

# On the path to the top league: sustaining Croatia's convergence

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Croatia, with a population of four million and independent as of three decades ago out-performs in many fields. The successes of its sports teams and of its leading athletes, and the beauty of its natural landscapes and the cities and islands along its sparkling coastline are well known. It is now aiming to achieve similar renown for its economy and quality of life.

An ambitious programme of reforms and investments over the past decade are bearing fruit and Croatia is advancing up the league tables. The economy is expanding and diversifying, generating jobs and raising incomes, and making poverty increasingly rare. The country navigated the COVID-19 and energy price shocks well, achieving robust rebounds in output and employment. The quality of the environment and of public services has improved, contributing to a markedly more optimistic outlook among younger generations. The country is also becoming increasingly attractive to immigrants. Croatia's integration into the euro- and Schengen areas at the start of 2023 is recognition of these changes and strengthens the base for continued progress.

Indeed, strong progress will need to continue if Croatia's is to move to the top of the league tables. For future generations to enjoy the incomes of the average OECD country, the economy will need to expand by 3% annually on average for the next thirty years, at the same time as it addresses the twin challenges of climate change and population ageing. The 2023 Economic Survey of Croatia, the first prepared by the

OECD and which is being launched in the context of Croatia's accession process to the OECD, identifies three groups of policy actions that can enable Croatia to build its form.

## **Robust growth will need to continue for Croatia to converge with OECD incomes**

GDP per capita, 2015 prices and PPPs, thousand USD

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Note: 'Peers' is the unweighted average of Czech Republic, Hungary, Slovak Republic, and Slovenia.

Source: OECD Annual National Accounts (database).

## **Ensure public finances and prudential supervision support sustainable growth**


Inflation is abating only gradually from its surge in 2022, when it peaked at 13.0% year-on-year in November, the highest rate since the 2000s. The labour market is tight, and employers report growing recruitment challenges. Meanwhile integration into the euro- and Schengen-areas are adding to demand from exports and investment, while banks have increased lending capacity. The government plans to shift the budget from a modest surplus in 2022 to a small deficit in 2023 and a larger deficit in 2024, further adding to demand pressures.

Avoiding fiscal stimulus while inflation remains high would ensure fiscal policy is counter-cyclical, and help inflation in Croatia return to the level of its peers. Vigilantly monitoring banks' new lending can support macroeconomic stability.

## **Consumer prices are still rising faster than in**

## **the euro area**

Consumer price inflation, year-on-year

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Note: 'Peers' is the unweighted average of Czech Republic, Hungary, Slovak Republic, and Slovenia.

Source: OECD Price Statistics database.

## **Support a more dynamic business environment where productive firms can grow**

Croatia has a lively start-up scene, and many new firms are relatively productive. But they grow less than in other countries. Instead, entrenched, lower-productivity firms dominate much of the business sector. Many firms' lagging productivity reflects low investment, especially foreign direct investment that brings new technologies, and investment in digitalisation and more innovative management.

Firms identify the time and resources spent on complying with regulations as a major constraint. Continuing to review, streamline and simplify regulations, and closely monitoring whether regulatory burdens are indeed diminishing can ensure progress.

## **In practice, businesses report that complying with regulations is burdensome**

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Many legal disputes remain slow to resolve, despite some recent gains, and many businesses report a lack of confidence in the legal system. Efforts to develop alternative dispute resolution, digitalise legal processes and better communicate

legal decisions can help.

State-owned enterprises (SOEs) continue to play an over-sized role in Croatia's economy, but many under-perform in how well they use their assets and workers and in the quality of the goods and services they deliver. Making SOE governance, arms-length from the government and more transparent about performance and returns can help. Listing state-owned enterprises where there is not a core justification for government ownership can also boost the firms' performance and the dynamism of Croatia's economy.

## **Strengthen skills and activate those out of the workforce to raise incomes and inclusiveness**

Croatia's growing and increasingly diverse economy requires ever higher levels of workforce skills. Many workers have solid intermediate skills, but investors report difficulties hiring higher-level skills. A big push to improve adult education can help. The strong take-up of a new adult education voucher scheme demonstrates that demand exists for a well-designed system, i.e. one that identifies workers' skill needs, adapts to their schedules and circumstances, and is affordable. Better connecting school and vocational education with employers' current and future needs would better prepare students for a dynamic economy.

## **Addressing barriers to adult education can raise participation**

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Alongside raising skills, a relatively large share of Croatia's younger and older adults is not in the labour force. These people are among those most at risk of poverty. Many

have few skills and little experience of working formally. Tailored activation services that develop skills and offer work experience can enable them to move into lasting jobs. Lagging areas with few opportunities are likely to need extra policy attention. Assisting older adults stay in work longer would help ensure they can enjoy adequate incomes and quality of life in retirement.

Croatia's reform and investment programme reflects its ambitions. Full implementing these efforts will take ongoing effort and energy. The benefits of graduating to the top league will be well worth the effort.