. Now, in the establishing stage, there are some types of investment banks, subsidiaries of foreign banks, as well as under way stock exchange market; open market operations of CNB are going to give some good results in shaping monetary aggregates.

3. Privatization of the social (state) owned enterprises is going to be completed soon. That means that according to the Law of transformation and the Company Law, in social owned companies, every company has its market oriented management board and shareholder's assembly. Equity of a company belongs to personal shareholders, to the social security institutions and to the state. Thus, enterprises have been working as the market entities now, i.e. as companies having specific structure of owners, which are pressed to behave on the market in a competitive manner. State's shares are conducted by Croatian Privatization Fund which is responsible for monitoring the privatization process as well. In the following stage, CPF

should sell out its (state owned) shares on the stock market. The intention of that obligation is to privatize totally equity of a company.

The most of the small and medium sized companies have been already totally privatized and they have their ownership in structure with state ownership as the minority. CPF has majority status in large companies, 15% of the total number of companies, but with an average of 52% of their capital. That type of companies contains 42% of total fixed capital in Croatian economy. In spite of that, CPF is present in the most of companies; it has majority status in a small number of them, but with great deal of total fixed capital. Finally, up to now, the greatest owner in the Croatian economy is the state. But it has to behave in a market competitive way, and it is obliged by the law in whole business sector to get rid of its ownerships.

In the public service sector and big industrial companies, state ownership will be kept up to the time when big private buyers of their shares would arise and when financial market would be developed enough.

Privatization of financial sector companies will take more time, and successful way of privatization in that sector is free entry of new entrepreneurs and companies of domestic and foreign ownerships. That is the way to improve competition in the financial market and impose to the government real responsibility for macroeconomic stability.

3. Trade Interrelationships of the Croatian Economy

1. The Croatian economy is in a phase of restructuring, considering ownership, market and financial institutions as well as production orientation, especially in regard to foreign trade orientation in a spatial sense. In **former** Yugoslavia, according to 1987 census, the **Croatian** economy **was** selling about 69% of its production on the territory of Croatia, 19% on the territory of ex-Yugoslavia and 12% outside the

borders of ex-Yugoslavia. The Croatian economy placed 7% of its total deliveries to the territory of the ex-republic of Serbia, and 12% to all the other former republics. The East-European and Soviet market significantly participated in the Croatian exports outside the Yugoslav territory. Analogously to the share of former Yugoslav republics in the marketing of the Croatian economy, it existed import dependence, of all components of consumption in Croatia, upon deliveries from abroad and former Yugoslav republics:³

- the share of Croatian production in 1987 intermediary consumption amounted to 59.4%, the share of imports in that consumption from former Yugoslav republics amounted to 25.5%, and the share of imports from outside Yugoslav territory was 15.1 %;
- the share of Croatian production in total final consumption (personal, public and investment consumption , and increase of stocks) amounted to 69.2%, a share of imports from former Yugoslav republics 23.7%, and the share of outside Yugoslav countries in that kind of consumption amounted to 7.1 %;
- in total consumption (intermediary and final) the Croatian economy participated in deliveries by 63.9%, former Yugoslav republics by 24.7%, and the rest of foreign countries (predominantly EU, EFTA, East-European countries) by 11.4%.

2. Disintegration of East-European and Yugoslav market causes radical reorientation of Croatian exports and imports, respectively forming new export and import structure in regard to countries of destination and countries of commodities and services origin. Total level of commodity exports and imports to developed countries during the last three years remains on the level of eighties, while trade with East-European, former socialist countries, including the Soviet Union, sharply decreased. Among former Yugoslav republics, Slovenia remains the only export-import partner, with which the trade has been also decreasing during 1993.

³ See quoted literature under (6) and (7)

Commodity exports from Croatia to the countries of former Soviet Union had decreased from USD 677 mil. in 1990 to USD 303 mil. in 1993, and imports from USD 432 mil. to USD 261 in the same periods. To the other ex-socialist countries (Hungary, Poland, Bohemia, Slovakia, Romania and Bulgaria) in 1990 Croatia exported commodities in value of USD 179 mil., and in 1993 USD 130 mil. During the same periods it imported from those countries USD 471 mil., respectively USD 233 mil.

According to the estimate, the Croatian exports of commodities and material services to the other former Yugoslav republics, in the prewar period amounted to USD 8.4 billion. The exports to the other countries in the world (convertible currency area and soft currency exports area) about USD 5.3 billion. Totally it amounts to USD 13.7 billion, all that at the level of about USD 18-19 billion of gross domestic product. Regarding the fact that former Yugoslav republics are foreign countries nowadays, it follows, that index of exports of the Croatian economy as ratio of exports to the gross domestic product is very high, among the highest in Europe (e.g. the Netherlands).

In order to realize prewar level of gross domestic product, it is evident that Croatia must realize approximately equal commodity exports (and material services) to the prewar one, or due to substitution of imports somewhat smaller. Supposing that export income multiplier is nearly the same as the prewar one or somewhat higher, then the necessary additional exports in relation to that it has been nowadays can be estimated of about USD 5.5-6.5 billion at least. That means that a total exports of commodities and material services should amount USD 11.5-12.5 billion, taking into account induced substitution of exports due to autonomous Croatian strategy of development versus "linked strategy" in former Federation. Foreign exchange inflow of tourism is relevant in earnings and outlays accounts of the balance of payments, while in this calculation it figures only as a "hidden" implicit exports, respectively additional export income multiplier. So tourism is only partly included into approximately estimated necessary exports.

From the previously mentioned it follows, that present total exports should increase somewhat less than twofold in order to achieve the prewar gross domestic product, taking into account, as before the war, a simultaneous share of tourism in creation of gross domestic product.

3. Calculated necessary additional exports to recover prewar gross domestic product can be realized as follows:

- by increase of exports into developed countries of Europe; by renewal of exports to the countries of ex-Soviet Union in the biggest possible amount; by renewal but also by remarkable increase of exports to the countries of Middle Europe, i.e. Austria, Hungary, the Czech Republic, Poland, Slovakia; only by partial renewal of exports to former Yugoslav republics, i.e. by renewal of exports to the part of Bosnia and Herzegovina, by entire recovery exports to Slovenia and partly to Macedonia. The territories of Serbia and Montenegro cannot be considered as complete trade partners, although trade will be renewed to a certain point, mostly in transport infrastructure. In the prewar commodity inflows, the importance of that market for the Croatian economy was overestimated. Namely, exports of goods of the Croatian economy to former underdeveloped Yugoslav republics, what included Kosovo and partially proper Serbia, then Macedonia, Montenegro and Bosnia-Herzegovina had been financed also by transfers from Croatia (and Slovenia) to them. For that purpose it was stipulated special intervention fund for their development as well as direct subsidies to their state budgets. Such transfers of the Yugoslav state, together with a policy of borrowing from abroad in behalf of undeveloped areas, generated additional demand, respectively imports of those areas from Croatia (and Slovenia), which surpassed their exports to Croatia (and Slovenia). In this way, Croatia was realizing surplus in commodity trade with that part of former Yugoslavia, mostly owing to the mentioned financial means transferring to them. This fact remarkably decreases the importance of that area for the exports of the Croatian economy

now. Accordingly, the exports would be directed differently in the future owing to the different allocation of financial means (tax revenue of the state i.e.) creating also additional demand in Croatia.

Starting from that, it is possible to estimate the following figures in allocation of necessary additional commodity exports (and services):

- to Slovenia, Bosnia and Herzegovina a renewed exports cannot be higher than USD 3 billion totally;⁴ afterwards, there is USD 3-3.5 billion left for which it is necessary to find out additional market. Distribution of that necessary exports can be realized as follows:
- by increase of demand of developed countries in relation to present demand by some 25-30%, that is in absolute terms USD 1.5 billion;
- by increase of demand of countries belonging to Community of independent states to the prewar level, and even less, that is to about USD 0.500 billion;
- the rest of lacking export demand of about USD 1-1.5 billion could be settled by countries of Middle Europe (Hungary, the Czech Republik, Slovakia, Poland); Austria, Germany and Italy as the members of the European Union have surely a chance of larger increasing the imports from Croatia than the other developed countries have; developing countries can "accept" additional USD 0.500 billion at least in relation to the present circumstances.

⁴ *This estimate should take into account a fact, that trade with Slovenia in 1993 essentially decreased in relation to 1992 and 1991, especially compared with a prewar level; thus Slovenia is not the biggest individual trade partner of Croatia. Nowadays, that position belongs to Germany and Italy, and furthermore to Slovenia. The reason of trade decrease with Slovenia may be a way of non-convertible payments which automatically maintains the trade balance by a tendency of establishing balance at the level of partner, who exports less than imports. The second reason could be, that both partners in current balance of convertible payments are solvent and they conduct a policy of certain liberalization of foreign trade. Thus importers choose more competitive supplier, who does not belong to the partner country.*

Consequently, it follows, that just the middle European countries could increase trade with Croatia, and that it is logical to expect stronger inclusion of Croatia into the Central European market area. Factors which would contribute to that would be:

- Central Europe will increase demand for transport services (ports, railway transit, oil pipeline transport);
- commodity trade will be strengthened; the exports from these countries to Croatia will be increasing on the basis of generated demand of tourism, as well as on the substitution of imports of raw materials, spare parts, and equipment from former Yugoslav republics into Croatia. The example of imports substitution to Croatia are meat products from Hungary instead from Serbia. The increased exports of finished textile products and clothes from Croatia to Hungary is also an example of market substitution.

Underdevelopment of economic relations with middle European ex-socialist countries is illustrated by a fact that in commodity exports of Croatia they participate to the level of Austria itself. In total commodity exports share of those countries is only 3.3% in 1993, but 6% in 1990, what is double than the Austrian share was. Orientation of these countries towards Croatia will be promoted by its capability of convertible currency payments of its imports. The advantage of these countries from the Croatian point of view versus east part of ex-Yugoslavia is their faster recovery and surmounting of transitional crisis, as well as the necessity of searching new markets due to remarkably slower recovery of the countries belonging to Community of independent states. Croatia can be very efficiently built in such courses. As the result of spatial restructuring of Croatian exports market, middle European countries could share its trade by 10-12% at least, or in absolute terms it amounts from USD 1 to 1.5 billion. If Austria and Slovenia are included in this category of countries, then it would amount to USD 4 billion on the whole. It is approximately 30% of total Croatian exports and imports respectively (with commodities and

material services, without tourism). That would be natural geopolitical market environment of Croatia.

4. Previously constructed figures are illustration of possible, but also logical future international relations of the Croatian economy. That is not an estimation, based on an econometric projection. Because, this is a period of "breaking down" processes of up to now existing trends and establishing of the new trends which are now on a low starting position. Further trade development of middle European countries depends upon several critical factors:

- first of all upon interacting trade arrangements, as it is Central European Free Trade Agreement, and that on the principles of GATT and policies of integration into single European market;
- upon economic relations of particular countries with European Union, bilaterally and multilaterally; upon relations with other East European countries, especially newly arisen independent states of South-east Europe.

Payments agreements i.e. payment systems between trade partners (convertible payment system, payments union, compensation payments system, clearing payment system) will be especially important factor in formation of the supposed trade zone, and in development of competitive environment.

The most important factor is the relationship of particular country with European Union and its obligations which are the consequence of its membership in GATT. With regard to Croatia, it experiences a special preferential status in European Union inherited from former Yugoslavia.

Fundamental elements of this status are the following:⁵

- trade privileges on the basis of unreciprocity, what is similar to status of developing countries to that market;

⁵ See quoted literature under (5)

- the imports from Croatia is free unless commodities are specified on the list of special regime;
- "delicate" products which are strong competition to EU producers are on a special regime, like quotas and ceilings, where there is imports without or with alleviated duties; after the ceilings and determined quantities has been exhausted, duties and surtaxes should be paid.

The structure of the Croatian exports to the European Union is such that the category "of delicate" products comprises a great deal of Croatian exports: mineral fertilizers, plastic products, plywood, planks, footwear, glass, steel tubes, electric engines and generators, furniture and parts, petroleum products, iron alloys;

- manufactures of agricultural products (cherries, plum-brandy, wines, frozen pease), and especially meat, as "baby beef"; live stock is on a rather convenient regime;
- a special group of products on a regime of quantitative restrictions consists of textile products and goods for final processing (synthetic textiles, cotton textiles, trousers, men's shirts, coats, men's suits).

All products need certificate of origin, and the quality should be of required technical standards.

The European Union participates in total Croatian commodity exports by more than 50%. It should be reminded here that the Croatian economy can export to that market a rather broad spectrum of commodities under competitive conditions. Considering imports, the European Union is also the most important Croatian partner and it participates in total commodity imports to Croatia by more than 60%. EFTA participates in total Croatian commodity exports by only 7-10%, and in the Croatian imports by 8-10%. The exports to those countries varies more than imports, owing to structure of exports, which contains the elements of periodic exports (ships predominantly).

5. Payments agreements respectively system of payments will influence the formation of Middle European trade zone. The character of payments agreement essentially influences formation of stronger or weaker competitive environment in a trade zone:

- clearing, compensations, and similar "natural" systems of payment alleviated competitiveness of a partner on the rest of the world market, and its economic structure, level of productivity and technical progress have been adjusted to a "softer" market conditions, especially in circumstances of customs union. In the short-run such a model of payments and customs union beneficially influence the level of employment and income. The experience of countries in international economic cooperation (Council for Mutual Economic Assistance, CMEA) as well as the experience of ex-Yugoslavia, shows bad developmental performance of such a system;
- convertible currency payments system in current balance of payments ensures to importer a choice of commodity supplier e' in competitive conditions, i.e. convertibility of his currency does not restrict him to narrow noncompetitive market which can be formed in a non-convertible system of payments.

Strategy of development open economy must have clear balance of payments' policy, which has to increase competitiveness of the economy, besides realizing balance of payments equilibrium.

Foreign exchange rate policy plays an important role in that strategy, in connection with policy of liberalization in foreign trade system. Policy of Middle European countries within the frames of CEFTA, according to already settled agreements, evidently follows such strategy. Croatian export economy can follow such a development strategy owing to following factors:

- Croatian economic structure has been export oriented (shipbuilding, textile industry, manufacturing industry, agriculture); service sector is export oriented too (port services, railway and road transit, tourism), and private transfers are also

- important (workers' remittances); all that enables maintenance of balance of payment's equilibrium for a long term;
- ability of Croatia to accept convertible currency payments system with its trade partners makes it attractive for countries of Middle Europe; the convertibility has been based especially on exports of service sector. This fact enables Croatia to realize remarkable commodity- trade deficit, without having problems with current balance of payments. In 1993, the trade balance was negative for about USD 762 million, which was covered without difficulties by positive surplus of service sector (about USD 560 million) and by private transfers mainly of Croatian citizens. The result of all these transactions enabled entirely appropriate growth of foreign exchange reserves, with equilibrium in the credit-financial transactions of balance of payments. Such movements have been realized by still greater outflow than inflow of foreign capital. However, the consequence of all that is stagnation of production. That stagnation of production has been attributed by impossibility of recovering of production in service sector, owing to war conditions, by impossibility of financing working capital, then by still restrained inflow of foreign capital as well as to periodic trade restrictions of some countries' importers from Croatia.

Conclusions

1. In determining the development strategy of the Croatian economy it is necessary to distinguish two strategic stages and the sub stage of recovery as the initial step in the first stage. The basic characteristic of the first stage is a relative autonomy of monetary and credit policy associated with a policy of the currency rate of exchange and foreign exchange reserves, with the aim of achieving full employment and reconstruction of productive facilities, which are not markedly structural problems. It should be expected that the inflow of capital into the country will predominantly evolve for the purpose of financing the current balance of trade deficit, especially in the stage of recovery.

The second stage in development strategy will be characterized by opening up towards the world capital market on the basis of market mechanisms. This stage will presuppose an appropriate development level of financial institutions and mechanisms, such as: a securities market, central bank open market operations, full convertibility of the domestic currency, automatic equilibration of the balance of payments through the functioning of the capital market and the sale of goods and services by a competitive economy and liberalized foreign trade system.

The integration of the financial market into the world (European) financial market will demand coordination of monetary and fiscal policies and the exchange and interest rate policies with partner countries (DECD, EU, EFTA, for example). This means that Croatia should be ready and prepared to join these economic communities.

2. Croatia has been stipulating modern liberal laws in the foreign trade and whole economic system. It gradually introduces the market oriented company law, the law on foreign trade operations and activities, the customs law, the law of National Bank and banking system, the law on the foreign exchange system, the law on privatization of social (state) owned companies.

The strategy of transition is to found competitive market of goods and services, private ownership, competitive financial market, and liberalized foreign trade system by establishing adequate legal institutional framework.

3. In the period till 1990, the Croatian economy supplied total consumption of Croatia (intermediary and final) by 63.9%, ex-Yugoslav republics by 24.7%, and the other foreign countries by 11.4%. By disintegration of East-European and Yugoslav market after 1990, it appears radical reorientation of Croatian exports and imports structure in regard to countries of destination and countries of commodities and services origin. In order to realize former gross domestic product, it is necessary for Croatia to double commodities and services exports compared to exports of 1993. It must be noted that former Yugoslav market is considered as foreign countries.

Unrealized additional exports demand can be formed in a following manner:

- by increase of exports to developed countries of Europe, to 25% at least;
- by renewal of exports to the countries of ex-Soviet Union, to the level of USD 0.500 billion at least;
- by renewal, but also remarkable increase of commodity and services exports to the countries of Middle Europe, including Austria, Hungary, Poland, the Czech Republik, Slovakia, and also Slovenia;
- by only partial renewal of exports to former Yugoslav republics, that is, by renewal of exports to the part of Bosnia and Herzegovina, by entire exports to Slovenia and partly to Macedonia; the Albanian market should be added here.

From the previously mentioned it follows that there are just Middle European countries which denote critical category of countries to increase trade with Croatia, and that it is logical to expect stronger integration of Croatia into that market space. To stronger orientation of

those countries towards Croatia will contribute its ability of convertible payment of its imports, as well as demand of those countries for services of Croatian infrastructural sector and tourism.

As the result of spatial restructuring of Croatian export market, middle European countries could share its trade by 10-12% at least, and in the absolute terms by USD 1.5 billion, without Slovenia and Austria. Together with Austria and Slovenia that would amount about 30% of total Croatian exports and imports, or in absolute terms about USD 4 billion of trade in each direction (without tourism).

4. Payments agreements respectively systems of payments will influence the formation of Middle-European trade zone. The character of payments agreement essentially influences the formation of stronger or weaker competitive environment in a trade zone:

- non-convertible system of payments decreases the competitiveness of a partner on the rest of world market, thus economic structure and level of productivity adjust to "softer" market conditions, especially in the circumstances of customs union;
- convertible currency payments system in current balance of payments ensures to importer a choice of commodity supplier in competitive circumstances, i.e. convertibility of its currency does not restrict him to narrow noncompetitive market.

Thus strategy of open economy development must have clear balance of payments policy which has to increase competitiveness of the economy, and besides to realize balance of payments equilibrium. Foreign exchange rate policy should be properly coordinated with policy of liberalization in foreign trade system. Such a policy should be accepted by the present and future members of the trade zone CEFTA. The capability of Croatian economy to accept convertible system of payments, to introduce liberalized foreign trade system and to keep stable exchange rate of its currency, makes it an attractive foreign trade partner for the countries of Central Europe.

STATISTICAL APPENDIX

- unauthorized data

	1992.	1993.
1. EXPORTS TOTAL (2+3) (in mio USD)	6108	5711
2. Exports of goods	4597	3904
3. Exports of non-factor services	1511	1807
4. IMPORTS TOTAL (5+6) (in mio USD)	5548	5907
5. Imports of goods	4461	4666
6. Imports of non-factor services	1087	1241
7. BALANCE (in mio USD)		
7.1. Goods and non-factor services (1-4)	560	-196
7.2. Goods (2-5)	136	-762
8. Exports to imports ratio in % (2:5)	103.05	83.67
9. Nominal GDP (in mio USD)	12393	11997
10. Ratio (%)		
a) Debt/GDP	21.2	22.0
b) Debt service/Export of goods and services	8.9	6.7
c) Tourism (in mio USD)		
receipts	543	831
expenditures	158	365

Source: a/ National Bank of Croatia

b/ State Institute of Macroeconomic Analysis and Forecasting

c/ See quoted literature under (1), (2), and (3)

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