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PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA7678

Project Name	Social Protection System Modernization Project (P145171)
Region	EUROPE AND CENTRAL ASIA
Country	Croatia
Sector(s)	Other social services (100%)
Theme(s)	Social safety nets (100%)
Lending Instrument	Investment Project Financing
Project ID	P145171
Borrower(s)	Ministry of Finance
Implementing Agency	Ministry of Social Protection and Youth
Environmental Category	B-Partial Assessment
Date PID Prepared/Updated	17-Jun-2014
Date PID Approved/Disclosed	18-Jun-2014
Estimated Date of Appraisal Completion	30-Jun-2014
Estimated Date of Board Approval	30-Sep-2014
Decision	

I. Project Context

Country Context

Croatia has gone through five consecutive years of recession since the outbreak of the global financial crisis in 2008. By 2013, projected real GDP was 12 percentage points lower than in 2008. While the rate of GDP contraction slowed to one percent in 2013, another year of recession is likely in the wake of further fiscal consolidation underpinned by the European Union's Excessive Deficit Procedure. With monetary policy constrained by the need to keep the kuna-euro exchange rate stable, progress with structural reforms and attracting Foreign Direct Investment needs to be accelerated. Otherwise, growth prospects over the medium term will remain limited.

The prolonged crisis has led to a rise in poverty. Although Croatia is classified as a high income country with average GDP of $13,920, poverty persists. Using an absolute poverty line fixed at 60 percent of median equivalent consumption in 2008, poverty increased by over four percentage points (from 13.3 percent in 2008 to 18 percent in 2012). Household Budget Survey data suggest that the poverty incidence increased further to 20 percent in 2013 due almost entirely to deterioration in living standards as job losses and real wage reduction depressed household consumption. It appears as though coping mechanisms in the early years of recession have been used up. The unemployment rate increased faster for men, reflecting the impact of the recession on sectors dominated by men, such as construction and manufacturing, whereas women are more reliant on pensions and public sector wages. Higher-than-average poverty incidence is found in single-elderly households, as well as in households headed by either an unemployed or inactive person without a pension (all above 40 percent in 2011). More than half of Croatia's poor live in households headed by a pensioner .

Spending on social welfare remains high and was largely protected during the crisis. Government efforts to protect social benefits and old-age pensions during the crisis have partially mitigated the impact on poverty and shared prosperity. Although overall consumption declined substantially between 2008 and 2011 (by 4.6 percent), distribution favored low-consumption households—that is, the bottom 40 percent whose mean consumption declined by 3.5 percent. The share of spending on categorical benefits or entitlements is high, while the share of poverty-focused programs is still disproportionally low, even after the recent reform of the Guaranteed Minimum Benefit. After five years of recession, the demand for social protection is on the rise, while the resources to finance them are increasingly scarce.

The social assistance system has become more administratively complex and costly over time. Administration of the many social assistance benefits is fragmented and inefficient, with over 80 cash and in-kind benefits for relatively small target groups. They are administered at various levels of government, by six line ministries and their subordinated agencies. The Government has embarked upon efforts to consolidate and harmonize benefits and to streamline their administration.

Croatia joined the European Union on 1 July, 2013. Croatia now has access to an average of 3.5 percent of GDP in EU grant financing over the 2014-2020 financial period. These funds can be used for a number of purposes including different aspects of social welfare reform.

Sectoral and institutional Context

Croatia has a costly noncontributory social assistance system (amounting to around 4.8% of GDP in 2011), about half of which is targeted at the poor and vulnerable. Half of Croatia's non-contributory social assistance goes to war veterans' pensions and benefits (1.8% GDP in 2011) and a further 1% of GDP is spent on a regressive child tax allowance. However, the 2.4% GDP spent on cash transfer programs for the poor is well targeted . These poverty-focused programs include the child allowance programs (0.5% of GDP in 2011); the social allowance program, the precursor of the Guaranteed Minimum Benefit (0.3% of GDP); a child birth grant and parental leave benefits (0.4% of GDP), and civilian disability allowances (0.1% of GDP).

Overall, the poor are well covered by a combination of categorical and targeted social assistance programs, or social insurance programs. As of 2010, 55% of the poor received social assistance programs (not including here war veterans pensions or benefits), and 92.5% were covered by a combination of social assistance and insurance programs. Annex 6 describes the Croatia social assistance system and its distributional performance.

Cash benefit administration is fragmented across different ministries and agencies. While the Ministry of Social Policy and Youth (MSPY) has policy and budgetary authority for all pro-poor cash transfer programs, many are administered by other agencies, including: child allowance, maternity benefits and birth allowances, unemployment benefits and some war veterans benefits (administered by the Croatian Pension Insurance Institute, the Croatian Health Insurance Institute, Croatian Employment Service and Public Administration Offices respectively) (see Annex 6).

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Each of these agencies has its own office in each county across Croatia. This fragmented administration creates costs for beneficiaries applying for benefits at multiple agencies, and augments the risk of error and fraud in the social assistance system.

Efforts to consolidate some cash transfer programs and improve targeting have been legislated in a new Social Welfare Law adopted in 2013. The law introduced a new Guaranteed Minimum Benefit (GMB), which consolidated four different social benefits (the social allowance program, the extended unemployment benefit, the homeland war veterans' benefit and the disabled WWII support allowance) and applied means-testing with changed equivalence scale to protect the most vulnerable (single elderly and single parents). Overall, the GMB could amount to about 0.4% of GDP (see table in Annex 6). It includes a revised list of asset filters, grounded in empirical analysis; and a cap of HRK 2,900 on accumulated benefits designed to limit dependency on benefits. The Social Welfare Act also contains inter alia measures to reduce administrative complexity and cost and reduce the scope for fraud and error. Given the social allowance payment had not been changed since 2008 and failed to cover even the basic food basket, the Government also increased the benefit by one-third to HRK800. The cost of the benefit increase will roughly be offset by the tightened eligibility rules and targeting over the course of the next 4-5 years.

Disability benefits in Croatia are among the highest in the EU, with certification spread across six sectors/agencies with no harmonized methodology. In 2010, Croatia spent 3.6% GDP on disability programs (disability pensions, transfers, other benefits), 64% above the EU 27 average level of expenditure on disability programs. Such a high level is largely the legacy of the 1991-95 war, but also due to unstandardized and loose disability criteria, lack of control, and corruption in the disability assessment system. Disability certification conducted by the pension, health, veteran, social, employment and education systems is now being consolidated. Creation of the Central Disability Certification Institute (CDCI) within the Institute for Disability Certification, Professional Rehabilitation and Employment of Persons with Disability (ICDPREPD) is expected to result in faster, more transparent, and more efficient certification process and service for clients.

It is likely that Croatia is losing significant amounts of money due to ineffective institutions and mechanisms to combat Error, Fraud and Corruption in the benefit system. Croatia operates a number of cash benefits with high a-priori risk of EFC, including income and means-tested programs (the child allowance and GMB programs), income replacement programs, disability pensions and allowances. The current delivery system of these benefits relies on preventive measures to avoid EFC; detection and deterrence efforts are minimal. The capacity of the system to detect or deter fraud is low. There are fewer than 10 staff in each ministry or agency working on EFC activities, substantially lower than in EU or other ECA countries. The investigative staff consists mainly of specialists in program certification rules (e.g. disability certification physicians or cash benefit administrators). Their expertise is not yet complemented by Information Technology (ICT) and data analysts, which could make their work more efficient by narrowing the scope of the reviews or inspections to cases that are of relatively high risk of EFC. The sanctions for error and fraud are also low or nonexistent. Thus, the cost of defrauding the system is rather small (small probability of detection coupled with a weak recovery and sanction policy), while the benefits are positive and, for some programs, very high. Following early implementation of some error and fraud control measures recommended by the World Bank team, 15 percent of the overall GMB caseload was found to have irregularities.

The legacy of State policies and practices in social care lingers in Croatia, with a continued reliance

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on institutional care for vulnerable people. Croatia houses over 8,300 children without parental care, children and adults with development difficulties, and mentally-ill adults in institutions. Many of these individuals could live more independent lives with foster families or in family-style organized housing units, which would allow them to fulfil their individual potential and promote social inclusion. A de-institutionalization Master Plan was approved in 2010. The corresponding Operational Plan will be approved in June 2014 setting out Croatia's goals for deinstitutionalization, transformation plans for existing institutions and roles for important stakeholders involved in the process.

Croatia experiences significant employment challenges, but its Employment Services could provide more efficient tailored services to the unemployed. Croatia has the lowest activity rate in the European Union. It is characterized by high and rising unemployment and increasing unemployment duration. In 2012, long term unemployment accounted for more than 60 percent of total unemployment. The recently approved Social Welfare Act (SWA) introduces measures to encourage work-able social assistance beneficiaries to transition from assistance to work. To be effective, these measures must be accompanied by active labor market policies tailored to support hard-to-employ beneficiaries in finding work. Employment officers already face an extremely heavy work load – on average, each is responsible for 700 unemployed; in Zagreb it the average is 840 - that does not allow adequate support to the unemployed, particularly to the hardest to employ. The caseload will increase with the enactment of the SWA. The Croatian Employment Services (CES) offer a relatively large menu of options for the unemployed, ranging from training programs, wages subsidies to public works on a first-come, first-served basis. To improve the efficiency of its services, the CES would need to employ tools to reallocate scarce resources to the individuals most at risk of becoming long-term unemployed..

Annex 6 provides more detail of the sectoral context.

II. Proposed Development Objectives

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The project aims to improve the efficiency and effectiveness of Croatia's social protection system.

III. Project Description

Component Name

Improving efficiency and effectiveness of the social protection system

Comments (optional)

This component will use a results-based approach. Payments made under this Component will go to the Ministry of Finance as reimbursement for expenditures made in the Eligible Expenditure Program (in this case, the Guaranteed Minimum Benefit). Payments will be triggered by achievement of pre-specified Disbursement Linked Indicators (DLIs) as well as evidence that sufficient expenditures have been made under the EEP. DLIs have been chosen to support the Government's social protection reform in four results areas:

a) consolidation of social assistance cash benefits administration under a one-stop-shop;
b) unifying and harmonizing the certification of disability;
c) reducing error, fraud and corruption in social protection cash benefits; and
d) deinstitutionalization of vulnerable children

Component Name

Investments and TA to support improvements in efficiency and effectiveness of the social protection system

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Comments (optional)

This Component will use a regular Investment Project Financing approach. It would support investments and technical assistance that are necessary, but not sufficient, to support achievement of the DLIs in the four thematic areas supported by results-based financing. It will also support activities in the fifth thematic area: activation.

Component Name

Project Management Functions

Comments (optional)

A Project Implementation Unit will be created in the Ministry of Social Policy and Youth. The PIU team will comprise: a Director, Head of Procurement, Procurement Assistant and two Financial Management staff. The individuals who will staff the PIU are being identified; some are already participating actively in preparation of the project, some are civil servants paid by the MSPY and will continue their jobs in the Ministry. Additional specific expertise, such as a Construction Engineer, who can provide expert advice on renovations and environmental standards, and support staff will be financed from the project.

Operating expenses for the PIU will be shared between the MSPY and the loan.

IV. Financing *(in USD Million)*

Total Project Cost:	95.00	Total Bank Financing:	95.00
Financing Gap:	0.00		

For Loans/Credits/Others	**Amount**
Borrower	0.00
International Bank for Reconstruction and Development	95.00
Total	95.00

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V. Implementation

Institutional and Implementation Arrangements

The MSPY, headed by the Deputy Prime Minister, is the driving force of the reform and would oversee the overall implementation of the project activities. MSPY is responsible for the legislative agenda covering social assistance and retains the policy and budgetary lead over most social assistance programs, even though their administration is undertaken by other agencies – a situation that will be addressed under the OSS results area. The MSPY will also house the PIU. Another key counterpart is the MLPS, which contributes to the CDCI agenda and leads the inter-ministerial working group for combating EFC in social protection programs. The MPA lead the implementation of the OSS.

A Steering Committee will coordinate the multiple Ministries and Agencies involved in implementation. A Project Steering Committee has been created, led by the Ministry of Social Policy and Youth (MSPY) and also comprising the representatives of the Ministry of Public Administration (MPA), Ministry of Labor and Pension System (MLPS) and Ministry of Health (MoH) and their agencies (IDCPREDP, CPII, CHII, CES and LI), as well as the Ministry of Finance, to oversee and supervise overall project implementation. In addition, a Project Implementation Unit (PIU) will be established in the MSPY, which will be responsible for the

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overall implementation of the project's second component, including providing all fiduciary services and M&E for the Project. A detailed implementing agency assessment has been carried out and is provided in Annex 3.

Under Component 1, the Ministry of Finance would be the recipient of the loan funds disbursed based on achieved results. The Ministries and Agencies achieving those results include:

• OSS – (i) MSPY: its Guaranteed Minimum Benefit currently administered by its decentralized Centers for Social Welfare (CSWs) will be transferred to the Ministry of Public Administration's decentralized Public Administration Offices (PAOs); (ii) MLPS: the Child Allowance currently administered by decentralized Croatian Pension Insurance Institute (CPII) and Unemployment Benefits currently administered by its decentralized Croatian Employment Services (CES) will be transferred to the MPA's decentralized PAOs; (iii) MoH: the maternity and paternity benefits and birth grants for non-insured beneficiaries currently administered by decentralized Croatia Pension Health Institute (CPHI) will be transferred to the MPA's decentralized PAOs.

• CDCI – The new agency will be established within the Institute for Disability Certification, Professional Rehabilitation and Employment of Persons with Disability (IDCPREPD), an independent agency responsible for disability certification, professional rehabilitation and employment of persons with disabilities under the MLPS, to simplify and harmonize disability assessment/certification processes currently scattered across six sectors/agencies.

• EFC – Three inspection teams will continue the detection work for risk-prone policies or SP benefit programs. The MSPY's Social Inspection team will inspect the GMB and disability allowance programs under its policy authority and will gradually expand its mandate and resources to cover the other social assistance programs once they are transferred to the OSS (child allowances and birth grant/parental leave for noninsured beneficiaries). The Labor Inspectorate of MLSP will continue to review compliance with labor market regulations for employers and employees. The disability review team in MLSP will expand its role to inspect high-risk disability pension claims, both new and existing. Prevention and deterrence activities will also involve the implementation agencies under the project (PAOs; CSWs; CES and CPHI networks, CDCI network).

• Deinstitutionalization – MSPY leads this area of work. Its decentralized CSWs provide social services and refer vulnerable persons to social welfare homes or other support services. It has a network of residential institutions providing for children without parental care, persons with disabilities and youth with behavioral disorders that would be transformed and some of their beneficiaries deinstitutionalized with the support from the project. It also manages family homes and organized housing for more independent living. These services are complemented by non-State social care providers.

Under Component 2, the project will finance TA and investments needed to support achievement of the DLIs under Component 1 as well as activities in Activation. Technical assistance and goods provided by the project under Component 2 will benefit: MSPY, MPA, MLPS and their subordinated agencies. In order to host the new OSS, PAOs will need to upgrade their physical, human and IT capacities to meet minimum service standards. Therefore, the PAOs, through the MPA, would receive the largest share of the TA and investment funds, including civil works, under Component 2.

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Under Component 3, a Project Implementation Unit will be established in the Ministry of Social Policy and Youth.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	**Yes**	**No**
Environmental Assessment OP/BP 4.01	✕	
Natural Habitats OP/BP 4.04		✕
Forests OP/BP 4.36		✕
Pest Management OP 4.09		✕
Physical Cultural Resources OP/BP 4.11	✕	
Indigenous Peoples OP/BP 4.10		✕
Involuntary Resettlement OP/BP 4.12		✕
Safety of Dams OP/BP 4.37		✕
Projects on International Waterways OP/BP 7.50		✕
Projects in Disputed Areas OP/BP 7.60		✕

Comments (optional)

VII. Contact point

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