

Navigating demographic headwinds in Croatia

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Croatia's economy has experienced robust and resilient GDP growth and improved living standards over the past decade. Yet a rapidly shrinking and ageing population threatens future growth and fiscal sustainability. Advancing pension, health care and labour market reforms will be essential to extend working lives, improve healthy ageing and raise labour force participation.

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In the past decade, Croatia's economy has experienced strong and resilient GDP growth, outpacing OECD and euro area averages. Wide-ranging structural reforms as well as the integration into the EU, euro and Schengen areas all helped boost living standards. However, Croatia's population is shrinking and ageing rapidly, a combination that bodes ill for future economic growth and public finances. According to UN projections, the working age population will decline by about 25% between 2024 and 2050 (Figure 1). Moreover, for every ten working-age Croatians, there are about four people older than 65 today; by 2050 there will be nearly six. A smaller workforce will drag down growth. According to the OECD Long-Term Economic Model, GDP growth is projected to fall from over 3% per year on average in the last decade to 0.5% by 2050. At

the same time, spending on pensions, health care and long-term care will come under increasing pressure.

According to the 2026 Economic Survey of Croatia, addressing demographic challenges requires pension, health care, and labour market reforms to extend working lives, bring more people into the labour force, improve the health of the ageing population, and enhance the efficiency of public spending.

Average pensions of the current generation of pensioners are low, mainly due to short contribution periods. In 2024 the expected duration of working life was just 34.8 years, compared with an EU average of 37.2 years. Short working lives and hence pension contribution periods help explain why relative poverty among older people is nearly twice the OECD average. A recent pension reform aims to increase pension incomes, but comes at a significant fiscal cost. Further tightening early retirement options and increasing the retirement age in line with gains in life expectancy would prolong working lives and help improve pension income without jeopardising the sustainability of the pension system.

Health outcomes also need to improve to enable longer working lives. A higher share of adults aged 65 and over than in most OECD countries report long-standing limitations in their daily activities due to health problems. Improving health outcomes in a cost-effective way requires stronger prevention policies and higher taxes on unhealthy products, more accessible primary care, and higher quality and efficiency of hospital care, including by centralising complex care in specialised facilities.

Population ageing will strain the long-term care system. Today, care relies heavily on informal family caregivers—mainly women—creating significant physical and emotional burdens and limiting their labour-market participation. As care needs grow, this model will become unsustainable. Reforms are needed to expand the formal long-

term-care workforce, by improving working conditions and formalising work contracts. Spending on long-term care must rise to improve access and quality of care. Insurance-based models, like those in Germany, Japan, the Netherlands, and Slovenia, can be a solution to ensure adequate funding. Better integration of health and social services would make long-term care more efficient and sustainable.

Bringing younger and older people into the labour force is essential to mitigate the impact of ageing (Figure 2). Stronger work-based learning in vocational education could ease school-to-work transitions. Expanding affordable childcare and formal long-term care would lift employment among women. Among older workers, disability and poor health are major barriers. The employment gap for people with disabilities—36 percentage points in 2024, more than double the EU average—suggests that earlier intervention and broader access to professional rehabilitation are needed. Removing age limits on rehabilitation and linking disability benefits to participation in rehabilitation, would help retain more workers.

Well-designed immigration policy can help ease skills shortages. Croatia has recently seen higher immigration, reversing decades of net emigration, as living standards improved and entry procedures were streamlined. To maximise the gains, however, more efforts are needed to better align migrants' skills with current and future labour-market needs. Regular assessments and forecasts of skills shortages, more favourable permit conditions for workers in high-demand occupations, and stronger integration services, would improve the country's ability to attract and retain the workers it needs the most.

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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.