The World Bank in Croatia

Country Snapshot

An overview of the World Bank's work in Croatia

April 2018

CROATIA	2017
Population, million	4.1
GDP, current US$ billion	54.9
GDP per capita, current US$	13,297
School Enrollment, primary (% gross)	98.0
Life Expectancy at birth, years	78.1

At a Glance

- In 2017, growth slowed down to 2.8%, due to reduced government investment and increasing imports. 2018 is expected to bring 2.6% growth with a slight pickup just below the 3% mark in 2019–20, thus maintaining solid growth.
- Croatia could improve its potentially low growth rate by boosting private sector productivity and competitiveness, reforming its justice and regulatory framework, raising the quality of human and physical capital, and modernizing its public services.
- The Bank is working to enhance Croatia's competitiveness by providing lending and technical assistance to support structural, institutional, and governance reforms and to help diversify its sources of growth, catch up with EU peers, and use EU funds more efficiently. The Bank's portfolio has a special focus on the transport sector.
- The International Bank for Reconstruction and Development (IBRD) portfolio comprises six investment projects, one regional Global Environment Facility grant, and two guarantees.

Country Context

After a protracted six-year recession, Croatia returned to growth in 2015 and is now in its fourth year of recovery. However, potential growth remains low and some vulnerabilities need to be addressed, as the country faces high debt levels in the state and private sectors, a low employment rate, unfavorable demographic trends, and a cumbersome investment climate.

Access to the European Union (EU) internal market helped connect part of the economy to global value chains, and tourism is experiencing a historic high. Yet these factors are not enough to deliver pre-crisis growth rates. GDP is roughly 1% lower than in the pre-crisis period, and youth unemployment remains high at 33%. The absolute poverty rate (at US$5.5 2011 purchasing power parity [PPP] per capita) increased from 4.7% in 2009 to 5.1% in 2017.

Croatia's economic challenges include maintaining macroeconomic stability while promoting exports and private sector productivity and competitiveness to create jobs and growth. Reducing high public sector debt and the large state presence in the economy will also help improve growth potential.

The projected population decline, due in part to out-migration, and the rapidly aging population present risks to growth and higher living standards, as well as to fiscal sustainability. Croatia also needs to continue modernizing its public services, the judiciary, and the governance of state-owned enterprises (SOEs), including the network industries.

The World Bank and Croatia

The World Bank's activities in Croatia are guided by the 2013–17 Country Partnership Strategy (CPS), and a new Strategic Framework is currently under preparation.

The Bank's activities are centered on supporting Croatia's economic convergence with the EU. During the initial stages, the engagement focused on promoting reforms in support of fiscal adjustment, enhancing competitiveness, and maximizing the economic benefits of EU membership. The Bank has also been emphasizing institutional capacity building related to EU membership, particularly relevant to Croatia's ability to absorb EU funds.

The Bank's current financial commitment focuses on the transport sector, with projects in health, innovation, and land administration. These projects incorporate significant support to public administration through building capacity in the public sector. The CPS has financed the development of an EU funds project pipeline worth €500 million. The focus of the advisory services program is twofold: helping to improve the business climate and the competitiveness of the economy and creating an evidence base for cross-sectoral policies and interventions to address social and regional disparities.

Key Engagement

Situated along three pan-European transport corridors between the EU and Southeast Europe, Croatia has an important geopolitical advantage.

For over a decade, and with more than half of its portfolio, the World Bank has been helping Croatia's transport sector become more competitive and develop into an important engine of growth. Since the beginning of the early 2000s, the Bank has been supporting the development of Croatia's key port in Rijeka through the Rijeka Gateway Program.

WORLD BANK PORTFOLIO

6 Projects, 1 regional GEF and 2 guarantees

Lending IBRD: $487 million (investments); $539.5 million (guarantees)

20 ongoing knowledge activities, TA and/or Reimbursable Advisory Services (RAS)

The current program aims to develop the capacity, financial performance, and quality of services of the port of Rijeka through public-private partnerships to meet growing traffic demand. It will improve port competitiveness by modernizing strategic port facilities and private sector involvement.

The World Bank, the Ministry of the Sea, Transport and Infrastructure, and three roads companies launched the Modernization and Restructuring of the Roads Sector Project in April 2017.

Designed as a blend of an investment loan and a guarantee, this intervention is supporting the operational and financial restructuring of roads companies in Croatia. The loan portion is funding the implementation of the companies' operational restructuring, while the guarantee is available to support the restructuring of liabilities to better match road-asset cash flows, reduce interest costs, and lengthen maturities.

The Bank has been working with Croatian railway companies to improve their operational efficiency in order to deliver better services in a financially sustainable way. The Sustainable Croatian Railways in Europe project complements major investments in infrastructure on international corridors funded by the EU by focusing on overall sector restructuring and the sustainability of public companies. This includes select financing of critical bottlenecks in railway infrastructure and safety measures, the modernization of IT systems, the rehabilitation of the rolling stock fleet, and the separation and management of assets.

Recent Economic Developments

In the last quarter of 2017, economic growth decelerated, with a decrease in the 2017 GDP growth rate to 2.8% from 3.2% in 2016. The slowdown was mainly due to a deceleration in government investment and a rebound in imports. Exports were the main driver of growth with a strong contribution from tourism, as overnights by foreign tourists rose by over 11%.

Private consumption also made a strong contribution to growth, supported by favorable labor market developments, cuts in the personal income tax rate, and a slight recovery in consumer confidence. Finally, investment growth decelerated markedly due to the weaker absorption of EU funds, leading to a sharp fall in government investments.

The economic recovery resulted in rising employment, which, coupled with high levels of out-migration, led to a notable decline in the unemployment rate to an estimated 11% in 2017 (2.1% lower than in 2016). The broad-based growth contributed to a further reduction in absolute poverty, bringing the poverty rate (measured at US$5.5 at 2011 PPP per capita) down to 5.8% in 2015 from 7.3% in 2013.

Fiscal consolidation continued in 2017 with an estimated budget surplus of 0. 1% of GDP, down from a deficit of 0.9% in 2016. External debt declined to 84.2% of GDP in November 2017, 5.6% lower than 2016.

Economic Outlook

Growth is expected to slow to 2.6% in 2018, following an expected fall in private consumption due to the end of the favorable tax reform effects and slowing wage growth. Exports of tourist services, after exceptionally strong growth estimated at around 6.5% in 2015–17 , are expected to slow down in 2018, due also to capacity constraints. On the other hand, a better absorption of EU funds will give a boost to investment spending and eventually raise economic growth to an average of 2.8% in 2019–20.

Although a further nominal consolidation is foreseen in 2018, the structural budget balance is expected to worsen, pointing to a moderately pro-cyclical fiscal stance. The government balance is expected to stay in surplus and may reach 1% by 2020, leading to a further decline in public debt to below 70% of GDP.

Positive labor market developments are expected to support the growth of disposable income for all segments of the welfare distribution, and the absolute poverty rate is expected to fall further to 4.0% in 2020.

Downside risks have moderated but are still present. As the operational restructuring of Agrokor Group unfolds in 2018, the negative effects on investment activity and private consumption might be greater than currently envisaged. The still high level of public debt makes Croatia vulnerable to interest rate shocks and worsening external financing conditions.

There is also a risk that the cyclical upturn and stronger fiscal position may result in complacency and diminished reform momentum, which would have an adverse effect on growth over the medium term. Croatia's prospects for reinitiating real convergence and promoting inclusive growth remain weak.

The currently low growth potential calls for a strong structural reform agenda. Substantial economic, social, and institutional weaknesses should be addressed to boost private sector productivity and competitiveness, raise the quality of human and physical capital, and modernize public services. This should also lead to increasing economic activity and employment, which is crucial for a further reduction in poverty.

Project Spotlight

Modernization and Restructuring of the Road Sector Project (MARS)

A safe and well-managed road network is essential for Croatia's economic growth.

A safe and well-managed road network is essential for Croatia's economic growth. The road network is possibly the country's largest infrastructure asset.

The Croatian Government has embarked on an ambitious program to lower the macro-fiscal impact of the road sector on the economy and to improve the performance and planning of the road sector and the operational efficiency of the sector's State-owned enterprises.

This process is being supported by a World Bank loan (€22 million) and a guarantee (€350 million) under the Modernization and Restructuring of the Road Sector project (MARS).

With regard to financial optimization, a €1.275 million sovereign bond was raised and on-lent to the road companies to refinance their existing short-term, high-interest loans on what was the cheapest and longest capital raising ever achieved by Croatia on international capital markets.

A further amount of €1.8 billion of existing commercial debt was renegotiated with domestic commercial banks. Now, 60% (€3.1 billion) of the debt has been refinanced, with visible financial benefits. Savings on interest payments for the sector will likely exceed €400 million over the next 10 years. Although drawing on the Bank's guarantee has not been necessary, it remains available to support further road sector debt optimization, as and when the Government determines that support would be most beneficial.

Once reforms are completed, the cost of motorway operations will decline by 30% compared to 2016, and the road companies will cover costs from their own revenues, freeing up state resources that, without restructuring, would have been needed to bail them out. These funds will instead be available to invest in other important areas of Croatia's development.

The "Country Snapshot" is a bi-annual update, highlighting the country's recent developments, economic outlook and major overview of the World Bank's partnership with the country. You can find the latest updates at http://www.worldbank.org/croatia

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