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# Financialization of the state in Croatia: findings of an interview-based case study

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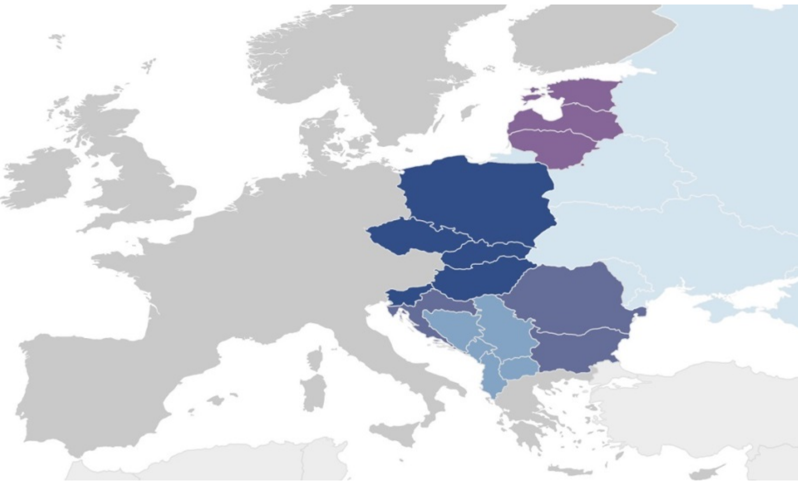



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# Financialization of the state in Croatia: findings of an interview-based case study

Marek Mikuš

**Abstract:**
This paper builds on interviews with members of the Croatian financial community (private and central bankers, pension fund managers, regulators, experts), statistical data, and other secondary sources to show that the key channels of state financialization in Croatia were public debt growth and pension system financialization. As a result of these interrelated processes, public debt assessment, management and sustainability, relationships between debt and monetary and fiscal policy, and the implications of pension funds for debt management and pension adequacy became increasingly significant policy considerations. The explosion of public debt and debt servicing costs after the Global Financial Crisis period contributed to a deepening and consolidation of a neoliberal (austerity) policy regime. Sovereign debt management underwent modest development and financialization while remaining characterized by limited competition and transparency and strong influence of a limited set of financial actors. Monetary arrangements conducive to peripheral financialization (informal euro peg) were maintained and perceived as the only realistic alternative. Overall, the Croatian financial community supported a continuation and potentially deepening of state financialization by privileging the interests and rationalities of creditors and other financial actors in policymaking, promoting the development and financialization of pension funds, using financialized debt management techniques, and so forth. At the same time, public debt and pension system issues informed growing concerns over the long-term sustainability of the current policy and politico-economic regime.

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## Introduction

In an earlier GEOFIN working paper based on comparative analysis of secondary quantitative data on ECE-11[1] countries, I identified Croatia as one of the East-Central European countries with signs of a relatively higher degree of state financialization, including high GDP shares of public debt and debt service costs, prevalence of high-risk forms of public debt such as foreign currency debt, and a high GDP share of pension fund assets (Mikuš 2019c: 35 –36; for a conceptual and methodological discussion of state financialization, see Mikuš 2019d). This has led to a working paper on state financialization in Croatia on the basis of an additional analysis of secondary quantitative data and analysis of relevant literature (Mikuš 2019b). The paper reiterated that levels of public debt and incidence of its high-risk forms were particularly significant indicators of state financialization in Croatia and contextualized these tendencies in critical accounts of the peripheral financialization of the Croatian political economy, characterized by a cyclical dynamics of debt-creating capital inflows, accumulation of macroeconomic asymmetries, and elevated vulnerability to external shocks. In this paper, I develop my case study of state financialization in Croatia through an analysis of primary interview data and analysis of additional statistical data and documents. The next section explains data collection and analysis methods. The rest of the paper presents results of the analysis in the following thematic clusters: relative levels of public debt; causes of public debt growth; public debt as a problem; debt service costs; sovereign debt management; fiscal policy; capital flows; monetary policy; pension funds and the pension system; and conclusions.

## Data collection and analysis methods

Data collection for this interview-based case study took place during 2.5 weeks of fieldwork in Zagreb, Croatia in May/June 2019. The pre-defined aims were to collect 15+ interviews while approximating as much as possible a balanced representation of three broad categories of interviewees: creditors of the Croatian state; financial regulators and policymakers; and experts, academics and journalists. Ultimately, 17 separate interviews with 19 individuals (12 men and seven women) were conducted in the Croatian language; four individuals were interviewed in pairs. Sixteen interviews were taped and subsequently transcribed; one interview, at the request of one of the interviewees, was recorded only in the form of notes. One interview was conducted

[1] ECE-11 are all postsocialist East-Central European (ECE) member states of the European Union (EU): Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

over Skype and all other interviews in person. Average duration of the taped interviews was about 66 minutes. The sample could be characterized as a convenience sample inasmuch as it depended on interviewees' willingness to participate and opportunistic use of personal contacts in addition to official channels; nevertheless, a reasonably good coverage of the three pre-defined interviewee categories and key institutional players has been achieved.[2] The structure of the sample is as follows:

- 5 economists, including one member of the Commission on Fiscal Policy (working body of the Croatian Parliament);
- 4 officials and economists of the Croatian National Bank (CNB), generally referred to as "CNB officials" below;
- 3 pension fund managers;
- 2 private bankers, incl. one engaged with primary emissions of government bonds;
- 2 Ministry of Finance (MoF) officials, incl. one engaged with sovereign debt management;
- 1 business journalist;
- 1 official of the Croatian Financial Services Supervisory Agency (HANFA), engaged with capital market supervision;
- 1 pension system expert (academic).

The interviews were semi-structured, following a pre-defined list of interview themes and questions adjusted to the interviewee's professional position and expertise. To achieve thematic cohesion and focus, interviewees were asked versions of the following pre-defined generic interview items:

1. What is your assessment of the level and characteristics of Croatia's public debt in comparison with other countries in East-Central Europe?
2. How high are Croatia's debt service costs, relative to comparable countries? / Do you think that Croatia's debt service costs are adequate?
3. How does public debt influence Croatia's public finances and public policies more broadly?
4. In your opinion, does Croatia have an issue with its public debt?

[2] The main weakness of the sample is an under-representation of the creditors, in particular bankers, who generally proved to be the least willing to participate or even acknowledge repeated e-mail requests for an interview. Unspecified policies or decisions of the management tended to be offered as explanations for rejecting the request. I also failed to secure an interview with a representative of the Zagreb Stock Exchange/ZSE, a private company which rejected quoting their impression that they were not the right addressee for my questions even if these mostly concerned the ZSE; however, they did provide some statistical data on request (see Table 4).

5. How sustainable Croatia's public debt is? / Can you imagine Croatia defaulting at some point in the future?
6. How should Croatia's public debt be managed?
7. As you probably know, before the global financial crisis the net balance of the financial account of Croatia's balance of payment became increasingly negative, suggesting major cross-border capital inflows, while after the crisis the negative balance first contracted and then, since 2014, turned positive, suggesting a reversal of capital flows. What do you think were the chief drivers of these developments?
8. It is general knowledge that the so-called nominal anchor and the main transmission channel of monetary policy in Croatia is the stable kuna/euro exchange rate. What is your assessment of this policy?

While questions 1–6 were formulated such as to be replicable in potential future GEOFIN interview-based case studies on state financialization, questions 7 and 8 were formulated as specific for Croatia. Even then, they could be applicable to at least some other ECE-11 countries, since these have been, with varying intensities and forms, exposed to similar patterns of capital flows and some have similar monetary policy arrangements.

Interview transcripts and notes were subjected to content analysis and critical discourse analysis to identify recurrent ideas, associations, controversies and ways of framing issues of relevance for state financialization in Croatia identified in earlier GEOFIN working papers (Mikuš 2019b, 2019c, 2019d). They were also analysed in relation to the earlier analysis of secondary quantitative data and relevant literature (Mikuš 2019b) as well as in relation to some new quantitative data (see the Data Annex) and documents obtained during and after my fieldwork. Results of the analysis are presented in thematic clusters that emerged as most relevant for the analytical focus as well as most significant and detailed in the collected data.

## Relative levels of public debt

My interviewees generally admitted that Croatia's public debt, measured as a ratio of GDP, was one of the highest in East-Central Europe. Several interviewees said that it was the very highest. According to Eurostat quarterly figures, Croatia has been indeed posting highest debt/GDP ratio in ECE-11 since the last quarter of 2017 to the end of 2019 (when time series ends). One economist (I-005) believed that Hungary's debt was the highest while one of the CNB officials (I-006) said more loosely that Hungary and Slovenia were the only two countries whose debts were comparable with Croatia (Slovenia's debt/GDP ratio was the highest in ECE-

11 in 2016–17 and Hungary's for much of the time up to 2014). At the same time, many interlocutors (especially, but not only regulators) made some of a set of arguments that seemed to aim at calling into question the apparent relative primacy of Croatia's debt in East-Central Europe. Three main relativizing arguments could be identified.

First, interlocutors pointed to recent debt reduction from the peak of 86.2% of GDP in the first quarter of 2015 to 74.5% of GDP in the first quarter of 2019 (Eurostat 2019c) as a highly encouraging development and a reason for being more optimistic about Croatia's public debt than a snapshot comparative view might suggest. One economist (I-003) even claimed not to know of any other country that would have achieved such a fast debt reduction. This was a stark overstatement, since even in the ECE-11 region there are experiences of significantly faster and more substantial debt reduction than the one recently achieved by Croatia. Probably most remarkably in the postsocialist period, Bulgaria cut its debt/GDP ratio from 92.9% in 1997 to 13% in 2008, i.e. at a pace of more than 6.5% a year or more than two times faster than Croatia's annual 3% reduction in 2015Q1–2019Q1. Still, most of my interlocutors felt that Croatia's debt reduction was a major achievement and should be considered in order to avoid being inappropriately alarmist about public debt.

The remaining two relativizing arguments could be described as methodological in nature since, to reduce them a common denominator, they questioned whether Eurostat methodology for measuring public debt, at least in the case of Croatia and relative to other ECE-11 countries (a comparison that matched the pricing of Croatia's debt in financial markets – see below), yields data that is truly directly comparable. The first of these two arguments pointed to the impact of the implementation of the European System of Accounts (ESA 2010) in Croatia in September 2014 when it became mandatory EU-wide. The adoption of this system of national accounts, which replaced the ESA 95 system,[3] resulted in an expansion of the scope of general government in Croatia and hence also of Croatia's public debt, inasmuch as Eurostat defines public debt as consolidated general government gross debt (Eurostat 2017). In particular, the debts of several major state-owned companies – namely Croatian Motorways (*Hrvatske autoceste*), Motorway Rijeka-Zagreb (*Autocesta Rijeka-Zagreb*), Croatian Radio-Television (*Hrvatska radio-televizija*, HRT) and Croatian Railways Infrastructure (*HŽ Infrastruktura*) – became part of public debt (Bajo and Petrušić 2014). According to a Ministry of Finance

[3] While Bajo and Primorac (2014: 1) argue that Croatian public finance statistics previously followed IMF's GFS 2001 manual, a Croatian Bureau of Statistics (2014) notification implies that ESA 2010 replaced ESA 95, i.e. the earlier ESA version. This discrepancy could be explained by the following sequence of national account systems: GFS 2001 prior to Croatia's accession to the EU in January 2013, ESA 95 in the relatively short period from January 2013 to September 2014, and ESA 2010 afterwards.

document, this retroactively[4] increased debt/GDP ratio in 2008–13 by about 9 percentage points on average (Ministry of Finance 2015: 28). The upward revision of Croatia's debt/GDP ratio in 2013 due to the implementation of ESA 2010 was the largest in the Union compared to much smaller or even downward revisions in other ECE-11 countries (Eurostat 2014: 3–4). What is more, in an additional step in the implementation of ESA 2010 rules in Croatia, Eurostat made Croatia reclassify the Croatian Bank for Reconstruction and Development (*Hrvatska banka za obnovu i razvoj*, HBOR) into the sector of general government in April 2015, which added further 4.4 percentage points to the debt/GDP ratio (Ministry of Finance 2015: 28). In sum, cumulative retrospective impact of these methodological changes on debt/GDP ratio was in the region of 13 percentage points (DG Economic and Financial Affairs 2015a: 10). According to one of the CNB officials (I-006), ports and tourism promotion organizations known as "tourism board offices" (*turističke zajednice*) were also reclassified into the sector of general government in 2018. The official implied that that all these Eurostat decisions might have been unfair toward Croatia by saying that "over here, everything that could enter public debt did enter public debt". They hinted that Croatia attempted to resist some of the Eurostat decisions but failed. Some of the debate between Eurostat and Croatian authorities over the reclassification of HBOR is summed up in a report on an Excessive Deficit Procedure (EDP) dialogue visit in Croatia in February 2015 (Eurostat 2015: 20–22). According to another CNB official (I-013), Eurostat justified its reclassification decisions by the degree of the dependence of the reclassified entities on government funding, the presence of government guarantees for the entities' liabilities, and/or the government's control over the entities through representatives in management boards.

The final relativizing argument was that unlike in other countries, Croatia's pension system contributed to its relatively higher public debt/GDP ratio at present but would limit its continued growth in the long run. A brief explanation is necessary to understand the logic of this narrative. Since 2002, Croatia has a three-pillar pension system. Two pillars are mandatory: the first is a pay-as-you-go scheme and the second is a fully funded, defined-contribution scheme – in essence, pension funds with individual savings accounts. Pension system participants thus typically pay two kinds of mandatory pension insurance contributions – 15% of their gross wages to the first pillar and 5% to the second pillar. The third pillar encompasses voluntary pension funds (Vukorepa 2018). The World Bank promoted this three-pillar model in various middle-income countries from the mid-1990s onwards (Orenstein 2008), which resulted in its adoption in several postsocialist ECE-11 countries including Croatia. However, since the global

[4] Croatian Motorways were reclassified into the sector of general government from December 2008 onwards and Motorway Rijeka-Zagreb from December 2010 onwards (Croatian National Bank 2015: 5).

financial crisis, most of these countries scaled back their second pillars in various ways, ranging from cutting second-pillar contributions (while increasing first-pillar contributions) through making second-pillar contributions voluntary to a de facto nationalization of the second pillar in Hungary in 2011 (Naczyk and Domonkos 2016).[5] Some of my interlocutors, in particular central bank and Finance Ministry officials, argued that Croatia's relatively higher debt/GDP ratio could be seen also as a result of its decision to buck this trend. They believed that the governments that eroded pension funds were able to lower their debt ratios by seizing their own bonds in pension fund portfolios and, more indirectly, diverting insurance contributions from pension funds to pay-as-you-go schemes, thereby reducing their chronic deficits for which they had to compensate with borrowing (see also Naczyk and Domonkos 2016). They argued that Croatia's maintenance of pension funds was a more virtuous policy because it would reduce future public spending on pensions and hence the need for public borrowing.

> *For much of the [2009–15] period, Croatia's borrowing was much more expensive than the borrowing of many other countries, especially since Croatia was paying a high risk premium and for a long time it was being assessed without considering that it did not intervene in the second pillar, which is a big difference from other countries, for example Poland and Hungary, which succeeded in stabilizing their debt by seizing much or all of the funds of the pension system, so the rating agencies' assessment perhaps wasn't the fairest from that perspective.* (I-006, a CNB official)

The argument about the impact of ESA 2010 and the one about the pension system thus centred around the same basic point, which was that common methods of defining and calculating public debt in the EU did not yield truly comparable and equitable results. The feeling of unfairness was particularly pronounced in the case of pension funds where interlocutors argued that rating agencies and markets rewarded countries like Hungary and Poland for their irresponsible policies with better ratings and lower debt service costs while punishing Croatia for its fiscal prudency. One of the officials of the Ministry of Finance (I-015) even hinted that Croatia

[5] According to Naczyk and Domonkos (2016), opponents of pension funds succeeded in scaling them back in countries where they could persuasively argue that mandatory pension funds contributed to large public debts by generating deficits in pay-as-you-go pension schemes and that they further harmed the economy by investing in government bonds (i.e. in that same "unproductive" public debt) instead of making "productive" investments. These factors are invoked to explain the particularly radical reversal of pension reforms in Hungary, compared to Poland and Slovakia. As I show below in the section on pension funds and the pension system, some of my interlocutors made or alluded to similar arguments in the Croatian context.

was hoping for some revisions of the EU's so-called "Two-pack"[6] and "Six-pack"[7] regulations such as to account for the differences of the member states' pension systems for the purposes of calculating and assessing their public debts. Together with the references to the recent debt reduction, these arguments also served the more general purpose of relativizing Croatia's relatively high level of indebtedness indicated by basic statistical measures. This was most apparent in cases when interlocutors, probably unconsciously, exaggerated the scope of the enlargement of public debt due to the implementation of ESA 2010 and mentioned supposed additions (e.g. government guarantees for shipyards) that, to my knowledge, did not actually occur as a result of ESA 2010.

**Causes of public debt growth**

Most of my research participants, mainly in response to the question about the relative level of Croatia's public debt but also other questions, offered more or less elaborate explanations for the growth of debt in the postsocialist period. These explanations are important because they reveal how actors understand principal reasons for public debt growth and how this, in turn, shapes their thinking about appropriate debt management and fiscal policies. While individual interlocutors did not necessarily mention all the factors and put varying emphases on individual factors, the following explanations were recurrent: debt-financed construction boom in the 2000s; insufficient and/or incorrect fiscal consolidation after the crisis; high debt service costs in the same period; and various "one-off" events. There was a general consensus about the significance of these factors among all categories of interlocutors.

Several interlocutors highlighted that Croatia has accumulated a significant debt legacy even before the crisis (ca. 38% of GDP in 2008 – see Mikuš 2019b, Table 2). This is an important consideration because this debt legacy had to be serviced and refinanced in a period of elevated debt service costs in 2009–15 (see below), thus contributing to the fast expansion of public debt at the time. As the chief reasons for this debt legacy, interlocutors mentioned the construction of infrastructure, especially highways, in the 2000s. As noted above, the (retroactive) inclusion of the debts of state-owned road companies in public debt in 2013 indeed

[6] Regulation (EU) no. 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area; Regulation (EU) no. 472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability.

[7] The "Six-pack" contains three regulations and one directive on fiscal policy (budgetary surveillance and the excessive deficit procedure) and two regulations on macroeconomic imbalance surveillance, all adopted in 2011.

led to a significant retrospective increase in public debt (Bajo and Petrušić 2014). One of the economists (I-002) highlighted endemic corruption as a result of which highway construction was heavily overpriced. One of the CNB officials noted, in the context of the discussion of capital inflows in the 2000s, that "the state was going into debt [to make] investments in infrastructure that were not always necessarily economically profitable" (I-013).

In general, however, interlocutors predictably focused on the period of major growth of public debt in 2009–15. They identified two broad (categories of) causes for this development: large government budget deficits, which had to be financed with new debt, and high debt service costs. Each year in 2009–14, Croatia ran budget deficits of more than -5% of GDP (Eurostat 2019a). My interlocutors argued that the chief reason for the large deficits was inadequate fiscal consolidation – in other words, inadequate response of the government to reduced public revenues and increased needs for public spending at the time of recession. In general, they criticized insufficient cuts on the expenditure side of the government budget and especially cuts in what they called current expenditure (*tekući rashodi*) or current consumption (t*ekuća potrošnja*) as opposed to capital expenditure.

The current expenditure categories that they mentioned particularly often as insufficiently slashed were public sector wages and pensions. Several interlocutors argued that Croatia had a very large and costly public sector (or more narrowly public administration) and that the government failed to reduce employment in this sector even at the time when employment in the private sector was falling. In doing so, they reproduced, without quoting specific figures or data sources,[8] an established public narrative about excessive public sector in post-Yugoslav countries (Mikuš 2016). At the same time, they generally ignored or underplayed the long period of the "freezing" of public sector wages (suspending their revalorization to keep pace with inflation) in 2009–16. One interlocutor, an economist, dismissed the fixing of nominal public sector wages as wholly inadequate in a context where other countries in the neighbourhood

[8] Relevant data are not readily available. Eurostat database does not contain any data on employment in "public sector" as opposed to "private sector". The relevant national accounts and Labour Force Survey (LFS) data use a sectoral classification that cuts across the public/private sector divide and hence can be only used to make, at best, very rough approximations of public sector employment. However, one study citing International Labour Organisation (ILO) data for 2005–8 found that while Croatia's share of employment in public companies was indeed above EU average, the more significant share of general government employment was average (Radić 2016: 30). Another work referring to a common approximation for public sector employment found that Croatia's share of combined employment in three sectors in which much of public sector employment is concentrated (public administration, defence and social security; education; health and social work) was actually one of the lowest in the EU in 2017 (Franjčević 2019: 27). While the GDP share of government spending on general public services in the same year was indeed noticably larger than the EU average, the share of education spending was only 0.1 percentage point above average and health spending was below the average (Eurostat 2019b).

were making “more significant cuts in material rights and everything else” (I-005). Only one interlocutor, a ministry official (I-015), even mentioned (in response to my specific question) the 3% cut to all public sector salaries in February 2013.

Regarding pensions, interlocutors typically argued that Croatia had a very high share of pensioners[9] who were of low average age as well as a very high share of so-called “privileged pensions” (*povlaštene mirovine*),[10] all of which resulted in excessive and unsustainable public pension expenditure. However, comparative data complicate this claim. While the Croatian pension system indeed displays a number of problematic features, such as high incidence of very low pensions or extensive special privileges afforded to war veterans in a context of clientelistic politics (Dolenec 2018), Croatia’s overall pension spending of some 10.7% of GDP in 2015 was in fact 2.1 percentage points lower than the EU average (Eurostat 2018). Overall, then, these arguments should be treated with some caution and as potentially influenced by received wisdom in the relevant epistemic communities as well as wider public narratives.

In general, interlocutors argued that the Croatian governments in the period of recession were unwilling to sufficiently reduce current expenditure for political reasons, and some argued that they instead reduced capital expenditure, which was detrimental for economic growth and development – it was “austerity in wrong places”, as one interlocutor described it (I-002, economist).[11] As the business journalist put it, “it was necessary to feed the vast state apparatus that serves as a voting machine” (I-009). Similar arguments were voiced about pension spending, sometimes with arguably good arguments. Interlocutors thus adopted a position of technocratic, fiscally conservative experts (though allowing for public spending where it would directly contribute to development, mostly defined in terms of GDP growth), by definition critical of populist, fiscally imprudent and developmentally inapt politics.

In addition to the existing debt legacy and inadequate fiscal consolidation, interlocutors mentioned two other broad categories of causes of rapid debt growth: high debt service costs at

[9] Croatia’s system dependency ratio (the number of pensioners divided by the number of workers) was the third highest in ECE-11 in 2006 and the highest in 2014, at which time it stood at about 88% (meaning there were 88 pensioners for 100 workers) (Krpan et al. 2019: 481).

[10] This is an informal term for pensions that are “not related to [a] previous pension insurance period or received wages and paid contributions” (Bejaković 2019: 232). These pensions are generally based on various special provisions that are not part of the Employment Insurance Law and, according to the pension system expert I interviewed, are more appropriately described as a “system of awards or a system of compensation” as opposed to “real”, “earned” pensions (I-014). There are 17 different categories of privileged pensioners, the most numerous of which are veterans of the 1990s Croatian war who receive significantly above-average pensions. In 2014, privileged pensions made up about 15% of all pensions (Vukorepa 2015: 291).

[11] There is some evidence to support this claim – capital expenditure i.e. expenditure for the “procurement of non-financial property” dropped from 3.7% of GDP in 2002 and 2005 to 1.7% in 2010 and remained at the level of ca. 2.5% in 2015–16 (Šimović 2017: 16).

the time of recession (see a separate section below) and one-off events with significant negative impact on the public sector. According to one of the CNB officials,

> *[the growth of public debt during crisis] was actually a mixture, when one looks at the decomposition of public debt … it was roughly 50/50 contribution of the snowball effect, that is a negative relationship between [GDP] growth rate and interest rates, and of [budget] deficits that were constant in Croatia from 2009 all the way to 2015.* (I-017)

However, the official immediately qualified their claim about "roughly 50/50 contribution" of the snowball effect and deficits by pointing (like other interlocutors did) also to the aforementioned methodological changes as something that increased debt statistically. At a later point in the interview, they further referred to various one-off events that resulted in additional debt. Other interlocutors also mentioned such events, especially acute liquidity problems of large public companies or "strategic" private companies necessitating costly government interventions (generically described as *sanacija*, literally sanation, rehabilitation), sometimes on the basis of previously issued government guarantees. Major "sanations" mentioned by interlocutors were those of shipyards (Bajo et al. 2016), the Agrokor conglomerate, and state hospitals that had accumulated large debts.

**Public debt as a problem**

Interlocutors' opinions on whether Croatia had a problem with its public debt were quite divided and ran the whole gamut from a firm "no" (I-008, a pension fund manager) to an equally emphatic "yes". Two economists (I-002, I-005) were particularly critical and, to my explicit follow-up question, responded without hesitation that they could imagine Croatia defaulting. Both argued that the recent debt reduction was not as much the government's achievement as a reflection of a boom stage of the business cycle, and hence not sustainable. One of them likened Croatia to a "patient kept alive by machines". Two such "machines", tourism and remittances, made it possible to fund current account deficits but this only postponed the bust that would inevitably come. The interlocutor argued that the failure to make radical cuts in public spending made Croatia unprepared for the eventual downturn in financial markets and could result in politicians attempting to "defend the budget" (i.e. refuse to make necessary cuts) even at the cost of default. What is more, default could be especially painful for Croatia due to its insignificance and lack of alliances within the EU:

> *Unlike Greece, Croatia is geostrategically insignificant ... Considering that we don't have the euro and that we have less than four million inhabits, I like to say that we will default in silence, nobody will even notice that we have defaulted, the European Union won't even feel that. Croatia is such a small, small* speck [of dust]*, we cannot even count on the kind of help from the European Union that Greece received. ... Croatia has a zero coalition potential in the EU, it cannot join the Visegrád group, it cannot join Mediterranean countries, it cannot join anybody.* (I-002, economist)

Most interlocutors, however, gravitated to various kinds of more nuanced (or, less generously put, ambiguous) responses. Especially common was an argument according to which public debt was not a problem at the time of interviewing but would likely re-emerge as a problem when the next major shock happens.[12] These interlocutors, who came mainly from the ranks of regulators and experts, generally acknowledged recent debt reduction but did not see it as necessarily sustainable in the long run without additional reforms. They pointed to the then felicitous conditions in both financial markets (historically low debt service costs due to low interest rates and quantitative easing policies) and the real economy (the general conjuncture in Europe and the world). None of this could last forever, they warned – the currently extremely loose monetary policies would have to be tightened at some point and the business cycle would turn down. As several interlocutors further pointed out, Croatia's economy has become overly dependent on tourism. Indeed, both direct and total contribution of tourism to GDP has been steadily growing since 2012 and reached 11% and 25% of GDP in 2018, the first and third highest in Europe, respectively[13] (World Travel & Tourism Council 2019). Interlocutors generally refused the idea that tourism could be sufficient as a basis for economic development, arguing that Croatia's dependence on this volatile industry made it vulnerable to sudden shifts in consumers' preferences and one-off events, for example a possible terrorist attack on the Croatian Adriatic coast. Several interlocutors also mentioned demographic changes – especially population ageing due to low fertility rates – as a factor that will likely threaten the sustainability of public debt and more broadly public finances in the long run. A final recurrent argument alleged that the reduction of public expenditures was still insufficient and that this could

[12] As a temporal variation on this type of answer, one of the Finance Ministry officials said that the trend in 2009–15 was unsustainable: "Maybe it was possible to go on like that for another year or two [but] after that markets would certainly say 'Game Over', like in the case of Greece" (I-015). However, regarding situation at the time of interviewing and future trends, they were much more upbeat and emphasized the successful debt reduction.

[13] Only Iceland and Albania had higher total contribution of tourism to GDP in 2018.

undermine the sustainability of public debt when the situation in financial markets and/or the real economy deteriorates; this subject is discussed in more detail in the section on fiscal policy.

An alternative kind of response made by several interlocutors was to say that Croatia's "real" problem was not public debt but something else. One of the private bankers (I-010) argued, somewhat unexpectedly, that the real problem, long-term, was basically austerity (without using the term) – the lack of public investments in things like education, research and development, and health care. The HANFA official (I-011) told me that the real problem was the weak economy that was expected to enable repayment of the debt, pointing especially to the dependence on tourism and a lack of reindustrialization compared to other ECE countries. One of the economists (I-016) argued, somewhat scholastically, that Croatia did not have a problem with its public debt but with sectors that were the "drivers of public debt" – shipyards, the state-owned road companies, and hospitals that generated recurrent debts to pharmaceutical companies. The business journalist (I-009) and one of the private bankers (I-007) articulated the same conviction that as a result of the recent boom in both public and private debt, a "social consensus" had been reached about the dangers of excessive borrowing and such an episode was unlikely to repeat itself – at least not while the current generation of voters held politicians accountable, the banker added.

One of the CNB officials (I-017) offered an elaborate optimistic account of the current state and prospects of Croatia's public debt. They argued that measures had been taken to prevent a similar explosion of public debt even in case of another major "shock" in the future. Before the crisis, there were constant government deficits, fiscal policy was highly procyclical, and hedging instruments were less readily available. In contrast, at the time of interviewing, Croatia was running budget surpluses,[14] fiscal policy was still procyclical but definitely less than before, the share of foreign currency debt in public debt has been reduced, the remaining unhedged US dollar bonds were about to be repaid, much of the debt has been refinanced on good terms, and the economy was also much better prepared for the next crisis – there has been a general restructuring, many bad companies that used to drag the whole economy down closed shop, and the growth model was more diversified than before, based not only on consumption but also investments and exports. According to the CNB official, future "one-offs" with major negative impact on public debt were unlikely as the long-standing issue with shipyards (see Bajo et al. 2016) was being resolved for good just at the time of interviewing (in

[14] Croatia has achieved its first budget surplus since 2001 (when the Eurostat data series starts) in 2017 (0.8% GDP) and another, more modest one in 2018 (0.2%) (Eurostat 2019a).

essence by letting these companies go bankrupt) and after failures of several small banks, the remaining banks appeared sound.

**Debt service costs**

In general, my interlocutors believed that Croatia's debt service costs had been high in comparison with other ECE countries until recently or indeed still were at the time of interviewing. As Fig. 1 shows, Credit Default Swap (CDS) spreads for Croatian government bonds in 2009–10 were higher than those for Czech, Polish and Slovak bonds but below the levels of Bulgarian, Hungarian and Romanian bonds. From 2011 onwards, however, Croatian CDS spreads were regularly higher than Bulgarian and Romanian spreads as well, second only to Hungarian spreads. Fig. 2 reveals that situation became even more dramatic from late 2013 to mid-2017 when spreads for Croatian bonds remained consistently and significantly higher than those for the bonds of all eight ECE-11 countries included in the graph (the three countries not included are Estonia, Latvia and Lithuania). From early 2016 to mid-2017, CDS spreads on Croatian bonds gradually converged with spreads on other ECE bonds but nevertheless remained one of the highest in the region up to now.

In addition, since late 2012, Croatia's credit ratings by the three major credit rating agencies were all below the investment grade and its bonds were formally classified as "junk". Standard & Poor's was the first to return Croatia to the lowest investment-grade category (BBB-) in March 2019, followed by Fitch in June. The degrading has had noticeable effects on Croatia's cost of borrowing. While the interest rate for a 7-year EUR-denominated eurobond issued in 2003 was 4.625%, it was 6.5% for a 6-year eurobond in 2009 (when international bond issues were resumed after a break of five years) and it peaked at 8.875% for a 7-year eurobond issued in 2011 (Table 1). Trends in the domestic market were similar: while the interest rate on a 10-year EUR-denominated bond issued in 2007 was 4.75%, it was 6.5% for the same bond in 2010 (Table 2). However, interest rates returned to the pre-crisis levels or below much faster than CDS spreads or credit ratings: in the eurobond market in 2014 and in the domestic market, in which there were then no new issues, a year later.

There was little controversy among my interlocutors that Croatia's debt service costs were comparatively high. What was interesting, however, was that several interlocutors were willing to question the objectivity of Croatia's credit ratings, risk premia and, ultimately, price of debt, while others, especially private bankers, refrained from making such arguments. I have already referred to the argument about how the supposed contribution of the architecture of

Croatia's pension system to its financial stability was insufficiently appreciated by investors and other actors; this was often extended also to the evaluation of the price of debt. One of the pension fund managers (I-004) mentioned a recently published Croatian article that argued that Croatia should have had an investment-grade credit rating a long time ago, considering the assets accumulated by pension funds. Other interlocutors hinted that stereotypes and received wisdom might have worked against Croatia. For example, one of the economists (I-001) described it as unfair that Croatia's risk premium at the time of interviewing was still higher than Bulgaria's and Romania's premia, arguing that Croatia was obviously more developed. In their opinion, this was down to "perceptions" influenced by the legacy of the 1990s, the ongoing tense relationships in the post-Yugoslav region, and Croatia's general "lagging behind" in processes such as EU integration, integration into the Schengen Area and euro adoption. A similar point was made by one of the MoF officials who suggested that Croatia might have been "damaged" (*oštećena*) especially when it came to a qualitative component of credit ratings:

> *Ratings consist of two components, one is measurable and the other is less measurable or qualitative and this is where Croatia has been, so to say, damaged by its ratings and perceptions, in our opinion the perception was not necessarily correct. It was about, I don't know, the fact that [Croatia] has come out of the war or political relationships in the region which created a perception of possible risk…* (I-015)

The business journalist (I-009) argued that Croatia should have had an investment-grade rating for some time now, considering the past several years of economic recovery, and hinted that credit rating agencies might have been deliberately keeping Croatia in the junk category to increase the pressure on the government to implement neoliberal reforms. The same interlocutor noted that financial markets responded to recovery faster than the rating agencies: interest rates reached the level of investment-grade countries before the ratings improved, which was a pattern already seen before. As this shows, interlocutors reserved most criticism for credit rating agencies; one of the economists described them as "inert" (I-001) while one of the pension managers noted that "financial markets seem to value our bonds more than rating agencies" (I-004).[15] In general, then, rather than necessarily seeing the price of Croatia's debt as objective and based on expert knowledge and impartial parameters, some interlocutors,

[15] One of the CNB officials (I-013) speculated that the agencies might have been postponing Croatia's return to the investment grade until it became clear how the government managed to resolve the issues with the shipyards and Agrokor.

mostly from the ranks of regulators and experts, saw it as influenced by irrational attitudes, insufficient knowledge or even covert agendas.

At the same time, interlocutors, including those who doubted the objectivity of Croatia's credit ratings and risk premia, discussed various broadly relevant and legitimate causes for their worsening and the increase in debt service costs after the crisis. Predictably, one of the most frequently mentioned factors was Croatia's comparatively long and deep recession in 2009–14, which has cumulatively reduced real GDP by 12.5% (EG Economic and Financial Affairs 2015b: 3). Several interlocutors laid the blame on the social-democratic government in 2012–15. One of the CNB officials (I-006) stressed that the loss of investment-grade rating came shortly after that government published its budget plan for 2013. According to him, "markets and investors" were expecting a continuation of fiscal consolidation and the "frontloading" of austerity measures (such as wage and benefits cuts) to the beginning of the government's mandate but the budget plan completely failed their expectations. One private banker (I-007) linked the growth of risk premia directly to the social democrats' supposed "nonchalant" approach to public finance reflected in large deficits and quickly growing public debt,[16] contrasting this to a prudence of right-wing governments since 2016. The same interlocutor mentioned that the growth of Croatia's risk premium was determined especially by investors' future projections that started to look alarming due the fast growth of debt at the time. Another private banker (I-010) pointed to the fact that Croatia's loss of investment-grade ratings was not paralleled by its "peers", i.e. other countries in East-Central Europe. At the same time, this interlocutor noted that although there was an expectation that this would make Croatia's borrowing catastrophically expensive, this did not really happen. The loss of ratings coincided with the loss of yields on the "benchmark" bond, the German Bund, so when Croatia's high risk premium was added on top of the benchmark, the final price was not as high as expected. At the same time, negative yields on the Bund prompted investors to look for alternative investments with renewed vigour.

The reasons that interlocutors identified for the reduction of risk premia and interest rates for Croatia's debt since 2016 mirrored the reasons they gave for their previous growth. Most frequently, they mentioned debt reduction, fiscal consolidation, economic recovery and the long-expected return to the investment grade as circumstances that improved investors'

[16] The responsibility of the largest Croatian political parties for the growth of public debt is, in fact, more distributed than this interlocutor argued. From end-2011 to end-2015, which roughly corresponds to the duration of the government led by the Social Democratic Party (SDP), the nominal value of public debt increased by ca. €71bn, i.e. about a third (the interlocutor claimed it increased by €100bn). However, during the reign of the previous government of the right-wing Croatian Democratic Union (HDZ), public debt increased by ca. €77bn from end-2008 to end-2011, and during the reign of all three HDZ governments in 2004–11, it increased by ca. €124bn (Table 3).

projections and ultimately their confidence. One of the private bankers argued that Croatia was following a broader trend of a closing gap between the Bund and ECE issues. The latter became “goods in high demand” because all governments in the region were making more or less consistent efforts to behave responsibly. However, the interlocutor argued that the relationship of demand and supply was particularly favourable (from the perspective of the government) in Croatia’s case, considering that demand was increasing at the same time as supply was constrained due to the debt reduction efforts:

> *So the playground is very crowded, there is a lot of investors, it seems that their number is growing and their appetites are growing as well, but there are fewer and fewer [bond] issues.* (I-007)

One of the CNB officials (I-017) also alluded to the effects of collective market behaviour when arguing that Croatia’s risk premium fell so much and so fast because at one point, investors wanted to make up for “years of neglect” of Croatian bonds and their sudden large purchases compressed Croatia’s risk premium so much that it was perhaps even too low at the time of interviewing, considering economic fundamentals.

**Sovereign debt management**

Interlocutors generally believed that the influence of public debt on public policy has increased in recent years. According to one of the CNB officials (I-017), public debt went from being practically invisible as a policy consideration to marking the entire mandate of the social democratic government (2012–15). Unlike some other interlocutors who, as we have seen, denied that government’s commitment to fiscal prudence, this interlocutor made the exactly opposite argument that “all reforms” in that period – cuts to public sector wages, reduction of some welfare benefits, introduction of means-testing in the welfare system, tax increases – were consequences of the “explosion” of public debt and the need to stabilize debt and budget deficits. They further said that this influence of debt on policy continued “to some extent” under the government incumbent at the time of interviewing (the government of the conservative HDZ led by PM Andrej Plenković), which defined a stabilization of public finance as one of its priorities. This implied especially debt reduction and “approximating” the Maastricht Treaty criterion of a public debt/GDP ratio of less than 60% in order to make progress towards euro adoption.

In this section, I will focus on interviewees' comments on debt management policy, moving on to fiscal policy more broadly in the next section. Interlocutors tended to articulate their comments in normative terms. Many thus praised debt management policy under the current government; as we saw, one of the economists even claimed that Croatia's debt reduction in recent years was unprecedented. In addition to debt reduction, several interlocutors appreciated also the reduction of debt service costs (see Mikuš 2019b, Table 2), which they attributed to the refinancing of existing debts at better conditions. One of the CNB officials (I-012) mentioned the refinancing of the debts of road companies as a particularly praiseworthy example (for details, see Ministry of Finance 2018: 8, 12, 15). Interlocutors credited these achievements especially to the incumbent Finance Minister Zdravko Marić (HDZ) whom they perceived as highly competent precisely in the field of finance. One of the economists referred to this perception by saying that "if the current minister had failed to do something even in this area, he would have been completely incompetent" (I-005).

Another economist said that the relevant sector at the Ministry of Finance, the Public Debt Management Directorate (*Uprava za upravljanje javnim dugom*; "Directorate" from now on), had visibly improved – at one point, it only had some two workers, but in the meantime it expanded and was reorganized into a front, middle and back office, „literally like in the bank" (I-016). One of the Ministry of Finance officials (I-015) confirmed that this reorganization occurred as part of a deliberate strategy of emulation of best practices elsewhere, which relied on foreign aid and advice. Two interlocutors also highlighted the fact that the incumbent government resumed the practice of regularly adopting an updated *Public Debt Management Strategy* in 2017 (the last *Strategy* before that, for 2011–13, was published in 2011). One of the latter two persons, an economist (I-016), claimed that this had been politically blocked under the SDP government in 2012–15.

The same economist highlighted savings that the government achieved by using financial derivatives (namely currency swaps) to hedge against foreign exchange risk associated with dollar-denominated debt. This practice, which was initiated by Finance Minister Martina Dalić (HDZ) in 2011 and continued by the SDP government, was estimated to have saved more than €1bn in total (Klepo 2015). This interviewee mentioned the so-called "crisis tax"[17] as a measure that "annoyed the whole population" while supposedly having a smaller "fiscal effect" than a single swap operation arranged by the Finance Ministry. This was a problematic comparison, since the tax still brought actual revenues (however meagre) while

[17] These were additional taxes on most kinds of personal income (above the census of 3,000 kuna per month and with a single-step progression above 6,000 kuna) introduced by the government of PM Jadranka Kosor (HDZ) in 2009.

the swap operations merely enabled savings on expenditures on debt service. However, the comparison served the interviewee's aim of depicting financialized sovereign debt management as a would-be solution to public finance issues as well as one that was superior to tax increases. Consistently with this broadly neoliberal orientation, they argued in another point in the interview that "tax policy has become a fetish" in Croatia while the focus should have been much more on expenditures.

At the same time, critiques of sovereign debt management policy and practice were probably even more numerous. As already mentioned, two economists (I-002, I-005) dismissed the recent debt reduction as a more or less spontaneous by-product of felicitous current conditions (GDP growth, low interest rates) or, as one of them put it, an "issue of luck" rather than government's achievement (I-005). What was missing was a more serious effort to reduce expenditures, i.e. radical changes in overall fiscal policy (see below). Regarding debt management policy per se, two economists (I-002, I-003) questioned the focus on reducing debt/GDP ratio alone, which relied on a combination of GDP growth and keeping the nominal value relatively constant since 2015 (see Table 3). In their opinion, the government should also strive to reduce the nominal value of debt because otherwise "we have to pray for GDP growth" (I-002) and this puts the sustainability of debt reduction in doubt. As this interlocutor believed, it was vital for euro adoption that Croatia can demonstrate a reduction of both debt/GDP ratio and the nominal value of debt. However, the Maastricht Treaty and the European Fiscal Compact refer only to the former. In response to my direct question, two CNB officials (I-012, I-013) rejected the argument that reducing the nominal value of debt was important and pointed out that the internationally relevant measure of public debt was debt/GDP ratio. However, one of them said that the question remained whether the recent debt reduction was sufficient and argued that it would be desirable if the government set itself an objective in terms of a debt/GDP ratio with which it wanted to await the next crisis so that it would subsequently have some room for increasing debt (in order to conduct countercyclical fiscal policy) without provoking a strong negative reaction of markets (I-013).

Beyond the appropriate pace and metric for debt reduction, interlocutors questioned also particular features of Croatian sovereign debt management. A substantial number of interviews criticized especially its transparency and efficiency defined in terms of market competition. Two economists (I-001, I-016) and one CNB official (I-012) mentioned that there was no "calendar" of government bond issues, which complicated investors' planning and put in doubt the

transparency of Croatia's public debt.[18] One of the economists (I-016) gave a fairly correct estimate of the persistently significant share of loans in total public debt (ca. 31% in end-2018, see Table 3) and implicitly criticized it as something that reduced the marketability and transparency of public debt and ultimately the credibility of Croatia as a debtor. The same interlocutor pointed to broader limits on market competition in the Croatian capital market:

> *Basically, public debt in the primary market works, issues sell easily, what is still missing is a...* commitment*, as they say, to developing the domestic market. These are small, shallow markets* [ECE capital markets] *dominated by a few players. If there are five of us, it is unlikely that we won't go for a coffee together and ... divide the market between ourselves.* (I-016)

Another economist (I-001) noted that Croatia's government bonds were not very liquid as investors typically preferred to buy to hold them (motivated by what this interviewee believed were excessive yields) and this resulted in a weak secondary market. These comments were confirmed by the HANFA official (I-011) who noted that there was very little trading with Croatian government bonds in the regulated market, i.e. in the Zagreb Stock Exchange (ZSE). Most of the trading was done over the counter (OTC), i.e. off-exchange and directly between the parties, by large institutional investors such as banks, pension funds and insurance companies. Indeed, the data obtained from the ZSE, which collects some data not only on regular (order book) trading but also block[19] and OTC trading, shows that from 2003 onwards, the share of regular trading in the total turnover in government bonds has rarely exceeded 5% and stayed below 2% in most years (Table 4).

The HANFA official believed that regular trading was more transparent and market-like and argued that OTC transactions were "not a real market relationship" because there were no public offers of which any market participant, even one without a prior knowledge of the seller, could take advantage. In response to my question, the official agreed that a higher share of regular trading would probably make Croatia's public debt cheaper: "Of course the state would finance itself more cheaply if the relationship of supply and demand operated more widely. If it

[18] The Croatian version of the Ministry of Finance website contains a section entitled "Bonds – Annual issuance plan", but at the time of writing it contained only outdated information for 2017 and even this was very rudimentary information limited to expected volumes of issues for "domestic market" and "international market" and the quarter/quarters in which the issues were expected to take place (Ministry of Finance n.d. b). The issue plan for 2019 was published in the most recent *Public Debt Management Strategy for 2019–21* but it remains limited to information on expected emission volumes and quarters (Ministry of Finance 2019: 38).

[19] "A block transaction (*blok-transakcija*) is a transaction with a financial instrument listed on the regulated market or accepted for trading at an MTP [multilateral trading platform], which includes a member or members of the [Zagreb Stock] Exchange and is agreed upon privately but by means of the trading system of the Exchange" (Zagreb Stock Exchange 2013: 11).

was more transparent" (I-011). Importantly, the HANFA official hinted that the issue of limited competition and transparency went beyond secondary market to primary issuance – the government had the option of conducting primary issuance through the stock exchange but instead chose to do it "through Bloomberg [electronic platform]". While the interviewee refused to speculate about the government's motivation for maintaining this status quo, they gave the following hint:

> *Look, issuing government bonds is difficult. When somebody buys your debt, you have to have a negotiating position for some future financing. So that probably also plays a role. –* ***So it's actually about maintaining relationships.*** *– Yes. Otherwise you could end up like Argentina, your debt gets bought up by hedge fonds and you know what they do with you then... So it's not that easy on [the government's] side.* (I-011).

When I asked one of the CNB officials (I-013) whether they thought that cheaper borrowing could have been enabled by a higher share of transactions in the regulated marked, they said "probably yes". In response to my question why the status quo was being maintained then, they said that it was "probably the issue of resources that those auctions require, it is necessary to invest more resources in communication with all potential investors", while qualifying this as a mere assumption. Another CNB official (I-017) agreed with my suggestion that a different technique of selling debt, such as auctions, would enable greater competition between investors:

> *Yes, most likely it would, as well as through public offering, I mean, at the moment you only have one limited group of investors from the financial sector so there isn't that much competition between them, if we opened [investing into debt] also to citizens, businesses, it could have a significant influence on that...* (I-017)

This interviewer considered such an opening as important also for the development of the secondary market in bonds and the kuna yield curve as one of the channels of monetary policy transmission (on the assumption that this opening would be based on kuna instruments). They further argued that Croatian banks (both directly and indirectly, through pension funds owned by the same mothers) were too exposed to the Croatian public debt and such a diversification would thereby contribute to a greater stability of the overall financial system. The same point about the lack of openness towards retail investors was made by one of the economists (0-001) who recounted that there was some talk about introducing so-called "people's bonds" at the time

of the mandate of the SDP Finance Minister Slavko Linić (2011–14) but this never materialized. This interviewee also criticized the focus in Croatian government borrowing on the European market, "there was a bit of the American [market] and even that was in the conditions of crisis – when Europe was too expensive, we went to America like everyone else" (I-001). Earlier there had been Croatian bond issues in Japan, but not anymore, and other markets, such as China and Middle East, were never targeted. The Finance Ministry official in charge of sovereign debt management (I-015) noted that the ministry would maintain the orientation to the eurobond market, which it considered Croatia's "natural" market. At the same time, they said that considering the improved credit rating and reduced gross borrowing requirements, the current plan was to rely even more than before on the domestic market that was "very liquid and mature", in particular thanks to the presence of pension funds (see below).

At this point, it is useful to briefly describe practices of primary issuance of Croatian government bonds to understand what interviewees were criticizing. In government documents such as the *Public Debt Management Strategies* and annual reports on public debt, Croatia distinguishes two broad categories of its government bonds: domestic bonds (*domaće obveznice*), which are issued in Croatia and listed on the ZSE, and "international bonds" (*međunarodne obveznice*), which are issued globally and typically listed on the Luxembourg Stock Exchange. Domestic bonds are either denominated in the kuna or indexed (with the use of the so-called "currency clause", *valutna klauzula*) to the euro; the value of euro-indexed bonds is expressed in the euro but the kuna is still the means of payment. In the financial community, Croatian international bonds are alternatively referred to as "eurobonds" (*euroobveznice*, *eurobondovi*). Active Croatian eurobonds are denominated in the euro or the US dollar; according to the bond issuance specialist (I-009), the latter are intended for both the European and the US market, as a result of which they have to comply with somewhat different regulation than euro-denominated eurobonds. In the past, Croatia also issued several "foreign bonds" (*vanjske/strane obveznice*), i.e. bonds issued in a single foreign country in its native currency. In particular, there have been several "samurai bond" issues (yen-denominated bonds listed on the Tokyo Stock Exchange) in 1999–2003, but not more recently. All domestic bonds and all international bonds except two London Club bonds issued in 1996 (the very first bonds issued by the independent Croatia) had fixed interest rates (Tables 1 and 2). This is a major difference vis-a-vis Croatia's bank loans that come quite frequently with variable interest rates, usually defined as a variable EURIBOR or LIBOR rate plus a fixed margin (see annual debt reports at Ministry of Finance n.d. b). Even then, the share of fixed-interest debt in total public

debt has been growing in recent years and reached 89.1% in end-2018 (Ministry of Finance 2019: 45).

While my interlocutors did not use this term directly (they talked merely about the creation of bank syndicates), Croatia uses a technique of sales of primary bond issue called syndication.[20] There are three main types of public debt selling techniques: auctions, syndication and issuance on tap (Fastenrath et al. 2017: 288, n. 12). According to Fastenrath et al. (2017: 282), auctions are a major indicator of the financialization of sovereign debt management since prices of government securities come to be determined by competitive bidding. They are also seen as more transparent and predictable than syndication and other selling techniques (Dyson 2014: 342). Syndication, on the other hand, means that a syndicate of banks ("lead arrangers/managers", *aranžeri/voditelji izdanja* in Croatian) underwrites the whole issue, i.e. commits to buying any unsold securities, and is responsible for selling it to final investors. Syndicate members for domestic bond issues are typically 4–5 major Croatian banks; since 2010, the same syndicate of four leading banks (Erste, Privredna banka Zagreb, Raiffeisen, Zagrebačka banka) managed all domestic bond issues. Syndicates for international bond issues tend to have a membership of 3–5 major international banks (Barclays, Deutsche Bank, JP Morgan, Citigroup, BNP Paribas, Merrill Linch), potentially including one or two mothers of major Croatian banks (historically only Erste Group, Raiffeisen Bank International, Société Générale and Unicredit) or even a major Croatian bank (in recent years exclusively Zagrebačka banka).

The primary issuance specialist (I-010) described the process of selling Croatian international bonds[21] as follows. In the first step, the government publishes a "request for proposals", to which banks respond with their offers. The government selects a syndicate of banks and the parties conclude a subscription agreement or another type of agreement to regulate their relationships. The banks agree on the division of labour within the syndicate and prepare necessary documentation. The most important document is a detailed "prospectus" that contains information about the issuer and the security required by relevant EU regulations. Another important document is the investor presentation, which is a distilled version of the prospectus. Next a "roadshow" is held – a fast-paced mini-tour of financial hubs to present the

[20] However, auctions are used to sell treasury bills (kuna- and euro-denominated) issued by the Ministry of Finance. According to Ministry of Finance (n.d. c) statistics, there were dozens of such auctions each year since 2005. Since 2007, Bloomberg Auction System is used to conduct these auctions. T-bills represent a relatively minor, although not insignificant share of Croatia's public debt – 12.7% in end-2018 (Ministry of Finance 2019: 19) – and these auctions should be therefore considered as one of the signs of an ongoing financialization of Croatian sovereign debt management.

[21] They noted that domestic bond issuance was broadly similar but there were some differences, e.g. no roadshow.

upcoming issue to investors. In the Croatian case, London and Frankfurt are typical destinations, but roadshows also targeted cities like Amsterdam, Milan, Munich or Vienna. Representatives of the government, preferably the Finance Minister, are present at the meetings. The roadshow is a chance for face-to-face communication between the issuer and investors. It also serves to elicit investors' feedback on a potential price of the security; this input as well as regular "market update calls" in the run-up to the issue are used to determine the initial price range. In the pricing process, an asset swap with the same maturity as the security in question is used as a benchmark, on top of which is superimposed, first, risk premium determined by comparison with similar issues (Croatia's previous issues as well as recent issues of its peers – geographically close countries with similar credit ratings) and, second, new issue premium based on the current market situation.

Typically immediately after the roadshow, "book-building" is conducted through an on-line system on a single day from the morning until early afternoon. "Initial price thoughts" (typically as a range of risk premia) are released and investors' non-binding orders, which may or may not be price sensitive, are received in the order book. After an hour or two of book-building, the price range may be updated (shifted, narrowed, broadened etc.) based on how book-building unfolds and how high demand is in relation to the target volume of the issue. Two or three price updates may take place and investors may respond by modifying or cancelling their orders. The closing of the order book is then announced and orders remaining in the book after the cut-off point are used as a basis for final pricing, which is done through a negotiation between syndicate members and the issuer and considers the rate of subscription and the composition or orders in terms of price sensitivity.

The final step in primary issuance is allocation, which is again based on negotiation and compromise between the syndicate members and the issuer. It is supposed to be done "on a fair principle", which in practice seems to boil down to "nobody should be deprived too much or rewarded too much" (I-010). The allocation process typically starts with a preliminary pro rata allocation – for example, if the issue volume is €1bn and there are €2bn worth or orders, every investor gets a half of their order – and continues with "fine-tuning". The issuer may express its preferences but generally does not interfere too much, and "of course each bank wants to give more to their own" (I-010). For example, if one of the banks in the syndicate is a "regional" bank such as Erste or Raiffeisein, it will lobby for investors from Austria, Slovenia and the like. Another consideration is investor size – "Tier 1" investors, i.e. leading US or London-based asset management firms such as BlackRock or Pioneer Investments, have to be given "at least 50 million". Otherwise they might lose interest in future Croatian bonds and this is an outcome

that needs to be avoided at all costs because these investors always have money to invest, which may be especially important in crisis conditions, and because compared to smaller investors, they are more likely to buy to trade, which increases bond liquidity. However, considering the relatively small volumes of Croatian issues, this means that there is often not much or even nothing left for “Tier 2” (investors large in European terms, mainly Frankfurt-based) and especially “Tier 3” (“regional”) investors.

As this brief account reveals, there are significant differences between syndication and auctions as the techniques of bond sales. While pricing and allocation in auctions is based on competitive bidding, in syndication they are based on negotiation and consensus. In addition, allocation involves many considerations other than price, especially the need to service the interests of particular investors and maintain relationships, which in turn often reflects and reproduces pre-existing hierarchies and solidarities. Allocation of public debt is a redistributive process that resembles the cutting of a cake where everybody will pay the same consensually determined price per gram but the biggest players and those with best relationships to the arrangers are likely to get bigger slices.

As early as 2011, several Croatian economists criticized the reliance on syndication as obsolete, inefficient and unfit for Croatia’s advanced level of financial market development. Syndication typically results in more expensive borrowing than auctions and tends to consistently reward the same banks instead of stimulating competition (Korunić and Bjelkanović 2011: 121), which fits with the profile of banks that have been acting as arrangers for Croatian bond issues. The reason for the higher price is especially hefty fees of the syndicate, which assumes the execution risk of the whole issue. Indeed, one of the private bankers (I-007) told me unambiguously that the main motivation for banks to participate in syndicates is the fees. They also noted that the “biggest banks” were most likely to participate in syndicates because they were able to underwrite the issues. One could further speculate that the non-competitive nature of the process also increases the cost. In addition, compared to primary dealers (Fastenrath et al. 2017: 282), syndicates do not assume a long-term responsibility for promoting and trading with the bonds in question, and hence contribute less to the development of liquid secondary bond markets (Raspudić-Golomejić 2011: 164–65). The use of syndication increases in the times of sovereign debt crises or more generally financial crises since it reduces execution risk (Dyson 2014: 342; Švaljek and Andabaka Bakurina 2011: 8). The fact that it is used as a permanent selling technique in Croatia could be interpreted as an indication that Croatian debt managers privilege the certainty of successful execution over price considerations even in good times. The Finance Ministry official responsible for sovereign debt management (I-

015) admitted that the issuance of dollar-denominated eurobonds in 2009–13 was motivated by a greater liquidity in the dollar market than in the euro market and a wish to avoid a failure to sell an issue, especially since this would have a detrimental impact on future issues. In the revealing words of one of the CNB officials:

> *It was not a question of whether you will manage to reduce the price by a few BIPS* [basis points] *or not but whether you will manage to execute the transaction at all. Long-term relationships with investors are important – maybe that is also one of the problems with financialization.* (I-006)

There was some controversy over the levels of foreign exchange risk in the Croatian public debt. In end-2018, 62.4% of the total public debt was denominated in the euro, 33.5% in the kuna and 4.1% in the US dollar (Ministry of Finance 2019: 15). While Ministry of Finance (2019: 16) data indicates a somewhat lower share of forex debt in total public debt than ECB data (Mikuš 2019b, Table 2), both data sets suggest some reduction of this share in recent years. Even then, it remains very high and dramatically above both ECE-11 and EU-15 averages. Two CNB officials described the foreign exchange risk of public debt portfolio as a crucial source of risk, but they put forward different solutions: one thought this was a major argument for adopting the euro as soon as possible (I-006), while the other said that increasing the kuna share of debt would be desirable but hinted that the investor pool for kuna debt was more limited (I-013). The Finance Ministry official in charge of sovereign debt management (I-015) said rather unambiguously that "we" have never perceived the euro debt as risky in consideration of the long-term stability of the kuna/euro exchange rate and Croatia's orientation to euro adoption. Another CNB official (I-012) said that the foreign exchange risk was mainly an issue of the perception of investors who do not sufficiently appreciate the overall nature of Croatia's monetary system (which guarantees exchange rate stability) and the fact that much of the forex debt is held by domestic investors, which reduces overall risk.

There was a general consensus among my research participants that the human resources and professional capacities of the Public Debt Management Directorate at the Ministry of Finance remained limited despite some improvements. Interlocutors repeatedly alluded to an insufficient staffing of the Directorate and argued that the civil service salaries that the Ministry was able to offer were insufficient to attract and/or retain competent workers. Several officials said, spontaneously or in response to my follow-up question, that a professional public debt management agency would be a better institutional solution, mainly because it could offer more attractive salaries. One economist (I-001) argued that such an agency could for

example buy back excess bonds and conduct primary issues instead of bank syndicates at a lesser cost but suggested that establishing additional public agencies was a politically unpopular move in Croatia due to the perception that there were already too many agencies. Another economist (I-016) lavished praise on the ÁKK, the Hungarian public debt management agency, as an example of professional, fully transparent and investor-oriented debt management agency that was far ahead of its counterparts in Croatia and other ECE countries. The Finance Ministry official in charge of debt management (I-015) admitted that the Directorate had far fewer workers than debt management agencies in other European countries – 17 at the time of interviewing, of which only 7–8 dealt with debt management agenda proper – but claimed that this did not diminish the Directorate’s capacity for taking all necessary actions. They also questioned the supposed differences between salaries at the Ministry and private financial sector mentioned by others, arguing that the latter were not anymore so attractive due to cost-cutting after the crisis and hence did not cause so much haemorrhaging of civil servants.

**Fiscal policy**

In the section on the causes of public debt, I discussed how multiple interlocutors attributed the fast expansion of public debt in 2009–15 to insufficient fiscal consolidation, which they interpreted as due mainly to insufficient cuts in “current consumption” spending. I also noted how interviewees traced this fiscal policy to populist and clientelistic politics, especially to politicians’ strategy of servicing the interests of significant segments of the electorate (pensioners, public sector workers) in order to remain in power. We have seen that most interlocutors believed that desirable measures, such as cuts in public sector wages and/or employment or cuts in welfare spending, had not been carried out to a sufficient degree or not at all. While there were occasional acknowledgments that the governments in this period did in fact implement some characteristic austerity policies, most interlocutors argued that they did the exact opposite – they sought to increase revenues through additional taxation, which in the context of recession amounted to a pro-cyclical policy. All this indicates a broadly neoliberal and pro-austerity orientation across the Croatian financial community.

The one important deviation from this ideological framework was the frequent claim that fiscal consolidation was achieved at the expense of capital investments (rather than current consumption) and therefore represented “austerity in wrong places”, as one economist (I-002) revealingly put it. This suggests that my interlocutors still saw a carefully delimited but crucial role for state-led developmentalism. Departing from the pro-austerity narrative, some

interlocutors identified a relative lack of public investments in areas such as education, research and development, infrastructure or health as a major problem, especially in the long run, since it would limit sustainable economic growth and development. This further indicates that most of my interlocutors sought to reconcile the neoliberal emphasis on balanced budgets with ongoing commitments to the development of the "real economy".

Relatively speaking, interlocutors tended to praise or at least be more lenient with the fiscal policy under the government of PM Andrej Plenković (incumbent since October 2016) or, more rarely, the short-lived government of PM Tihomir Orešković (an HDZ appointee) that preceded it. I noted that one interlocutor, a private banker (I-007), made an unusually explicit argument that the centre-left government in 2012–15 was particularly responsible for public debt growth and a wider "nonchalant" treatment of public finance. The same interlocutor argued that budget planning under the SDP government started from desirable expenditures without aligning these with reduced revenues, which resulted in the large deficits and rapid debt growth in this period. They contrasted this with the incumbent government, under which budget planning supposedly started from actual revenues and allowed expenditures only within the space they afforded. One of the Finance Ministry officials (I-015) described the government's policy in very similar terms, noting that it was based on "realistic or conservative macroeconomic projections that yield realistic or conservative projections of revenues". Similar arguments about improved macroeconomic projections of the Ministry of Finance were made by at least two other interlocutors, one economist (I-002) and one CNB official (I-012), who both credited this to the EU-led macroeconomic surveillance and discipline within the European Semester framework and its impact on Croatia's conduct of fiscal policy. The CNB official stressed especially what they saw as a positive impact of Croatia's Excessive Deficit Procedure in 2013–17: while the imperative to implement fiscal consolidation came at a very "ungrateful" moment of recession, consolidation had been eventually achieved, a "budgetary framework" (however "approximative") tying expenditures to revenues had been set up, and the dogma that nothing can be done about established expenditures had been dispelled. One economist (I-016) described the resulting institutional arrangement as one in which the Ministry of Finance played the role of a "fiscal board" in relation to other ministries and kept their spending firmly in check. At the same time, several interlocutors noted as a parallel positive development that Croatia had recently started to improve its capacities for the absorption of EU funds and used this to partly compensate for the lack of public investments due to the austerity policy. In a similar vein, the Ministry of Finance official (I-015) complimented their own ministry by describing its policy as

"growth-friendly fiscal consolidation" on the basis of an argument that budget surpluses were not used for additional spending but for tax cuts and public debt reduction.

**Capital flows**

As discussed in more detail in an earlier GEOFIN working paper, balance of payments statistics suggests that Croatia had received substantial cross-border capital inflows during the 2000s credit boom, which gradually declined in volume after the global financial crisis and since 2014 switched to net outflows (Mikuš 2019b: 5). This was in line with the dynamics of capital flows in the wider ECE region in the same period as well as the model of peripheral financialization developed by heterodox economists, which emphasizes volatile and cyclical dynamics of cross-border flows of capital (especially interest-bearing capital) as its key characteristics (Mikuš 2019d: 16–18). Accordingly, I enquired about interviewees' opinions on the chief drivers of this capital flows dynamic in Croatia.

In general, interviewees did not contest my interpretation of statistics, with the exception of one CNB official (I-006) who believed that in recent years Croatia was experiencing merely reduced capital inflows compared to the pre-crisis period, not outright outflows. In general, interviewees attributed the inflows in the 2000s especially to a lack of domestic capital and savings, foreign direct investments (FDIs), mainly brownfield investments in industries like banking, telecommunications and construction, and a built-up demand for credit after a period of extremely high interest rates in the 1990s. One economist thus emphasized how banks channelled much of the economic capital into non-tradable sectors, especially construction, thereby fuelling the housing boom in the 2000s and an unhealthy orientation of Croatia's economy to tourism and rent-seeking. Another economist (I-002) noted that the FDIs mostly targeted "classical monopolies" and argued that these were the only truly profitable fields for foreign investments, considering Croatia's high labour and start-up costs and its notoriously inefficient and corrupt public administration. Now that such industries and companies have been privatized, new inflows of similar magnitude could not be expected. In this interlocutor's assessment, Croatia had already lost a race against other ECE countries that managed to reindustrialize their economies in the right moment. In addition, they attributed the reversal of capital flows to the fact that households and business have been deleveraging after the crisis, which reduced the need for capital inflows into the banking sector and indicated that "Croatia has exhausted a growth model based on debt". One of the CNB officials (I-017) similarly argued that "what could have been privatized has been privatized" and therefore it was unlikely that

similar inflows would occur again in the future. Another CNB official (I-013) described the earlier inflows as mostly debt-creating and not contributing to the increase of export capacities. Pointing to the fact that much of this capital was used to finance public infrastructural projects that were not always economically sound, thus contributing to the large debt legacy, they argued that the reduction of capital inflows was in fact not a problem. It would be desirable if Croatia managed to attract more FDIs that would contribute to the expansion of export capacities, but for that comprehensive reforms were necessary to improve Croatia's competitiveness. The business journalist (I-008) underscored Croatia's elevated profitability precisely in fields like banking and telecoms as a major reason for capital inflows in the 2000s. To back this familiar popular narrative about Croatia as a sort of transitional El Dorado, this person claimed that Croatia, a comparatively small country, was at one point the source of some 30% of profits of the entire Hypo Alpe-Adria-Bank International group, by now dismantled. Accordingly, they attributed the reversal of capital flows especially to the loss of this ultra-profitability, for example in telecoms due to EU regulations on roaming costs and in banking due to problems with bad loans and increased capitalization requirements of the central bank, which led foreign-own banks to sell parts of their portfolios or even exit Croatia completely.

One of the economists (I-001) argued that this process of capital flight was over at the time of interviewing and that inflows would return as soon as the economy starts booming again, gesturing to an arrival of some new players in the banking sector. However, most interlocutors perceived the reversal of capital flows as more or less permanent. As already mentioned, they attributed this shift to the completed privatization of profitable parts of the economy, the exhaustion of the growth model based on debt, and the loss of Croatia's extreme profitability in specific markets. One private banker (I-007) described the earlier capital inflows as part and parcel of the process of postsocialist transition in which countries such as Croatia had to compensate for their inherited lack of domestic capital with foreign capital. The current capital outflows reflected the fact that additional foreign capital was not needed anymore; on the contrary, so much capital has accumulated in Croatia that it was increasingly looking for profitable investments abroad. This interlocutor interpreted this process as a sign of the Croatian financial system becoming more mature, balanced and independent - in a word, “normal”. Two interlocutors also mentioned the increased reliance on EU funding as an additional reason for reduced capital inflows in recent years, suggesting that that the availability and improved absorption of those funds reduced the need for funding (for example of public infrastructural projects) from other sources.

### Monetary regime

I noted in an earlier GEOFIN working paper that a defining feature of the monetary regime in Croatia since mid-1990s has been an informal peg of the Croatian kuna to the euro, which serves as the so-called “nominal anchor” (*nominalno sidro*) of the monetary regime (Mikuš 2019b: 8). Critical Croatian economists argued that this policy prioritized the narrow agenda of price stability and the interests of the financial sector over the development of the real economy inasmuch as it required rigid and overvalued exchange rate and high interest rates, thereby promoting imports rather than exports and fuelling the deindustrialization and peripheral financialization of Croatia’s economy. They also claimed that this policy amounted to a de facto relinquishment of monetary independence, also reflected in the extremely high degree of euroization in Croatia. Critics expect this long-term monetary policy to come to completion in the form of the adoption of the euro. The CNB and the incumbent government are indeed strong promoters of euro adoption and recently stepped up their efforts in that direction with their joint publication of a euro adoption strategy in late 2017 and the initiation of the process of applying for entry into the Exchange Rate Mechanism (ERM II) in July 2019. Importantly, scholarship identifies fixed exchange rate policies and euroization/dollarization as characteristic features of peripheral financialization (Mikuš 2019d: 17–18, 22). Accordingly, I included questions about monetary policy in my interviews.

In general, my interlocutors, from the ranks of experts, regulators and creditors alike, saw Croatia’s monetary policy as the only real alternative that the country had. To begin with, they emphasized that it was necessary and successful in containing the hyperinflation in the early 1990s and subsequently keeping inflation in check. One CNB official (I-017) argued that the 1990s stabilization programme based on the currency peg was “declared the most successful stabilization programme in history”. Furthermore, they argued, it was also correct policy considering that price stability was the CNB’s main objective as well as crucial precondition for economic growth. My interlocutors also pointed to the fact that Croatia is a “small open economy” that is import-oriented and highly euroized (in terms of deposits as well as credits), so letting the exchange rate float could have disastrous consequences. One of the economists (I-002) noted that central bank interest rates were “dead” as a channel of monetary policy transmission so the central bank did not have any “operational alternative” to the exchange rate policy, but did not explain why the interest rate mechanism was defunct. This person further rejected the claim that the exchange rate policy resulted in an overvalued kuna

and thereby harmed exports, arguing that what mattered was real (not nominal) exchange rate and since the global financial crisis there has actually been real depreciation. This was true but it ignored real appreciation up to 2009 (see Mikuš 2019b, Table 1). The CNB official (I-017) likewise argued that real exchange rate, not nominal, mattered for exports and denied that the exchange rate policy could have contributed to deindustrialization since Croatia experienced one of the lowest rates of real appreciation in the ECE region. This interlocutor also rejected the critiques according to which Croatia did not have an independent monetary policy and its central bank, reliant on money creation through foreign currency purchases, was forced to conduct an ultimately pro-cyclical policy. In this person's opinion, the CNB in fact acted like other central banks, including those that target inflation or "have their own interest rate" – it reduced liquidity before the crisis and released it afterwards, only by different means of macroprudential regulation.

In line with these views, most of my interlocutors, again across all three categories, also supported the orientation to the adoption of the euro and believed that its benefits far outweighed the costs. Several interlocutors downplayed the worries that euro adoption would lead to price hikes as exaggerated or wholly unfounded, in one case claiming that "currency can have no influence on prices". Instead, they pointed to the nature of Croatia's economy – its small size, openness, import orientation and high degree of euroization – as circumstances that made this an obvious, if not inevitable policy choice. Two interlocutors (I-002, I-013) argued that Croatia's business cycle was already closely synchronized with the business cycle in the eurozone and therefore the ECB's monetary policy should be suitable for Croatia. One of them argued that the "kuna is merely in the way" – it generates profits for banks and exchange bureaus and costs for everybody else. At the same time, they denied that Croatia could gain much with an independent and flexible monetary policy and especially that such a policy could enable reindustrialization. One of the CNB officials (I-006) argued that the structure of the economy had already adjusted to the monetary policy, with the result that Croatia "does not have an industry anymore" and there are no companies with "some fantastic products" that could benefit from depreciation by increasing their exports. One of the pension fund managers (I-008) likewise believed that "it's done" since there were no exports left and there was little scope for benefitting from national currency. A private banker (I-007) held that the economists arguing for depreciation as a way of helping the industry and exports still assumed an old Marxist or Keynesian model of national economy that had lost its relevance in the contemporary globalized world. As this shows, some interviewees believed not only that an alternative monetary policy would bring few benefits but also that it was in fact impossible. In particular, two

CNB officials (I-006, I-013) argued that de-euroization/kunization, which would be a prerequisite for such a policy, was nearly or totally impossible in Croatia and that there were no instances of countries with Croatia's levels of euroization that would have succeeded in reducing it. One of them (I-013) further argued that the euro would help "discipline" Croatian policymakers in the same way that the European Semester, the Macroeconomic Imbalance Procedure and, remarkably, the ESA 2010 adoption did. In an even more explicit statement of this benevolent self-colonializing attitude, one private banker (I-010) said that it had historically always been better if Croatia was under somebody else's "control" and that the euro would set up "clear rules of the game".

Critical views of the monetary policy and the push for euro adoption were relatively rare among my interlocutors. The business journalist (I-009) argued that Croatia did not use its monetary sovereignty when it could and should have, and as a result it did not have much of it left. Still, this interlocutor believed that euro adoption would deprive Croatia even of those remnants of monetary sovereignty, which was a very problematic position for a small country, especially in times of crisis. Croatia should have been implementing a more "propulsive" monetary policy; at one point, there was 30 billion kuna of liquidity that was just lying dormant in banks. The CNB failed to do anything to increase the share of kuna loans and deposits or to prevent the Swiss Franc debacle (Mikuš 2019a; Rodik 2015; Rodik and Žitko 2015). Instead of being autonomous, it was acting as an "extended arm" of the ECB and the incumbent Governor Boris Vujčić was pushing for euro adoption so much because he was counting on a position in one of the European institutions as a reward.

One of the economists (I-005) admitted that the monetary policy was very effective in containing inflation and providing economic stability, but the problem was that it was never critically evaluated later and no effort was made to explore alternatives; in particular, unlike other countries such as Serbia, the CNB did not do anything at all to reduce euroization. The CNB's only strategy has always been an "exit strategy", i.e. euro adoption, which would enable central bankers to get rid of almost all unwanted responsibility and "live finely and nicely". In reality, Croatia should not hurry to the eurozone since its economy was structurally different from the eurozone and it could easily experience what Greece did: being exposed to the ECB's monetary policy that was not aligned with its own business cycle but the "rest of the eurozone led by Germany". There was still a difference between little monetary sovereignty and no monetary sovereignty and once Croatia adopted the euro, it would not even benefit from the kind of (nominal) depreciation that it experienced in response to the global financial crisis. Neither did Croatia meet the conditions for euro adoption when it came to sustainable growth,

productivity and quality of institutions, which would make a precocious euro adoption harmful rather than helpful. However, the interlocutor worried that the eurozone could still allow Croatia in just to demonstrate the continued viability of the euro.

**Pension funds and the pension system**

In an earlier GEOFIN working paper, I noted that Croatia has accumulated the highest GDP ratio of pension fund assets in ECE-11, which potentially indicates a higher degree of financialization of pension system than in other countries in the region (Mikuš 2019c, Table 19). This is why I included questions about pension funds and the pension system more broadly in my interviews and interviewed three pension fund managers and an academic specializing in the pension system. Above, I mentioned how my interlocutors argued that Croatia's ongoing commitment to the preservation and development of mandatory pension funds (the "second pillar" of the pension system), unlike for example in Hungary and Poland, increased Croatian public debt at the present but reduced pressures on its growth in the long term. I also noted how they identified an excessive public spending on pensions, which they traced to an overly generous system of pension entitlements and politicians' unwillingness to change this, as major causes of the growth of public debt, in particular in 2009–15. This suggests that pension funds and the pension system were seen as related to public debt in multiple significant ways that deserve a closer discussion.

In general, my interlocutors were decidedly supportive of the continued existence of the mandatory second pillar and believed that the overall pension reform in 1999–2002, which established the three-pillar pension system, was well intended. At the same time, they were critical of the evolution of the second pillar (the fact that the mandatory contributions were not gradually increased; perceived erosion of the second pillar in favour of the first pillar) as well as of the overall pension system, especially its first pillar – a pay-as-you-go scheme. They perceived the first pillar as too redistributive and unfair: there was an insufficient linkage between pension contributions and benefits, minimum pensions were too high, and there were too many "privileged" pensions, which were "too high", "not earned" and did not at all belong in the pension system. These characteristics made the whole pension system a massive and unsustainable burden on public finance. Accordingly, interviewees praised the second pillar, a mechanism of a partial individualization of pensions, as a welcome corrective to the overly redistributive and permissive first pillar. They emphasized that pension fund assets were legally private property – "our property" (I-001) – which protected at least some funds earmarked for

future pensions from reckless government spending. Accordingly, they tended to describe policies that would seek to erode or scale back pension funds with the generic term "nationalization". Several interlocutors also argued that high earners would undoubtedly see the benefits of pension funds in the future, thus implicitly privileging the perspective of such a demographic.

While appreciative of pension funds in the context of the overall pension system, interviewees were more critical of their relationship with the rest of the economy and ambivalent about their relationship to public debt. These two considerations were interconnected since the perception was that pension funds had not been sufficiently investing "in the economy", which was one of the expectations and justifications when they were being created, and instead concentrated their assets in public debt. There is some evidence to support this perception. As Tables 5 and 6 show, the share of domestic government bonds in the assets of mandatory pension funds[22] has never fallen below 55% and for a large majority of years since 2002 it was above 65%. In past five years, the share of Croatian government bonds in the assets of category B funds (by far the largest category of mandatory pension funds) stayed in the region of 67–71%. At the same time, the shares of investments in domestic and foreign shares (stock) stayed relatively small and after some growth in the aftermath of the crisis they have been declining in recent years; in end-2018, their combined share was about 17% of the total. The share of investments in domestic corporate bonds is about 1.5% while investments in foreign corporate bonds are non-existent. The significance of pension fund investments in public debt is also obvious from the structure of public debt by the sector of holders. The share held by Croatian pension funds has been growing nearly continuously from about 6% in end-2003 to ca. 23% in March 2019 (Table 7). This made them the second largest category of Croatia's creditors – only Croatian banks held a bigger share of the debt (31% in March 2019), but their share has been declining for most of the time since end-2011, when it peaked at nearly 38%.

Commenting on this structure of pension fund assets, one of the CNB officials (I-006) admitted that the expectation that pension funds would contribute to the development of the Croatian financial market and the wider economy did not really materialize, and that due to the dominant investments in public debt "it looks as if [money] is just being moved around aimlessly

[22] Table 5 presents the structure of assets of all mandatory pension funds in 2002–13 while Table 6 presents the structure of assets of one category of mandatory pension funds (category B) in 2014–19. The reason for this difference is the change in the construction of the second pillar that occurred in 2014. While previously each of the four mandatory pension fund companies only had one mandatory pension fund, from 2014 they are obliged to have three types of pension funds (labelled A, B and C) of different risk profiles. Most assets of the previous pension funds were transferred to category B funds and these remain by far the largest category of mandatory pension funds in terms of assets.

and getting lost in the process". At the same time, this interlocutor said that the Ministry of Finance had been deliberately encouraging the investments of pension funds in public debt by issuing domestic bonds with features expected to be suitable for them, such as, presumably, long maturity and denomination in the kuna. The presence of this stable domestic demand was good because it meant that Croatia was able to sell its bonds even in a situation of deep recession and poor credit rating. One of the pension fund managers (I-004) echoed both arguments of the official. First, they told me that pension funds were able to communicate their preferences regarding bond issues to the Ministry of Finance:

> *[T]here are certain contacts with the Ministry of Finance regarding the government issues of bonds and similar things. We are occasionally in a position to give certain signals what kind of an issue would suit us in that particular moment. It is not always taken into consideration.* (I-004)

Specifically, the fund communicated its preferences regarding the currency and maturity of bonds and did so either to the Ministry of Finance or arrangers for upcoming issues. At another point of the interview, this interlocutor mentioned that pension funds used to have a certain privilege in the allocation of domestic bond issues, but this was not the case anymore. The interlocutor also echoed the second argument of the CNB official by claiming that the steady funds' demand for government bonds had been key to the reduction of the foreign share of the public debt (cf. Mikuš 2019c, Table 17) and that Fitch, the credit rating agency, referred precisely to this in an explanation of its recent upgrade of Croatia's rating. This person gave the relationship of the state and pension funds a generally positive spin and characterized it as one of "trust". The business journalist (I-009) told me that in the absence of "real investors", meaning private foreign investors, the state actually needed the investments of pension funds. These also had the advantage of making privatization more politically palatable inasmuch as the public perceived pension funds as an "extended arm of the state".

At the same time, the pension fund manager (I-004) told me that pension funds were "forcibly exposed (*prisilno izloženi*) to Croatian government bonds" and claimed that "we still have to invest a certain part of our portfolio in [Croatian] government bonds". In reality, as the same interlocutor also told me in another part of the interview, the law sets minimum thresholds merely for their shares of investments in kuna property and in bonds of issuers from Croatia or other EU/OECD member states.[23] Nevertheless, the formulation "forcibly exposed" gestured to a less harmonious and cosy aspect of the state–pension funds relationship. Two other pension

[23] At the time of writing, the relevant thresholds for the dominant category B mandatory pension funds were at least 60% for kuna property and at least 50% for bonds of issuers from Croatia, other EU member states, or OECD member states (UMFO n.d.).

managers whom I interviewed jointly (I-008) had a brief exchange about this issue, with one of them arguing that pension funds were investing in public debt voluntarily, not due to regulation, while the other disagreed and pointed to the combined threshold for investments in kuna bonds. The business journalist (I-009) described pension funds as “hostages” of the state that had kept them “in subservience”, although at another point of the interview they characterized their relationship as one of symbiosis and mutual interdependence.

It seems likely that this ambivalence about the nature of the state–pension funds relationship reflected the fact that the domination of Croatian government bonds in pension fund portfolios was due to the legal thresholds but also other circumstances, which complicates the straightforward narrative about pension funds as, essentially, captive debtors of the state. To begin with, all pension managers as well as one of the CNB officials (I-013) alluded to a lack of suitable alternative investments that would meet the legal requirements, such as kuna-denominated bonds of other issuers. The general weakness of the Croatian financial market was discussed also by the HANFA official (I-011) who pointed to the limited number of bonds being traded at the ZSE and the significantly larger turnover in equity than bonds, among which government bonds dominated (see Zagreb Stock Exchange n.d.). At the same time, one of the pension managers (I-004) admitted that the funds’ investments were still larger (in fact, substantially larger) than the legal thresholds supposedly obliged them to be; in other words, pension funds did not even make full use of the legal room for other types of investments. One of the CNB officials (I-013) suggested that fund managers might have been simply afraid of a heightened “responsibility” that accompanied for example investments abroad. Another pension fund manager (I-008) told me that funds were quite happy with investing in public debt in the post-crisis years when yields were high but now that these returned to the levels of 2007–8, the supposed obligation to invest in Croatian public debt was becoming a problem. The manager told me that a recently adopted law allowed funds to invest up to 35% of their assets in “infrastructural projects” but there were hardly any such projects to invest in. Just days before the interview, the head of HANFA gave his support to the calls of pension funds that the government draw up a list of such projects in which they could invest (see Drljača 2019). The manager mentioned a planned expansion of the Gaženica port in Zadar or a monetization of Croatian highways as potential investment venues; later on, they referred also to proposals for a privatization of *Hrvatska elektroprivreda* (HEP), the national power company. This suggests that pension funds continued to look up to the state to create expanded investment opportunities for them on top of their existing investments in general government debt.

Some of my interlocutors from the ranks of experts and regulators criticized the concentration of pension fund assets in Croatian public debt. One of the economists (I-002) and one of the CNB officials (I-012) alluded to Croatia's credit risk and potential for default as something that could threaten the security of future pensions. According to the economist, "anything [any debt instrument] that the state issues, the banks and pension funds just pack into their portfolios, it's like a perverted perpetuum mobile" (I-012). Above, I mentioned that some interlocutors believed that the fact that leading Croatian banks and pension funds, which are generally owned by the same mother groups, held so much of the Croatian public debt was a risk for the stability of the overall financial system. Two CNB officials (I-012, I-013) as well as the pension system expert (I-014) further suggested that the focus on government bonds would result in insufficient yields, which in turn would add to the expected future inadequacy of pension benefits. As already mentioned, there were also critiques according to which the nexus of public debt and pension funds amounted to a pointless, unproductive circulation of money. Another CNB official (I-012) said that the domination of government bonds in funds' portfolios gave the critics of pension reforms an opportunity to point out how these reforms created a "transitional cost" – the loss of government revenues in the form of first pillar pension contributions for which the state had to compensate with borrowing, thereby enabling pension funds to profit from this crediting. One of the pension managers (I-008) told me somewhat unexpectedly that they found the Croatian pension system essentially "absurd" since "we are basically paying interest to ourselves" – people relied for their pensions on pension funds that credited the government and to whom the government repaid its debts with the money of the same citizens. What is more, it was "Austrian middlemen" who profited from the whole construction.

**Conclusions**

This paper has showed that the key channels of state financialization in Croatia were the interrelated processes of public debt growth and pension system financialization, as a result of which debt assessment, management and sustainability, relationships between debt and monetary and fiscal policy, the debt–pension funds nexus, and the implications of pension funds for pension adequacy and sustainability became increasingly prominent and significant policy considerations. To begin with, there has been a general consensus among interviewees about Croatia's high level of indebtedness relative to other ECE countries and its own level of economic development. At the same time, there were recurrent arguments that complicated this

conclusion about Croatia's relatively high level of indebtedness by pointing to recent debt reduction, methodological changes (which arguably did result in a significant expansion of public debt) and the need to consider public debt in relation to the characteristics of pension systems in Croatia and countries with which it was being compared. Opinions on whether Croatia was having a problem with its public debt were divided. Most interlocutors gravitated to various ambivalent conclusions, such as that public debt was not a problem in the economic and financial conditions of recent years but would re-emerge as a problem in case of a future external shock. Several interviewees believed that Croatia's default was a realistic prospect while some were more optimistic than the rest and thought that another episode of rapid growth of public debt (such as the one in 2009–15) was unlikely since policymakers and voters had learnt the lesson about the dangers of excessive borrowing.

Though interviewees laid varying emphases on particular points, they generally agreed on the importance of following four (categories of) causes of the growth of Croatian public debt in the postsocialist period: accumulation of a considerable debt legacy before the global financial crisis, especially due to the infrastructural construction boom in the 2000s; insufficient fiscal consolidation after the crisis (in 2009–15); high debt service costs in the same period; and various "one-off" events, in particular government interventions in public or private companies with liquidity or solvency issues. The insufficient fiscal consolidation was mostly interpreted as governments' unwillingness to achieve balanced budgets and stabilize public debt in the context of a deep and long recession by cutting spending on "current consumption", in particular on pensions and public sector wages. While there was a consensus about Croatia's very high debt service costs in 2009–15, a significant number of interviewees questioned the objectivity and fairness of Croatia's ratings by credit rating agencies, which they tended to see as biased against Croatia. However, they also connected high debt service costs to the recession in Croatia and the inadequate fiscal consolidation and public debt dynamics in that period. Mirroring this, they attributed the reduction in debt service costs since 2016 to economic recovery, fiscal consolidation and debt reduction, but also collective behaviour in financial markets.

Interlocutors recognized that the influence of public debt on public policy has increased in recent years, although one of the CNB officials (I-012) believed that the understanding and engagement with the issue of public debt in politics and the public sphere were still at a "rudimentary" level. Most interlocutors (at least implicitly) portrayed the social democratic government in 2012–15 as relatively unresponsive to the issue of public debt in the sense that it did not sufficiently cut expenditures and limit public debt growth. This appears basically true, but

debt had been rapidly growing also under the HDZ government incumbent in 2009–11, which was more rarely mentioned. Some interviewees also admitted that even the SDP government adopted some characteristic austerity policies to stabilize public debt. Most interlocutors believed that there have been more or less significant improvements in sovereign debt management and wider fiscal policy in recent years, in particular under the incumbent HDZ government (since late 2016). However, critical voices argued that reduction of public debt/GDP ratio and a shift from budget deficits to surpluses was in part cyclical (driven by wider economic conjuncture) and in part driven by historically low interest rates. In other words, the government did not resolve structural issues of Croatian public finance and economy that would sooner or later inevitably re-emerge. In particular, these interlocutors believed that the government did not make sufficiently targeted and deep cuts on the expenditure side of the budget to prevent another episode of rapid debt growth in case of a future external shock. They also believed that there was a lack of systemic reforms that were needed to improve Croatia's productivity and competitiveness and lay foundations for faster and more sustainable economic growth. One of them (I-005) highlighted that Croatia's economy remained financialized also in the sense of a continued dependence on the finance-housing nexus and its associated industries, especially construction and tourism.

There were indications of a modest and gradual professionalization and financialization of sovereign debt management. This remained the responsibility of a relatively small department in the Ministry of Finance. Some of my interlocutors criticized this institutional model and argued that a separate public debt management office would enable a more substantial professionalization of sovereign debt management, with one interviewee praising such an office in Hungary as a role model. Still, the relevant directorate has gradually expanded over years, absorbed models and ideas from abroad, and adopted some innovations. Croatia has been issuing euro-denominated eurobonds since the late 1990s and kuna- and euro-denominated domestic bonds since the early 2000s; before crisis, it has also issued several samurai bonds and in the post-crisis years several dollar-denominated bonds to tap into additional liquidity. It has been routinely using competitive auctions to sell t-bills since 2005. There have been successful experiences with the use of derivatives to hedge against currency risk of USD bonds and with refinancing of older debts that made use of the improved funding conditions in recent years and enabled a general reduction in debt service costs.

At the same time, there were continued concerns about the transparency and efficiency of sovereign debt management. The shares of loans and foreign-currency debt in public debt were persistently large, although most interlocutors did not seem to perceive the dominance of

euro-denominated debt as a cause for concern. Syndication remained the dominant technique of sales of government bonds, which had the effect of limiting market competition in bond sales and infusing these processes with elements of negotiation, compromise and redistribution influenced by pre-existing hierarchies and solidarities between market actors. We have also seen that global banks, the leading Croatian banks and their mothers have been in a privileged position to shape and directly benefit from primary bond issuance in their role of arrangers. Possibly connected to the use of syndication but also the profile of dominant investors in Croatian public debt was the weakness of secondary markets in public debt and the domination of OTC transactions therein. The Public Debt Management Directorate, despite some improvements, was generally still believed to be understaffed, under-resourced and insufficiently pro-active, transparent and investor-oriented.

Regarding fiscal policy more broadly, most interlocutors appreciated fiscal consolidation under the incumbent government, especially the role of the Ministry of Finance as an institution that kept in check the spending of the rest of the state and the growth of debt. Some praised the influence of EU macroeconomic and fiscal surveillance mechanisms on these processes. However, as already noted, there remained appetite for more targeted and deeper (rather than across-the-board but relatively shallow) cuts in expenditures. Overall, then, the rise in the importance of public debt as a policy issue seems to be associated with a preference for broadly neoliberal and fiscally conservative (austerity) policies and for the EU-led institutionalization of such policies as permanent. However, an important exception to this was a frequent argument that the government should not conduct austerity at the expense of capital investments, which shows that my interlocutors still saw an important role for state action in the field of economic development. Some interlocutors also questioned the sustainability of current austerity more broadly, especially the relative lack of public investments in education, health, infrastructure, research and development and other areas, mostly framing this in terms of something that would limit economic growth and development.

Nearly all of my interlocutors defended the monetary regime based on the stable exchange rate policy since the 1990s and supported euro adoption rather than potential efforts to reduce euroization and conduct a more autonomous monetary policy. They tended to justify the existing arrangements as the only realistic alternative for Croatia, even though some admitted that the impact of this monetary policy on the economy might have made a shift to an alternative regime increasingly difficult and that policymakers and regulators did not even make an effort to critically evaluate the policy and explore alternatives. Most interlocutors believed that Croatia was already de facto in the eurozone and that the kuna was an obstacle rather than a

resource from which Croatia could benefit. Overall, then, the Croatian financial community seems to support monetary arrangements associated with peripheral financialization, such as rigid exchange rate regimes and euroization.

Interviewees were generally supportive of the basic idea and continued existence of pension funds, especially in relation to the rest of the pension system of which they were highly critical. They also believed that pension funds would have a beneficial impact on public debt in the long run as they would limit the need for public pension spending. However, they were more critical about the evolution of pension funds regarding a perceived lack of support (or even attempts at erosion) from the government and the structure of pension fund assets in which Croatian government bonds remained highly dominant. Interviewees criticized this in relation to the security of pensions as well as the lack of expected contribution of pension funds to the wider economy, especially productive sectors. At the same time, they tended to see the steady demand of pension funds for the Croatian public debt as beneficial for its stability, although there were some concerns about the fact that such a large part of the debt was held by several international banking groups that owned leading banks as well as leading pension funds in Croatia. The funds appeared to be becoming more ambivalent about what they perceived as a de facto obligation to invest in public debt, on the one hand speaking about a relationship of trust with the state and on the other expressing frustration with reduced yields in past few years and a lack of suitable investment opportunities, for which they nevertheless continued to look up to the state. The nexus between public debt and pension funds is likely to continue increasing in importance, unless there is a substantial shift in either government policy (towards scaling pension funds back) or funds' investment strategy, to the extent that regulation and investment opportunities permit.

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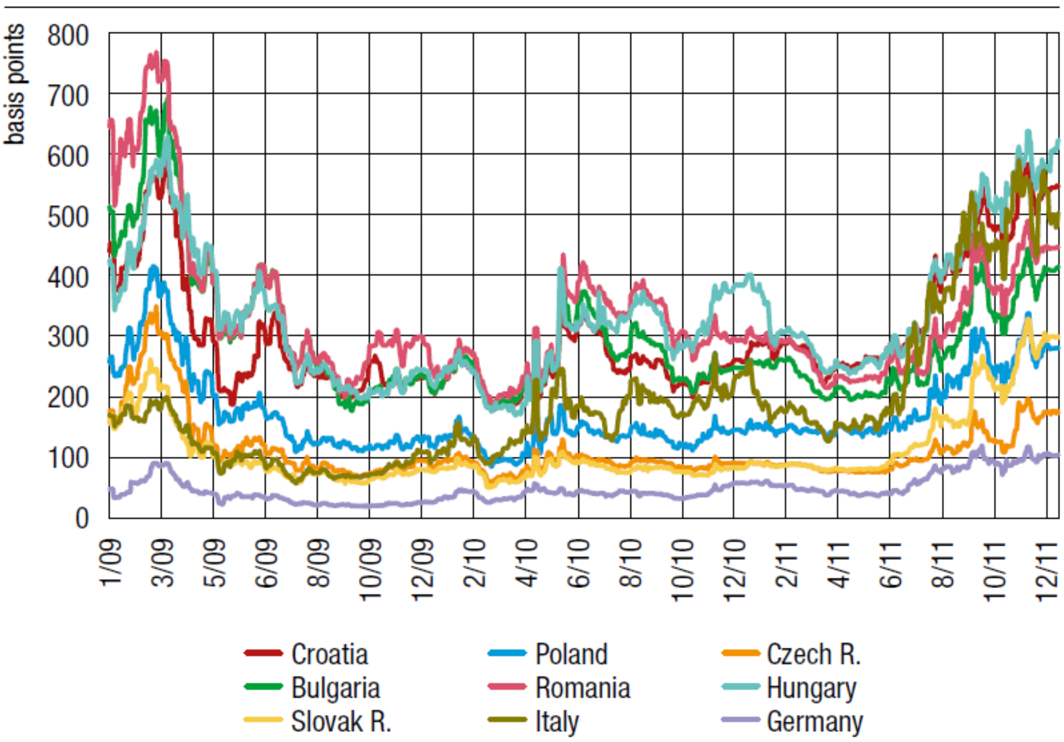
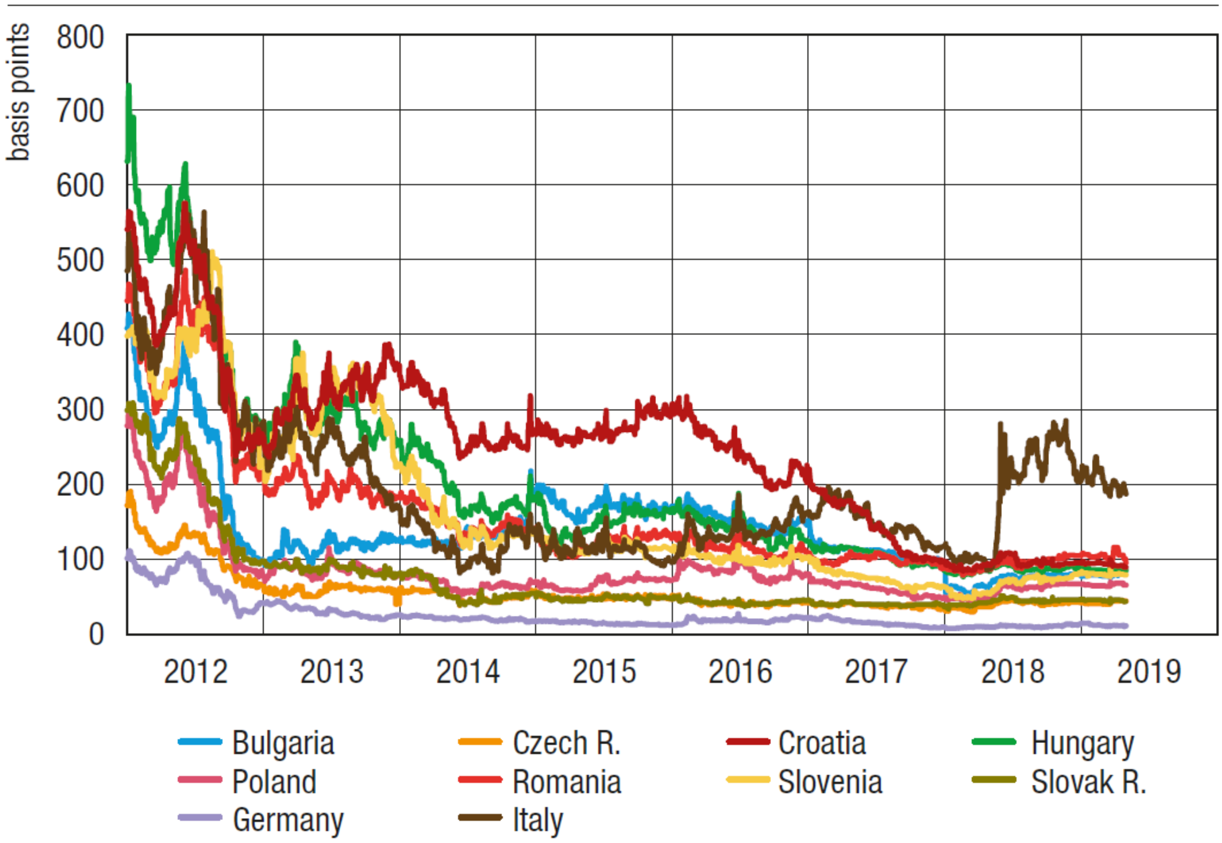
## DATA ANNEX

### Fig. 1. CDS spreads for 5-year government bonds of selected countries, 2009–11




**Data source**: Croatian National Bank (2012), *Bulletin 177*, p. 9. Accessed at https://www.hnb.hr/documents/20182/122809/ebilt177.pdf/33ab5542-2af7-4da7-b998-804365ae9aa9 on 14 October 2019.

Fig. 2. CDS spreads for 5-year government bonds of selected countries, 2012–19




**Data source:** Croatian National Bank (2019), *Information on Economic Trends: May 2019*, p. 9. Accessed at https://www.hnb.hr/documents/20182/2808758/ebilt251-informacija.pdf/7437c25d-53a3-86e2-ea75-0d4e62454864 on 9 October 2019.

## Table 1. International bonds issued by the Republic of Croatia

| month/year | volume (mil.) | currency | interest rate | maturity (yrs) |
|---|---|---|---|---|
| 07/1996 | 858 | USD | 6-m USD LIBOR + 81.25 bp | 3 grace, 11 repayment |
| 07/1996 | 604 | USD | 6-m USD LIBOR + 81.25 bp | 10 |
| 02/1997 | 300 | USD | 7.000% | 5 |
| 07/1997 | 300 | DEM | 6.125% | 7 |
| 08/1998 | 15,000 | ESP | 6.500% | 3 |
| 02/1999 | 300 | EUR | 7.375% | 7 |
| 12/1999 | 25,000 | JPY | 4.000% | 5 |
| 03/2000 | 500 | EUR | 7.000% | 5 |
| 07/2000 | 40,000 | JPY | 3.000% | 7 |
| 02/2001 | 25,000 | JPY | 2.500% | 5 |
| 03/2001 | 750 | EUR | 6.750% | 10 |
| 01/2002 | 500 | EUR | 6.250% | 7 |
| 06/2002 | 25,000 | JPY | 2.150% | 6 |
| 02/2003 | 500 | EUR | 4.265% | 7 |
| 06/2003 | 25,000 | JPY | 1.230% | 6 |
| 04/2004 | 500 | EUR | 5.000% | 10 |
| 05/2009 | 750 | EUR | 6.500% | 6 |
| 11/2009 | 1,500 | USD | 6.750% | 10 |
| 07/2010 | 1,250 | USD with cross currency swap | 6.625% | 10 |
| 03/2011 | 1,500 | USD with cross currency swap | 6.375% | 10 |
| 07/2011 | 750 | EUR | 8.875% | 7 |
| 04/2012 | 1,500 | USD with cross currency swap | 6.250% | 5 |
| 04/2013 | 1,500 | USD with cross currency swap | 5.500% | 10 |
| 11/2013 | 1,750 | USD with cross currency swap | 6.000% | 10 |
| 05/2014 | 1,250 | EUR | 3.875% | 8 |
| 03/2015 | 1,500 | EUR | 3.000% | 10 |
| 03/2017 | 1,250 | EUR | 3.000% | 10 |
| 11/2017 | 1,275 | EUR | 2.750% | 12 |
| 05/2018 | 750 | EUR | 2.700% | 10 |
| 06/2019 | 1,500 | EUR | 1.125% | 10 |

**Data source:** Adapted from a spreadsheet published by the Ministry of Finance, http://www.mfin.hr/hr/obveznice-medunarodne, last accessed on 25 October 2019.

## Table 2. Domestic bonds issued by the Republic of Croatia and entities owned by the Republic of Croatia

| month/year | volume (mil.) | currency | interest rate | maturity (yrs) | issuer |
|---|---|---|---|---|---|
| 07/2000 | 222 | EUR | 8.500% | 4 | Croatian Health Insurance Fund |
| 12/2000 | 105 | EUR | 8.000% | 3 | State Agency for Deposit Insurance and Bank Resolution |
| 12/2000 | 225 | EUR | 8.375% | 5 | State Agency for Deposit Insurance and Bank Resolution |
| 09/2001 | 200 | EUR | 6.500% | 3 | Republic of Croatia |
| 12/2001 | 200 | EUR | 6.875% | 7 | Republic of Croatia |
| 05/2002 | 500 | EUR | 6.875% | 10 | Republic of Croatia |
| 05/2003 | 1,000 | HRK | 6.125% | 5 | Republic of Croatia |
| 04/2004 | 650 | EUR | 5.500% | 10 | Republic of Croatia |
| 07/2004 | 400 | EUR | 3.875% | 3 | Republic of Croatia |
| 11/2004 | 1,000 | EUR | 5.375% | 15 | Republic of Croatia |
| 03/2005 | 3,000 | HRK | 6.750% | 5 | Republic of Croatia |
| 07/2005 | 350 | EUR | 4.250% | 10 | Republic of Croatia |
| 12/2005 | 5,500 | HRK | 5.250% | 10 | Republic of Croatia |
| 07/2006 | 4,000 | HRK | 4.500% | 7 | Republic of Croatia |
| 02/2007 | 5,500 | HRK | 4.750% | 10 | Republic of Croatia |
| 03/2010 | 5,000 | HRK | 6.750% | 10 | Republic of Croatia |
| 03/2010 | 1,000 | EUR | 6.500% | 10 | Republic of Croatia |
| 11/2010 | 4,000 | HRK | 6.250% | 7 | Republic of Croatia |
| 07/2011 | 3,500 | HRK | 5.750% | 5 | Republic of Croatia |
| 07/2011 | 1,000 | EUR | 6.500% | 11 | Republic of Croatia |
| 07/2013 | 6,000 | HRK | 5.250% | 5 | Republic of Croatia |
| 07/2013 | 1,400 | EUR | 5.750% | 11 | Republic of Croatia |
| 07/2015 | 6,000 | HRK | 4.500% | 10 | Republic of Croatia |
| 12/2015 | 10,000 | HRK | 4.250% | 11 | Republic of Croatia |
| 07/2016 | 6,000 | HRK | 2.750% | 5 | Republic of Croatia |
| 02/2017 | 3,000 | HRK | 2.250% | 5 | Republic of Croatia |
| 02/2017 | 5,500 | HRK | 2.875% | 11 | Republic of Croatia |
| 07/2017 | 3,000 | HRK, EUR index | 3.250% | 15 | Republic of Croatia |
| 11/2017 | 11,300 | HRK | 1.750% | 6 | Republic of Croatia |
| 07/2018 | 10,000 | HRK | 2.375% | 11 | Republic of Croatia |
| 02/2019 | 500 | EUR | 0.500% | 3 | Republic of Croatia |

**Data source:** Adapted from a spreadsheet published by the Ministry of Finance, http://www.mfin.hr/hr/obveznice-domace, last accessed on 25 October 2019.

## Table 3. Public debt by type of instrument, mil. HRK, 1995–2018

| instrument type / year | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| debt securities | 15,238.2 | 24,431.4 | 27,052.1 | 26,415.7 | 34,269.4 | 44,403.8 | 53,156.4 | 54,750.6 | 61,114.5 | 70,299.4 | 73,788.5 | 75,047.7 |
| short-term debt securities | 0.0 | 276.0 | 350.1 | 465.9 | 776.7 | 2,570.6 | 4,972.0 | 5,632.7 | 6,548.1 | 8,987.3 | 12,491.8 | 12,401.3 |
| long-term debt securities | 15,238.2 | 24,155.4 | 26,702.0 | 25,949.8 | 33,492.7 | 41,833.1 | 48,184.4 | 49,117.9 | 54,566.5 | 61,312.1 | 61,296.7 | 62,646.5 |
| loans | 11,204.6 | 8,341.7 | 9,452.1 | 10,611.3 | 14,205.0 | 19,579.3 | 17,704.8 | 22,686.7 | 27,431.9 | 30,624.2 | 37,266.8 | 38,647.1 |
| short-term loans | 0.0 | 0.0 | 0.0 | 314.2 | 1,252.9 | 3,860.9 | 926.9 | 1,654.2 | 2,889.3 | 2,391.7 | 1,330.9 | 955.0 |
| total public debt | 26,442.8 | 32,773.0 | 36,504.2 | 37,027.1 | 48,474.4 | 63,983.1 | 70,861.3 | 77,437.3 | 88,546.4 | 100,923.5 | 111,055.3 | 113,694.8 |
| share of loans in total debt (%) | 42.4% | 25.5% | 25.9% | 28.7% | 29.3% | 30.6% | 25.0% | 29.3% | 31.0% | 30.3% | 33.5% | 34.0% |

| instrument type / year | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| debt securities | 75,411.5 | 77,529.5 | 90,146.3 | 105,349.3 | 113,912.9 | 126,704.8 | 155,025.4 | 167,716.2 | 175,734.3 | 179,872.0 | 194,033.6 | 195,959.0 |
| short-term debt securities | 10,806.3 | 13,457.4 | 17,636.3 | 18,666.5 | 17,567.5 | 16,318.2 | 20,417.0 | 20,512.8 | 15,431.1 | 12,767.5 | 12,780.3 | 11,913.7 |
| long-term debt securities | 64,605.2 | 64,072.1 | 72,510.0 | 86,682.8 | 96,345.4 | 110,386.6 | 134,608.4 | 147,203.4 | 160,303.2 | 167,104.5 | 181,253.2 | 184,045.3 |
| loans | 44,736.4 | 58,093.8 | 69,896.8 | 83,407.3 | 99,061.2 | 103,174.7 | 111,727.4 | 110,777.3 | 108,638.6 | 102,894.0 | 90,282.2 | 88,735.2 |
| short-term loans | 626.0 | 1,435.7 | 2,651.3 | 2,223.8 | 1,794.1 | 3,278.1 | 3,094.3 | 1,194.3 | 639.4 | 1,075.1 | 906.7 | 1,191.4 |
| total public debt | 120,147.9 | 135,623.3 | 160,043.1 | 188,756.6 | 212,974.0 | 229,879.4 | 266,752.8 | 278,493.5 | 284,372.9 | 282,766.0 | 284,315.7 | 284,694.2 |
| share of loans in total debt (%) | 37.2% | 42.8% | 43.7% | 44.2% | 46.5% | 44.9% | 41.9% | 39.8% | 38.2% | 36.4% | 31.8% | 31.2% |

**Data source:** Eurostat, Government deficit/surplus, debt and associated data [gov_10dd_edpt1], https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10dd_edpt1&lang=en, last updated on 22 October 2019, last accessed on 25 October 2019; own calculations.

## Table 4. Government bond trading at the Zagreb stock exchange by type of transaction, HRK, 1995–2018

| year | regular (order book) trading | block trading | OTC trading | total turnover | share of regular trading |
|---|---|---|---|---|---|
| 1995 | 125,460 | 0 | 0 | 125,460 | 100.0% |
| 1996 | 243,176,893 | 0 | 0 | 243,176,893 | 100.0% |
| 1997 | 562,569,658 | 0 | 0 | 562,569,658 | 100.0% |
| 1998 | 304,458,479 | 0 | 0 | 304,458,479 | 100.0% |
| 1999 | 21,441,703 | 0 | 0 | 21,441,703 | 100.0% |
| 2000 | 0 | 0 | 0 | 0 | N/A |
| 2001 | 559,023,607 | 0 | 0 | 559,023,607 | 100.0% |
| 2002 | 839,832,983 | 1,358,281,169 | 2,189,550,790 | 4,387,664,942 | 23.7% |
| 2003 | 574,220,938 | 852,345,053 | 7,749,433,112 | 9,175,999,103 | 6.7% |
| 2004 | 683,747,946 | 2,467,410,712 | 16,460,471,792 | 19,611,630,451 | 3.6% |
| 2005 | 609,200,170 | 3,941,496,140 | 24,132,335,248 | 28,683,031,557 | 2.4% |
| 2006 | 569,988,215 | 4,799,859,556 | 28,178,602,379 | 33,548,450,149 | 1.7% |
| 2007 | 593,495,168 | 4,074,001,426 | 37,953,576,892 | 42,621,073,486 | 1.4% |
| 2008 | 316,570,685 | 1,133,922,358 | 10,659,180,461 | 12,109,673,504 | 2.7% |
| 2009 | 163,206,699 | 258,529,353 | 2,256,294,833 | 2,678,030,885 | 6.5% |
| 2010 | 247,971,298 | 1,334,142,424 | 5,140,945,809 | 6,723,059,531 | 3.8% |
| 2011 | 94,781,888 | 415,645,066 | 12,832,538,327 | 13,342,965,281 | 0.7% |
| 2012 | 236,682,681 | 409,457,471 | 12,726,560,298 | 13,372,700,450 | 1.8% |
| 2013 | 150,584,347 | 341,088,163 | 14,056,396,845 | 14,548,069,356 | 1.1% |
| 2014 | 345,453,928 | 323,699,920 | 25,933,170,625 | 26,602,324,473 | 1.3% |
| 2015 | 268,332,210 | 202,635,168 | 21,386,757,661 | 21,857,725,039 | 1.2% |
| 2016 | 401,876,976 | 255,178,578 | 24,904,081,882 | 25,561,137,436 | 1.6% |
| 2017 | 350,752,705 | 80,966,003 | 18,767,045,234 | 19,198,763,942 | 1.9% |
| 2018 | 656,633,761 | 46,040,034 | 12,463,796,293 | 13,166,470,088 | 5.3% |

**Data source:** Zagreb Stock Exchange, personal communication (e-mail), 12 June 2019; own calculations.

## Table 5. Assets of mandatory pension funds by domicile and investment instrument, %, end of period, 2002–13

| asset type / year | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *domestic assets* | *95.15%* | *91.52%* | *92.75%* | *89.01%* | *90.92%* | *95.73%* | *92.50%* | *90.50%* | *88.22%* | *88.50%* | *88.12%* | *87.32%* |
| securities and deposits | 88.99% | 86.32% | 88.74% | 85.85% | 89.21% | 94.08% | 91.23% | 89.16% | 87.72% | 87.60% | 86.59% | 85.25% |
| shares and GDRs | 4.79% | 3.35% | 3.45% | 2.78% | 5.31% | 14.75% | 11.19% | 13.31% | 15.54% | 13.95% | 12.80% | 11.27% |
| government bonds | 77.89% | 67.95% | 76.82% | 72.63% | 71.35% | 63.60% | 70.47% | 56.93% | 64.38% | 65.95% | 65.14% | 68.20% |
| municipal bonds | 0.00% | 0.00% | 0.82% | 0.50% | 0.39% | 0.36% | 0.36% | 0.27% | 0.20% | 0.10% | 0.07% | 0.05% |
| corporate bonds | 0.00% | 2.95% | 6.45% | 3.69% | 2.97% | 2.13% | 3.24% | 3.78% | 3.30% | 3.11% | 2.54% | 2.02% |
| closed-end funds | 1.10% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.25% | 0.24% | 0.18% | 0.05% | 0.03% | 0.01% |
| open-end funds | 0.00% | 0.00% | 0.00% | 2.16% | 7.15% | 11.99% | 1.65% | 3.51% | 1.49% | 2.51% | 1.75% | 2.57% |
| short-term securities | 5.06% | 10.92% | 0.74% | 1.36% | 0.07% | 0.10% | 1.28% | 6.90% | 0.95% | 0.27% | 1.93% | 0.52% |
| deposits | 0.14% | 1.14% | 0.45% | 2.72% | 1.97% | 1.14% | 2.79% | 4.23% | 1.67% | 1.66% | 2.33% | 0.61% |
| cash | 3.70% | 2.54% | 2.74% | 1.24% | 0.86% | 1.10% | 1.17% | 1.28% | 0.30% | 0.55% | 1.04% | 1.02% |
| receivables | 2.46% | 2.66% | 1.27% | 1.92% | 0.85% | 0.55% | 0.09% | 0.05% | 0.20% | 0.34% | 0.49% | 1.05% |
| *foreign assets* | *4.85%* | *8.48%* | *7.25%* | *10.99%* | *9.08%* | *4.27%* | *7.50%* | *9.50%* | *11.78%* | *11.50%* | *11.88%* | *12.68%* |
| shares | 0.15% | 1.96% | 0.78% | 1.12% | 1.36% | 3.25% | 2.13% | 2.60% | 5.03% | 7.06% | 7.13% | 7.83% |
| government bonds | 3.81% | 1.86% | 0.51% | 1.74% | 1.45% | 0.00% | 1.36% | 4.27% | 1.20% | 0.52% | 0.49% | 0.96% |
| corporate bonds | 0.00% | 1.13% | 0.72% | 0.44% | 1.14% | 0.20% | 2.10% | 0.21% | 0.14% | 0.00% | 0.00% | 0.00% |
| closed-end funds | 0.89% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| open-end funds | 0.00% | 3.54% | 5.24% | 7.69% | 5.13% | 0.82% | 1.91% | 2.43% | 5.40% | 3.92% | 4.25% | 3.88% |
| total assets (mil. HRK) | 2,120 | 4,792 | 8,085 | 11,992 | 16,045 | 21,202 | 22,617 | 29,364 | 36,930 | 41,213 | 51,173 | 58,844 |
| net assets (mil. HRK) | 2,037 | 4,677 | 7,913 | 11,714 | 15,919 | 21,002 | 22,591 | 29,265 | 36,328 | 41,067 | 51,134 | 58,238 |

**Data source:** Croatian Financial Services Supervisory Agency (HANFA), C-04 Mandatory pension funds investment structure, https://www.hanfa.hr/media/3872/c-04_struktura_omf.xlsx, last updated on 16 September 2019, last accessed on 30 September 2019; own calculations.

## Table 6. Assets of mandatory pension funds (category B) by domicile and investment instrument, %, end of period, 2014–19

| asset type / year | 2014 | 2015 | 2016 | 2017 | 2018 | 08/2019 |
|---|---|---|---|---|---|---|
| **cash** | **1.60%** | **0.78%** | **2.21%** | **2.32%** | **3.33%** | **1.75%** |
| **receivables** | **0.17%** | **0.20%** | **0.37%** | **0.08%** | **0.05%** | **0.39%** |
| **securities and deposits** | **98.23%** | **99.02%** | **97.42%** | **97.60%** | **96.62%** | **97.85%** |
| ***domestic securities and deposits*** | ***84.87%*** | ***85.47%*** | ***87.83%*** | ***85.91%*** | ***84.25%*** | ***83.70%*** |
| **shares and GDRs** | 10.35% | 10.55% | 12.53% | 11.08% | 10.72% | 10.62% |
| **government bonds** | 70.45% | 71.15% | 70.74% | 70.85% | 67.70% | 67.68% |
| **municipal bonds** | 0.02% | 0.01% | 0.00% | 0.00% | 0.00% | 0.00% |
| **corporate bonds** | 0.84% | 1.53% | 1.67% | 1.45% | 1.52% | 1.57% |
| **AIFs*** | 0.25% | 0.25% | 0.24% | 0.24% | 0.20% | 0.18% |
| **UCITS** funds** | 0.97% | 1.06% | 1.89% | 0.69% | 0.81% | 0.18% |
| **money market instruments** | 0.00% | 0.00% | 0.00% | 0.23% | 1.34% | 1.27% |
| **deposits** | 1.98% | 0.92% | 0.76% | 1.36% | 1.95% | 2.19% |
| ***foreign securities and deposits*** | ***13.35%*** | ***13.55%*** | ***9.59%*** | ***11.70%*** | ***12.38%*** | ***14.15%*** |
| **shares** | 8.30% | 8.60% | 7.47% | 6.16% | 5.94% | 6.16% |
| **government bonds** | 0.71% | 0.00% | 0.00% | 0.51% | 0.95% | 1.15% |
| **corporate bonds** | 0.00% | 0.18% | 0.00% | 0.00% | 0.00% | 0.03% |
| **AIFs** | 0.00% | 0.01% | 0.02% | 0.05% | 0.13% | 0.28% |
| **UCITS & OIFs*** w/ public offering** | 4.34% | 4.75% | 2.09% | 4.98% | 5.35% | 6.53% |
| **total assets (mil. HRK)** | **65,082** | **72,453** | **81,120** | **88,041** | **93,013** | **102,603** |
| **net assets (mil. HRK)** | **64,351** | **71,352** | **80,624** | **87,375** | **92,634** | **102,246** |

* Alternative Investment Funds; ** funds based on the Undertakings for Collective Investment in Transferable Securities (2009/65/EC) Directive; *** Open Investment Funds

**Data source:** Croatian Financial Services Supervisory Agency (HANFA), C-04 Mandatory pension funds investment structure, https://www.hanfa.hr/media/3872/c-04_struktura_omf.xlsx, last updated on 16 September 2019, last accessed on 30 September 2019; own calculations. Rows for foreign municipal bonds, money market instruments and deposits were deleted as there were zero investments in all time-points.

## Table 7. Consolidated general government debt by the sector of holder, %, end of period, 2003–19

| holder sector / year | ESA 2010 sector code | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| ***domestic holder sectors (total)*** | ***S. 1*** | ***41.50*** | ***43.46*** | ***50.35*** | ***52.24*** | ***49.66*** | ***52.74*** | ***52.43*** | ***55.19*** |
| non-financial corporations | S.11 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.08 |
| deposit-taking corporations | S.122 | 27.59 | 26.56 | 31.64 | 30.72 | 28.95 | 31.98 | 31.89 | 32.89 |
| money market funds | S.123 | 1.34 | 1.09 | 0.56 | 1.04 | 0.66 | 0.79 | 2.21 | 2.05 |
| non-IMF investment funds | S.124 | 1.54 | 2.77 | 3.96 | 3.48 | 1.84 | 1.31 | 0.42 | 0.43 |
| other financial intermediaries | S.125 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| financial auxiliaries | S.126 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| insurance corporations | S.128 | 4.77 | 6.02 | 5.36 | 7.07 | 7.15 | 5.06 | 6.53 | 5.78 |
| pension funds | S.129 | 6.27 | 7.02 | 8.83 | 9.93 | 11.07 | 13.62 | 11.39 | 13.95 |
| households | S.14 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| ***rest of the world*** | ***S.2*** | ***58.50*** | ***56.54*** | ***49.65*** | ***47.76*** | ***50.34*** | ***47.26*** | ***47.57*** | ***44.81*** |

| holder sector / year | ESA 2010 sector code | 2011 | 2012 | 2013 | 2014 | 2016 | 2016 | 2017 | 2018 | 03/2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| ***domestic holder sectors (total)*** | ***S. 1*** | ***58.17*** | ***57.89*** | ***57.10*** | ***57.52*** | ***58.40*** | ***61.28*** | ***60.81*** | ***63.35*** | ***64.33*** |
| non-financial corporations | S.11 | 0.39 | 0.19 | 0.08 | 0.11 | 0.09 | 0.10 | 0.10 | 0.10 | 0.10 |
| deposit-taking corporations | S.122 | 37.89 | 37.19 | 35.32 | 32.87 | 32.70 | 32.44 | 29.56 | 31.20 | 31.00 |
| money market funds | S.123 | 1.26 | 1.00 | 1.89 | 1.74 | 1.45 | 2.09 | 1.60 | 0.97 | 0.00 |
| non-IMF investment funds | S.124 | 0.12 | 0.05 | 0.10 | 0.39 | 0.63 | 1.14 | 1.84 | 2.56 | 3.73 |
| other financial intermediaries | S.125 | 0.04 | 0.00 | 0.00 | 0.00 | 0.00 | 0.01 | 0.05 | 0.07 | 0.02 |
| financial auxiliaries | S.126 | 0.13 | 0.09 | 0.12 | 0.24 | 0.31 | 0.27 | 0.29 | 0.39 | 0.38 |
| insurance corporations | S.128 | 5.41 | 5.42 | 5.08 | 5.70 | 5.67 | 5.83 | 5.71 | 5.63 | 5.67 |
| pension funds | S.129 | 12.68 | 13.73 | 14.26 | 16.16 | 17.27 | 19.13 | 21.39 | 22.16 | 23.11 |
| households | S.14 | 0.26 | 0.21 | 0.25 | 0.30 | 0.28 | 0.27 | 0.28 | 0.28 | 0.32 |
| ***rest of the world*** | ***S.2*** | ***41.83*** | ***42.11*** | ***42.90*** | ***42.48*** | ***41.60*** | ***38.72*** | ***39.19*** | ***36.65*** | ***35.67*** |

**Data source:** Croatian National Bank, personal communication (e-mail), 30 August 2019. Rows for central bank (public), captive financial institutions, and non-profit institutions serving households were deleted as there was a zero share of investments in all time-points.

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