

**Document of
The World Bank**

Report No: 18975-HR

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED LOAN
IN THE AMOUNT OF US\$7.3 MILLION
TO THE
REPUBLIC OF CROATIA
FOR A
TECHNICAL ASSISTANCE PROJECT
FOR INSTITUTIONAL AND REGULATORY REFORM FOR
PRIVATE SECTOR DEVELOPMENT

March 24, 1999

Private and Financial Sector Development Unit
Europe and Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective end-February 1999)

Currency Unit = Kuna

Kuna 1 = US\$ 0.159

US\$1 = Kuna 6.9

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

APMC	Agency for the Protection of Market Competition
BRA	Bank Rehabilitation Agency
CAS	Country Assistance Strategy
CBS	Central Bureau of Statistics
CMDP	Capital Markets Development Project
CNB	Croatian National Bank
CROSEC	Croatian Securities and Exchange Commission
EFSAL	Enterprise and Financial Sector Adjustment Loan
EU	European Union
FDI	Foreign Direct Investment
FMS	Financial Management System
HEP	Croatian Electrical Power Enterprise
HPT	Croatian Post and Telecom
IBRD	International Bank for Reconstruction and Development
IDP	Institutional Development Plan
IMF	International Monetary Fund
INA	Oil and Gas Conglomerate
MOF	Ministry of Finance
MOE	Ministry of Economy
NGOs	Non-Governmental Organizations
OECD	Organization for Economic Cooperation and Development
ORESE	Office for the Restructuring and Economics of State-owned Enterprises
PE	Public Enterprise
PIU	Project Implementation Unit
PSD	Private Sector Development
SDA	Securities Depository Agency
SGA	State Geodetic Administration
SME	Small and Medium Enterprises
SOE	Socially Owned Enterprise
TAL (I)	(First) Technical Assistance Project
URA	Utilities Regulatory Agency
ZAP	Central Payment Institute

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REPUBLIC OF CROATIA

Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development

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REPUBLIC OF CROATIA

Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development

Project Appraisal Document

Europe and Central Asia Region
Private and Financial Sector Development Unit

Date: March 24, 1999	Team Leader: Gerardo Corrochano
Country Director: Arntraud Hartmann	Sector Director: Lajos Bokros
Project ID: PE-57767 Sector: FSD/PSD	Program Objective Category: Enterprise Sector and Economic Management
Lending Instrument: Technical Assistance Loan	Program of Targeted Intervention: <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

Project Financing Data	<input checked="" type="checkbox"/> Loan	<input type="checkbox"/> Credit	<input type="checkbox"/> Guarantee	<input type="checkbox"/> Other [Specify]	
For Loans/Credits/Others:					
Amount: US\$7.3 million					
Proposed terms:	<input type="checkbox"/> Multicurrency	<input checked="" type="checkbox"/> Single currency, specify: US\$			
Grace period (years):	<input type="checkbox"/> Standard Variable	<input type="checkbox"/> Fixed	<input checked="" type="checkbox"/> LIBOR-based		
Years to maturity:					
Commitment fee: %					
Service charge: %					
Financing plan (US\$m):					
	Source	Local	Foreign	Total	
Government		0.7	0.0	0.7	
Cofinanciers					
IBRD		1.4	5.9	7.3	
Other (specify)					
	Total	2.1	5.9	8.0	
Borrower: Government of Croatia					
Responsible agencies: Ministry of Finance, Office for the Restructuring and Economics of State-owned Enterprises, Utilities Regulatory Agency, Agency for the Protection of Market Competition, Croatian Securities and Exchange Commission, Securities Depository Agency, State Geodetic Administration, Central Bureau of Statistics, Bank Rehabilitation Agency, Project Implementation Unit.					
Estimated disbursements (Bank FY/US\$m):		2000	2001	2002	2003
	Annual	0.5	2.3	2.5	2.0
	Cumulative	0.5	2.8	5.3	7.3
Project implementation period: 4 years. Expected effectiveness date: July 1999. Expected closing date: June 30, 2003.					

A: Project Development Objective

1. Project development objective and key performance indicators (see Annex 1):

The development objective of the proposed project is to support improvements in the business enabling environment for private sector growth. Specifically, the project would:

- support the creation of an appropriate regulatory and institutional framework for public utilities;
- support further development of the regulatory and institutional framework for market competition;
- support further strengthening of the institutional framework for capital market development;
- assist in the modernization of the registries system;
- assist in the restructuring and modernization of the statistical agency;
- support ongoing efforts to complete the privatization of the three largest State banks.

To achieve this objective, the loan will finance consultant services, training and equipment. Progress in achieving the development objective will be assessed on the basis of:

- the establishment of a regulatory agency for public utilities and of new legislation in the energy sector;
- improved regulatory and enforcement capabilities of the Agency for the Protection of Market Competition;
- improved regulatory and enforcement capabilities of the Securities Exchange Commission and Securities Depository Agency;
- the harmonization of the cadastre system to the European coding system;
- the preparation of an institutional development plan for the Central Bureau of Statistics;
- completion of privatization strategy and due diligence of the three largest state banks.

B: Strategic Context

1. Sector-related Country Assistance Strategy (CAS) goal supported by the project (see Annex 1):

CAS document number: 14088-HR Date of latest CAS discussion: April 20, 1995

The project supports a key area delineated in the CAS, that is, encouraging private sector-led growth, by supporting improvements in the institutional and regulatory framework for the development of private businesses. Ongoing preparation of the new CAS (FY99-01) also gives priority to necessary improvements in the business enabling environment that would make possible further growth of private sector investments, including Foreign Direct Investment (FDI), and that would develop credible regulatory institutions in order to attract private investment and to maintain consumer confidence. Furthermore, the project builds on the successful implementation of the almost fully completed first Technical Assistance Project (TAL I, March 1996), which has been instrumental in advancing the structural reform agenda of bank and enterprise reform supported by the ongoing Bank's Enterprise and Financial Sector Adjustment Loan (EFSAL, April 1997).

2. Main sector issues and Government strategy

Private Sector Development

Early efforts in Croatia to promote private sector development (PSD) started shortly after independence (1991) when the first Law on Transformation of Socially Owned Enterprises (SOEs) was adopted. At that time, ownership structures were inherited from the former Yugoslavia - small private enterprises, cooperatives, and mostly SOEs. While entry barriers to new enterprises were almost eliminated, Government efforts concentrated on the privatization program that transformed about 3000 enterprises in all sectors of the economy into joint stock companies, and transferred almost 50 percent of their shares to private owners, primarily through employee and management buy-outs. In parallel, the

transformation of a small number of large strategic enterprises (mainly the oil conglomerate and the public utilities) followed ad-hoc legislation by which their share capital remained under State ownership.

Despite these developments, a large number of enterprises undergoing privatization remained, in effect, controlled by the State. Little consolidation of private ownership and slow progress in the divestiture of the remaining shares held by the State happened during the first 4-5 years that followed the 1991 program. Only limited trading of shares took place on the secondary market for a variety of reasons, i.e., inadequate capital market infrastructure, title deficiencies, overpricing, the overhang of the payment obligations on worker-subscribed but not fully paid for shares, and even expectations of upcoming new privatization schemes. As a result, despite the noticeable increase in private participation, ownership in privatized enterprises remained heterogeneous and dispersed, and was generally not conducive to improving governance.

Government policies towards the completion of privatization continued to show strong commitment. In 1996, the Ministry of Privatization and the Croatian Privatization Fund (CPF) moved decisively to complete the divestiture of the State's portfolio through a more forceful search for strategic investors and a new voucher privatization program with participation of investment funds, as well as improvements in the existing privatization methods (e.g., realistic pricing of shares) brought about the new 1996 Privatization Law. Implementation of the US\$2 billion voucher privatization program was launched late 1997 and was completed by the last quarter of 1998. In this manner, the privatization of the original SOEs was about 90 percent complete by end 1998 and is expected to be largely completed by mid 1999.¹

Institutional and regulatory reform to support PSD

Croatia has made some progress in supporting PSD by improving the environment for business development. Like other Central European economies, it has adopted a legal and regulatory framework compatible with a market economy through the enactment of important laws beginning in 1991.² Furthermore, Croatia has moved forward with a comprehensive enterprise and financial sector reform program (supported by the Bank's EFSAL and TAL I). In addition to the completion of the restructuring and privatization of the largest State banks and enterprises, the EFSAL/TAL I program includes parallel efforts aimed at the development of an adequate institutional and regulatory framework for the development of the financial system.³

The development of adequate institutions and regulations related to the start-up of capital markets was tackled decisively and supported by the Bank's Capital Markets Development Project (CMDP,

¹ Except for the shares contributed to the pension funds and the restitution fund.

² In addition to the Privatization Law (1991 and 1996) and Securities Law, the most significant legislation enacted since 1991 includes: (i) the Law on Obligations (1991) - based on the former SFRY law; (ii) the Law on Accounting (1992) - making mandatory the use of IAS, and the Law on Audits (1992) - requiring independent audits for large and medium companies (1993); (iii) the Law on Protection of Market Competition (1995); (iv) the Law on Labor (1995) - which permits collective bargaining agreements; (v) the Law on Companies (1995) - drawing primarily on German Law; (vi) the Law on foreign credit relationships (1996); the Law on court enforcement procedures (1996); (vii) the Law on real property ownership (1996); (viii) the Law on Bankruptcy (1997); (ix) the Law on Compensation for Nationalized Property (1998); (x) the VAT law (1998); and (xi) the Law on Banking (1998).

³ During project negotiations, the Government requested that additional funds be added to the loan amount to support ongoing efforts to privatize the three major State banks. This process is an essential part of the EFSAL program, and is currently being supported by the TAL I. At the moment, the Bank is supporting the Croatian Bank Rehabilitation Agency (BRA) in the ongoing selection of privatization advisors. This selection process has been carried in accordance to Bank procurement guidelines. The funds allocated to this particular component will be eligible for retroactive financing, and will supplement financing that was allocated for this purpose under the TAL I. A more extensive discussion of the rationale for Bank support to the BRA and the process of bank privatization was done in the TAL I and EFSAL reports, Ln 3989 HR and P-6792 HR, respectively.

March 1996). The aim of the CMDP was to support the Government's transformation program by facilitating the privatization process and, more generally, by developing the capital markets institutions required for a modern market-based economy. The project addressed three critical areas: (i) the policy framework for capital markets, especially the regulation of securities markets and the creation of the Croatian Securities and Exchange Commission (CROSEC); (ii) the operational capabilities of key capital markets entities, especially the Securities Depository Agency (SDA); and (iii) a comprehensive public awareness campaign of the role of capital markets and of shareholder rights. Overall, the program has been successful in setting the institutional basis for the development of the securities market, though rapid market developments and demands on the newly created institutions are a growing challenge. In order to sustain the progress made under the CMDP, both the SDA and CROSEC require further assistance in strengthening their enforcement capacities, in developing public access to information, and in setting up an information system for market surveillance.

Despite these developments, the institutional framework to support PSD and to foster and protect market competition is still limited. Until recently, the only two formal organizations were the Croatian Chamber of Economy (CCE) and the Chamber of Artisans, both inherited from the former Yugoslav system. The CCE covers a broad range of sectors and has a regional network of chambers and sectoral associations. It has become more independent vis-à-vis the Government and plays important advocacy and information roles for enterprises. The Ministry of Economy has also started a program for SME development. Its objective is to support SMEs by proposing policy guidelines, training, information and technological development, and SME support infrastructure (i.e., advisory centers).

Property legislation and registration are in their own right major issues in Croatia. Despite some improvements, the system of registries of business and properties remains split among separate institutions and pieces of legislation. Efforts are under way to revise and harmonize the property and registries legislation which have not yet been finalized and have not reached consensus among policy makers. However, even when the legal framework is better harmonized, the institutional back-up to support the proposed changes in legislation and the modernization of the registry system will still be inadequate. For generations, Croatia has had a "ground-book" method for registering property rights, which at the moment consists in large part of fragile book entries that are disintegrating, and in some cases becoming not only inaccessible, but also highly inadequate to keep up with the demands of market transactions. Institutional support for updating and creating electronic property registries is important not only to secure property rights, but to form the basis for quality secured lending within the financial system.

One of the most serious problems affecting the business environment lays in the inadequacies of the judicial system. At the moment the court system in Croatia is overloaded and is incapable of dealing efficiently with the number of cases that are piling. As a result, the system has no credible resolution mechanisms for commercial disputes, secured transactions are not honored, and poorly defined venues for exiting insolvent entities from the system remain uncontested.⁴

Competition Policy

In terms of market competition, enterprise privatization, liberalization of trade and investment, and deregulation have together led to a more efficient reallocation of resources, demonopolization and increased exposure of markets to firm rivalry. To further support these measures, a specific competition law was enacted in 1995, which was followed soon thereafter by the creation of a dedicated agency, the Agency for the Protection of Market Competition (APMC), to implement and enforce it.

⁴The Government of Croatia has recently requested of the Bank the preparation of a new Judicial Reform program.

However a genuine competition culture does not yet exist, and various anti-competitive business behaviors and arrangements, notably in services, are prevalent. Competition also is experiencing distortions due to a number of government-promoted barriers to trade by means of unnecessary exclusive concessions, permits and administrative approvals and requirements, which have provided commercial advantages to incumbents. Some importers have avoided competition through alleged price-fixing and market-sharing agreements. In certain sectors (i.e., retail trade, agro production, and food distribution), former State conglomerates have regrouped or new companies have formed financial/industrial holdings and have abused their dominant position through, arguably, predation, discrimination, and closure of market opportunities for smaller or more efficient competitors. In all these cases, the gains of trade and investment liberalization are undermined and measures taken to promote a more efficient reallocation of resources and demonopolization have not provided sufficient discipline to preclude firms from raising prices above the competitive level.

For these reasons, the implementation of the competition law and the strengthening of the APMC should be a priority. This process is still in the early stages. The APMC began operating in early 1997, two years after enactment of the law in 1995. Since then, the APMC has tried to apply the law without the necessary capital and human resources. In addition, the business community and, to some extent, the government and other public bodies have not been adequately informed of goals and scope of the law as to guide its activities and policies. With almost two years of operations, APMC's services have been in high demand, and the agency's capacity to respond has not been able to meet expectations.

To overcome these limitations, a strategy to implement competition law and policy is essential. This strategy should focus on three goals: (i) to improve regulatory and enforcement capabilities of the APMC; (ii) to develop and implement a program to make the law operational, including institutional arrangements (staffing and training); and (iii) to develop a competition culture through public communication and corporate compliance programs and by ensuring effective development of capacity for competition advocacy. The strategy should also point towards steps that minimize the likelihood of a Government policy reversal or failure of stakeholders to support the policy.

Public enterprises and regulatory reform

In parallel to ongoing efforts in private sector development, a small number of very large, so called "strategic" enterprises were legally transformed into public enterprises (PEs) under specific laws - with their share capital owned directly by the State. The largest companies in this group were the Railways, Post and Telecom (HPT), Electric Power (HEP), and the Oil and Gas conglomerate (INA). For some of these (i.e., INA, HEP, HPT) the 1991/96 laws already provide for some partial privatization (up to 25 percent of their equity). In practice, each PE has followed its own reform track, and ad-hoc plans for restructuring and/or privatization have been initiated.

A significant problem had been poor monitoring, and lack of active supervision of the PEs by the Government and its lack of success in having them implement forcefully their restructuring and privatization programs. Back in 1993, a Government unit was established to monitor the PEs - the Office for the Restructuring and Economics of State-owned Enterprises (ORESE) to address these problems. While ORESE succeeded in imposing improved financial controls on the largest PEs, its efforts have fallen short of effectively controlling and guiding management decisions on the restructuring of several of the largest and more complex PEs.

Institutional weaknesses have been compounded by the size and complexity of the PEs and their political clout. In the larger PEs, INA and, to a lesser extent, the electricity and railways companies, the combination of intricate corporate structures and of technically complex lines of business makes effective

monitoring a challenging endeavor. These enterprises typically consist of a cluster of 10-20 units, frequently resulting in extensive cross-subsidization within group structures and soft budget constraints in loss-making units. The restructuring process of the natural monopolies has not progressed far yet (INA being the exception). In fact, efforts to move ahead with the restructuring and privatization process of PEs had been hampered by the lack of adequate legislation, particularly in the energy sector and in the telecommunications sector, conducive to private sector investment. The preparatory work to create a new regulatory and institutional framework for public utilities has thus been at the top of the Government's policy agenda. The initial studies were carried out in 1997-1998 under TAL I financing. A new law on the regulation of public utilities has just been drafted and a plan to set up the new multi-sectoral regulatory agency was prepared under ORESE. This law is expected to be adopted during the first quarter of 1999, allowing for the creation of the new regulatory agency immediately thereafter. A new telecommunications law has been drafted and preparation of a comprehensive legislation for the energy sector is planned for the second half of 1999. Whereas there had been for some time a consensus within the Government on the need to move fast with the privatization of public utilities, the lack of full political consensus had so far resulted in implementation delays, with potentially long-term costs for the economy and to the detriment of attracting possible future international investors. A first concrete step has been the splitting, as of January 1, 1999, of HPT between post and telecommunications. A second step was the Government's announcement to start in 1999 with partial privatization, first, of the new telecommunications company, HT, followed by INA and part of the electrical power sector in 2000. Advisers are being recruited to assist in the sale of a major stake of HT to a strategic investor planned for the second half of 1999. In parallel, amendments to the earlier privatization laws are expected shortly in order to allow privatization of the utilities beyond the currently allowed 25 percent limit.

Information in the marketplace

As Croatia continues to move forward in its transition process towards a market economy, the availability and dissemination of statistics in the market place is becoming a visible deficiency. During the last few years, the Croatia National Bank, the Payments Institute, various ministries, and the Central Bureau of Statistics (CBS), have been the major providers of statistical information. Despite these efforts, proper dissemination and timely and adequate statistical information is still considered a major constraint.

The Law on Statistics was adopted by Parliament in 1994, though the CBS is currently preparing amendments to the Law to adjust its established systems and procedures to changes in the social and economic conditions which have evolved since the Law's adoption. The latter is part of ongoing Government efforts to develop Croatia's statistical system in order to improve the availability of data needed for a market-oriented economy, as well as overall economic management. The Government has begun reforming the statistical system by introducing international classifications and compiling new indicators. However, data needs for policy and business decisions are emerging at a higher pace than the statistical system can develop and deliver. Thus the statistical system will require the introduction of new data collection methods, improved management of the statistical system, training of staff, and considerable upgrading of equipment to process, store, share and disseminate information efficiently.

A plan to improve and restructure the statistical system must be developed. It has to cover several agencies involved in data collection, though it should focus primarily on the CBS. The priority activities for the development of the statistical system would best concentrate on: (i) filling in gaps in macroeconomic data utilized for economic policy and management; (ii) capturing new economic and social activities; (iii) meeting the needs of analysts, policy makers and the business community; (iv) introducing international standards and methodologies; and (v) improving efficiency and productivity with improved organization, data collection and processing methods and equipment. The Croatian Government has subscribed to the Special Data Dissemination Standards of the IMF. This places an additional burden on the statistical system to adhere to certain standards in data quality and periodicity.

3. Sector issues to be addressed by the project and strategic choices:

The project provides technical assistance - consultant and advisory services, training and equipment - which will help improve specific aspects of the regulatory and institutional framework to support private sector activity. Specifically, the project will address:

- The need to establish an adequate regulatory and institutional framework for public utilities. The proposed component will support the creation of a multidisciplinary utilities regulation agency (URA) and the preparation of modern legislation for the energy sector. In turn, this is expected to facilitate progress in the privatization program of the utilities sectors (electricity, oil and gas, and telecommunications), as well as to encourage the entry and participation of private investors in these sectors, and provide a framework for their efficient and transparent operations. A successful implementation of this component will complement efforts on the reform agenda of large public enterprises, sponsored by the Bank's EFSAL and TAL I.
- The need to enforce compliance with antimonopoly regulations and to strengthen the newly established Agency for the Protection of Market Competition (APMC).
- The need to further compliance with newly established capital markets regulations and institutions (CROSEC and SDA), improved public access to information, and better market surveillance. These components will largely extend the TA provided in the context of the ongoing CMDP. Further, it will focus more on strengthening compliance with the new regulatory framework for capital markets.
- The need to support progress in the reform program of registries. A successful implementation of this component will modernize and harmonize Croatia's cadastre system with the European coding system and will enhance the institutional capabilities of the State Geodetic Agency (SGA).
- The need to strengthen the CBS. A successful implementation of this component will foster a comprehensive system of collection, proper dissemination and adequate availability of statistics.
- The need to further support ongoing efforts being carried out by the Bank Rehabilitation Agency (BRA) to complete the privatization of the three largest State banks. This component will supplement the financing being made available under TAL I.

C: Project Description Summary

1. Project components (see Annex 2 for a detailed description and Annex 3 for a detailed cost breakdown)

Regulatory and institutional framework for public utilities. This component will assist the Government to create and build the capacity of a new utilities regulatory agency (URA) and draft a comprehensive legislation for the energy sector. The loan will finance mainly: (i) a resident advisor and other advisory services to assist ORESE to design the new agency's organizational structure and develop detailed regulations, a comprehensive staff training program, twinning arrangements with a foreign regulatory agency, implementation of a campaign to promote public awareness of new regulatory arrangements and development of an information management strategy, including the purchase of hardware and software and establishment of a library; and (ii) advisory services to assist the Ministry of Economy (MOE) draft new energy laws covering electric power, gas and petroleum products, as well as the secondary legislation and regulations necessary for their implementation.

Strengthening of the APMC. The loan will finance a resident advisor and other advisory services to develop secondary legislation for the 1995 Competition Law. Assistance will support preparation of a development plan for the APMC, including design of recruitment and training programs, the design and implementation of a public relations campaign to encourage business compliance with the Competition Law, and training activities.

Strengthening of the CROSEC and SDA. The loan will assist in strengthening CROSEC and SDA's capacities, through provision of expert advice and continuation of ongoing institutional development and on-the-job training in each agency.

Support for registry reform. This component will include advisory services to foster the program of harmonization of the cadastre to the European coding system.

Strengthening of the CBS. This component will develop an appropriate plan for a statistical system to publish and disseminate data for policy makers, businesses, and the general public. This will be accomplished through the preparation of an institutional development plan focused on redesigning the organizational structure of the statistical agency and developing a training program for managers and statisticians. This component will also assist to improve preparation of the new system of national accounts and price statistics.

Support to the BRA. The Loan will provide advisory services to continue ongoing Bank support for bank privatization activities.

Support to the PIU. The Loan will finance advisory services to assist the PIU in the establishment of a financial management system, project management and accounting, and auditing of project accounts.

Component	Category	Cost Incl. Contingencies (US\$M)	% of Total	Bank- financing (US\$M)	% of Bank- financing
1. Regulatory and institutional framework for public utilities	Institutional Devt, Physical	3.9	48.8	3.5	47.4
2. Strengthening of the APMC	Institutional Devt.	0.9	10.7	0.8	11.5
3. Strengthening of the CROSEC	Institutional Devt.	0.7	8.7	0.6	8.8
4. Strengthening of the SDA	Institutional Devt.	0.9	10.8	0.8	11.5
5. Support for registry reform	Institutional Devt.	0.2	3.0	0.2	3.3
6. Strengthening of the CBS	Institutional Devt.	0.3	4.2	0.3	4.7
7. Bank Privatization	Institutional Devt.	0.5	6.7	0.5	7.4
8. Project Implementation Unit	Institutional Devt.	0.5	6.2	0.3	4.5
	Total /a	8.0	100.0	7.3	100.0

/a includes front-end fee

2. Key policy and institutional reforms supported by the project

In support of the Government's objective to improve the institutional and regulatory framework for PSD, this project seeks to:

- provide the appropriate regulatory and institutional framework for public utilities, essential to develop private participation in delivery of public services (through privatization of existing public enterprises as well as investments in new privatization projects), particularly in the energy sector where private investment projects are under preparation;
- promote compliance with antimonopoly and market competition regulations;
- further strengthen compliance with the new regulatory framework for capital markets;
- advance the reform program of Croatia's system of registries;
- develop a plan for the improvement of the country's statistical system;

- support the privatization of three State banks.

3. *Benefits and target population*

The proposed project aims at improving key aspects of the institutional and regulatory environment for PSD. More specifically, benefits will include a new regulatory framework for public utilities, improved competition policies and better enforcement of securities regulations. The target population is the enterprise sector at large which will ultimately benefit from an improved business enabling environment.

4. *Institutional and implementation arrangements*

Project Implementation: The main executing agency will be the Ministry of Finance. The individual components will be coordinated by the various agencies involved: (i) for public utilities regulation, ORESE and the URA, in consultation with affected line ministries, and the MOE for energy sector legislation (ii) for improving the environment for market competition, the APMC; (iii) for capital market development activities, CROSEC and SDA; (iv) for the registries component, the SGA; (v) for improvement of the statistical system, the CBS; (vi) for bank privatization, the BRA. The Project Implementation Unit (PIU) will play an overall coordination role, will provide assistance to the implementation agencies in Bank procurement, will prepare progress reports with inputs from the implementation agencies, and will support the MOF and the Bank in other operational matters.

Financial Management System (FMS): The capabilities of the PIU were assessed with respect to financial management and reporting systems, including accounting, financial reporting, auditing, internal and other control procedures. The PIU is already managing two on-going Bank projects, namely the CMDP and TAL I. The FMS established for these projects is mainly geared towards monitoring and controlling the procurement and disbursements of loan proceeds and does not provide financial management reports as required under the new World Bank guidelines. An accounting firm will be engaged to design a proper accounting system which, when implemented, will ensure that the project accounting meets "International Accounting Standards" as issued by the International Accounting Standards Committee. In this context, draft terms of reference for the establishment of a financial management system have been agreed (see Annex 7). The PIU will seek a qualified accounting firm to establish the FMS. Draft templates for the Financial Management Reports appear in the PIP.

Project Audits: The Special Account and the project accounts will be audited in accordance with "International Standards of Auditing" as issued by the International Federation of Accountants. The PIU will provide the Bank, within six months of the end of each government fiscal year, an audit report by an independent auditor acceptable to the Bank.

D: Project Rationale

1. *Project alternatives considered and reasons for rejection:*

One project alternative which was rejected was that of creating several sector-specific regulatory agencies. Multisectoral regulatory institutions have not so far been established in ECA countries, although Latvia is giving consideration to establishing one, as is Slovenia. They have, however, been created in a range of other countries, including Australia, Bolivia, Canada, and Colombia. A major motivation in Croatia's case is to economize on scarce regulatory resources. There is strong competition from a range of sources for personnel with the economic, financial and legal skills needed to operate an effective regulatory agency. Creating a single agency can facilitate the sharing of skills across sectors. It

can also help to support the independence of the agency, since any attempts to improperly influence the regulator will have implications for a wider set of stakeholders.

During project preparation, the possibility of implementing a fully funded program for the Central Bureau of Statistics was considered. This option was found to be premature, given the capacity of the CBS to absorb such a program. The project focuses on assisting the CBS to design its institutional development plan as a necessary first step for a possible comprehensive program at a later time. The project also includes financing for key urgently needed activities, i.e., to develop a new system of National Accounts.

A larger scale support component for a comprehensive reform program of registries was also considered. It was rejected due to the lack of consensus of various stakeholders on the scope and pace of reform. Furthermore, such a program would have had to deal with a complex set of issues related to the resolution of property rights which would have exceeded the scope of the proposed technical assistance.

2. Major related projects financed by the Bank and/or other development agencies (completed, ongoing and planned)

Sector issue	Project	Latest Supervision Ratings (Bank-financed projects only)	
		Implementation Progress (IP)	Development Objective (DO)
Bank-financed			
Privatization and reform of public enterprises and banking sector	Enterprise and Financial Sector Adjustment Loan – ongoing	S	S
Institutional development – support to the EFSAL	Technical Assistance Project – ongoing	S	S
Capital markets development	Capital Markets Development Project – ongoing	S	S
Other development agencies			
UK KnowHow Fund	Assistance to the banking sector – ongoing		

IP/DO Ratings: HS (Highly Satisfactory), S (Satisfactory), U (Unsatisfactory), HU (Highly Unsatisfactory)

3. Lessons learned and reflected in the project design

Implementation of the ongoing TAL (Ln. No. 3989-HR) continues to be satisfactory, although the component for the financial sector was delayed due to the slow pace of reform, alternative arrangements made for financing bank restructuring, and the use of grant funds that have been made available (UK KnowHow Fund) for consultant services originally to be financed by TAL I. The Government has recognized the value and necessity of well-defined technical assistance. Like TAL I, implementation of each component under the proposed project will be the responsibility of the relevant implementing agency which will work with assistance from the PIU. Several of the implementing agencies have had previous experience with Bank projects, therefore implementation of TAL II should benefit from this past experience. Finally, as under TAL I, flexibility has been built into the project to allow funds to be reallocated, if requested by the Government and with the Bank's prior approval, should grant funds become available or to accommodate evolving needs under the Government's reform program should any emerge during project implementation.

4. Indications of Borrower commitment and ownership

The Government requested support through this project during the CAS discussions in March 1998 and confirmed its need for support during the 1998 Annual Meetings. The Government recognizes that the privatization of utilities will require an appropriate regulatory framework. Further support to the establishment of a competitive market environment will be accomplished through strengthening of the APMC and continued technical assistance to the CROSEC and the SDA. The Government has been selective in its borrowing for technical assistance. Its decision to borrow for this project and its involvement in the design of this assistance is a further sign of its commitment.

The Borrower's commitment is also reflected in recent actions taken by the Government to influence enterprise governance, the most important being the passage of legislation to split posts from telecommunications. Other actions include the Government's announcement to launch in 1999, first, the privatization of the telecommunications and, second, that of INA.

5. Value added of Bank support in this project

Given its substantial inter-country experience on privatization, restructuring and regulatory issues, the Bank is in a unique position to facilitate the rapid and efficient transfer of learning emerging from ongoing experience on optimal regulatory policies, enforcement of capital markets and enhancement of competition policy.

E: Summary Project Analysis (Detailed assessments are in the project file, see Annex 8)

1. Economic: *Not applicable*

2. Financial: *NPV and FRR:* Not applicable *Fiscal impact:* Not applicable

3. Technical: Not applicable

4. Institutional: a. Executing agencies: MOF will be the main executing agency and will oversee the implementation and take overall responsibility for the project. Other implementing agencies are: the Office for the Restructuring of State-owned Enterprises (ORESE), the new Utilities Regulatory Agency (URA), the Ministry of Economy (MOE), the Agency for the Protection of Market Competition (APMC), the Croatian Securities and Exchange Commission (CROSEC), the Securities Depository Agency (SDA), the State Geodetic Authority (SGA), the Central Bureau of Statistics (CBS), and the Bank Rehabilitation Agency.

b. Project Management: The proposed Project Implementation Unit (PIU) has substantial project implementation and procurement administration experience from its management of the ongoing CMDP and TAL I. TORs for initial services procurements have been prepared and will be included in standard Bank invitation/contracting documentation packages. HW/SW and office equipment specifications will be prepared after the Regulatory Agency is established.

5. Social: *Not applicable*

6. Environmental assessment: *Environmental Category* A B C

7. *Participatory approach [key stakeholders, how involved, and what they have influenced; if participatory approach not used, describe why not applicable]:*

a. Primary beneficiaries and other affected groups: Not applicable.

b. Other key stakeholders: Not applicable.

F: Sustainability and Risks

1. Sustainability

The Government is committed to the transformation of Croatia into a full market economy and to its integration into Europe. Fully recognizing the difficulties and risks, it is determined to adjust its institutions to the new market-economy environment, to complete restructuring and privatization of enterprises and banks, and to create conditions for private sector investment. The project focuses on essential activities to assist the Government to implement its long-term strategy. Follow-up operations (e.g., in the energy sector and PSD) will also help the Government address issues targeted by this project.

2. Critical Risks (reflecting assumptions in the fourth column of Annex 1):

Risk	Risk Rating	Risk Minimization Measure
<i>Annex 1, cell "from Outputs to Objective"</i>		
Parliament approval of new regulations and procedures may be problematic and delayed.	M	Seminars for Parliament and Government members; public information campaign.
Opposition to creation of a regulatory agency by those opposed to privatization.	S/M	Public information campaign.
Political support and will of Government to enforce new regulatory framework.	S/M	Government's desire to create full market economy; policy dialogue.
Continued Government commitment to reforms.	M	Policy dialogue.
<i>Annex 1, cell "from Components to Outputs"</i>		
Implementation of recommendations by advisors and findings of studies.	S/M	Government's desire to create full market economy.
Application of laws/regulations/procedures.	S/M	Government's desire to create full market economy.
Adequate budget for operation of respective implementation agencies.	S/M	Discussions held with MOF and agencies to ensure budget availability.
Overall Risk Rating	M	

Risk Rating - H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

3. Possible Controversial Aspects:

The Prime Minister has given his support to the establishment of a multisectoral agency. However, this option was not favored by the telecommunications ministry officials, who consider that there should be a separate communications agency covering telecommunications and broadcasting, or by the energy officials, who consider that there is no need as yet for an energy regulatory agency.

G. Main Loan Conditions

1. *Board Conditions:* None.
2. *Effectiveness Conditions:* (i) Establishment of a FMS acceptable to the Bank; (ii) staffing of the PIU acceptable to the Bank (see below).
3. *Other:*

The Loan Agreement requires that: (i) the PIU be maintained with adequate staff, satisfactory to the Bank, to carry out the project; (ii) the PIU will provide reports to monitor project activities and assess progress against the performance indicators; (iii) the Borrower and the Bank will review these reports and agree, if necessary, on activities to improve project performance and objectives.

H. Readiness for Implementation

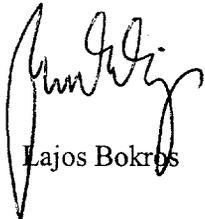
The Government is ready to implement the project, with the PIU handling the day-to-day administration. Terms of Reference for the main assignments have been agreed or are under preparation. The Borrower's Project Implementation Plan has been appraised and found to be realistic and of satisfactory quality.

I. Compliance with Bank Policies

This project complies with all applicable Bank policies.



Team Leader: Gerardo Corrochano



Sector Director: Lajos Bokros



Country Director: Arntraud Hartmann

Annex 1

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development**

Project Design Summary

Narrative Summary	Key Performance Indicators	Monitoring and Evaluation	Critical Assumptions
Sector-related CAS Goal:			(Goal to Bank Mission)
To encourage private sector-led growth			* Political and macroeconomic stability * Continued Government commitment to reform
Project Development Objective:			(Objective to Goal)
To support improvements in the business enabling environment for private sector growth			
Outputs:			(Outputs to Objective)
* Improved regulatory and institutional framework for public utilities	* Establishment of a regulatory agency for public utilities * Passage of the law for regulatory agency * Passage of ancillary legislation	* Progress reports submitted by the PIU (with inputs from relevant implementing agencies) to the MOF and the Bank	* Political support of Government to enforce the new regulatory framework * Continued Government commitment to reforms * Passage by Parliament of appropriate legislation; approval of new regulations and procedures
* Improved regulatory and enforcement capabilities of the APMC	* Approval of primary/secondary legislation * Public awareness campaign * Training provided to APMC officials		
* Improved regulatory and enforcement capabilities of the CROSEC and SDA	* Establishment of an information system for market surveillance * Training provided to CROSEC and SDA officials		
* Modernized cadastre system	* Harmonization of Croatian cadastre coding with the European coding system		
* Design of an institutional development plan for the CBS	* Adoption of the IDP by CBS's Board * Implementation of new System of National Accounts		
Project Components/Sub-components: (see Annex 2)			(Components to Outputs)
1. Regulatory and institutional framework for public utilities	3.5 million	* Progress reports submitted by the PIU to the MOF and the Bank	* Timely appointment of advisors * Implementation of recommendations by advisors and findings of studies * Application of laws/regulations/procedures * Adequate budget for operation of respective agency
2. Strengthening of the APMC	0.8 million		
3. Strengthening of the CROSEC	0.6 million	* Bank supervision missions	
4. Strengthening of the SDA	0.8 million		
5. Support to registry reform	0.2 million		
6. Strengthening of the CBS	0.3 million		
7. Assistance to the BRA. ⁵	0.5 million		
8. Project Implementation Unit	0.5 million		

⁵ See footnote No. 3 in the main text. This component is eligible for retroactive financing.

Annex 2

Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development

Project Description

Project Component 1 - Public Utilities Regulatory and Institutional Framework

Finalizing the Regulatory Framework and Building Capacity in a Regulatory Agency (US\$3.5 million)

- Technical assistance addressing market structure issues.
- Assistance to develop detail of the regulatory framework.
- Resident advisor to assist ORESE to coordinate tasks related to creation of the regulatory agency, and to build regulatory capacity.
- Gas sector study covering market, tariff and distribution.
- Training program which will address generic issues of economic regulation as well as specific technical issues and should address the needs of all levels of staff; study tours to examine how foreign regulators perform their tasks; twinning arrangements, allowing for the funding of staff from a foreign regulatory agency.
- Information management strategy, including purchase of computing equipment, selection of software and establishment of a library.
- Public campaign to promote awareness of new regulatory arrangements and means of addressing inadequate performance from service providers.
- Supplementary tasks emerging over time.

Project Component 2 - Strengthening of the Agency for Protection of Market Competition (US\$0.8 million)

- **Preparation of substantive and procedural primary and secondary legislation (law amendments, implementing decrees and regulations), administrative guidelines, and policy and law interpretation documents to:**
 - * Develop analytical standards for horizontal practices, abuse of dominance, vertical agreements and merger control.
 - * Define markets, gauge actual or potential exercise of market power, assess barriers to entry, and evaluate efficiencies and consumer welfare.
 - * Develop methods for collecting and safeguarding business confidentiality, and analyzing industry and firm economic data.
 - * Assess sectoral regulations in cooperation with other regulatory agencies.
 - * Determine fines, penalties, consent orders and alternative approaches to case resolution.
 - * Draft internal policy documents on investigative techniques, administrative rule-making, and adjudicative practices and procedures.
 - * Identify administrative requirements for filing and processing applications, complaints and other requests for official action.
- **Development of a training program and linkages with foreign competition authorities and international organizations**
 - * Implement short visits and internship programs in collaboration with major competition agencies.

- * Provide for APMC management staff to participate in international seminars, conferences and workshops organized by major competition agencies and international organizations.
- * Establish arrangements and other communication linkages with major competition agencies to promote exchange of information and documentation on best practices.
- **Building of institutional-expertise capacity**
 - * Engage a resident advisor to assist APMC in building up expertise, helping develop secondary legislation and guidelines, providing technical support in law enforcement and competition advocacy activities, and training staff.
- **Implementation of a public information and dissemination strategy aimed at creating a culture of competition and compliance with the law**
 - * Conduct a seminar-workshop for APMC, government authorities, judges, business and consumer associations, academics, and journalists.
 - * Develop a corporate compliance program which allows APMC to provide advice and support to business activities in accordance with the law.
- **Definition of organizational structure and personnel profile**
 - * Assess human resource requirements, including governance setting, incentive systems, personnel policies and staffing structures.
 - * Define job descriptions.
 - * Design information management systems and procedures.

Project Component 3 - Strengthening of CROSEC (US\$0.6 million)

- **Resident advisor to assist CROSEC to implement the following**
 - * Assist CROSEC to ensure the timely collection, storage and dissemination of corporate disclosure documents, to increase the number of issuers filing reports with the Commission, and to develop a program to start disseminating the information in hard-copy.
 - * Provide technical assistance to the Enforcement Division in conducting investigations of possible violations of the securities laws and make recommendations as to the disposition of those matters.
 - * Assist the Division of Investment Management in promulgating operational standards, reporting forms, disclosure rules, and calculation regulations concerning net asset value for investment funds and privatization investment funds.
 - * Assist the Market Regulation Division, to disseminate operational standards for brokerage companies, and organized securities exchanges, and to conduct compliance examinations of registered market participants and evaluate the outcome of the inspections.
 - * Assist the CROSEC to assess the existing data storage and retrieval system at the Commission as well as recommendations for an immediate process by which dissemination can begin.
 - * Provide continuous training of executives, professionals and staff, primarily through on-the-job consultation on inspection, enforcement and disclosure issues, in order to facilitate an efficient transition for CROSEC from a start-up to a steady state operation.

Project Component 4 - Strengthening of SDA (US\$0.8 million)

- **Resident advisor to continue ongoing institutional development and training efforts in the SDA. The advisor will provide operational assistance and technical support to:**
 - * Ensure that all listed securities are eligible for clearing and settlement services through the depository.
 - * Make 150 unlisted securities eligible for registry services and be in a position to accept 10 new securities per month into the registry as part of a routine operation.

- * Allow the SDA to be in a position to accept all new issues of securities directly into the registry. In the case of new issues that are to be listed, assist the SDA in being able to make these securities immediately eligible for clearing and settlement.
- * Provide continuous on-the-job training of staff.

Project Component 5 - Support to Registry Reform (US\$0.2 million)

- Consultant services to assist State Geodetic Administration to harmonize Croatian registry coding with the European system of coding.

Project Component 6 - Strengthening of Central Bureau of Statistics (US\$0.3 million)

Activities to strengthen the statistical system:

- Consultant services to help design an institutional development plan (IDP) for the Central Bureau of Statistics, with a view to restructuring the statistical agency to be responsive to the new data collection methods and data flows.
- Resident advisor to assist the CBS in the development of a new system of national accounts as well as improvements to price statistics. The resident advisor will also help liaise with the consultants in charge of the IDP.

Project Component 7 – Bank Privatization Unit (US\$0.5)

- Supplemental funds to support the privatization of Croatia’s three largest State banks.⁶

Project Component 8 – Project Implementation Unit (US\$0.5)

- Consultant services for PIU staff positions.
- Establishment of Financial Management System.
- Annual audits of loan accounts.

⁶ See footnote No. 3 in main text. This component is eligible for retroactive financing

Annex 3

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development**

Estimated Project Costs

Project Component	Local	Foreign	Total
	-----US \$ million-----		
1. Regulatory and institutional framework for public utilities	1.1	2.3	3.3
2. Strengthening of the APMC	0.1	0.7	0.8
3. Strengthening of the CROSEC	0.3	0.4	0.7
4. Strengthening of the SDA	0.1	0.7	0.8
5. Support for registry reform	0.0	0.2	0.2
6. Strengthening of the CBS	0.0	0.3	0.3
7. Bank Privatization	0.0	0.5	0.5
8. Project Implementation Unit	0.4	0.0	0.4
Total	2.1	5.1	7.2
Total Baseline Cost			
Physical Contingencies	0.0	0.0	0.0
Price Contingencies	0.0	0.8	0.8
Total Project Cost	2.1	5.9	8.0

Figures include Government counterpart and front-end fee.
Figures may not total due to rounding.

Annex 4

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development**

Cost Benefit Analysis Summary

Not Applicable

Annex 5

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development**

Financial Summary

	Local		Foreign		Total	
	US \$ m	%	US \$ m	%	US \$ m	%
Financing Sources (% of total project costs)						
Government	0.7	9	0.0	0	0.7	9
IBRD	1.4	17	5.9	74	7.3	91
Total	2.1	26	5.9	74	8.0	100

Annex 6

Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development

Procurement and Disbursement

Procurement

Procurement methods (Table A)

Procurement will be handled by the Project Implementation Unit (PIU) which reports to the Assistant Minister of Finance. The PIU over the past two and one-half years has developed a degree of procurement experience through its administration of other Bank Loans and, with guidance, will be capable of managing procurement for this project. A general procurement notice covering all planned purchases will be issued at the start of the project, with annual procurement updates published thereafter as appropriate. Procurement of goods will be done according to the provisions of the "Guidelines for Procurement under IBRD Loans and IDA Credits" (January 1995, revised in January and August 1996 and January 1999). **International Shopping** will be used to procure imported goods, mostly computer hardware/software for the Regulatory Agency for Public Utilities, for contracts up to US\$300,000 each, up to an aggregate of US\$400,000. **National Shopping** will be used for goods estimated to cost below US\$50,000 equivalent per contract, up to an aggregate amount of US\$100,000.

Selection of consultants will be done according to the provisions of the: "Guidelines for Selection and Employment of Consultants by World Bank Borrowers" (January 1997, as revised September 1997 and January 1999). **Quality and cost-based selection (QCBS)** will be used for consultant services contracts expected to total about US\$4.0 million equivalent (for long and short-term advisory services). The **least-cost selection (LCS)** process will be used for contracts totaling about US\$90,000 (for periodic project audits). Selection based on qualifications (project accountant, \$90,000) and single source selection (project management specialist, \$150,000), including procedures for selection of individual consultants will be used. The standard forms of contracts and documentation for consultant services contracting issued by the World Bank will be used for complex time-based assignments and for contracts based on lump-sum remuneration.

Prior review thresholds (Table B)

Goods: Goods will be procured under International and National Shopping procedures. Proposed procurement documentation for the first International Shopping package and the first National Shopping package will require prior review by the Bank.

Consultants' Services: Selected procurement procedures and documentation for consultants (see Table B) will require prior review by the Bank.

Disbursement

Allocation of loan proceeds (Table C)

Disbursements will be administered by the PIU. The proceeds of the Loan will finance 100 % of eligible direct foreign exchange expenditures for goods and 100 % of expenditures for

consultants' services and training, less identifiable taxes levied by the Croatian Government. The Loan is expected to be disbursed over three years, with expected project completion by December 31, 2002. The Closing Date will be June 30, 2003.

Use of Statements of expenditures (SOEs)

Disbursements for expenditures for goods procured under contracts below US\$100,000 equivalent and for consulting services under contracts below US\$100,000 equivalent for firms, and below US\$50,000 equivalent for individuals, will be made against Statements of Expenditure (SOEs). Documentation to support these expenditures will be retained by the PIU for at least one year after receipt by the Bank of the audit report for the year in which the last disbursement was made, and will be made available to the Bank and the auditors on request. Withdrawal applications for payments against other contracts and which require the Bank's prior review will be fully documented.

Special account

To facilitate timely project implementation, the Borrower will establish, maintain and operate, under terms and conditions acceptable to the Bank, a Special Account, in US dollars at a commercial bank acceptable to the Bank. The Special Account would have an Authorized Allocation of US\$1 million representing the expected advance payments (20 percent) on contracts during the peak quarter of expenditures if made exclusively through the Special Account. At the start of the project, the Special Account deposit would be limited to half of the Authorized Allocation and the remaining portion of the Authorized Allocation would be disbursed upon Government request when the aggregate amount of withdrawals from the Loan Account plus the total amount of all outstanding Special Commitments entered into by the Bank shall be equal to or exceed the equivalent of US\$2 million. Replenishment applications would be submitted at least every three months, and would include reconciled bank statements as well as other appropriate supporting documents. The minimum application size for payments directly from the Loan Account for issuance of Special Commitments is 25 percent of the Special Account authorized allocation.

Annex 6

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development**

Table A: Project Costs by Procurement Arrangements

(in US\$ million equivalent)

Expenditure Category	Procurement Method				Total Cost (including contingencies)
	ICB	NCB	Other	N.B.F.	
1. Goods			0.45 (0.45)		0.45 (0.45)
2. Services					
Consultants			6.93 (6.23)		6.93 (6.23) /a
Training/Study Tours /b			0.55 (0.55)		0.55 (0.55)
TOTAL /c			7.93 (7.23)		7.93 (7.23)

Goods will be procured by international and national shopping. Consultant services will be procured by QCBS, LCS and from individuals, as appropriate.

N.B.F. = Not Bank-financed

Figures in parenthesis are the amounts to be financed by the Bank loan/IDA credit.

/a Includes contingency funds currently unallocated.

/b May be performed in part by hiring of individual consultants.

/c Total does not include front-end fee of US\$73,000.

Annex 6

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development**

Table A1: Consultant Selection Arrangements (optional)

(in US\$ million equivalent)

Consultant Services Expenditure Category	Selection Method							Total Cost (including contingencies)
	QCBS	QBS	SFB	LCS	CQ	Other	N.B.F.	
A. Firms	4.00			0.09				4.09
B. Individuals						0.54		0.54
Total ⁷	4.00			0.09		0.54		4.63

Note: QCBS - Quality and Cost-Based Selection
 QBS - Quality-based Selection
 SFB - Selection under a Fixed Budget
 LCS - Least-Cost Selection
 CQ - Selection Based on Consultants' Qualifications
 Other - Selection of individual consultants (per Section V of Consultants Guidelines), Commercial Practices, etc., including project management specialist under Sections 3.8 – 3.11

N.B.F. = Not Bank-financed

⁷ Total does not include: US\$0.3 million for ancillary services and TA for privatization activities not yet identified; US\$0.5 million for bank privatization; or US\$0.8 million contingency funds currently unallocated. The procurement method(s) for the US\$0.3 million will be decided when each task is identified.

Annex 6

**Technical Assistance Project
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Table B: Thresholds for Procurement Methods and Prior Review

Expenditure Category	Contract Value (Threshold) (US \$ thousands)	Procurement Method	Contracts Subject to Prior Review / Estimated Total Value Subject to Prior Review (US \$ millions)	
1. Goods	< 300	IS	1	0.10
	< 50	NS	1	0.05
2. Services *				
Firms	> 200	QCBS	11	3.41
	< 200	QCBS	7	0.59
	< 200	LCS	1	0.09
Individuals	> 50	Selection of Individual Consultants - Consultant Guidelines, Section V	6	0.54
	< 50	Selection of Individual Consultants - Consultant Guidelines, Section V	--	--
	Total value of contracts subject to prior review: as percent of total loan:		27 66%	4.78

* The Bank will review all TORs and proposed procurement methods for services engagements. This will also apply to the US\$0.3 million available for ancillary services and TA for privatization activities, not included above. The procurement method(s) for these activities will be decided when the tasks are identified.

Annex 6

**Technical Assistance Project
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Private Sector Development**

Table C: Procurement Plan

Package No.	Description	Procurement Method	Document Preparation mm/yr	Invitation mm/yr	Contract Signature mm/yr	Estimated Contract Amount /1
A. SERVICES						
1	Economic design of market structure for electricity	QCBS	Jun-99	Jul-99	Aug-99	90000
2	Gas tariff study	QCBS	Jun-99	Jul-99	Aug-99	400000
3	Gas market and distribution study	QCBS	Jun-99	Jul-99	Aug-99	250000
4	Preparation of comprehensive energy legislation and regulations	Other a/	Apr-99	Jun-99	Jul-99	300000
5	Design of telecoms regulatory arrangements	QCBS	Apr-99	Jun-99	Jul-99	300000
6	Development of initial telecom licenses	QCBS	Apr-99	Jun-99	Jul-99	60000
7	Resident advisor for ORESE	QCBS	Apr-99	Jun-99	Jul-99	250000
8	Capacity development for URA	QCBS	Jul-99	Aug-99	Oct-99	200000
9	Public Awareness Campaign for Regulatory Arrangements	QCBS	Mar-00	Apr-00	Jun-00	100000
10	Resident Advisor for APMC	QCBS	Jun-99	Jul-99	Aug-99	360000
11	Public Awareness Campaign for APMC	QCBS	Jul-99	Sep-99	Nov-99	90000
12	Preparation of Legislation - APMC	QCBS	Oct-99	Dec-99	Feb-99	200000
13	Resident Advisor for CROSEC	QCBS	Apr-99	Jun-99	Jul-99	350000
14	Public Awareness Campaign for CROSEC	QCBS	Sep-99	Nov-99	Jan-00	50000
15	Resident Advisor for SDA	QCBS	Apr-99	Jun-99	Jul-99	350000

Annex 6

**Technical Assistance Project
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Table C: Procurement Plan (cont.)

Package No.	Description	Procurement Method	Document Preparation mm/yr	Invitation mm/yr	Contract Signature mm/yr	Estimated Contract Amount /1
16	Public Awareness Campaign for SDA	QCBS	Sep-99	Nov-99	Jan-00	100000
17	System development for clearing and settlement - SDA	QCBS	Sep-99	Nov-99	Jan-00	350000
18	Harmonization of cadastre coding	QCBS	Oct-99	Nov-99	Jan-00	200000
19	IDP for CBS	QCBS	Sep-99	Nov-99	Dec-99	200000
20	Development of new National Accounts/Price Statistics	QCBS	Sep-99	Nov-99	Dec-99	100000
21	Services for bank privatization	/2				500000
22	Supplementary tasks to establish regulatory framework/agency	/3				300000
23	Project Manager	Other b/	NA	NA	Feb-99	150000
24	Project Accountant	Other c/	Mar-99	Apr-99	May-99	90000
25	Project Audits	LCS	May-99	Jun-99	Jul-99	90000
26	Training/Study Tours	Other d/				550000
B. GOODS						
27	Agency library (URA)	NS	Mar-00	Apr-00	May-00	50000
28	Information management system - software (URA)	IS	Jan-00	Mar-00	May-00	100000
29	General office HW and SW (URA)	IS	Jan-00	Mar-00	May-00	200000
26	IT for Public Reference Room (CROSEC)	IS	Oct-99	Dec-99	Feb-00	100000
					CONTINGENCY	800000
					TOTAL	7230000

Annex 6

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development****Table C: Procurement Plan (cont.)**

QCBS	Quality and Cost-Based Selection
LCS	Least Cost Selection
IS	International Shopping
NS	National Shopping
Other	a/ Consists of 4 - 5 small contracts for which individuals will be selected. b/ Current project manager will be contracted through single source selection. c/ Individual or, if unavailable, a firm. d/ May be performed in part by hiring of individual consultants.

/1 Contract amounts do not include contingency funds currently unallocated.
/2 Supplemental funds for services already procured under TAL I using Bank procurement guidelines.
/3 Ancillary services and TA for privatization of public services and central or local government owned enterprises. Procurement method will be decided when task identified.

Annex 6

**Technical Assistance Project
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Table D: Allocation of Loan Proceeds

Expenditure Category	Amount in US\$ million	Financing Percentage
Goods	0.5	100% of foreign, 100% of local expenditures (ex-factory cost) and 80% of local expenditures for other items procured locally
Consultant services and related expenditures	5.4	100% less identifiable taxes levied by the Croatian authorities
Training	0.6	100%
Front end fee	0.1	
Unallocated	0.8	
Total	7.3	

Figures do not total due to rounding.

Annex 7

Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development

Financial Management Arrangements

Project Financial Management System

The Bank's financial management specialist assessed the capabilities of the Project Implementation Unit (PIU) with respect to financial management and reporting systems, including accounting, financial reporting, auditing, internal and other control procedures. The PIU is already managing two on-going Bank projects, namely the Capital Markets Development Project (CMDP) and the Technical Assistance Project (TAL I). The financial management system established for these projects is mainly geared towards monitoring and controlling the procurement and disbursements of Loan proceeds in accordance with the schedules established in the Staff Appraisal Reports, and do not provide financial management reports as required under the Bank's new guidelines. Nor does the PIU have the in-house capability to design such a system. A proper accounting system will be designed and implemented to ensure that adequate recording of project transactions as well as the preparation of financial statements meet Bank requirements. In this context, draft terms of reference for the establishment of a financial management system have been agreed (see below). The PIU will seek a qualified accounting firm to establish the financial management system. Draft templates for the Financial Management Report appear in the PIP (Appendix E).

Project Audits

The Special Account and the project accounts will be audited in accordance with the Bank Guidelines, Financial Reporting and Auditing of Projects Financed by the World Bank. The PIU will provide the Bank, within six months of the end of each government fiscal year, an audit report of such scope and detail as the Bank may reasonably request by an independent auditor acceptable to the Bank. The report will include a separate opinion by the independent Auditor on disbursements against certified SOEs. The separate opinion should mention whether the SOEs submitted during the fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawal applications.

Annex 7

Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development

Terms of Reference Establishment of a Project Financial Management System

BACKGROUND

The Government of Croatia is expected to receive from the World Bank (IBRD) a loan of US\$7.3 million to help finance the above Project.

In the implementation of Bank assisted projects, the role of financial management, as part of overall project management, in a world of scarce financial resources and complex projects, is fundamental. Its aim is to provide timely, reliable, and useful information for accountability and decision making. In addition, accounting and auditing are essential elements of stewardship-achieving the greatest benefit for the funds invested. This implies an integration of financial and program disciplines to manage available resources to achieve common goals. Accordingly, the Bank includes in all legal agreements one or more accounting, financial reporting, and auditing covenants as a means of ensuring accountability for the use of its funds. Loan covenants are used to assure compliance with general Bank policies.

OBJECTIVE

The objective of the project Financial Management System (FMS) is to ensure that accounting, procurement, disbursement, and audit are woven together to contribute to good project financial management, reduce the administrative burden on the Borrower, and ensure better client service. Better integration of all these elements of the loan administrative process will yield financial management reports that present the whole picture, virtually at a glance.

QUALIFICATIONS

In order to establish the FMS of the above project, the selected consultant/s should have training and experience in financial management and its related disciplines of accounting and auditing. Consultant/s should be a professionally qualified accountant (CPA, CA, or equivalent qualifications), or if not, have appropriate financial management qualifications:

- (a) Proven knowledge of and experience in implementing financial management systems, based on International Accounting Standards (IAS). In this respect, the consultant/s will be expected to provide appropriate references for the firm/individual, as well as for the personnel establishing the FMS;
- (b) The consultant/s should have an affiliation (i.e., be a member) in an accounting association with International Federation of Accountants (IFAC) membership;
- (c) Experience in carrying out accounting and auditing diagnostic work, making specific recommendations, and discussing and obtaining client concurrence;
- (d) Experience with the role and application of internal control systems and procedures, along with the ability to assess such systems and to recommend remedial action where necessary;

- (e) An understanding of information systems and the application of new information technologies;
- (f) All personnel involved in the establishment of the FMS of the said projects must be proficient in the English language, both written and spoken;
- (g) Experience in establishing FMS in World Bank financed projects is desirable, but not mandatory.

SCOPE OF WORK

The selected consultant/s will establish a “free standing” project financial management system in accordance with World Bank Financial Management Systems guidelines. It is recommended that the consultant/s utilize an “Off the shelf Accounting Package”, which can be modified to record project accounts and to produce financial management reporting formats and ensure that the proposed system can also be integrated into the client’s existing accounting data base. Security procedures should be built into the proposed system to ensure that data cannot be manipulated by unauthorized persons. Sample reporting formats are available to the client. In particular, the FMS should produce the following quarterly reports:

- A Project Progress Report which explains variances between actual physical and financial progress versus forecasts;
- A Project Financial Statement which includes a summary of sources and uses of funds, an updated six-month project forecast, a Special Account reconciliation statement, and expenditures by category statement; and
- A Procurement Management Report which shows project procurement status and contract commitments.

The consultant/s will also be required to train the client’s financial staff in the operation of the FMS. The main output relating to the design of the financial management system will be a ‘Financial Management Manual’ for the project. The financial management manual will comprehensively document the operation of the financial management system and will serve as a reference document for all project staff in operating the financial management system. In designing the system, particular attention should be paid to the:

- (i) Development of a Chart of Accounts: The Chart of Accounts will be used to: (a) capture financial data under appropriate headings; and (b) classify and group financial data for the various financial reports. The structure of the Chart of Accounts should cater for data to be captured by: (i) project components and sub-components; (ii) expenditure categories; (iii) World-Bank disbursement categories for the project; and (iv) implementing agencies. The structure of the Chart of Accounts should conform closely to the project cost tables to enable comparison of actual project costs during implementation with those estimated during project preparation. The Chart of Accounts should also provide appropriate linkages with the reporting heads used for Government budgeting purposes.
- (ii) Development of Financial and Accounting Policies: Simple, clear and transparent financial and accounting policies which will govern financial management of and accounting for the project should be developed. These will include both: (i) Accounting Policies for accounting and financial reporting for the project; and (ii) Financial Policies and Procedures, e.g., policies and procedures for transfer of funds and accounting for expenditures (including payment of advances, recovery of amounts); policies regarding expenditures which can be treated as project expenditures; and the classification of these expenditures under appropriate headings in the Chart of Accounts; etc.

(iii) Development of Financial and Accounting Procedures (for various types of transactions). The most important considerations in designing the various procedures are to ensure: (i) a satisfactory system of internal controls; and (b) smooth working/operation of the financial system. These procedures should incorporate standard internal check/controls such as delegation and separation of duties, authorization of transactions, physical custody of assets, periodic and regular reconciliations, independent verification, conformity to project procurement policies and procedures, etc. Given that the system will be a computerized system, internal controls should also include aspects such as controls over data integrity, standard EDP controls, etc.

(iv) Financial Reporting: Formats of the various periodic financial reports which will be generated should be developed. The financial reports should be substantially generated from the computerized financial management system. Therefore there should be clear linkages between the information in these reports and the Chart of Accounts. The financial reports should provide quality and timely information to project management, implementing entities, and various stakeholders on project performance. The financial reports should also include all the Project Management Reports (financial statements, output monitoring reports, and procurement management reports) to be provided in the quarterly Withdrawal Application to the World Bank under the World Bank's Loan Administration Change Initiative (LACI).

Financial Management Manual: The following aspects will be covered in the Financial Management Manual:

- (a) Flow of Funds
- (b) Financial and Accounting Policies for the Project
- (c) Accounting System (including Chart of Accounts, formats of books and records, accounting and financial procedures)
- (d) Budgeting
- (e) Financial Forecasting
- (f) Procurement and Contract Administration Monitoring System
- (g) Financial Reporting (including formats of reports, and linkages with Chart of Accounts)

NOTE: Most of these refer to the formats expected to be produced by the system.

The consultant/s should visit the client and familiarize themselves with the project as well as the existing accounting database. It is highly desirable that the consultant/s become familiar with the Bank's *Financial Reporting and Auditing of Projects Financed by the World Bank*, which summarize the Bank's financial reporting and auditing requirements. The consultant/s should also be familiar with the Bank's Disbursement Manual and the Loan Administration Change Initiative (LACI) Implementation Handbook. These documents will be provided by the Project Implementation Unit of the client.

CLIENTS

The Financial Management System is expected to be installed at the Project Implementation Unit (PIU) at the Ministry of Finance. In developing their financial proposal, the consultants should take into account the cost of the required software. Further details will be provided in the Letter of Invitation (LOI).

GENERAL

The consultant/s will be given access to all legal documents, correspondence, and any other information associated with the Project and deemed necessary by the consultant/s in the discharge of their assignment.

IMPLEMENTATION SCHEDULE

Upon award of a contract , the consultant/s is expected to adhere to the following implementation schedule:

- (a) Commencement of the work – within 10 calendar days from contract signature.
- (b) Establishment of the FMS – no later than a month after the start of the assignment.

PAYMENT TERMS AND SCHEDULE (To be revised as appropriate)

The payment for the FMS will be effected 10 percent upon signature of the contract and 90 percent upon presentation and acceptance of the FMS.

Annex 8

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development**

Project Processing Budget and Schedule

A. Project Budget (US\$000)	Planned	Actual
	(At final PCD stage)	
	113.0	100.7
B. Project Schedule	Planned	Actual
	(At final PCD stage)	
Time taken to prepare the project (months)		
First Bank mission (identification)	05/20/1998	05/20/1998
Appraisal mission departure	10/15/1998	NA
Negotiations	01/15/1999	03/03/1999
Planned Date of Effectiveness	04/15/1999	07/15/1999

Prepared by: Ministry of Finance, ORESE, APMC, CROSEC, SDA, SGA, CBS, BRA, PIU

Preparation assistance: NA

Bank staff who worked on the project included:

Name	Specialty
Gerardo Corrochano	Team Leader
Misha Belkindas	Senior Statistician
Yves Duviervier	Principal Financial Analyst
Francis Kenefick	Procurement Specialist
Ilene Photos	Operations Analyst
Roberto Tarallo	Financial Management Specialist
Luis Tineo	Market Competition Specialist
Michael Warlters	Regulatory Specialist
Tunc Uyanik	Peer Reviewer

Annex 9

Technical Assistance Project for Institutional and Regulatory Reform for Private Sector Development

Documents in the Project File*

- A. Project Implementation Plan

- B. Bank Staff Assessments
Financial Management Assessment – BTO [July 98]

- C. Other

*Including electronic files.

Annex 10

**Technical Assistance Project
for Institutional and Regulatory Reform for
Private Sector Development**

Statement of Loans and Credits

as of February 28, 1998

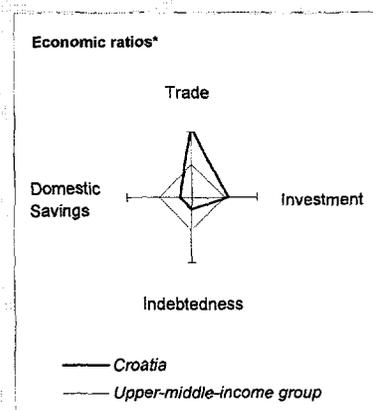
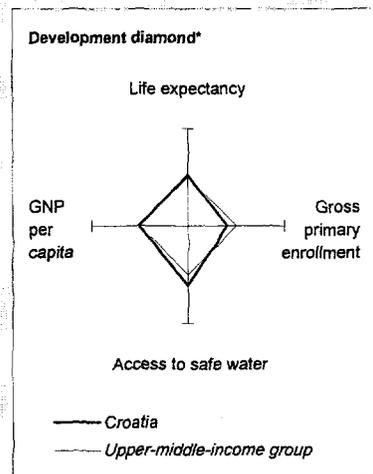
Loan/Credit	Fiscal Year	Purpose	Amount in US\$ million (less cancellations)			
			Bank	IDA	Undisbursed	Closing Date
Credits						
0 Credits				0.00		
Loans						
19 Loans closed			218.94		0.00	
30690	1989	Istria Water Supply	28.00		13.81	6/30/99
37600	1994	Emergency Reconstruction	128.00		1.70	12/31/99
38430	1995	Health Project	40.00		3.66	12/31/99
38690	1995	Highway Sector	80.00		18.29	12/31/00
39990	1996	Farmer Support Services	9.50		0.97	6/30/99
39890	1996	Capital Market Development	5.00		1.74	6/30/99
39880	1996	Technical Assistance	17.00		13.17	6/30/01
41590	1997	EFSAL	95.00		45.04	6/30/99
41190	1997	Coastal Forest	42.00		38.87	6/30/02
41040	1997	Emergency Transport/Mine	102.00		46.75	6/30/00
42470	1998	Investment Recovery	9.00		8.78	12/31/01
43510	1998	Municipal Environment	40.60		41.66	6/30/03
42460	1998	Eastern Slavonia Reconstruction	8.00		7.29	12/31/01
43520	1998	Investment Recovery	36.30		36.60	6/30/06
42490	1998	Investment Recovery	3.00		2.77	12/31/01
42480	1998	Investment Recovery	10.00		7.91	12/31/01
44330	1999	Railway Modernization & Rest.	101.02		94.04	6/30/03
Total Number of Loans = 17			754.42		383.05	
Total			973.36	0.00		
of which repaid			215.50	0.00		
Total held by Bank & IDA			757.86	0.00		
Amount sold			0.05			
of which repaid			0.05			
Total Undisbursed					383.05	

Annex 11
Technical Assistance Project for
Institutional and Regulatory Reform
for Private Sector Development

Country at a glance

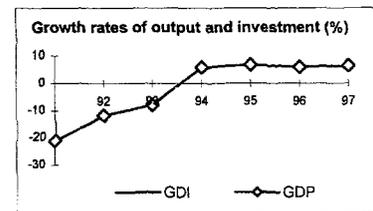
3/24/99

POVERTY and SOCIAL	Europe & Central Asia		Upper-middle-income	
	Croatia	Asia		
1997				
Population, mid-year (millions)	4.5	476	571	
GNP per capita (Atlas method, US\$)	4,610	2,320	4,520	
GNP (Atlas method, US\$ billions)	20.7	1,106	2,584	
Average annual growth, 1991-97				
Population (%)	-0.1	0.2	1.5	
Labor force (%)	0.0	0.5	1.9	
Most recent estimate (latest year available, 1991-97)				
Poverty (% of population below national poverty line)	..	..	..
Urban population (% of total population)	57	67	73	
Life expectancy at birth (years)	73	69	70	
Infant mortality (per 1,000 live births)	9	25	30	
Child malnutrition (% of children under 5)	..	..	..
Access to safe water (% of population)	96	..	79	
Illiteracy (% of population age 15+)	..	..	15
Gross primary enrollment (% of school-age population)	86	92	107	
Male	87	..	..
Female	86	..	..
KEY ECONOMIC RATIOS and LONG-TERM TRENDS				
	1976	1986	1996	1997
GDP (US\$ billions)	19.7	19.5
Gross domestic investment/GDP	22.1	24.2
Exports of goods and services/GDP	42.0	42.0
Gross domestic savings/GDP	12.4	7.8
Gross national savings/GDP	17.5	11.7
Current account balance/GDP	-4.5	-12.5
Interest payments/GDP	0.7	1.2
Total debt/GDP	24.4	31.1
Total debt service/exports	4.9	8.6
Present value of debt/GDP	21.2	..
Present value of debt/exports	45.0	..
	1991-97	1996	1997	1998-02
(average annual growth)				
GDP	-1.6	6.0	6.5	..
GNP per capita	-1.1	10.3	6.2	..
Exports of goods	..	-6.3	8.8	..

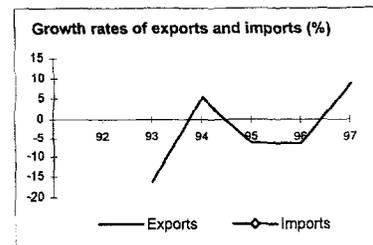


STRUCTURE of the ECONOMY

	1986	1996	1997
(% of GDP)			
Agriculture	..	8.6	8.4
Industry	..	24.2	24.5
Manufacturing	..	18.9	19.2
Services	..	67.2	67.1
Private consumption	..	59.0	65.2
General government consumption	..	28.5	27.1
Imports of goods and services	..	51.7	58.4



	1991-95	1996	1997
(average annual growth)			
Agriculture	-6.7	..	..
Industry	-12.6	..	..
Manufacturing	-12.9	..	..
Services	-3.0	..	..
Private consumption	..	..	..
General government consumption	..	..	..
Gross domestic investment	..	..	..
Imports of goods and services	..	..	..
Gross national product	-1.5	6.2	6.2

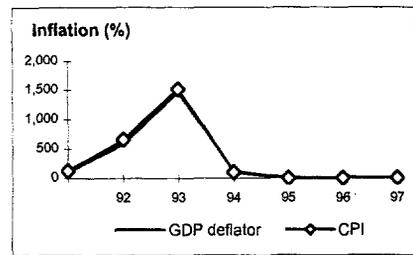


Note: 1997 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

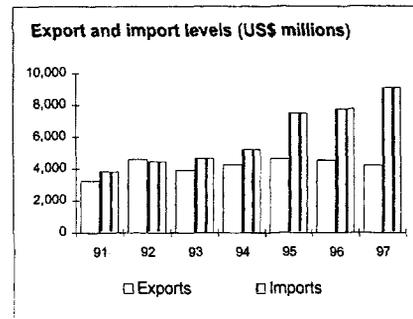
PRICES and GOVERNMENT FINANCE

	1986	1996	1997
Domestic prices			
(% change)			
Consumer prices	..	3.6	3.7
Implicit GDP deflator	..	2.8	4.2
Government finance			
(% of GDP, includes current grants)			
Current revenue	..	49.2	49.6
Current budget balance	..	5.5	4.7
Overall surplus/deficit	..	-0.4	-1.1



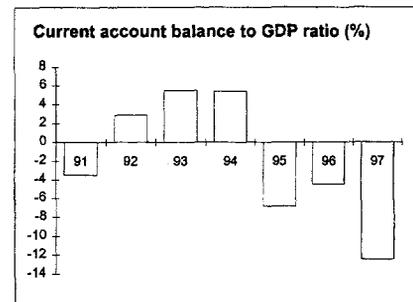
TRADE

	1986	1996	1997
(US\$ millions)			
Total exports (fob)	..	4,546	4,206
Capital goods
Chemicals	..	643.0	570.4
Manufactures	..	4334.0	4145.0
Total imports (cif)	..	7,788	9,104
Food	..	767.1	831.6
Fuel and energy	..	857.4	849.9
Capital goods
Export price index (1995=100)	..	110	112
Import price index (1995=100)
Terms of trade (1995=100)



BALANCE of PAYMENTS

	1986	1996	1997
(US\$ millions)			
Exports of goods and services	..	8,024	8,199
Imports of goods and services	..	9,911	11,402
Resource balance	..	-1,887	-3,202
Net income	..	-21	-84
Net current transfers	..	1,028	852
Current account balance	..	-881	-2,435
Financing items (net)	..	1,304	2,623
Changes in net reserves	..	-423	-188
Memo:			
Reserves including gold (US\$ millions)	..	2,314	2,539
Conversion rate (DEC, local/US\$)	..	5.4	6.1



EXTERNAL DEBT and RESOURCE FLOWS

	1986	1996	1997
(US\$ millions)			
Total debt outstanding and disbursed	0	4,815	6,067
IBRD	0	195	277
IDA	0	0	0
Total debt service	0	450	806
IBRD	0	26	29
IDA	0	0	0
Composition of net resource flows			
Official grants	0	0	0
Official creditors	0	23	57
Private creditors	0	455	1,225
Foreign direct investment	..	509	196
Portfolio equity	0	27	174
World Bank program			
Commitments	0	176	125
Disbursements	0	105	112
Principal repayments	0	16	14
Net flows	0	89	98
Interest payments	0	11	14
Net transfers	0	78	84

