



Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 11-Jun-2019 | Report No: PIDISDSC25063



BASIC INFORMATION

A. Basic Project Data

Country Croatia	Project ID P167247	Parent Project ID (if any)	Project Name Justice for Business Program (P167247)
Region EUROPE AND CENTRAL ASIA	Estimated Appraisal Date Sep 02, 2019	Estimated Board Date Dec 18, 2019	Practice Area (Lead) Governance
Financing Instrument Investment Project Financing	Borrower(s) Ministry of Finance	Implementing Agency Ministry of Justice	

Proposed Development Objective(s)

The Project Development Objective is to improve the business environment by enhancing the efficiency and the quality of regulatory procedures and judicial services.

PROJECT FINANCING DATA (US\$, Millions)

SUMMARY

Total Project Cost	117.27
Total Financing	117.27
of which IBRD/IDA	117.27
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	117.27
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Environmental and Social Risk Classification
Moderate

Concept Review Decision
Track II-The review did authorize the preparation to continue



B. Introduction and Context

Country Context

1. Croatia is a small, open economy with moderate pace of economic convergence to the European Union. Since its independence in 1991, Croatia made remarkable progress in economic reforms and living standards. It created a liberal democracy, established a market economy, achieved the status of an upper-middle income economy, and on July 1, 2013 joined the European Union (EU) as the latest entrant to the Union. Gross Domestic Product (GDP) increased by more than 4 percent a year from 1992 to 2008, and GDP per capita (in PPP nominal terms) reached US\$22,000 or 63 percent of the EU28 GDP per capita level. The 2008 international economic crisis and drying up of capital inflows impacted heavily on Croatia, resulting in a severe, lengthy recession and derailed convergence towards EU living standards. The recession lasted for six years, reducing output by 12 percent and investment by 33 percent, while unemployment doubled to 17.3 percent by 2013 and youth unemployment reached 50 percent. Croatia's economy is currently recovering, with growth averaging around 3 percent over the last three years. However, Croatia's national income and investment level have yet to return to pre-crisis levels. While growth is projected to remain positive around 2.5 percent over the medium-term, these projections are not enough to revive, let alone accelerate, the pace of convergence with other countries in the European Union.

2. Slow growth in Croatia is driven by limited productivity gains, which in turn is affected by a poor business environment. Rapid growth prior to the crisis reflected rising labor force participation and massive investment, rather than increases in Total Factor Productivity (TFP). TFP made a significant, negative contribution to growth from 2002 to 2014, and only a small positive contribution in 2015-16. By contrast, in the same period growth in Croatia's Eastern European peers was mostly based on rising productivity. The decline in TFP during the recession largely reflected a slowdown in productivity performance of the most productive firms. This was in part driven by policy uncertainty that depressed investment, and a poor business environment, which impaired product market competition and limited firms' efficiency due to excessive red tape.

3. The poor quality of Croatia's institutions is a key determinant of the poor quality of the business environment. According to the European Quality of Government Index (EQI, 2017), Croatia's public sector performance lags behind EU peers across most governance, business environment and human capital indicators. Key government institutions, most notably the public administration and the judiciary, underperform according to both EU and global benchmarks. Croatia's public sector performance lags behind EU peers across most governance indicators. Insufficient coordination and cooperation between agencies and levels of government impairs policy coherence and results in the fragmentation of government-to-business services. In turn, this raises administrative costs for government and reduces the quality, effectiveness and sustainability of services delivery for businesses. The Worldwide Governance Indicators rate Croatia the worst in the EU for regulatory quality and among the worst in other key public sector governance indicators. In the Global Competitiveness Index Croatia also scores persistently below the average in terms of the quality of its public institutions. Out of the 140 countries ranked in the 2018 report, Croatia was placed 74th on the overall institutional pillar, and significantly lower on certain business-relevant indicators (e.g. 120th on judicial independence, Croatia ranked 138th on the burden of government regulation, and 135th on the efficiency of the legal framework in challenging regulations).

4. Transforming the role of the state and increasing its effectiveness are paramount to reinvigorating the process of both institutional and economic convergence. The success in reshaping how businesses interact with government will very much depend on the policy makers' ability to redefine and reduce the role of the state in the economy, as well as remove binding constraints for the private sector to thrive. This particularly refers to the state's role as a regulator, to

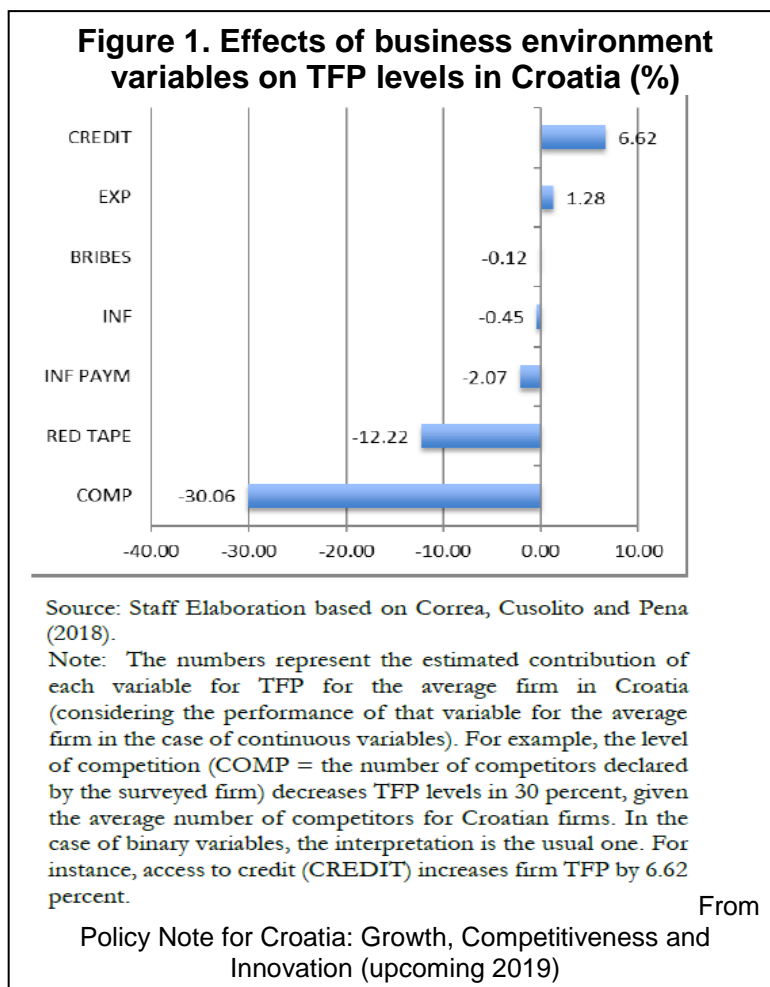


steer competition and to provide the required services to enforce those regulations. Moreover, as the guarantor of the rule of law, the state bears responsibility to effectively resolving disputes when required. Ultimately, Croatia has an opportunity and an obligation to not only compare with its EU peers, but also to outperform them, where possible, in organizing a state that provides excellent public services.

Sectoral and Institutional Context

5. Croatia’s weak business environment constrains the private sector’s potential.

A recent World Bank report estimates that the current level of red tape faced by Croatian businesses is reducing Total Factor Productivity by 12.2 percent (Figure 1).¹ The country continues to lag behind best performers in key Doing Business indicators. It currently ranks 58th among 190 economies in the 2019 *Doing Business* Report and it is among the lowest-ranked in the EU. The country’s position dropped 18 places over the past three years, particularly on some issues salient to market entry for businesses and business operations, such as the *Dealing with Construction Permits* and *Starting a Business* indicators where it ranked 123rd and 159th, respectively.² The regulatory burden on businesses is also reflected in Croatia’s low ranking in the *Burden of Government Regulation* indicator (138th out of 140 economies) in the World Economic Forum’s 2018 *Global Competitiveness Index*. Weaknesses in the business environment include a complex and costly business registration system, a restrictive framework limiting the supply of professional services, high compliance costs associated with operating a business (e.g. obtaining operational or building licenses and permits, frequent business inspections), as well as inefficient commercial dispute resolution.



Regulatory Barriers to Market Entry and Competition

6. Procedures for starting a business in Croatia are cumbersome and costly and as such represent a regulatory barrier to market entry. The length and cost of starting a business in Croatia remains above the regional average in Europe and Central Asia (ECA), and the OECD average. *Doing Business* 2019 reported that to start a business in Zagreb, entrepreneurs must go through 8 procedures, which take 23 days on average. This is significantly higher than the ECA

¹ Policy Note for Croatia: Growth, Competitiveness and Innovation (upcoming 2019)

² Croatia’s ranking on ease of doing business was 58th in 2018, 51th in 2017 and 43th in 2016.

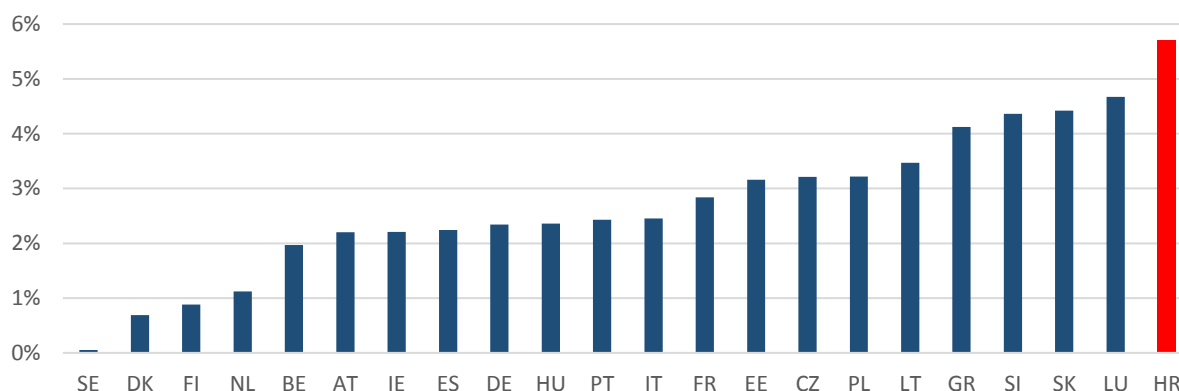


(12.9 days) and OECD (9.3 days) averages. The cost (6.6 percent of Croatia’s income per capita) is also higher than the regional average in ECA (4.6 percent) and the OECD (3.1 percent). The business registration process in the Commercial Court Registry compares unfavorably with international good practice as it is subject to broad discretionary powers that derive from the constitutional right and freedom of judges to interpret the law. The current registration process requires applicants to interact separately with each stakeholder authority (FINA, Tax authority, Statistical Bureau, Commercial Court Registry, Croatian Institute for Pension Insurance, Croatian Institute for Health Insurance, public notary, and commercial bank) mostly in paper form.

7. The regulatory framework in Croatia is less conducive to competition than in many European countries. The Organization for Economic Co-operation and Development (OECD) finds that product market regulations (PMR) and the regulation of professions in Croatia are more restrictive than in peer countries. For example, there are more requirements to provide professional services than in 53 out of 57 countries covered by internationally comparable indicators collected by the OECD and the World Bank. The World Bank estimates the number of regulated professions to be above 300 in Croatia while the European Commission’s database records on average 200 regulated professions in EU countries.³

8. Furthermore, overly tight regulation of professional services limit output and create economic rents. As a result, there is less work available, and the work is split between fewer professionals who can charge higher prices. Once undue barriers are removed, service providers can compete on merits and not on privilege. This competition allows buyers to buy more and better services at lower prices. It also translates into productivity gains in the entire economy, as businesses that rely on professional services as inputs become more competitive internationally. According to a World Bank Group research, Croatia stands to increase productivity the most of all EU countries if it relaxes services regulation to levels seen in least restrictive EU countries (Figure 2).⁴

Figure 2. Total factor productivity gains from services liberalization



Source: Van der Marel, Erik et al. 2016

9. The Government has recognized the need to remove barriers to entry through its National Reform Program (NRP). The NRP foresees the launch of an integrated platform for business registration (known as START) connecting relevant registries, namely the court register, statistics register, tax administration register, health and social security register, and the opening of a bank account. The objective is to enable electronic business start-up through a single procedure that can be completed online, and without the need to engage a public notary. In addition, the NRP includes targeted actions for the deregulation of services following both the European Commission’s recommendations and the EU Services Directive towards liberalization of regulated professions. Implementing these reforms however, may prove

³ See Annex B for a list of regulated professions in Croatia compiled by the World Bank Group.

⁴ World Bank 2016. For more details see Van der Marel, Erik et al. 2016.



challenging and difficult as they will require not only appropriate technical assistance, but also the incentives for effective inter-institutional coordination and cooperation among the various government agencies that are involved.

High Transaction Costs for Government to Business Services

10. Procedures to comply with administrative formalities necessary to operate a business, such as permits and licenses, are complex and costly. A European Commission study⁵ that ranked countries in Europe based on their licensing complexity on a scale of 1 for lowest level of complexity to 26 for the highest level, found that Croatia has one of the most complex licensing regimes, with a rank of 21.8. Only three other countries had a lower ranking. For example, according to this study in order to operate a hotel with a restaurant in Croatia, between 6 and 9 licenses are required and take an average of 45 days to obtain, compared to less than 5 licenses and 7 days in the UK. Procedures to obtain a construction permit also remain a challenge. In the 2019 Doing Business *Dealing with Construction Permits* indicator Croatia is ranked 159th out of 190 countries. Investors and building professionals in the construction sector report delays in acquiring pre-approvals from utility companies and other applicable law agencies, as well as onerous inspection procedures. In addition, potential investors and design professionals cannot access online important information on infrastructure availability and land planning and zoning through a centralized Geographic Informational System (GIS).

11. The Judicial Sector adds up to the administrative burden on businesses by also imposing cumbersome procedures in courts. Even though efforts were made to automate most of the administrative procedures in the Judiciary to facilitate interactions between litigating parties and judges or other court proceedings, utilization of automated tools is still limited. Interactions with courts continues to be paper-based implying that lawyers need to file or mail their massive documents adding time and cost to the already lengthy procedures. Court tariffs and fees continue to be paid at court locations unnecessarily complicating simple procedures that have already been automated.

12. Based on the NRP, the Government enacted an action plan for administrative burden reduction for the private sector⁶ which identified 3076 formalities as burdensome. Out of these, the Government has initially identified 314 administrative processes that will be abolished or simplified and would lead to annual cost savings for businesses of around 626 million Kuna (Euro 95 million). The Government is also taking action to simplify construction permitting and improve availability of land planning and zoning information. In 2015, the Ministry of Construction and Physical Planning (MoCPP) introduced an online platform for construction permitting. However, the platform has significant limitations as it has not been made available to the private sector in Zagreb and has had limited uptake outside of Zagreb. Moreover, even though the online application simplified some procedures, others have been neither streamlined, nor digitized. A team in the Ministry is currently developing additional components to strengthen the platform's scope, features and functionalities. The Ministry has developed an application to better coordinate pre-approvals from the various stakeholder agencies and is expected to roll it out in calendar year 2019. Furthermore, the NRP foresees the integration of databases to produce an online, up-to-date Geographic Informational System (GIS), which will include land planning and zoning information from several regulatory agencies.

Delays in Dispute Resolution and low quality of judicial services

13. Inefficiency, unpredictability, and delays in court processing cases are among the greatest impediments to businesses in Croatia. An OECD research⁷ conducted in 2013 provided vast evidence on judicial efficiency being one of the key determinants of a favorable business environment in OECD countries. By measuring the length of judicial proceedings and accessibility to justice services, the report concluded that lengthy civil proceedings can impose

⁵ European Commission, *Enterprise and Industry, Business Dynamics: Start-Ups, Business Transfers and Bankruptcy*, January 2011.

⁶ For more information, visit: <https://www.mingo.hr/page/u-2019-godini-poduzetnici-se-rasterecuju-za-626-milijuna-kuna>.

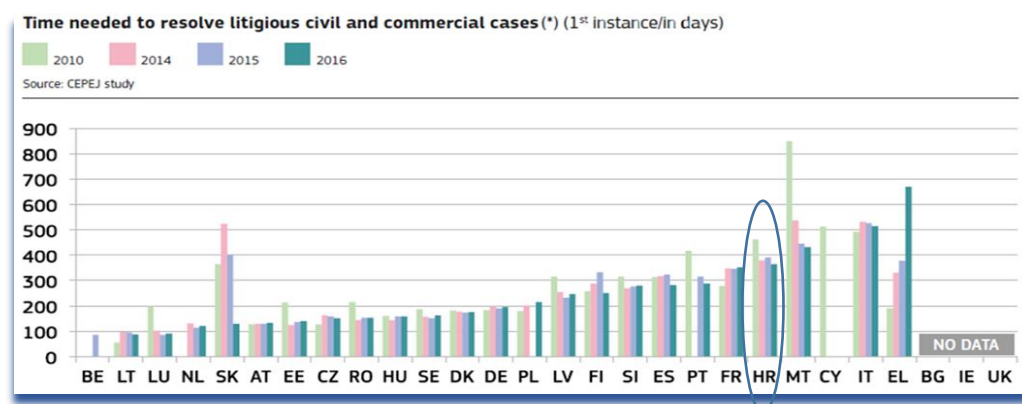
⁷ OECD, *What Makes Civil Justice Effective?*, 2013.



constraints to economic activity. Such a link has also been demonstrated in the specific case of Croatia, where a comparative research study found a positive correlation between the rule of law and the institutional performance and their effects on economic performance and growth.⁸ The number and disposition time in litigious commercial cases in Croatia remain among the highest in the EU. The extensive demands on judicial services are compounded by the provision of non-litigious administrative services (e.g. company registration, land ownership registration, etc.)

14. Recent measures to modernize judicial procedures are helping to enhance business processes in courts balancing caseload and thus accelerating judicial proceedings. For instance, investments in digitalization of judicial information systems yielded some positive results. They have contributed to reducing case disposition time and costs of litigation, as well as to increasing confidence in and access to the judicial system, thus helping to lower the cost of doing business. The Ministry of Justice (MoJ) is also working on increasing the use of the existing case management systems (Integrated Court Management System – ICMS and the Case Tracking System – CTS) by adopting electronic communication between the parties and the courts, and by providing interoperability among different information systems and databases managed by other government entities. Furthermore, the newly adopted Court Fees Act entered into force as of January 1, 2019 also provides incentives for using ICMS by reducing 50% of the court fees. This is expected to increase payment of the fees and contribute to further automatization in the justice sector. Finally, progress has been made in reducing the number of unresolved/pending cases, including the backlogged cases from 616.686 at the end of 2014 to 407.062 at the end of 2018.⁹

Figure 3. Time needed to resolve litigious civil and commercial cases in EU Member States



Source: Justice Scoreboard 2018, European Commission

15. Despite progress, there is still room for improvement in justice services for businesses. The 2016 report of the Council of Europe’s European Commission for the Efficiency of Justice (CEPEJ) acknowledges improvements in the functioning of the judiciary in terms of backlog reduction and clearance rates at the first instance levels. At the same time, the report highlights that the 380 days disposition time of civil and commercial litigious cases is significantly higher than the European average of 237 days. The EU Justice Scoreboard 2018 also confirms that the duration of court proceedings and backlogs in Croatia remain among the highest in the EU (see Figure 3). Moreover, the EC Country Report for 2018 reported lengthy delays in resolving cases at the first instance, with a global average time for resolution still at 884 days, and even higher in commercial courts at 730 days.

⁸ Badjun Marijana, *The Quality of Governance and Economic Growth in Croatia*, Faculty of Economics, Zagreb, 2005.

⁹ Ministry of Justice Statistical Report 2019.



16. In addition, court performance is negatively affected by the current sub-optimal and significantly deficient physical facilities. The low level of investments in judicial infrastructure over the years has resulted in very poor working conditions across the courts as well as state attorneys' offices. The lack of a public investment management planning further contributed to a fragmented approach to improving the judicial infrastructure as well as inefficient utilization of resources dedicated to this objective. Improving transaction costs and quality of justice services for businesses undeniably urge for balanced investing in judicial infrastructure. The challenges are manifold: in some courts, 3 or 4 judges share offices; space for archives for courts and land and business registries is deficient; there is a shortage of courtrooms to hold open trials and conduct other court proceedings; there is lack of adequate ICT cabling, whereby LANs and WANs are not properly functioning or provided; facility entrances and internal spaces are not suitable for the access of disabled persons; and most courts still require upgrading to conform to EU energy efficiency standards. Moreover, insufficient capital investment is taking a heavy toll on cities with the largest caseload (e.g. Zagreb). Here some courts are located in significantly deteriorated buildings which do not meet international standards. Several courts operate in leased facilities as they await funds to relocate. Planning for new construction, rehabilitation and facilities management is complex. All these problems are even more acute in those buildings housing courts with higher caseload levels, several court types, and those in remote locations, where efforts to renovate building have been neglected for years.

17. The government authorities in Croatia see the Justice for Business project as an opportunity to align the incentives for all relevant ministries to coordinate efforts to address the business environment challenges. By tackling issues related to regulatory barriers to business entry and competition, high transaction costs in the interactions between businesses and government, and ineffective dispute resolution procedures, the project will contribute to the broader objective of improving the business environment in the country. The proposed project will support a wide range of activities aimed at reducing regulatory burden as well as enhancing quality and responsiveness of judicial services more broadly. This will help reduce the transaction costs and increase certainty for doing business and thus contribute to the broader objective of attracting and increasing private investment and growth.

Relationship to CPF

18. The proposed project is fully aligned with the new Country Partnership Framework (CPF) for Croatia, particularly with the objectives under Focus Area 1: Enhancing public sector performance and institutions and Focus Area 2: Strengthening market institutions to enable a dynamic enterprise sector. The project will contribute to meeting objectives in both areas by improving the business environment through a set of comprehensive measures that will enhance the efficiency and quality of regulatory procedures and judicial services and by supporting improvements to the judicial infrastructure in selected courts to enhance working conditions and increase access, quality and efficiency in the delivery of its services.

C. Proposed Development Objective(s)

19. The Project Development Objective is to improve the business environment by enhancing the efficiency and the quality of regulatory procedures and judicial services.

Key Results (From PCN)

20. The Project's achievement of the PDO will be measured via the following indicators:

On the business environment:



- Reduced administrative burden for businesses to interact with government

On the efficiency and quality of regulatory procedures and judicial services:

- Reduced time and cost of business entry
- Reduced time and costs for obtaining a construction permit
- Reduced disposition time for commercial cases in courts
- Project-supported rehabilitated court buildings meet international standards

D. Concept Description

21. The Justice for Business Project (Just-B) has two components. Component 1. is a results-based component that will finance against Disbursement-Linked Indicators (DLIs) related to improving the business environment and the quality and efficiency of judicial services, which are expected to reduce the administrative burden for businesses to interact with government. Component 2. is an investment component that will finance improvements in the justice sector infrastructure management, including the rehabilitation and renovation of selected court facilities. This will contribute to improved quality of judicial services to businesses and other users. Initiatives to be supported under the two components are aligned with, and complement, the Government’s 2019 NPR priorities and other ongoing activities.

Component 1 – Enhancing and Streamlining the Regulatory Framework and Judicial Services for Businesses (Results-Based Component, EUR 50MM)

22. The objective of this component is to streamline processes and services provided by the government to businesses. The component comprises three subcomponents: (a) removing regulatory barriers for market entry; (b) reducing transaction costs and increasing transparency in government-to-businesses services; and (c) accelerating dispute resolution procedures. The proposed operation will reimburse relevant Government expenditures from the National Budget upon achievement of agreed results indicators and targets as preliminarily described in each sub-component. Specific budget lines to be reimbursed will be identified as part of project preparation.

Component 2 - Strengthening investment and infrastructure management and rehabilitation of judicial facilities (Investment Component, EUR 55MM)

23. The objective of this component is to improve public investment management in the justice sector, including the adoption of modern resource management tools, and investment in the physical rehabilitation of up to 4 courts/judicial facilities. Component 2 includes two subcomponents: (a) Rehabilitation of court buildings and (b) institutional strengthening of MoJ’s investment management and M&E capacity.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No
Summary of Screening of Environmental and Social Risks and Impacts	
Environmental and Social Risks and Impacts are assessed as moderate. Potential environmental and social risks and	



impacts of the planned interior upgrade/renovation works of physical infrastructure in Zagreb Municipal Court, and judicial facilities in Vinkovci, Kutina and Varazdin are predictable, expected to be temporary and reversible, low in magnitude, and site specific. The Bank team visited all four locations and reviewed available projects designs and cost estimates for each of the facility.

Note To view the Environmental and Social Risks and Impacts, please refer to the Concept Stage ESRS Document.

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