

DOING BUSINESS IN CROATIA

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For a country keen on attracting more foreign direct investment, Croatia still lays many unnecessary road-blocks to doing business. While it has made an effort to improve the business climate over the past few years, other countries have done so more rapidly or more deeply, leading to a relative decline in the Croatian economy's ranking.

Firms in Croatia bear high administrative burdens in terms of time and costs, even without considering the time spent on gathering information on the procedures required. The global financial crisis laid bare some areas that still need attention, namely starting a business, dealing with construction permits, registering property and trading across borders. Luckily, many of the improvements can be done in a cost-effective way, without putting too much stress on the public budget. These areas should be at the core of future reforms.

This paper is based on the reports prepared by the Doing Business organization of the World Bank, which are co-published with the International Finance Corporation.

Ease of doing business

Ease of doing business refers to how easy or difficult it is for an entrepreneur to set up and run a business when complying with relevant regulations. The World Bank report on the topic assesses it by measuring regulations affecting 10 areas of small and medium-sized enterprises (SMEs) operating in a country's largest business city: starting a business, dealing with construction permits, getting electricity, registering prop-

erty, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency (World Bank 2014). It also separately measures labour market regulation.¹ The report ranks 189 economies by their distance to the regulatory frontier, i.e. their distance to the country with the best practice in the respective field, as well as by an overall score.² A high score indicates a regulatory environment that is conducive to setting up and operating a business. It should be noted that the countries that score highest are not those with no regulation, but those where regulations support market interactions without hindering the private sector.

Making it easier to start a business is positively related to firm concentration, which in turn creates jobs and promotes growth. Klapper and Love (2010) find that an improvement in the overall distance-to-frontier score is associated with an increase in new firm density, with the effects being stronger for higher improvements in terms of distance to frontier. Doing Business scores are also found to be positively correlated with inflows of, and extracting more benefits from, foreign direct investment (Corcoran and Gillanders 2012; Anderson and Gonzales 2013), suggesting that Doing Business reflects the overall investment climate in the private sector, beyond the concerns of domestic SMEs.

Croatia's performance

Out of 189 listed economies, Croatia ranked the 65th in 2014, gaining two positions compared to the previous year.³ This corresponds to a distance-to-frontier score of 66.53. Figure 1 shows the development over time of the absolute Doing Business ranking for Croatia and comparison countries, namely Bulgaria, Hungary, Poland, Romania, Slovenia and Slovakia. In addition Germany which ranked the 14th in 2014 is shown for reference. Croatia clearly does relatively badly.

¹ Labour market regulations are not covered in this article; see specific article in this issue.

² The methodology was changed in 2014 and the distance to frontier was introduced as a supplement to the simple ranking.

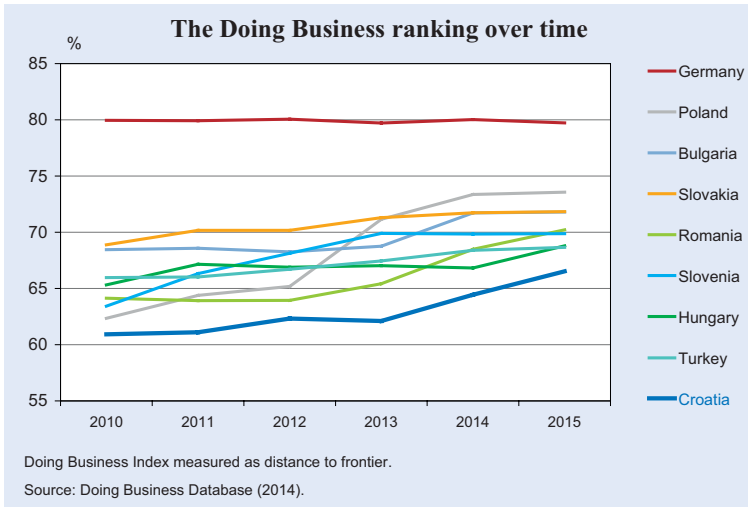
³ The methodology was changed in the Doing Business Report 2015. Rankings for the previous reports have been adjusted in accordance with the new methodology to allow for direct comparison.

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Figure 1



Croatia has introduced a number of regulations in the past decade in an effort to improve matters, earning a place among the 30 economies which improved most between 2013 and 2014 (World Bank 2014).

The relatively poor score stems from the fact that, despite the reforms, some critical areas remain. Figure 2 displays the strengths and weaknesses of the ten fields in Croatia, measured as the distance to the frontier. Figure 3 shows the ordinal ranking in absolute terms. The most problematic indicators will be analysed in detail below, namely starting a business, getting a construction permit, registering property, and trading across borders, in addition to enforcing contracts and resolving insolvency, which, while not ranked poorly, are key to attracting business.

Figure 2

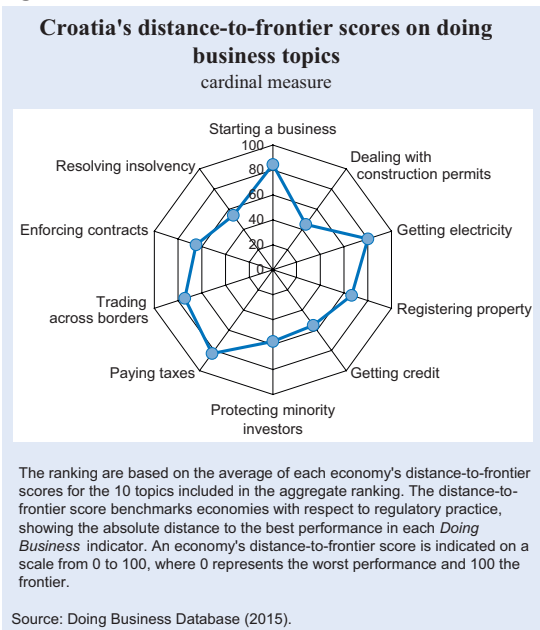
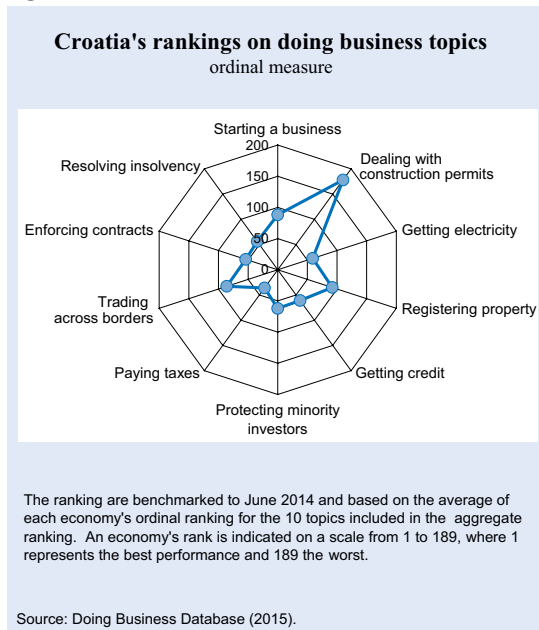


Figure 3



Starting a business (rank 88/189)

Croatia ranks better than, for instance, Germany or the Czech Republic. The number of procedures is fairly low (7) and the time it takes (15 days) is comparable to 14.5 days in Germany. The paid-in minimum capital requirement lies at 26.6 percent of the average per capita income.

And yet its score, at rank 88, is modest and has even slid since 2013. The problem is that other economies have caught up even

faster, leading to a relative decline in Croatia's ordinal ranking. It is still not possible to register a limited liability company solely online with the Commercial Court, as the e-signature has not yet been established, and picking up the registration may only be done on Fridays and Tuesdays (World Bank 2014).

Among the measures introduced over the years to improve this indicator are a streamlining of procedures through a one-stop shop, allowing limited-liability companies to file their registration application electronically, and introducing a new form of limited-liability company with a lower minimum capital requirement and simplified incorporation procedures. In addition, reduced notary fees have made starting a business less costly. But, as the score shows, more must be done.

The benchmark is New Zealand, where one procedure, half a day and 0.3 percent of per capita income is all one needs to set up a business. The minimum capital required is zero (as is the case for 111 economies out of the 189 in the ranking). A limited-liability company can be registered online by reserving a name and completing the incorporation application, subject to a small fee of currently about 100 euros (Companies Office 2015).

Dealing with construction permits (rank 178/189)

Cumbersome and costly procedures to obtain construction permits not only deter business starts, but tend to foster corruption and create incentives to build illegally. Croatia ranks a miserable 178, worse than Bulgaria, Hungary, Poland or Romania. Clearly, this is Croatia's weak spot for doing business.

Croatia has made some effort to improve this index, with the establishment of a one-stop-shop and enforcement of the building code, and by replacing the location permit and project design confirmation with a single certificate. The time for all procedures has been reduced by about six months, thanks among others through the Physical Planning and Building Act, which relaxed the order of the procedures (building permits can now be obtained prior to paying contribution fees and utilities). Moreover, fees for building permits were reduced. Registering the building with the land registry is now carried out by the municipality without further action by the builder. Despite this, the procedures are still laborious. In 2014 no less than 21 procedures were required, involving the municipal authority, the Inspectorate for Fire at the Ministry of Interior Affairs, the National Croatian Electric Grid, the Waste Collection Department, and the Cadastre, to name just a few. The whole process takes 188 days and costs, in the case studied, 10.9 percent of the building's value.

The benchmark is Hong Kong, where only 5 procedures are required (submission of applications, inspection of the foundation strata, certificate of completion, joint inspection by licensing authorities, obtaining water connection) and take 66 days to complete. In terms of speediness, Singapore leads with 26 days.

Registering property (rank 92/189)

Croatia holds the worst position among its peers, even though it closely follows Germany (89) and

Slovenia (90). This ranking represents the procedures, cost and time that buyers and sellers incur by a standard property transfer to a buyer's name. The main institutions involved are the Land Registry and the Cadastre. On-going improvements at the Croatian Land Registry have considerably speeded up the process (World Bank 2015a), reducing it from 956 days in 2006 to 173 days by 2008 and 72 days now. Still, measured by the distance to the frontier, Croatia stopped improving in this field in 2010. The 5 procedures required cost 5 percent of the property's value. The bottleneck is the Land Registry Court, where recording the sale agreement takes more than 60 days. A one-stop-shop was established as part of the 'Real Property Registration and Cadastre Joint Information System (JIS)', launched in 2014 (Uredjena Zemlja 2015), which allows online access to the harmonized land registry and cadastre databases.

The benchmark is Georgia, with only one procedure which can be completed between one and four days. Purchase agreements do not need to be notarized, and property may be registered online. Extracts are also issued online.

Trading across borders (rank 86/189)

The indicator measures the number of documents, the time and costs associated with exporting and importing a standard product by sea transport. Despite Croatia's favourable geographic location, with good access to the coast and a number of well-equipped seaports, it ranks only 86, bested by such landlocked peers as Slovakia (71) and Hungary (72). Exporting/importing a standard container of goods requires six/seven documents, takes 16/14 days and costs 1,335 US dollars/1,185 US dollars, respectively. Recent improvements to the physical infrastructure and the information system at the port of Rijeka made trading across borders easier, but insufficiently equipped transport facilities in the hinterland hamper its role as a transit hub to the European Union.

In Singapore, the benchmark in this field, it takes 1 to 2 days and only three documents to export or import, namely a bill of lading, a commercial invoice and a customs declaration. Croatia, in addition, requires a cargo release order, a packing list, a clean report of findings and terminal handling receipts, taking between 7 and 8 days.

Enforcing contracts (rank 54/189)

This is Croatia's second-best field, where it ranks 54. It shows the effectiveness (in terms of time, costs and overall complexity) of commercial dispute resolution. It takes 572 days, 38 procedures and costs 13.9 percent of the claim to enforce a contract, well in line with the comparison groups but with relatively low costs associated with dispute settlement. In 2013, Croatia streamlined litigation proceedings and transferred certain enforcement procedures from the courts to state agencies.

Here, Singapore is again as the benchmark, with a low number of procedures and the option of electronic filing of court cases.

Resolving insolvency (rank 56/189)

A robust system for resolving insolvency ensures the efficient return of a firm to business operation and generates trust among investors, thereby increasing access to finance. Croatia, with 3.1 years to solve the procedure and costs amounting to about 14.5 percent of the debtor's estate value, ranks well in this field among its peers. It is, however, more likely that the procedure results in the liquidation of the firm rather than in its continuation as a going concern. The recovery rate for creditors is 30.5 cents to the dollar, a low value compared to, for instance, Finland, which ranks best with 90.2 cents on the dollar, and where it takes less than one year to complete the procedure.

With its recent Pre-Bankruptcy Settlement Agreement Act, Croatia introduced an out-of-court restructuring procedure where creditors and debtors can reach an agreement. It allows companies' survival and therefore increases creditors' (including the state) chances of repayment of obligations. Pre-bankruptcy must be completed within 120 days.

Policy proposals

Full implementation of e-government processes, by establishing the e-signature as a fully valid element for all relevant procedures, is key, as shown by all the globally best-ranked economies. Going electronic would also curtail the opportunities for corruption along the many procedural steps. The restriction imposed by being allowed to pick up a business registration only on Tuesdays and Fridays should be eliminated forthwith.

In the field of construction permits, unnecessary regulations should be removed. Following Singapore's lead, procedures in registering property could be differentiated for industries with different risk profiles, allowing for easier procedures (such as online registration) for low-risk industries. To speed up the process of registering property, Croatia could introduce maximum duration on certain 'bottleneck procedures', such as the request for property registration at the Land Registry Court. Building of the electronic JIS database should be speeded up.

Trading across borders would profit from a reduction in the number of necessary documents. Also, Croatia should invest in complementary infrastructure in the hinterlands to make Croatia's ports a competitive alternative to other European ports and to better exploit its favorable geographic location.

Corruption must be tackled rigorously. Croatia ranks 61st out of 174 economies, affecting its international competitiveness. Among its prime peers, only Bulgaria and Romania are more corrupt. Sound institutions, transparent regulations, electronic procedures and a reduction in the number of steps required for the granting of permits or the registrations of businesses and property would reduce the grounds and opportunities for corruption.

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