World Bank Group Croatia Partnership Framework  2019-23
Consultations with Partners

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World Bank Group

**IBRD**
International Bank for Reconstruction and Development

- Lends to governments of middle-income countries for development projects
- **Instruments:**
  - Loans, guarantees for investments, policy and programs
  - Advisory services, technical assistance

**IFC**
International Finance Corporation

- Provides loans / equity to stimulate private sector investment
- **Instruments:**
  - Investment
  - Advisory services
  - Asset management

**MIGA** – Multilateral Investment Guarantee Agency

**ICSID** – International Centre for the Settlement of Investment Disputes

**IDA** - International Development Association

**IBRD** is a development institution owned by 189 Member Countries

- Governor of the World Bank for Croatia is the Minister of Finance

- **IBRD Global reach:** 1,726 projects totaling $204.70 billion in 21,231 locations across 146 countries.
25 Years of World Bank Group Support to Croatia

The World Bank has financed 50 operations worth $3.5 billion and 300 Technical Assistance, Studies and Policy Notes:
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25 Years of World Bank Group Support to Croatia

The International Finance Corporation - US$1.2 billion financing including US$323 million in mobilization, including:

- Financed 3 windfarms, which represents 25% of the total installed wind capacity. Financed Zagreb airport through equity and debt.
- Support for domestic production companies expanding in the region, as well as flagship FDIs, with a focus on frontier, underserved regions.
Current Lending Program

### Portfolio Sector Composition
- **31%** Railways and Rijeka Port
- **45%** Roads - SOE restrict./debt mgmt.
- **2%** Science and innovations
- **12%** Health
- **10%** Public administration (w/transport)

<table>
<thead>
<tr>
<th>Project</th>
<th>Implementing body</th>
<th>$ m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rijeka Gateway 2</td>
<td>Port of Rijeka Authority</td>
<td>122.5</td>
</tr>
<tr>
<td>Integrated Land Admin. System</td>
<td>Min. of Justice, State Geodetic Administration</td>
<td>47.9</td>
</tr>
<tr>
<td>Science and Technology 2</td>
<td>Min. of Science and Education</td>
<td>26.2</td>
</tr>
<tr>
<td>Improving Quality and Efficiency of Health Services</td>
<td>Min. of Health</td>
<td>103.5</td>
</tr>
<tr>
<td>Adriatic Sea Environ. Pollution Control (GEF grant)</td>
<td>Environment Protec. and Energy Efficiency Fund</td>
<td>4.3</td>
</tr>
<tr>
<td>Sustainable Croatian Railways in Europe</td>
<td>Railway companies, Min. of Transport</td>
<td>183.4</td>
</tr>
<tr>
<td>Modern. and Restructuring. of the Road Sector (IBRD loan)</td>
<td>Min. of Transport, Road companies</td>
<td>23.3</td>
</tr>
<tr>
<td><strong>Total loans $ m</strong></td>
<td></td>
<td>511.1</td>
</tr>
<tr>
<td>Roads IBRD Guarantee</td>
<td>Min. of Transport, Road companies</td>
<td>370.7</td>
</tr>
<tr>
<td><strong>Total guarantees $ m</strong></td>
<td></td>
<td>370.7</td>
</tr>
</tbody>
</table>
Highlights of Past IFC Program

IFC Past Investments:

Financial markets: over EUR250 million loans to financial institutions to support the development of SMEs and energy efficiency projects in Croatia. Invested in first regional P/E funds in the region.

Agri and food processing: supported the two largest food companies in Croatia with over EUR200 million in financing to increase efficiency of operations and farming and expand in the W. Balkans region. Developed the agri food chain by supporting an FDI in agri machinery in Slavonia, aimed at increasing the efficiency of farming in the Slavonia region.

Food retail: supported one of the largest global retail chains to expand its operations in Croatia and increase the offer of affordable quality food to the underserved population.

Metal processing: supported post-privatization restructuring of the one of the largest steel mills in an impoverished region in Croatia, and developed the supply chain by supporting the largest scrap steel processor in the country.

Forestry: invested equity immediately after the war in one of the largest pulp and paper manufacturer in the region.

Past Advisory work:

PPP Advisory (Croatia airlines privatization): The government mandated IFC’s PPP advisory unit to assist it in assessing the market interest in the privatization of CA and to hold preliminary discussions with market players on the transaction structure(s) that would (i) be palatable for key sector players and (ii) optimize the viability of the project and the overall benefits to Croatia.

Corporate governance manual for the Zagreb Stock Exchange

Resource efficiency advisory for the largest meat processing plant in Croatia
Croatia - Systematic Country Diagnostic (SCD)

• Analysis of growth, inclusion and sustainability
• Country’s challenges and opportunities
• Identification of priorities
Losing speed vis-à-vis EU peers

Stagnant Convergence with the EU

(GDP per capita at EU28 at Purchasing Power Standards)

Source: Eurostat, WEF and WB staff calculations.
Croatia faces a major convergence challenge

Stagnant Convergence with the EU

If Croatia's growth rates slow down to 1.3% (towards its potential growth rate), it would take 21 years for the country to catch up with the current levels of per capita income in Slovakia, or 58 years for Austria (by 2074).

If Croatia can keep 3% growth rate, it will catch up with today's Slovakia in 9 years and today's Austria in 26 years.
Eastern and Central rural Croatia are disproportionately affected by poverty and emigration

Small areas poverty maps
What is the source of the problem?

- Hiring labor
- Buying products and services

Policies and regulation

Hiring labor

Buying products and services
Key issues

• **State is too big in some parts** (SOEs) and too little in others (Regulatory role to enhance competition)

• **Government effectiveness is low** (slow and cumbersome decisions, lack of proper coordination, strategies without actions, weak incentives to perform in public administration...)

• **Lagging firm productivity and innovation environment constrained**

• **Labor potential not used** at its fullest and **weak productivity**
Main messages

• **Croatia’s development** has been lagging its peers over the last ten years

• **Unused potential of labor and lagging firm productivity** driven by inefficient state policies and regulations

• Current **favorable external environment** should be used to build **fiscal resilience**

• **Euro adoption plan** offers fresh **opportunity** for **reforms** that could spearhead real and resilient convergence

• But bold **actions are required to overcome Croatia’s stagnation** and low level equilibrium
Recommendations

• A **comprehensive reform program** is crucial to renew the real convergence.

• The **key priority reform areas** can be articulated around the **three objectives**:
  - Enabling the emergence of a dynamic enterprise sector;
  - Boosting participation and contribution of individuals to economic and social development; and
  - Enhancing the sustainability and performance of the public sector.

• **Reshaping the role of the state** to set the right incentives for individuals and enterprises is the cornerstone of the reform agenda.

• The longer the delay in **improving skills** and enabling Croatian firms to participate effectively in **innovation-led productivity growth**, the more difficult it will be to catch up.
## Systematic Country Diagnostic - Main Priorities

<table>
<thead>
<tr>
<th>Objective A: Enabling the emergence of a dynamic enterprise sector</th>
<th>Objective B: Boosting participation and contribution of individuals to economic and social development</th>
<th>Objective C: Enhancing the sustainability and performance of the public sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foster a more competitive environment</td>
<td>Improve skills of the workforce</td>
<td>Pursue efforts to reduce fiscal vulnerabilities</td>
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<tr>
<td>Boost justice system performance</td>
<td>Foster labor market participation</td>
<td>Improve quality and efficiency of public administration</td>
</tr>
<tr>
<td>Unleash firm innovate capabilities</td>
<td>Ensure productive aging through lifelong learning, healthy aging and promotion of longer working lives</td>
<td>Ensure the preservation of natural capital</td>
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</tbody>
</table>
Preparation of the New Country Partnership Framework (CPF) for 2019-23

Consultation and stakeholder engagement
- To validate WBG CPF priorities and ensure alignment with Croatia development needs

CPF 2019-23 – selective, flexible, high-impact WBG program
- Help country reduce poverty, and improve inclusion
- Draws on Croatia’s strategy and priorities, WBG corporate priorities (e.g. global public goods)
- Draws on lessons from past WBG country strategy
- Selects high impact areas and engage selectively
- Aligns with EU and other partners (IFIs), complements and leverages others’ resources
- Flexible approach – program adjusting every two years (for a 6-years CPF)
CPF – Proposed Areas of Engagement

Human Capital Development & Improved Institutions

**Inclusion** – supporting development of lagging regions and poverty reduction (e.g. Slavonia)

**Improve the resilience of the country** – focusing on efficiency of institutions, fiscal sustainability, and structural reforms (e.g. in health and education)

**Competitiveness and business environment** – tackling regulations, improving the justice system, supporting development (e.g. SMEs), competitive private sector, and innovation
Indicative Areas

HUMAN CAPITAL DEVELOPMENT

IMPROVE THE RESILIENCE OF ECONOMY

INCLUSION – lagging regions, poverty
- Disaster Risk Management
- Pre-school Education
- Agriculture sector
- Regional development
- Support to lagging regions - Slavonia
- Solid Waste Management

Health sector

Water/Wastewater

Regional development

National Development Strategy

COMPETIT. & BUSINESS ENVIRONMENT – regulations, justice, SMEs
- Judiciary
- Science Innovation Digitalization
- State-owned enterprises
- Railways
- Doing Business reform

Agriculture sector

Support to lagging regions - Slavonia

Indicative Areas

Doing Business reform
IFC’s Priority Areas in Croatia for new CPF

**Priority Area**
- Enhanced private sector role in the economy
- Efficient delivery in infrastructure
- Deepening capital markets

**Key IFC Interventions**
- Support investments in frontier regions
- Support local and regional players in the tourism sector
- South-south investments and transfer of know-how (innovation)
- PPP’s and post-privatization financing
- Support critical infrastructure (including social) through PPPs and investment
- Promote projects in the energy sector in the renewable energy space
- Co-invest with EU funds at municipal level
- Capital markets development (bonds/equity)
- Credit lines for SMEs/ agribusiness with focus on lagging regions
- VC and P/E funds support

**Desired Impact Result**
- Increased number of corporate bonds and IPOs
- Increased VC money available for start-ups and innovations
- Reach more corporate and SMEs through innovative products and services
- Increased private sector participation in infrastructure and increased efficiency of delivery
- Increased share R/E projects in the energy mix
- Reduced infra gaps vs EU (solid waste)
- Increase private sector job opportunities.
- Promote export oriented sectors and FDI; support value chains and development of Eastern Croatia
- Creating jobs – focus on youth and gender (eastern region, lagging regions)
- Support Croatia as a sustainable tourism destination
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We would appreciate your inputs!

Please, take a few minutes to fill out our survey:

**QR code:**

**LINK:**

https://www.surveymonkey.com/r/RCQP373
Zooming in on..........

WBG support to Projekt Slavonija, Baranja & Srijem
Objective:
To support the Government of Croatia to deploy effectively European Structural and Investment Funds in Slavonija, Baranja & Srijem to address constraints on growth and jobs.

Format:
3 year project.
• **2014-2020**: support to improve the quality of the project pipeline, and to identify additional priority projects and reforms.
• **2021-2027**: support to design a strategy and integrated program of projects and reforms.

Across both periods, the World Bank will provide capacity building and support to the Ministry and to regional counterparts to implement priority projects and reforms.
## Opportunities

<table>
<thead>
<tr>
<th>Sector</th>
<th>Description</th>
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| Agriculture   | Earn higher value and prices  
|               | **Diversification** of farm incomes (e.g. agritourism; bioenergy)                                                                         |
| ICT           | Moving to **software development & peer-to-peer**  
|               | Provision of **productive ICT enabling environment**                                                                                     |
| Tourism       | **Raising Slavonia’s image, branding and tourism offer**—including in niche markets (rural tourism, gastronomy, cycling)                    |
| Wood          | Moving from raw exports to **customized and high value wood products**                                                                     |

*World Bank Group*
Constraints

- **Fragmented** spending
  (many small projects; but fewer initiatives that combine efforts to a big scale for international competitiveness)

- Subsidies for existing activities, rather than an emphasis on **transformation**?
## Zooming in on WBG support to Projekt Slavonija, Baranja & Srijem

### Timeline

<table>
<thead>
<tr>
<th>Activity</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
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<tbody>
<tr>
<td>1.1 Rapid diagnostics and advisory</td>
<td></td>
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<td>1.2 Prioritization of current pipeline</td>
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<td>1.3 Identification of additional projects or schemes</td>
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<td>1.4 Implementation support for Project Slavonija, Baranja and Srijem</td>
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<td>2.1 Strategic diagnostics and institutional framework for territorial development program</td>
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<tr>
<td>2.2 Identification of projects, schemes and reforms to increase investment, productivity, and jobs</td>
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<tr>
<td>2.3 Implementation capacity</td>
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### Key
- **Output**: Green
- **Implementation Support**: Orange
Zooming in on...........

WBG support to Projekt Slavonija, Baranja & Srijem

Implementation structure
Cumbersome business environment weighs on investment and resource allocation

**Business barriers inhibit private sector investments and distort resource allocations**

*Croatia lags best performers*

*(Distance to the frontier, Doing Business Indicators, 2018)*

Private Sector Challenges in Croatia

**Difficult business environment**
- Croatia lags best performers in key Doing Business indicators, including access to credit, resolving insolvency, and obtaining construction permits.

**Substantial difficulties in accessing finance**
- Croatia ranks 75th out of 190 countries in DB report in terms of getting credit; SMEs and start-ups are the most affected.
- The equity markets are constrained by small size and bond markets are underutilized.

**Weak competitive environment and limited innovation**
- Croatia remains on the periphery of networks of global value chains (GVCs) and has the most restrictive economy compared to peers (state control, barriers to entrepreneurship and barriers to trade and investment).
- Limited availability of risk capital financing exacerbated by cumbersome insolvency framework.
- R&D expenditures less than half of EU average.

**Large role of the state**
- SOEs play an important role but also impose large burden on the economy.