



# **Croatia's medium-term growth and investment challenges**

**Servaas DEROOSE**

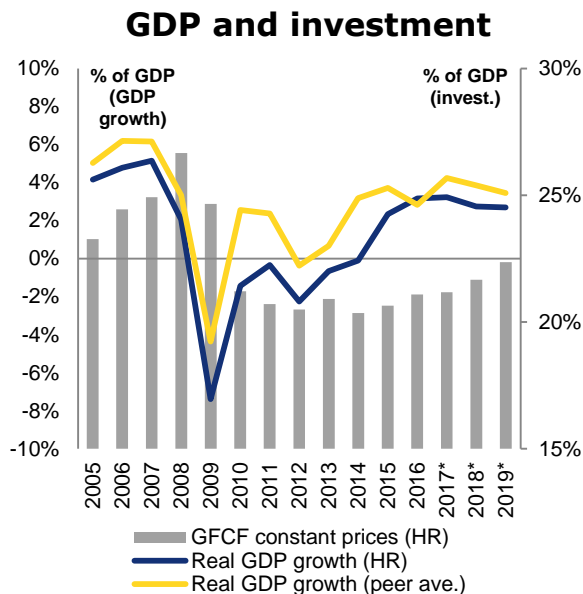
**Deputy Director-General**

**European Commission, DG Economic and Financial Affairs**

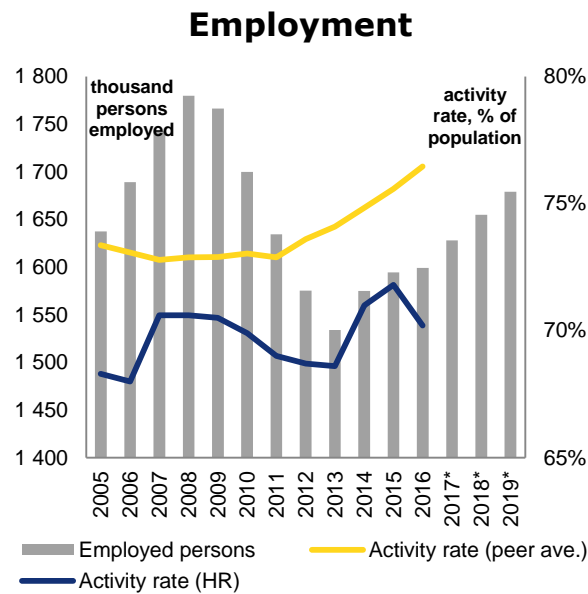
**Investments – Moving productivity frontier  
Joint conference by EIB and Croatian National Bank  
Zagreb, 7 March 2018**

# Setting the scene

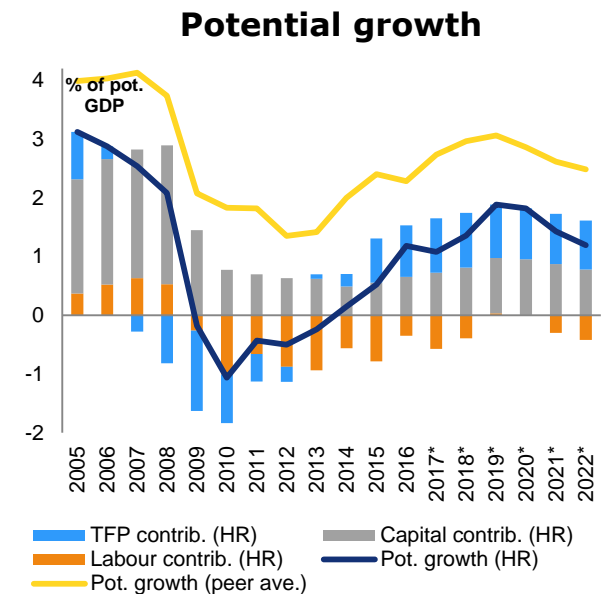
- Croatia's GDP finally set to surpass pre-crisis level next year
- Investment also rebounding after a big slump followed by stagnation
- Employment growing for fifth year in a row in spite of low activity rate
- However, real and potential growth still lag behind peers (CZ, HU, PL, SK, SI)



Source: European Commission  
Note: (\*) indicates forecasts



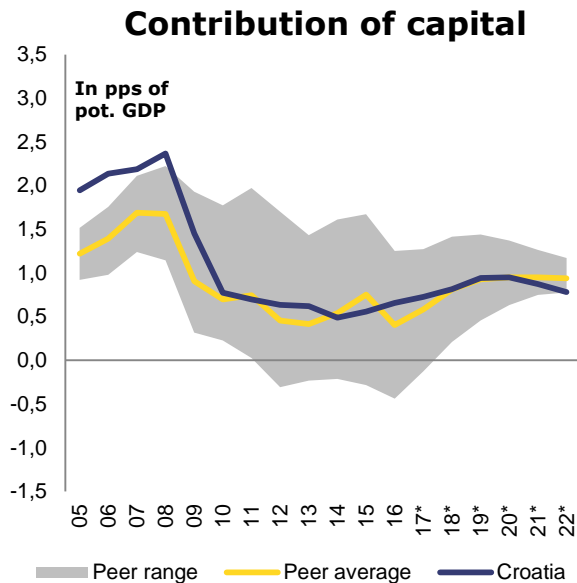
Source: European Commission  
Note: (\*) indicates forecasts



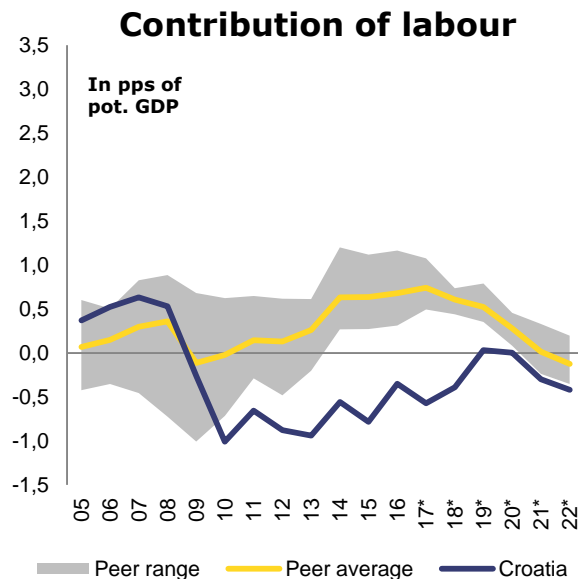
Source: European Commission  
Note: (\*) indicates forecasts

# Drivers of potential growth

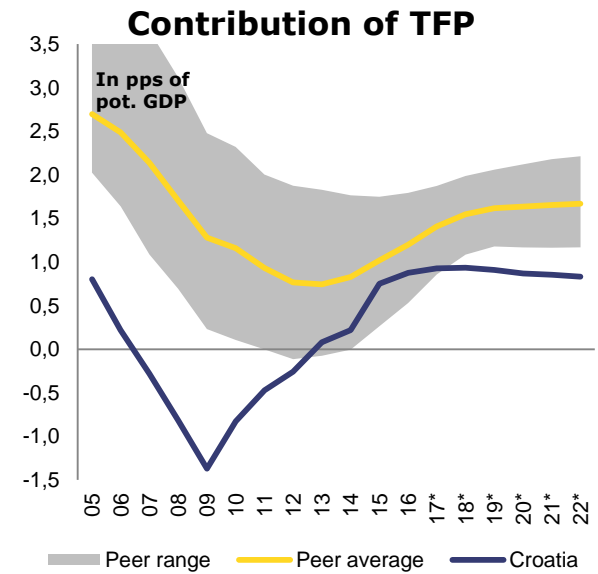
- *The contribution of capital deepening has been consistently positive and in line with peers*
- *However, TFP and especially labour were less growth-supportive and even detracted from growth in some periods*
  - TFP contribution was negative in the period before and during the crisis
  - Labour contribution plummeted during the crisis



Source: European Commission  
Note: (\*) indicates forecasts



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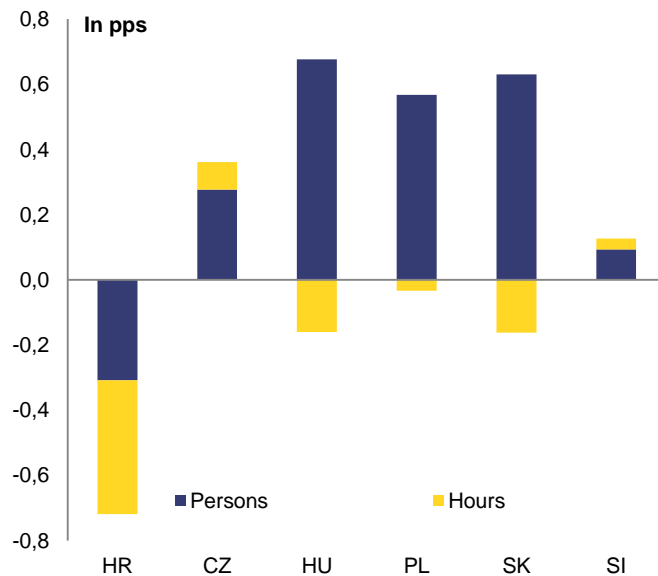


Source: European Commission  
Note: (\*) indicates forecasts

# Challenges to durable growth

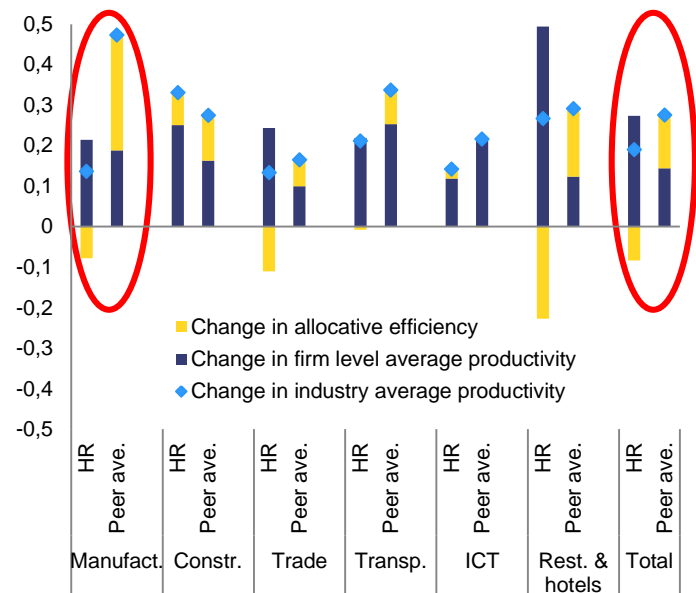
- *Negative contribution of labour since 2010 was driven by decreases in both hours worked and number of people in employment*
- *By contrast, in peers the slight decrease in hours worked was more than offset by rising employment*
- *Increasing the participation rate poses the main labour market-related challenge*
- *With regard to TFP, the key problem is allocative efficiency*

## Breakdown of labour contribution to potential growth (avg 2010-2017)



Source: European Commission

## Change in productivity (2010-2014)



Source: European Commission

# Wide range of barriers to investment

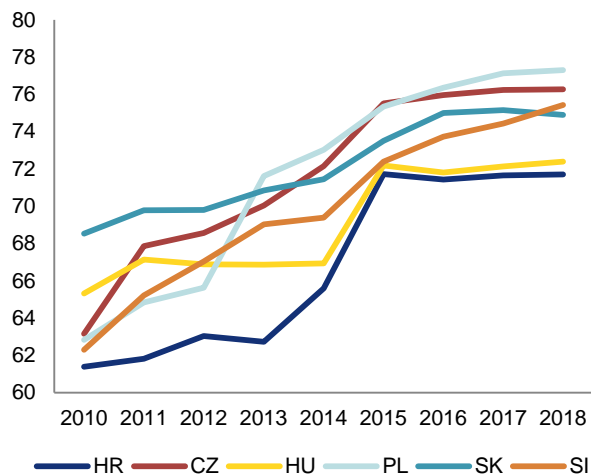
|  |  | Reform progress |         |
|--|--|-----------------|---------|
|  |  | CR 2018         | CR 2017 |
| Public administration/<br>Business environment | <b>Regulatory/administrative burden</b>        | Limited         | Some    |
|  | <b>Public administration</b>                   | None            | Some    |
|  | Public procurement/PPPs                        | Limited         | None    |
|  | <b>Judicial system</b>                         | Limited         | Some    |
|  | <b>Insolvency framework</b>                    | Limited         | Some    |
| Labour market/Education                        | <b>Wages &amp; wage setting</b>                | None            | None    |
|  | <b>Education</b>                               | None            |         |
| Financial sector                               | Access to finance                              | Limited         | Some    |
| Sector specific regulation                     | <b>Business services/Regulated professions</b> | None            | None    |
|  | Digital Economy/Telecom                        | None            | None    |
|  | Energy   | None            | None    |
|  | Transport                                      | None            | None    |

Note: Investment barriers that are also subject to a current CSR in bold; Education was not identified as a barrier to investment in the 2017 Country Report

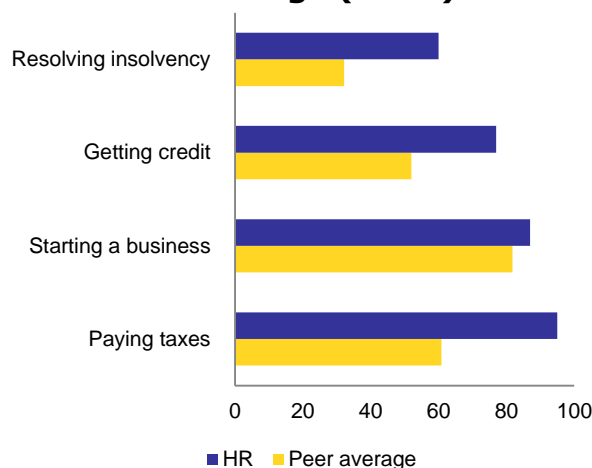
# Main deficiencies in the business environment

- *Cumbersome business environment*
- *Excessive regulation in product and services markets*
- *Regulatory uncertainty: frequent changes in regulation and excessive recourse to urgent legislative procedures*
- *Legal uncertainty: big backlogs of cases and long duration of proceedings in the judiciary*

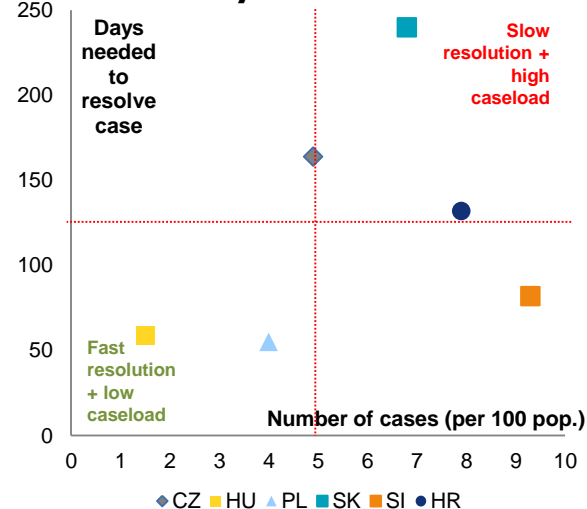
### Ease of Doing Business scores



### Doing Business, selected indicator rankings (2018)



### Justice system indicators



Source: World Bank Doing Business  
Notes: Methodological changes in 2014, 2015 and 2016; scores indicate distance to frontier (100=best)

Source: World Bank Doing Business

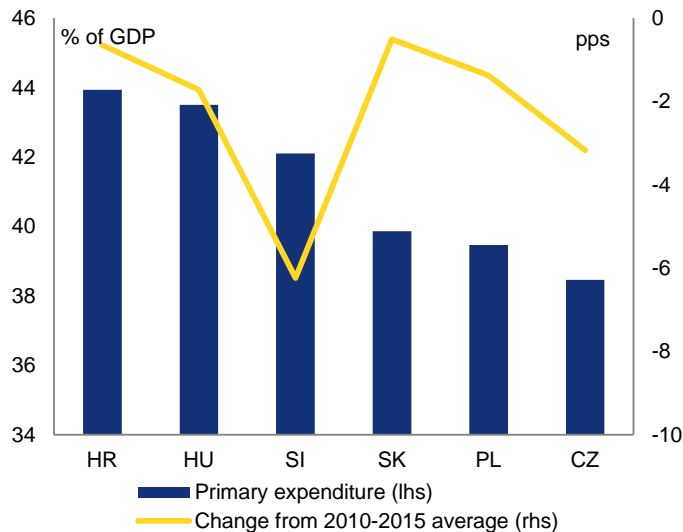
Source: European Commission



# Efficiency of public spending

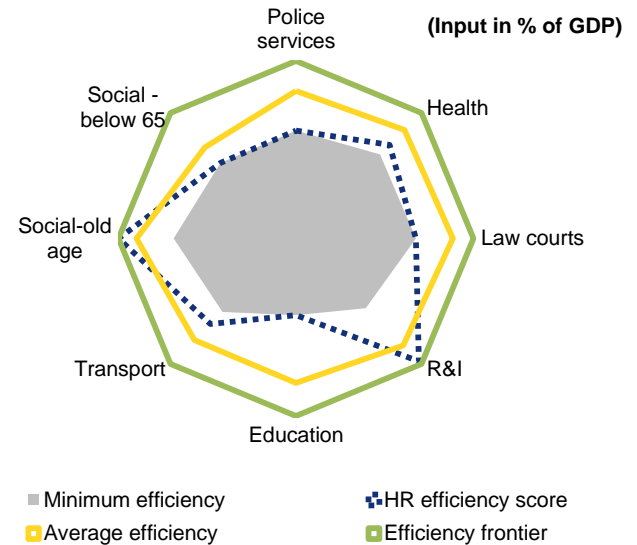
- *In spite of higher public spending, in most areas Croatia does not achieve better outcomes than its peers*
- *This suggests scope for improvement of outcomes for citizens and businesses without increasing spending*
- *Structural reforms needed: e.g. means-testing of social benefits, education reform, e-communication, reform of judicial map...*

**Primary spending (2016)**



Source: European Commission

**Efficiency of spending compared to peers**



Source: European Commission

# How can the EU help?

|                                   |  |
|-----------------------------------|--|
| EU funds, EFSI                    | <ul style="list-style-type: none"><li>• Financing of productivity-enhancing investments which spur growth</li><li>• More than EUR 10 billion available for HR by 2020</li><li>• Selected projects: Loan guarantees for start-ups, new Dubrovnik airport, "digitally mature schools"</li></ul>  |
| European Social Fund              | <ul style="list-style-type: none"><li>• Supporting employment and social inclusion</li><li>• EUR 1.6 billion available for HR by 2020 for the operational programme "Efficient Human Resources"; ten-fold increase from previous programme</li><li>• Funds primarily channelled towards (i) sustainable and quality employment for job seekers and inactive persons; and (ii) increasing the skills of the workforce</li></ul> |
| Structural reform support service | <ul style="list-style-type: none"><li>• Offers funded technical support in reform design and implementation</li><li>• 36 projects since 2016 in Croatia, mostly related to CSRs</li><li>• More than EUR 140 million available by 2020</li></ul>  |
| Reform delivery tool              | <ul style="list-style-type: none"><li>• Support for national reforms. The convergence facility for MS on the Euro adoption path</li></ul>  |



# Conclusions

- *Despite the ongoing broad-based recovery, medium-term projections reveal feeble potential growth*
- *Labour market activation and improved allocative efficiency are key stepping stones to lift growth*
- *Various obstacles to investment need to be removed, particularly in the domain of public administration and the business environment*
- *Reform implementation has been disappointing, Croatia should step up its efforts*
- *The EU can help by providing financial and technical assistance*

# Background: Reform implementation

## Overall assessment



### On track

- Disposal of state assets
- NPL reduction



### Wait-and-see

- Reform of public sector wages
- Reduction of administrative burden and parafiscal charges
- Education system reform
- Improving public assets management
- Reduction of backlogs in judicial system
- HBOR's asset quality review



### Action wanted

- Recurrent property tax
- Strengthening of fiscal frameworks
- Modernisation of public administration
- Pension system reform
- Social protection reform
- Reducing fiscal risks in healthcare
- Reform of regulated professions and other service markets