



Croatia Market Reforms: Status Quo and the Way Forward

Austrian National Bank Conference

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Roadmap

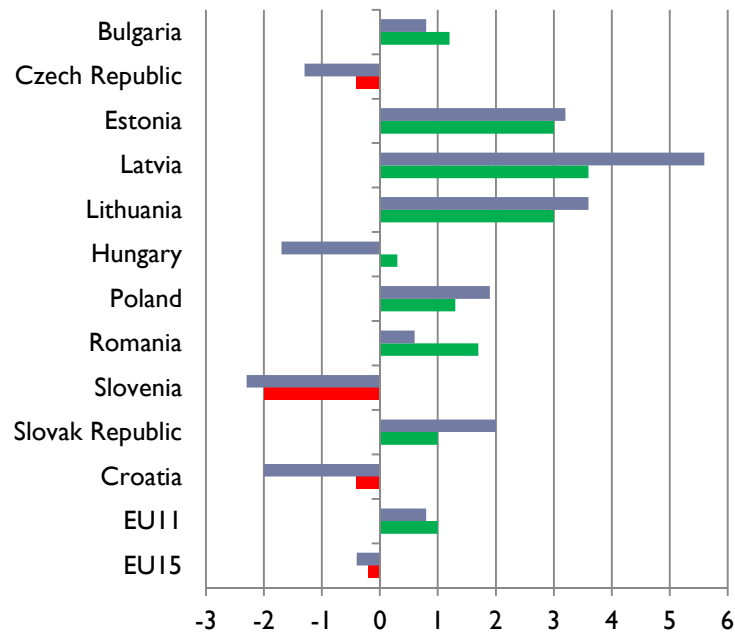


Croatia's drivers of growth before the crisis

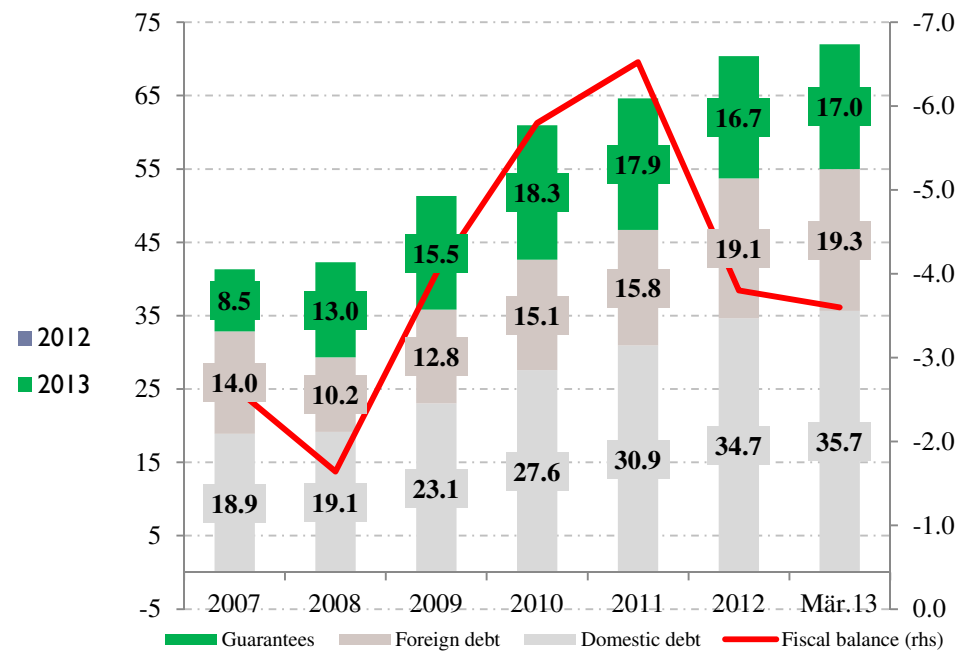
- ▶ **Capital** accumulation key driver of growth: investment levels above middle-income countries, but impact on growth comparatively limited (mostly civilian construction)
- ▶ Limited contribution of **total factor productivity** (TFP) due to limited trade integration, modest (off-the-frontier) innovation performance and inefficiency in the use of labor and capital
- ▶ Close to null contribution from **labor**-- aging and skills mismatches are challenging current and future obstacles
- Striking difference with the CEE whereby growth driven mainly by TFP gains, i.e. **using existing resources more efficiently and improving the investment climate.**

Fifth year of recession deepened vulnerabilities

EU 11 and EU15: GDP growth, y/y



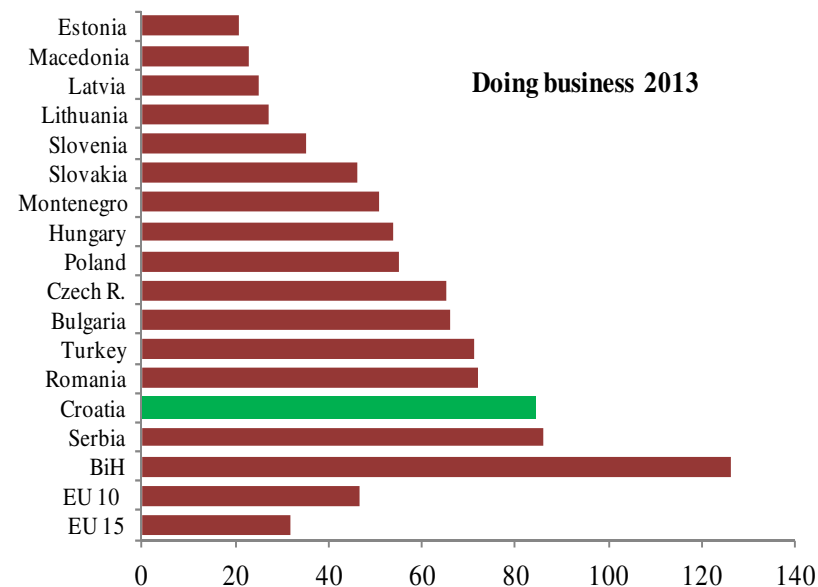
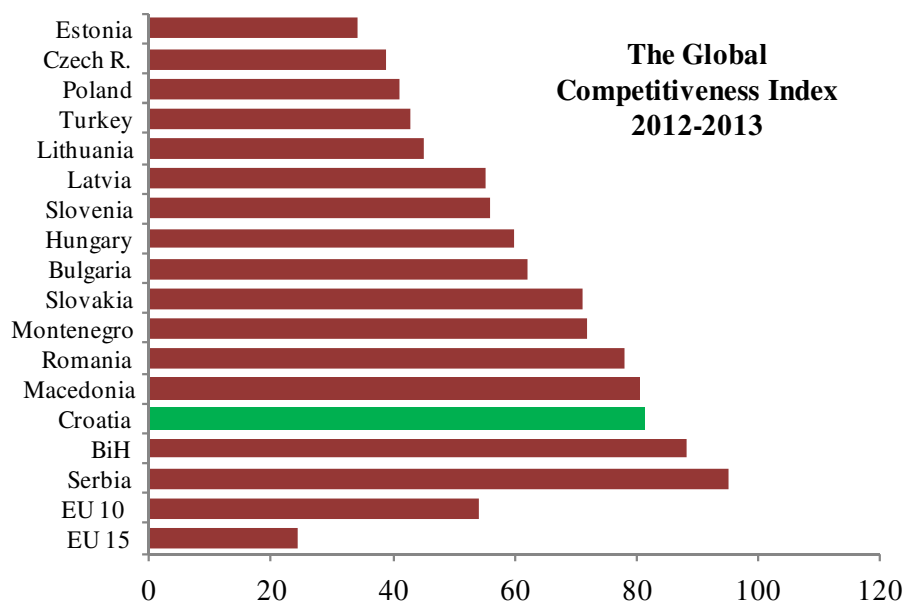
Public Debt and Deficit (% of GDP)



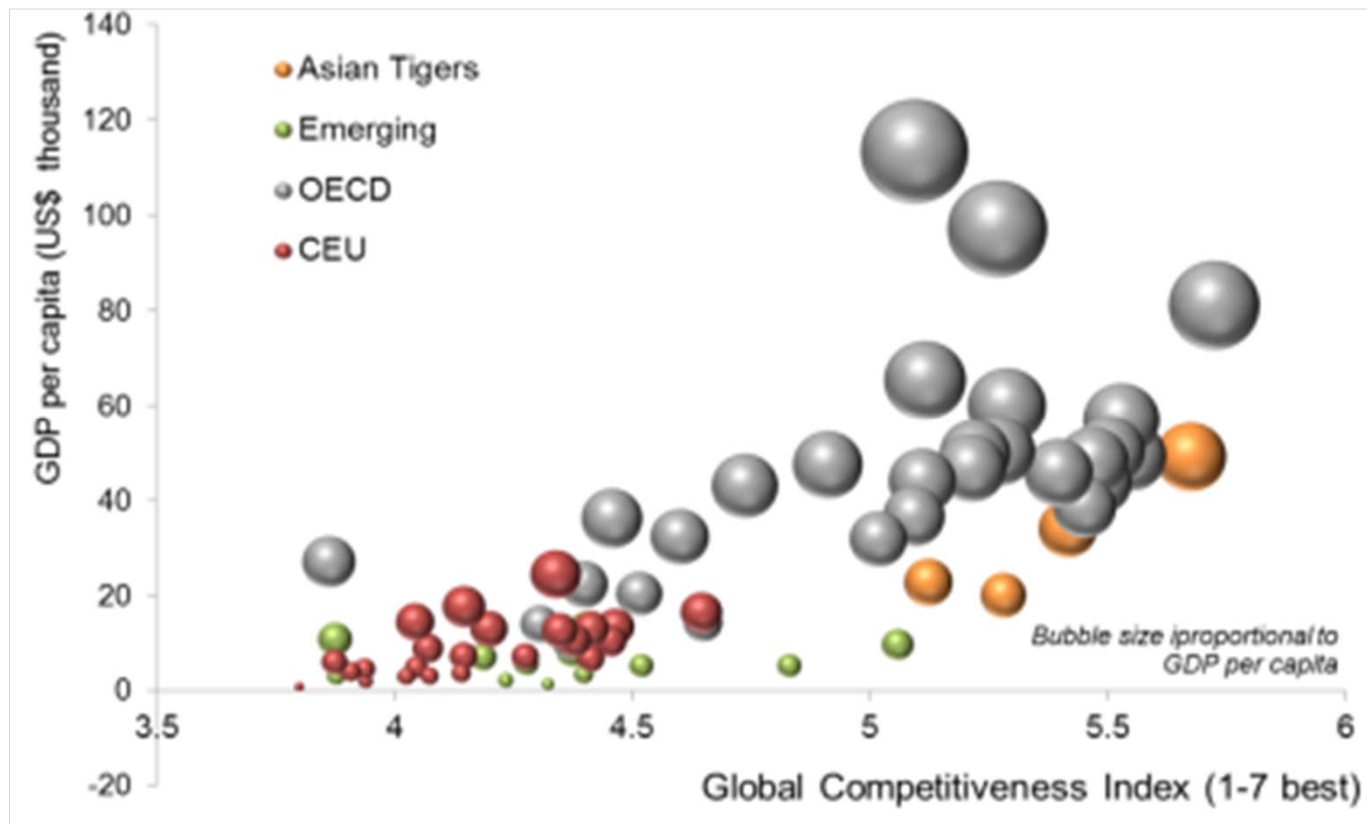
Note: Fiscal deficit assessed for 2008-2011 as per the required ESA95 coverage
 Source: Eurostat, CROSTAT, World Bank staff calculations

Continuous Decline in Croatia's Competitiveness

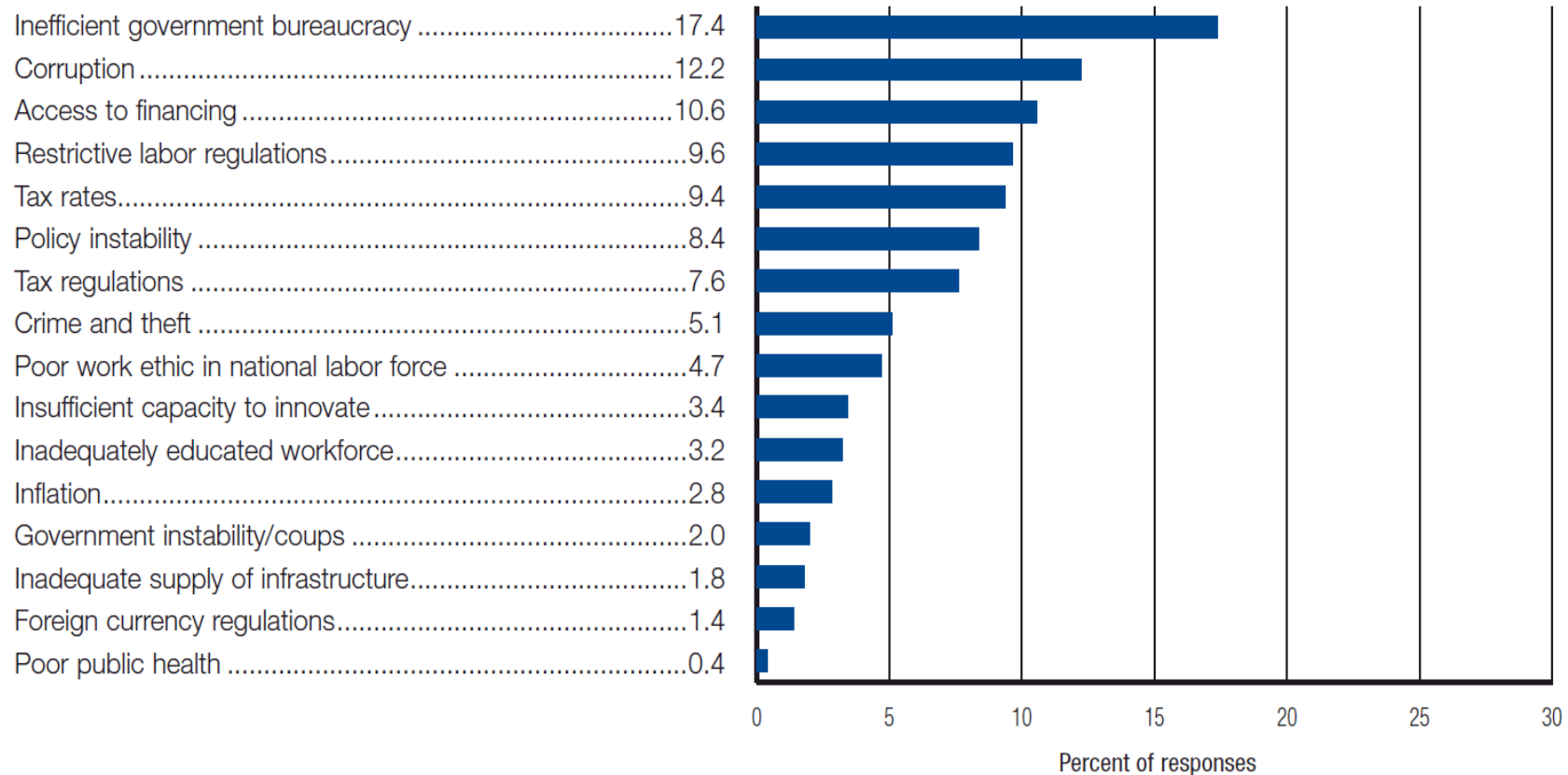
- Ranked 81st on the GCI and 84th in the Doing Business Survey
- Continuous decline from 2008
- Among the SEE countries, while comparative GDP pc with CEE
- Lags in protecting investors, dealing with construction permits, and registering property



Lack of Competitiveness Constrains Growth

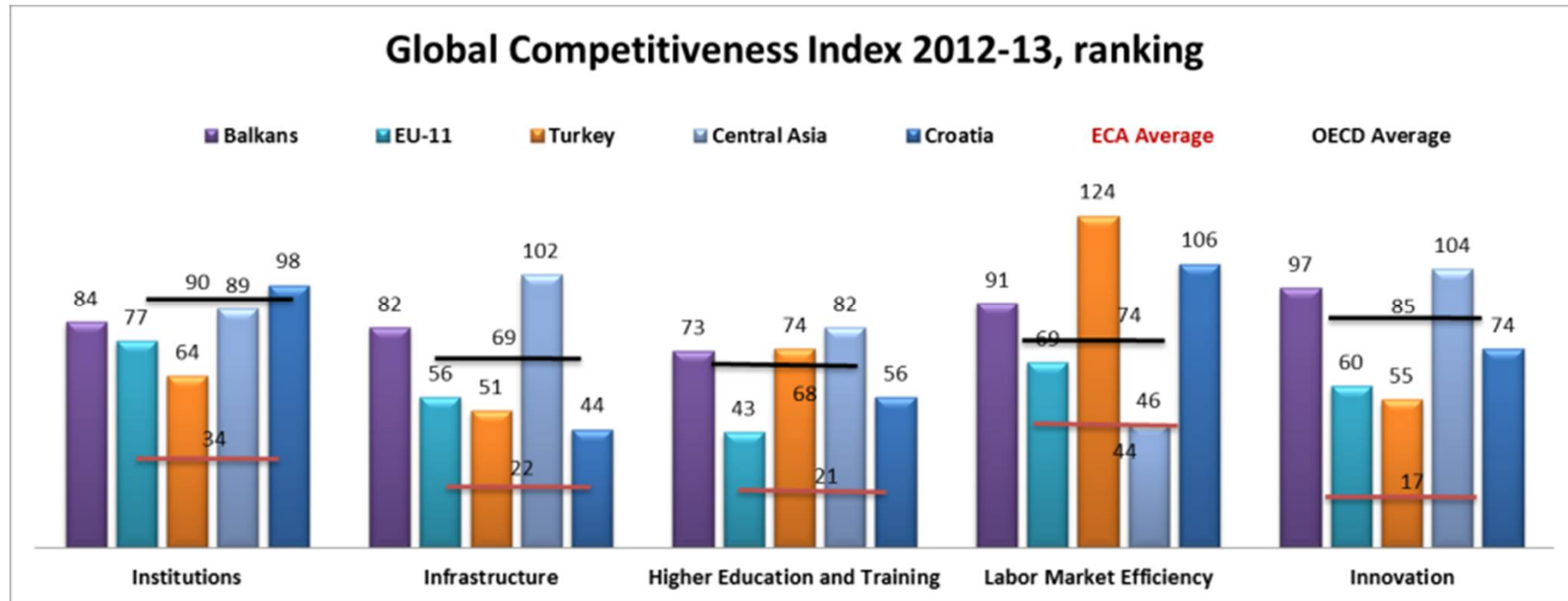


Croatia: The Most Problematic Factors for Doing Business, 2012-2013



Source: *Global Competitiveness Index, World Economic Forum*

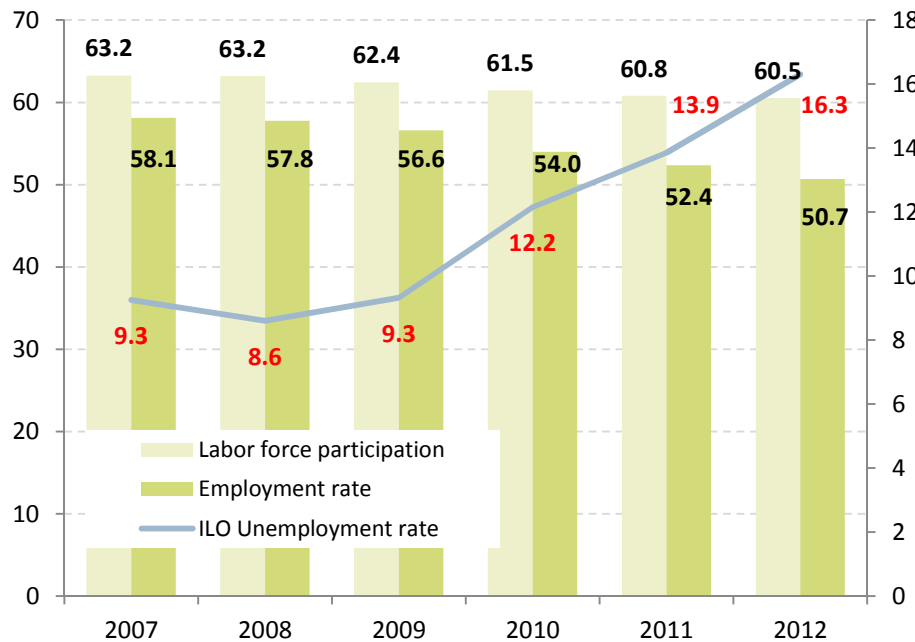
It's about institutions, innovation and labor market



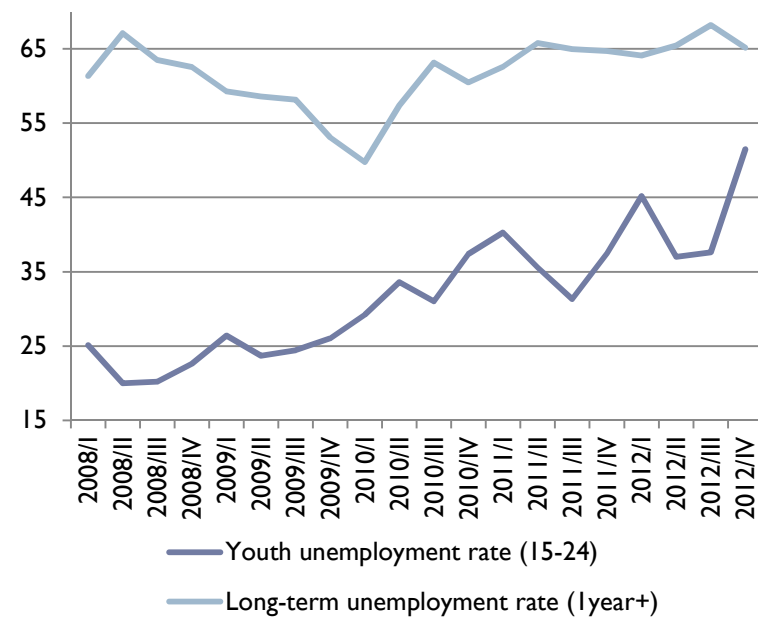
- Croatia performs notably poorly in terms of institutions, labor and goods market efficiency, innovation and from recently macroeconomic environment.
- Croatia's strengths are seen in infrastructure, health and primary education, and technological readiness.

Structural problems persist on the labor market

The lowest participation and employment rate in EU



Labor market entry for youth particularly constrained



Source: CROSTAT, HZZ, World Bank staff calculations

What To Do – Fiscal Consolidation

- Need to regain the investment credit rating before the capital market deteriorates (again)
- Growth strategy based on further capital accumulation and high levels of external financing unrealistic given Croatia's high public debt (67 percent of GDP if guarantees are included) and external vulnerability (debt to GDP ratio at above 100 percent).
- Expenditure-based consolidation remains priority – public spending at around 45% of GDP as opposed to 40% of GDP of EU10
 - Fiscal space exist in the area of wage bill, subsidies and consumption
 - Social spending requires redistribution from categorical to targeted social programs and a separation from contribution-based benefits from categorical benefits
 - Capital spending needs to be EU-funded based and under consideration of future maintenance cost

What To Do – Business Environment

- Investment climate - insolvency proceedings; issuance of construction permits; registering property; and transparency of related-party transactions.
- Open up the network industries such as energy, railways, postal services and telecoms to competition to deliver better services at better prices for business and citizens.
- Deepen the governance reform – e-governance, performance-based public sector pay; territorial reorganization; review business necessity of quasi-fiscal institutions

	Overall rank in 2013	Dealing with construction permits	Registering property	Protecting investors	Trading across borders	Resolving insolvency
EU15	32	51	72	67	25	21
EU10	47	85	41	72	56	56
Croatia	84	143	104	139	105	97

Source: World Bank

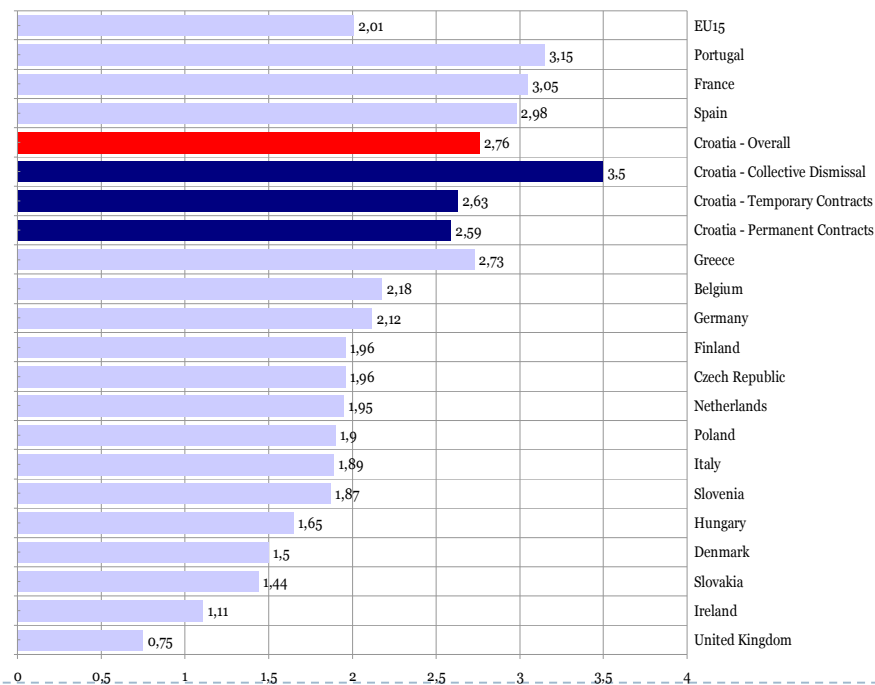
Time/Cost

Disclosure

What To Do – Labor Market and Skills

- Increase hiring flexibility (a good set of proposals submitted by the government)
- Reduce rigidity of collective firing
- Improve VET education and provide incentives for life-long learning
- Reduce incentives for early retirement, consolidate social benefits and improve their targeting

Employment Protection Legislation, Croatia and the EU, 2008



What To Do - EU Funds

- ▶ July 1, 2013 Croatia Becomes 28th EU Member State
- ▶ EU Structural Funds: Croatia will have 1.2% of GDP available for absorption in 2013 or 0.8% of GDP in payments or threefold from 2014.
- ▶ EU funds an opportunity to ease the external balance position and improves debt sustainability
- What needs to be done?
 - Create fiscal space of about 1 percent of GDP per year as counterpart funds and for pre-financing
 - Develop sector and regional development strategies linked to sustainable fiscal frameworks, so the funds are not used for 'roads leading to nowhere'.

To summarize

Growth performance from pre-crisis hardly to be repeated soon; new sources of growth are needed.

Urgent priority to address vulnerabilities through fiscal consolidation and reduction of public and external debt, backed by fiscal rules.

More proactive structural reform strategy to improve investment climate, labor market and increase efficiency of public sector.



Thank you!

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