Croatia's medium-term growth and investment challenges

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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)

GDP and investment

- % of GDP (GDP growth)
- % of GDP (invest.)

Employment

- Thousand persons employed
- Activity rate, % of population

Potential growth

- % of pot. GDP

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

Contribution of capital

Contribution of labour

Contribution of TFP

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
## Wide range of barriers to investment

<table>
<thead>
<tr>
<th>Category</th>
<th>2018 Progress</th>
<th>2017 Progress</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Regulatory/administrative burden</strong></td>
<td>Limited</td>
<td>Some</td>
</tr>
<tr>
<td><strong>Public administration</strong></td>
<td>None</td>
<td>Some</td>
</tr>
<tr>
<td><strong>Public procurement/PPPs</strong></td>
<td>Limited</td>
<td>None</td>
</tr>
<tr>
<td><strong>Judicial system</strong></td>
<td>Limited</td>
<td>Some</td>
</tr>
<tr>
<td><strong>Insolvency framework</strong></td>
<td>Limited</td>
<td>Some</td>
</tr>
<tr>
<td><strong>Wages &amp; wage setting</strong></td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Access to finance</strong></td>
<td>Limited</td>
<td>Some</td>
</tr>
<tr>
<td><strong>Business services/Regulated professions</strong></td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Digital Economy/Telecom</strong></td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Energy</strong></td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Transport</strong></td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

### 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

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

Doing Business, selected indicator rankings (2018)

Source: World Bank Doing Business

Justice system indicators

Source: European Commission

Day needed to resolve case
Number of cases (per 100 pop.)
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)

Efficiency of spending compared to peers

Source: European Commission
### How can the EU help?

| EU funds, EFSI | • Financing of productivity-enhancing investments which spur growth  
|               | • More than EUR 10 billion available for HR by 2020  
|               | • Selected projects: Loan guarantees for start-ups, new Dubrovnik airport, "digitally mature schools" |
| European Social Fund | • Supporting employment and social inclusion  
|                      | • EUR 1.6 billion available for HR by 2020 for the operational programme "Efficient Human Resources"; ten-fold increase from previous programme  
|                      | • Funds primarily channelled towards (i) sustainable and quality employment for job seekers and inactive persons; and (ii) increasing the skills of the workforce |
| Structural reform support service | • Offers funded technical support in reform design and implementation  
|                                   | • 36 projects since 2016 in Croatia, mostly related to CSRs  
|                                   | • More than EUR 140 million available by 2020 |
| Reform delivery tool | • Support for national reforms. The convergence facility for MS on the Euro adoption path |
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

<table>
<thead>
<tr>
<th>On track</th>
<th>Wait-and-see</th>
<th>Action wanted</th>
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| - Disposal of state assets  
- NPL reduction | - 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 | - 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 |