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PRESS RELEASES

EBRD report on transition toward sustainable market economy: Croatia lags behind

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The European Bank for Reconstruction and Development (EBRD) has been publishing annual reports on the progress of transition countries since 1994[1]. Its recently published Transition Report 2017 – 2018, entitled Sustaining Growth, focuses on sustainable growth challenges, particularly in middle-income countries, and on their productivity, infrastructure, environmental challenges, macroeconomics, and structural reforms.

At the beginning of the transition period, all these countries faced similar challenges – from economic reforms and introducing market prices to creating an appropriate institutional framework for growth and economic stability. Much has changed since and the institutional frameworks and market orientations have diversified significantly.

Based on the 2013 report, evocatively titled Stuck in Transition? to point out the slow-down in transition, EBRD has revised its approach to monitoring the progress of the observed countries. In this report, it is offering an updated interpretation of transition, according to which the goal of transition should be a sustainable market economy whose key characteristics are competitiveness, good governance, green economy, inclusiveness (as regards gender, regional and age balance), resilience (in regard to financial instability and energy) and integration (in terms of foreign trade, finance and infrastructure).

The concept of the role of the state and the private sector has changed as well, particularly following the global financial crisis. It is becoming increasingly clear that unfettered markets and poor regulation could lead to unwanted results such as a rise in inequality, variable productivity and negative environmental impact. Insufficient economic growth, high unemployment rates and weak real income growth have led to disillusionment with the market and a decline in public support for market reforms.

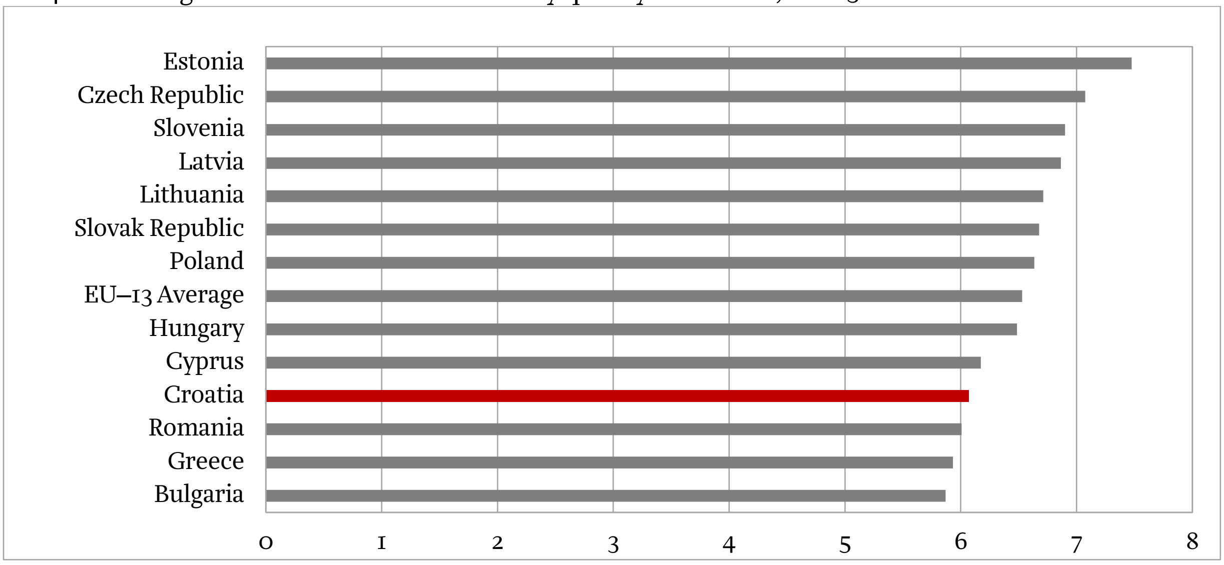
The roles of the state and the private sector are obviously closely intertwined. To have a healthy private sector, the state must ensure sound legal and regulatory frameworks to uphold the rule of law, correct market failures, prevent abuses by interest groups, ensure a level playing field to all, and allow all sections of the society to have equal access to economic opportunities.

[1] EBRD was set up in 1991 to provide support for the transition process in Central and Eastern European countries. Having expanded its activity, EBRD is currently present in three continents, in the following regions and countries: Central Europe and the Baltic states (Croatia, Estonia, Hungary, Latvia, Lithuania, , Poland, Slovakia, Slovenia); South-eastern Europe (Albania, Bosnia and Herzegovina, Bulgaria, Cyprus, FYR Macedonia, Greece, Kosovo, Montenegro, , Romania, Serbia); Turkey; Eastern Europe and the Caucasus (Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine); Russia; Central Asia (Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan, Uzbekistan), and Southern and eastern Mediterranean (Egypt, Jordan, Lebanon, Morocco, Tunisia). The Czech Republic is the only one of the original transition states that has "graduated" to not being considered a transition state by the EBRD any longer.

While EBRD's previously used methodology and indicators emphasised the progress of the markets' structural aspects, such as private ownership and competition, the new approach focuses on outcomes, looking at the characteristics of market economy sustainability. The above six indicators can be regarded as a natural extension of the original transition concept, remaining focused on those characteristics of the market and the private sector that are indispensable for development and growth. The new methodology is based on market economy sustainability indicators rather than on structural or sectoral indicators. Progress in each of the six indicators is measured on a scale of 1 to 10, 10 indicating a fully sustainable market economy[2].

As shown in the table of indicators for transition countries observed by the EBRD and several non-transition countries included for the sake of comparison (Sweden, Germany, the USA, and the Czech Republic), the major difficulties faced by transition countries, on average, are competitiveness and good governance, while they are showing slightly better results in the areas of integration and resilience. Central European and Baltic countries (especially Estonia, Latvia and Slovenia) come closest to a sustainable market economy, while Central Asian countries face the biggest challenges. Croatia's major challenges are the quality of governance and competitiveness, but Croatia also shows below-average results as regards all other sustainable market economy indicators in comparison with Central European and Baltic countries. While all indicators, especially average values such as those shown in the EU-13 graph, should be taken with a grain of salt, Croatia has no reason to feel good about itself. Not only is its indicator average, at 6.07, far below that of the leading country, Estonia (7.48), it is furthermore below the average distance from sustainable market economy for the thirteen countries taken together, with only Romania, Greece and Bulgaria lagging further behind.

Graph 1 Average sustainable market economy quality indicators, EU-13



Source: Author based on the Sustaining Growth report

In the Report section referring to country assessments, EBRD points out that Croatia's growth accelerated and general government deficit fell in 2016, as well as that the 2017 National Reform Programme contains a number of reforms. The following are pointed out as key priorities for 2018:

- *Sustaining fiscal discipline and underpinning it by additional structural measures* as envisaged in the Convergence Programme. In order to do so, sustainable public debt reduction requires targeted public expenditure cuts, increased efforts to tap EU funds and improvements in the efficiency of state-owned enterprises.
- *Accelerating business environment reforms to attract much-needed investment*, with the announced measures, including a gradual reduction of administrative costs and parafiscal charges, improvement in the cadastre and land registry systems, enhancement of the management and monitoring of state-owned enterprises, and making court procedures more efficient being welcome in this context.

[2] New indicators cannot be compared with previously used indicators (measured on a scale from 1 to 4+), meaning that it will only be possible to monitor the countries' progress in the years to come.

– *Further resolution of non-performing loans and corporate restructuring to sustain long-term economic growth*, since the level of non-performing loans, though falling, remains excessively high in comparison with other countries in the region.

The EBRD report is but another of a series of reports published year after year by that and other sources, such as the European Commission and the IMF, repeatedly pointing to more or less the same problems Croatia is facing, especially to poor governance and low competitiveness. One has no choice but to hope that local decision makers in charge of decisions that have a direct impact on improving governance and competitiveness (such as appointing personnel to posts in national and local public administration, state-owned enterprises, regulatory bodies etc.) read at least the summaries of those reports and feel uneasy about the differences between Croatia and, for example, Estonia and the Czech Republic.

Table 1 Sustainable market economy quality indicators

	Competitive	Well-governed	Green	Inclusive	Resilient	Integrated	Average
Sweden*	8,72	9,11	7,49	7,93	7,83	8,36	8,24
Germany*	8,43	8,66	7,39	7,27	8,41	8,23	8,06
United States*	8,72	8,63	6,09	6,64	8,93	7,39	7,73
Estonia	7,58	7,58	6,44	7,30	8,19	7,77	7,48
Czech Republic*	6,83	6,28	6,62	6,41	8,07	8,25	7,07
Slovenia	6,93	5,74	6,67	7,02	7,44	7,61	6,90
Latvia	6,53	6,09	6,37	6,82	7,66	7,73	6,87
Lithuania	6,06	6,10	6,06	7,05	7,23	7,78	6,71
Slovak Republic	6,82	4,98	7,05	5,73	7,64	7,85	6,68
Poland	6,38	6,15	6,56	6,29	7,64	6,79	6,64
Hungary	6,42	5,31	6,37	6,27	6,65	7,89	6,49
Cyprus	7,21	6,15	5,76	6,20	5,19	6,52	6,17
Croatia	5,75	5,14	6,03	6,03	6,61	6,85	6,07
Romania	6,28	4,97	5,86	5,08	6,98	6,88	6,01
Greece	6,31	4,34	6,27	5,63	6,67	6,38	5,93
Bulgaria	5,96	4,69	5,82	5,33	6,54	6,86	5,87
Georgia	4,54	5,98	4,58	5,14	5,71	6,54	5,42
Turkey	4,89	5,30	5,12	4,21	7,08	5,90	5,42
Montenegro	4,89	5,12	5,15	5,62	5,93	5,59	5,38
Serbia	4,94	4,39	5,77	5,16	5,55	6,39	5,37
Russia	5,20	4,55	4,92	5,94	5,95	5,17	5,29
Macedonia	5,39	5,20	4,91	4,72	5,31	6,04	5,26
Jordan	3,92	5,26	5,65	4,88	5,66	6,12	5,25
Armenia	4,47	4,79	5,41	5,72	5,04	5,94	5,23
Belarus	4,99	4,32	6,16	5,72	4,17	5,38	5,12
Mongolia	4,25	4,50	5,28	5,64	4,57	5,68	4,99
Kazakhstan	4,30	5,05	4,42	5,37	5,66	5,00	4,97
Morocco	3,98	4,35	5,47	4,16	6,06	5,45	4,91
Ukraine	4,68	3,58	5,54	5,88	4,60	5,04	4,89
Albania	4,41	4,31	4,85	5,11	4,86	5,76	4,88
Moldova	4,87	3,94	4,14	5,19	5,27	5,64	4,84
Bosnia and Herzegovina	4,74	3,66	4,85	4,83	5,35	5,47	4,82
Azerbaijan	3,64	4,61	5,23	4,71	4,46	5,84	4,75
Tunisia	3,94	4,33	4,78	4,72	4,75	4,70	4,54
Kosovo	3,37	3,73	3,80	4,70	5,09	4,89	4,26
Kyrgyz Republic	3,45	3,33	4,36	4,46	4,98	4,94	4,25
Egypt	2,87	3,90	4,41	4,24	5,41	4,27	4,18
Tajikistan	2,66	3,69	5,58	4,58	3,76	4,23	4,08
Uzbekistan	2,72	4,32	3,20	5,34	3,98	4,20	3,96
Turkmenistan	1,46	3,83	4,13	4,86	3,12	4,64	3,67
Lebanon	4,92	TBD	TBD	TBD	TBD	5,82	TBD
EBRD–37 Average**	4,91	4,81	5,36	5,43	5,74	5,99	5,38

** Non-EBRD countries, shown for the sake of comparison*

*** 37 EBRD country average, excluding Sweden, Germany, USA and the Czech Republic*

Source: Author based on the Sustaining Growth report