



CROATIA

ADMINISTRATIVE BARRIERS TO FOREIGN INVESTMENT

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TABLE of CONTENTS

	PAGE
ACRONYMS	V
EXECUTIVE SUMMARY.....	VI
CHAPTER I INTRODUCTION	1
CHAPTER II INVESTOR ENTRY INTO CROATIA	7
A. Foreign Investor Entry – Business Visa.....	7
B. Work Permits.....	10
C. Expatriate Labor – Employment Visa.....	12
D. Procedures after Receiving a Work Permit	12
E. Analysis.....	13
F. Recommendations	20
CHAPTER III COMPANY REGISTRATION AND OTHER BUSINESS ESTABLISHMENT PROCEDURES	23
A. Types of Economic Organization.....	23
B. Establishing a Business in Croatia	26
1. Company Registration.....	27
2. Other Procedures for Establishing a Business in Croatia.....	29
C. Applying for Special Sectoral Licenses	30
D. Analysis.....	31
E. Recommendations	33
CHAPTER IV LOCATING.....	37
A. Acquiring Business Premises and Land.....	37
B. Renting Land and Premises.....	38
C. Additional Procedures for Purchasing Land as a Foreigner.....	39
D. Land Acquisition and Ownership Issues	39
1. State-owned land.....	40
2. Acquiring land not held by the state or quasi-public institutions.....	41
3. Small parcels of land.....	43
E. The Process of Acquiring and Registering Land	43
F. Construction Permits and Procedures	50
1) Location permit	51
2) Building permit	53
3) Usage Permit	55
4) Construction Permit Procedures Outside Zagreb	55
5) Utility Issues.....	56
1. Electricity Connections	56
2. Fixed-Line Communications Services	57

3.	Water and Sewerage.....	58
4.	Gas.....	58
L.	Analysis.....	59
M.	Locating: Recommendations.....	66
1.	Land ownership-related recommendations	67
2.	Land registration-related recommendations.....	69
3.	Construction-related recommendations.....	69
4.	Utility-related recommendations.....	71
CHAPTER V OPERATING		73
A.	The Taxation System in Croatia.....	73
1.	Corporate Profit Tax.....	73
2.	Value-Added Tax	74
3.	Social Insurance	75
4.	Real Estate Transaction Tax.....	76
5.	Tax Reporting.....	76
6.	Tax Audit and Inspection	77
B.	Taxation Analysis.....	77
C.	Taxation Recommendations.....	78
D.	Import, Export and Trade	79
E.	Import, Export and Trade – Analysis	86
F.	Import, Export and Trade - Recommendations	87
G.	Labor	88
1.	Labor Legislation	88
2.	Layoffs and Downsizing	89
H.	Labor - Analysis	90
I.	Inspections – The State Inspectorate.....	90
J.	Inspections - Analysis	91
K.	Inspections - Recommendations.....	91

LIST OF TABLES

Table II.1: The Generic Process for Foreigners to Begin Work Legally in Croatia, and Official Time Requirements and Costs.....	14
Table III.1: Company Registration Procedures: Croatia in International Comparison.....	33
Table V.1: Social Insurance and Other Contributions	76

LIST OF FIGURES

Figure I.1: Overview of Administrative Procedures for Investing in Croatia	3
Figure II.1: International Comparison of Time Required to Issue a Work Permit	16
Figure III.1: The Process of Company Registration in Croatia.....	26
Figure IV.1: Procedures for Land Acquisition, Land Registration and Construction in Croatia.....	38
Figure IV.2: Property Acquisition and Registration in Croatia	46
Figure IV.3: International Comparison of Time Required for Land Acquisition	60
Figure IV.4: International Comparison of Time Required for Site Development Approvals.....	63

LIST OF BOXES

Box II.1: Residence and Work Permit Procedures in the United Kingdom	18
Box II.2: Residence and Work Permit Procedures in Germany	19
Box II.3: Work Permits in Lithuania and Zambia	20
Box III.1: Company Registration in South Africa	35
Box IV.1: Building permits in South Africa	64
Box IV.2: Building permits in Tanzania	64
Box IV.3: Site Development Approval Procedures in Germany and Ireland	65
Box IV.4: The Role of Industrial Parks in Ireland's Development.....	68
Box V.1: Customs Reform in Mexico	87

ACRONYMS

BDC	Book of Deposited Contracts
CCL	Croatian Company Law
CEI	Croatian Employment Institute
d.d.	(Joint Stock Company suffix)
d.o.o.	(Limited Liability Company suffix)
DfEE	Department for Education and Employment (UK)
DM	Deutschmark
EEA	European Economic Area
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
GDP	Gross Domestic Product
GDSA	Gross Developed Surface Area
HMO	(Pension Institute's asset management arm)
ISA	Insurance Supervisory Authority
JSC	Joint Stock Company
LLC	Limited Liability Company
MoFA	Ministry of Foreign Affairs
MoJ	Ministry of Justice
MUP	(Ministry of Internal Affairs)
NN	Narodne Novine
PDV	(Value-Added Tax)
SAD	Single Administrative Document (for customs)
SMEs	Small and Medium Enterprises
SOE	State-Owned Enterprise
VAT	Value-Added Tax
WTO	World Trade Organization
ZAP	(Croatian National Payments Agency / Agency for Payments)
SZUP	(Office for Protection of Constitutional Order)

EXECUTIVE SUMMARY

i. This report uses a standard methodology to analyze administrative barriers to investment in Croatia. To this end, it looks in detail at the procedures an investor would have to do in order to establish and operate a business legally in Croatia today. The investigation breaks the investment process into four generic areas: entry procedures (immigration procedures, work permits, and related procedures); business establishment (company registration and various licensing procedures); locating procedures (land acquisition, land registration and construction); and operating procedures (paying taxes, customs procedures, labor regulations and government inspections).

ii. With the exception of several high-profile privatization-related foreign investments in the past couple of years, Croatia has relatively little experience of new greenfield foreign investment. Indeed, the country needs to stimulate both foreign and domestic investment, especially among smaller companies, in order to address its development needs and chronic unemployment problems. Currently, Croatia's inward investment profile consists mainly of smaller service type companies and a few longer standing investments, and foreign entrepreneurs and "returning" Croatians are only now beginning to investigate promising new sectors for investment. Both they and Croatia's indigenous entrepreneurs, are running into a variety of administrative barriers to investment.

iii. Administrative barriers, while sometimes appearing mundane to high-level policymakers, can make the difference between a country being an attractive location for foreign investment, and one that is shunned. Many governments worldwide avidly seek to tailor incentive policies in order to attract investment, or expend much energy drafting first-class laws in a similar expectation. However, complicated and time-consuming administrative procedures are among the most important disincentives to foreign investment, and can chase investors away in spite of generous incentives and a solid legal environment. A delay of a few weeks at each of several government agencies may seem of little consequence to the responsible officials in each, and they may even profit a little from the delay, but it can cost an investor hundreds of thousands of dollars in wasted time and lost revenues, and set the wrong tone with investors.

iv. The removal of unnecessary administrative barriers is not a panacea to stimulate investment. However, it can boost competitiveness, help ensure the success of other larger, systemic reforms, such as trade liberalization and privatization, and send valuable signals to foreign and domestic investors that the government is serious about reform and promoting investment. Often the actions needed to remove administrative barriers are not costly in financial terms, but involve the much harder task of overturning an ingrained way of thinking among government officials or re-thinking the role of the state in economic affairs. At the same time, many problems are due to an easily repaired absence of dialogue between government departments, and with the investor community, or to bottlenecks that are less daunting than they appear.

v. Streamlining administrative procedures is important in the larger reform context as Croatia moves towards full membership of the European Union and the intensified competition that membership implies. Stimulating overall enterprise sector investment (both foreign and domestic), and especially encouraging new companies that have strategic alliances with foreign investors, will be critical to the process of improving Croatia's capacity to cope with greater competition. In an attempt to explore optimal solutions to the challenges facing Croatia, this report provides examples of international best practice from the EU and elsewhere as useful references for Croatia's reform options.

vi. As in many other countries, crucial, larger reforms need to be complemented by efforts to address more mundane, but significant issues. The difficulties that the FIAS team faced in gathering information on some administrative procedures for this report reflected logistical problems to some degree, but it is likely that new foreign investors would encounter similar problems. Utility connection procedures, environmental assessments and appeals procedures are examples in the case of Croatia.

vii. The need for both larger, longer- term reforms on the one hand, and the potential contribution to improving the investment environment of relatively quick and simple actions on the other is reflected in the recommendations of this report. Thus, in the Executive Summary, reforms, often longer- term, requiring more careful planning and discussion among government bodies and with the private sector on how to achieve them, are indicated in *italic script*. One of the key objectives of the workshops that FIAS held with the government and the private sector was to help the government formulate an action plan and next actions with respect to these larger reforms. Meanwhile, underlined text is used to indicate the relatively quick and simpler recommendations that could help improve the investment environment in the short- term.

viii. This report's investigation of the four key dimensions of the investment process – entry, business establishment, locating and operating procedures – produces a very uneven picture. They are covered in this order to reflect the rough order in which investors would encounter them. On the one hand, investors did not consider company registration and other business licensing procedures to be too onerous. The operating environment, including the new Customs Code, did not pose significant administrative challenges, and Croatia compares well with other leading countries in Eastern and Southeast Europe. On the other hand, the process and requirements for acquiring entry visas and work permits – many investors' first encounter with the country – are unnecessarily complicated and burdensome. Also, the process of acquiring land, registering it and building new premises is fraught with difficulty for investors. Although these locating issues clearly represent a long- term agenda, Croatia needs to take immediate actions to improve its performance.

ix. This report concentrates on administrative procedures for the general investor at the national level, and on land-related procedures at the local level in Zagreb and (to some extent) Rijeka. Although the team gained some insights into problems faced by investors in certain *sectors*, such as banking, insufficient information was forthcoming to analyze the situation in other key sectors, such as tourism. Also, a detailed investigation

of *subnational* administrative impediments, and how they vary across the country, was beyond the scope of this study, but is clearly necessary as a next step, given that procedures relating to land and construction are highly problematic. Thus, the government could usefully combine an investigation of subnational barriers to investment, and problems holding back investment in the tourism sector.

x. Before summarizing the team's findings and recommendations for the four key dimensions of the investment process, a few general suggestions are in order, relating to coordination within the government and between the government and the private sector; monitoring of the progress of reforms; provision of procedural information to potential investors; and availability of legal documents in translation. Improvements in these four areas should not be too difficult politically or too costly, but could offer ways of improving the investment environment fairly quickly.

xi. *Enhance cooperation and encourage greater dialogue across the government structure at all levels, and between it and the private sector in order to address certain discrete problems and to build the cooperative mechanism necessary for healthy private sector development.* Institutional coordination and collaboration within government and between government and the private sector is generally weak in Croatia. This conclusion applies to many of the areas investigated, whether land and construction issues at the subnational level, immigration issues at the national level, or the simpler case of several different identification numbers for companies and individuals. There appear to be very few working groups or forums, either functional (e.g. customs or immigration) or sectoral, where government agencies get together with each other or with the private sector. The Government of Croatia needs to encourage new mechanisms to build better working linkages of this kind as a matter of urgency.

xii. Although the normal democratic process establishes the overall reform agenda, it is very useful to have such input from "stakeholders" (i.e. those involved in, and affected by, reforms) in the development of the more detailed regulations and procedures that govern the implementation of reforms. In particular, representatives of the business community should help establish priorities for reforms, and provide feedback about their success (e.g. whether they are having the desired impact). In addition, knowledgeable members of both the business community and government agencies can be useful sources of ideas for improving procedures. That said, it is also necessary to guard against "cronyism" by ensuring both diversity among the business representatives, as well as regular turnover in membership every two to three years.

xiii. *Progress with reforms should be monitored on a regular basis.* This is necessary in order to ensure that reforms are appropriate, effective and properly administered. Such monitoring should include both hard data from the various government agencies (e.g. data about the volume of work, and the time required for processing) as well as information about beneficial outcomes, such as new business creation, investment volume and land readily available for investment. In addition, there should be regular surveys of the business community to document their experiences regarding the cost and time requirements involved in completing government procedures. Such data can allow

the government to verify whether the reforms are having their desired impact, and can guide efforts to improve the reform process.

xiv. Increase the provision of information to both domestic and foreign investors by preparing comprehensive official guides to investment procedures and legislation at the national and subnational levels. The publication of a detailed guide to investment procedures and legislation would go a long way to improving the investment environment in Croatia, by setting out the requirements and expectations of government departments and utilities on the one hand, and of investors on the other. Currently, as reflected throughout this report, there is much confusion about who is responsible for what.

xv. Improve access to legal documents in translation. Although some of Croatia's key legislation has been translated from Croatian for the purposes of EU Association and WTO membership, these have not been made widely available. The Government could add these translations to the extremely impressive collection of Croatia's legal documents already on the Narodne Novine website (www.nn.hr).

Entry Procedures

xvi. Acquiring entry visas and work permits in Croatia is a time-consuming process, and gives investors a bad first impression of the country. It typically takes three or four months before an expatriate employee can be employed legally in the country, even after the many required documents have been assembled. Investors have found ways around the system, and many expatriate employees begin work before formalities have been completed, but this only demonstrates the redundancy of the complicated system in place.

xvii. The full set of procedures required for investors or expatriate employees wishing to work legally in Croatia includes a number of redundant steps (including proof of residential address, landlord's ID and proof of property ownership), and requires separate, repeated and duplicative interactions with the Ministry of Internal Affairs and Ministry of Labor, in particular. To do this without the sponsorship of an established investor or Croatian partner, or without the intermediation of a consulting company or other agent, is daunting.

xviii. The immigration and work permit process is characterized by a lack of coordination among ministries and agencies, human resource bottlenecks (e.g. at the Croatian Employment Institute and the Ministry of Labor), and variable interpretation of regulations by officials (e.g. visa duration). Croatia would benefit from the establishment of a consultative mechanism between government agencies and the private sector in this area, and from the adoption of a "one-stop shop" approach that gave investors a single window of interaction. Specific recommendations regarding entry procedures in Croatia include the following:

- *Eliminate the duplication of procedures involved in the business / employment visa and work permit applications (involving departments of the Ministries of Internal Affairs and Labor), and shorten the overall time*

required for an expatriate to begin work legally. The process should be condensed into a period of one month or less, with the bulk of the time spent approving the necessary visas before the investor reaches the country.

- *Streamline / eliminate the employment vetting procedures reflected in the Ministry of Labor Resolution and Croatian Employment Screening requirements.* Both requirements could be largely eliminated by the compilation of a negative list of professions that are discouraged (or a positive list of ones that are encouraged, as in the UK or Australia). However, for professions / skills not on the negative list, applicants would be required to produce the necessary evidence of their eligibility in conjunction with their business / employment visa application.
- *Increase dialogue among the various government agencies, and between them and the investor community.* The objective of any particular committee or task force will be to address discrete problems, such as duplication of procedures. However, more broadly, such mechanisms will provide a basis for effective policy advocacy, a way of announcing new legislation and procedures, and a means to process particular administrative cases or problems as they arise. Currently, there is very little interaction between the various participants in the immigration and work permit approval process, and almost none with the investor community.
- Extend the term of business and employment visas and of associated work permits (so long as they are separate items). It is recommended that the term of business visas be increased from the current one year to two or three years, with simplified renewal procedures to match better the term of the investment cycle.
- Publish a single, comprehensive guide to immigration procedures for investors and expatriate employees.
- Eliminate excessive submission requirements for proof of residential address.

Company Registration and Other Business Establishment Procedures

xix. Croatia's company registration process is relatively straightforward and does not present private enterprise with any significant barriers. The basic registration requirements are in line with standard practice throughout the EU. It is important to note that the government seems to be trying to further normalize these processes by:

- offering expedited services at the commercial court;

- moving toward a universal identification number to be used throughout the different offices and ministries of the government; and
- privatizing the ZAP and opening the payment processing service to competition.

xx. There is, however, room for improvement in Croatia's company registration performance. One of the main reasons why company registration takes longer than the one week or so common in the rest of Europe is the overburdened commercial court system. In particular, there is a shortage of judges, who must also deal with simple matters such as company registration. Procedures could be improved by training more clerks, rather than judges, to undertake this function, and by deploying better electronic systems. Other steps that the Government of Croatia might want to consider include the following:

- Time limits. Using Hungary as an example, Croatia could benefit from setting definite time limits for company registration, whereby, if an applicant has no response within 30 days, then registration is automatic.
- *Reduce the various costs of company registration.* Compared to other countries, the costs of establishing a business in Croatia are rather high, and the Government of Croatia should make efforts to reduce the direct and indirect costs of establishing a company that are incurred at various stages in the process.
- Other business establishment procedures, such as registration with the Statistical Office and the Payments Agency (ZAP) are not considered overly bureaucratic by investors. However, the overall business registration system could be made more efficient by harmonizing the identification numbering system across the various ministries and agencies. Finally, the bad reputation of the Payments Agency is due largely to its policing function under which corporate bank accounts can be frozen for minor disagreements or oversights. These policing powers should be removed, and perhaps absorbed into the tax departments oversight function. As a payments clearing house, however, ZAP is generally considered to be very efficient.

Land Acquisition, Registration and Construction

xxi. Land acquisition, registration and site development are the most complicated parts of the investment process in Croatia. There are problems of restitution, predatory land speculation, unnecessary and time-consuming bureaucratic procedures, and discriminatory application of regulations common to many transition and other economies. Although land restitution problems, which are common to most transition countries, are well-known, land-related issues for investors have, with some exceptions, received limited attention in Croatia. This is perhaps because there is currently very little greenfield foreign (or domestic) investment, and much of the manufacturing and service sector is dominated by former or current state-owned enterprises (SOEs) that have

established landholdings, or by smaller local companies that may also have learned to deal with the system's problems.

xxii. The difficulty of ascertaining the ownership of land and property, and purchasing (especially larger plots of) land over which it is possible to establish legal title is a growing cause of concern to the many investors beginning to assess the investment potential of Croatia. The government is taking longer-term steps to address these issues – for example, efforts to update and computerize the land registry and cadastre, but it is also crucial to put some emphasis on shorter-term solutions and improvements in administrative procedures, such as an initial focus on potentially attractive commercial areas.

xxiii. Once land has been acquired from either private or municipal owners and registered, a process which may take many years, a new investor is still faced with construction-related constraints, including the need for unofficial payments. Of the three construction-related permits, the building permit is the most expensive and problematic to secure, involving numerous approvals from different local and central government departments and utilities. At this stage, an investor is also more “vulnerable” to the whims of government and utility officials, and to pressures for unofficial payments.

xxiv. Securing the final Usage Permit for a structure seems to be relatively easy, but the actual connection of utility services is highly problematic. In the absence of bribes that can amount to several thousand dollars, investors report delays of several years.

xxv. Since land and construction-related issues are administered by subnational authorities, reform efforts at both national and subnational levels are crucial. In other words, central government needs to make available financial and technical resources to subnational regions that are attractive to investors, and that have local leadership committed to improving the investment environment. Moreover, a more detailed analysis of land and construction-related procedures in various subnational regions is necessary, in order to clarify procedures and identify best practice within the country. Subnational governments should, for example, be encouraged to draw up detailed land-use or zoning plans.

xxvi. Croatia also needs to improve coordination and cooperation among local government departments and utilities involved in land- and construction-related procedures, and between them and investors. Institutional coordination and collaboration is generally weak in Croatia, but land acquisition, land registration and construction procedures are particularly complicated. This is because so many different groups are involved: elected local councils, local bureaucracies, local judiciaries, utilities, landowners and the private sector. Moreover, at the subnational level there are fewer resources, and officials are perhaps less used to initiating collaboration themselves, than to being directed from above.

xxvii. A number of longer and shorter-term recommendations can be made with respect to **land acquisition procedures**:

- *Generally speaking, the supply of larger commercial sites with clear ownership needs to be increased in Croatia, and the time required to establish clear ownership reduced.* To improve this situation over the medium to long- term, the Government of Croatia needs to speed the land restitution process by enforcing time limits on claims, clarify ownership issues, and harmonize the Land Books and Katastas.
- In the shorter- term, subnational governments, supported by the national government, could focus on resolving these issues, and increasing the supply of readily available land, *in certain commercially attractive areas, and then rolling the reforms out to the whole country.*
- *Local and central governments should work together to streamline and clarify municipal land sale procedures.* Inefficient auction procedures for land owned by counties and municipalities need to be shortened and clarified. In particular, the situation regarding when, and under what conditions, a local government can sell land directly needs to be clarified.
- *Croatia should also consider laws to permit faster assembling of plots through the exchange of land parcels.*
- *The establishment of Pilot Commercial Zones, an approach used successfully by many countries to encourage investment, should also be considered.* In addition to offering plots of land with clear ownership (for long lease or sale), such zones would also offer streamlined construction-related procedures, and various improvements in infrastructure provision.
- *Efforts should also be made to improve coordination, and reduce overlap, between land acquisition and construction permit procedures.* Some units of local government or other appropriate body should establish, with solid political backing, institutional mechanisms to bring together the various local government departments and utilities for the purpose of coordinating these investment-related procedures. The City Office is clearly one possibility, but given the importance of utilities, they too need to be involved with the support of line ministries / regulators. The participation of investors, as end-users, is essential.

xxviii. The following short and medium- term recommendations are offered in the area of **land registration procedures**.

- *Local governments in Croatia should make the accelerated land registration process (as exists in Zagreb) standard.* While the current “standard” land registration process can take several years, the “accelerated” land registration process in Zagreb shows that local

administrative systems are capable of processing applications very quickly, although these systems need to be cleaned up, made more transparent, and opportunities for bribes reduced.

- *Croatia should continue to focus on training more judges and clerks for Land Registry Courts.* Croatia needs to continue its efforts to train more judges and officials for the Land Registry Court. Although the registration of title transfers and burdens have been correctly identified as the most important areas, expertise in the consolidation of land parcels should not be overlooked.

xxix. In the area of **construction- and utility-related procedures**, the following short and medium- term recommendations can be made.

- *Conduct a detailed internal review at the subnational level of the different permissions and opinions required in order to find ways of simplifying construction-related permits.* The focus of responsibility for obtaining the many approvals should be clarified, the procedures better explained, and response times from the various approving departments improved through enforceable time limits. The overlap of having to get permission twice (the second time for the building permit) from the same departments and utilities needs to be reviewed. Subnational authorities may perceive the benefits for the local economy to initiate this review process of their own accord, but it may be necessary for central government to promote their cooperation. The local authorities' perspective clearly needs to be compared with the experience of local private investors (and any foreign investors) using the system.
- Prepare a subnational guide for construction-related procedures. Municipalities and counties should prepare a guide for all land- and construction-related procedures under their jurisdiction. It should make quite clear which government departments are responsible for each stage of the process, and what fees are required for each stage. The guide should serve as the standard and common reference for government officials and investors alike.
- *Make building permits the main focus of construction-related approvals in Croatia with location permits gradually phased out in favor of improved spatial planning (see below).* As things stand, there is considerable overlap between location permit and building permit procedures, and some local authorities may approve the location permit relatively quickly, given that they must again be approached at a time when there are perhaps greater rent-seeking possibilities. In the meanwhile, if the location permit is maintained, local authorities should ensure that it does not overlap with the building permit. In particular, it should be more generic (i.e. deal with general zoning,

heritage and environmental issues), and should leave specific construction-related issues to the building permit application stage.

- *Establish a clear focus of responsibility, and time limits for responses, for gaining approval from various local authority departments for the location/building permits.* Currently, investors are often unsure whether it is their responsibility or that of the construction department of the local authority to get the necessary approvals. Typically, the construction department of the local authority should be responsible for soliciting opinions or approvals from other departments / utilities where necessary, or for distributing the building permit application (and the location permit, if retained). Those other departments should be obliged to approve or provide a reason for rejecting an application within a given time period.
- *Detailed zoning plans, beginning with key areas should be drawn up by local authorities, in order to eventually eliminate the need for a formal location permit.*
- Local authorities should also make clear appeals procedures for applications that have been turned down.
- Drop the requirement that the City Office must consult with all neighbors for the building permit. Under current procedures, neighbors are in a position to block the building permit process by making themselves unavailable for consultation.

xxx. Securing **access to utility services** appears to be a highly problematic area for investors. Although improvements are clearly necessary, the FIAS team was unfortunately unable to gain detailed information on these issues, partly as a result of logistical problems that investors would also encounter. More work is clearly necessary in this area using specialists in utility issues. Nevertheless, the following general, but key, recommendations are offered.

- *Local authorities, central government and utility companies must work together to improve utility connection performance, which would probably include regulatory reform and some privatization.* After land has been acquired and registered, and the various construction permits obtained, investors face substantial problems in getting utility services connected, and often make large unofficial payments. Pricing for utility connections, including necessary upgrades and expansions, urgently needs to be addressed in a comprehensive manner.
- *A follow-up mini analysis of administrative barriers in the area of utility services is also needed, perhaps in conjunction with subnational projects within Croatia.*

Operating Procedures

xxxi. An investor in Croatia, once established, still has to deal on a regular basis with tax, customs and inspection procedures, as well as various labor issues. Generally, these pose only few problems in Croatia. Customs procedures, for example, were considered efficient by investors, and a new Customs Code in force since early 2000 may bring further improvements.

xxxii. One of the few investor complaints in the area of tax administration was directed at the Financial Police, who, according to some investors, seem to abuse their considerable powers to inspect companies' records. Many of the functions of the Financial Police overlap with the audit function of the Ministry of Finance's Tax Department, and the Government of Croatia may be considering a merger of the two units.

xxxiii. Finally, the State Inspectorate has consolidated many of the previously dispersed inspection functions under one roof. The agency makes a major contribution to improving the quality of interaction between the government and the private sector and should be encouraged for this reason. However, it should seek to strengthen its communication with relevant government agencies.

CHAPTER I

INTRODUCTION

1. This report uses a standard methodology to analyze the administrative barriers to investment in Croatia. Although it does so from the standpoint of foreign investors, the impediments identified represent an equally formidable constraint to domestic private investment by small and medium size companies. The report looks in detail at the procedures an investor would have to go through in order to establish and operate a business legally in Croatia today. The investigation breaks the investment process into four generic areas: entry procedures (immigration procedures, work permits, and related procedures for foreign investors and expatriate workers); business establishment (company registration and various licensing procedures for all investors, both foreign and domestic); locating procedures (land acquisition, land registration and construction); and operating procedures (paying taxes, import/export procedures, inspections, and other routine interactions between business and government agencies during normal business operations).

2. Why is a report of this kind important for Croatia? First, administrative barriers, while sometimes appearing mundane to high-level policymakers, can make the difference between being an attractive location for investment and one that is shunned. Many governments worldwide avidly seek to tailor incentive policies in order to attract investment, or expend much energy drafting first-class laws with similar expectation. However, complicated and time-consuming administrative procedures are among the most important disincentives to investment, and can chase investors away in spite of a solid legal framework. A few weeks delay at each of the several government agencies may seem of little consequence to the responsible officials, and may even profit them a little, but it can cost hundreds of thousands of dollars in lost revenues to an investor.

3. Second, relating the removal of administrative barriers to Croatia's larger international context and streamlining procedures can help the country become more competitive, and help ensure the success of other reforms, such as trade liberalization and privatization. These reforms are also needed in order not to lose out to other countries such as Hungary and Latvia who have made progress in addressing them.

4. Third, the benefits of streamlining administrative procedures are not limited to large foreign investors, although Croatia certainly needs to attract them. Rather, these benefits also extend to indigenous small and medium size enterprises that are disadvantaged relative to parastatal enterprises.

5. Fourth, if political will and leadership can be brought to bear on administrative barriers in the short- term, this will pave the way for longer- term reforms, and send valuable signals to foreign and domestic investors that the government is serious about reform and promoting investment. After all, as will be shown, the actions needed to remove administrative barriers to FDI are often not costly in financial terms, but involve

a much harder task of overturning an ingrained way of thinking among government officials. Many problems are, for example, due to an easily repaired absence of dialogue between government departments and the investor community, or to bottlenecks that are less intractable than they appear.

6. Finally, streamlining administrative procedures is important in the larger reform context as Croatia moves toward full membership of the European Union and the intensified competition that it represents. All existing enterprises will need to make more investments to upgrade and innovate technology and to improve efficiency and productivity. Also, more greenfield investments will be required to increase both the volume and range of products, generate new employment, and encourage competition. In short, stimulating overall investment in the enterprise sector and especially encouraging new companies that have strategic alliances with foreign investors will be critical to Croatia's capacity to cope with the competitive pressures associated with future EU accession. In an attempt to explore optimal solutions to Croatia's administrative barriers to investment, international experience, especially best practice among EU countries, is provided as useful references.

7. For this draft report, it was not possible, or it proved very difficult, for the team to gather information on certain administrative procedures. In part this reflected logistical problems encountered by the FIAS team. The suspicion is that foreign investors would encounter similar problems, and the government should probably give extra attention to these areas. Examples include utility connection procedures, incentive application procedures, environmental assessments, appeals procedures, and so on.

8. This report concentrates on administrative procedures for the general investor at the national level, and on land-related procedures at the local level in Zagreb and (to some extent) Rijeka. Although the team gained some insights into problems faced by investors in certain *sectors* such as banking, insufficient information was forthcoming to analyze the situation in other key sectors such as tourism. Also, a detailed investigation of *subnational* administrative impediments, and how they vary across the country, was beyond the scope of this study, but is clearly necessary as a next step, given that procedures relating to land and construction are highly problematic. Thus, the government could usefully combine an investigation of subnational barriers to investment and problems holding back investment in the tourism sector.

9. To date, Croatia has relatively little experience with new greenfield foreign investment, and in the past couple of years foreign investment statistics have been boosted by several high-profile privatizations. Croatia's performance in attracting foreign direct investment grew sharply from US\$100 million per annum in 1993-95 to US\$500 million in 1996 (two per cent of GDP) after the end of the war, and thereafter to US\$890 million in 1998, and US\$1.35 billion in 1999.

Figure I.1: Overview of Administrative Procedures for Investing in Croatia

ENTRY (General) – Foreign Investor / Expatriate Labor	REGISTRATION – Company Registration / Other Procedures	LOCATING – Land acquisition, Construction, Utility connection
Business Visa Croatian diplomatic missions Ministry of Labor Min. of Internal Affairs (police) <i>2 weeks</i>	Drafting of memorandum of association / company name check <i>1 week</i>	Identify site and ownership pattern Municipal Court (Land Registry) Real Estate Agents / Lawyer Cadastral Office <i>1 day – several years</i>
Business visa registration / receipt of “extended residency permit” Min. of Internal Affairs (police) <i>2-3 weeks</i>	Registration of company with commercial Court Commercial Court (local) <i>2 days – 6 months</i>	Acquire permission to purchase land as foreigner Ministry of Foreign Affairs (Ministry of Justice) <i>6 months</i>
Work permit screening / issuance Ministry of Labor Croatian Employment Institute <i>5 weeks</i>	Registration with Statistical Office Statistical Office <i>1 week</i>	Conclude conditional purchase contracts <i>1 day – several years</i>
Identification no. for foreigners Min. of Internal Affairs (police) <i>1 day</i>	Open an account with the National Payments Agency National Payments Agency (ZAP) <i>1 week</i>	Acquire location permit City Office (or equivalent, as coordinator) <i>2 months (up to 14 if re-zoning required)</i>
Preparation / endorsement of work book City Economic Department <i>2 weeks</i>	Registration with tax authorities Local Tax Office <i>1 day</i>	Purchase land <i>1 week</i> (given clear existing title and conclusion of conditional purchase contracts)
Acquisition of tax card Local Tax Office <i>unclear</i>	Registration with Customs authorities (case-dependent) Customs Administration <i>1 week</i>	Pay real estate transfer tax Institute for the Development of the City (or equivalent) Local Tax Office National Payments Agency (ZAP) <i>1 week</i>
	Registration with Pension Fund State Pension Fund	Register land ownership Cadastral Office Municipal Court (Land Registry) <i>10 days – 5 years</i>
	Special sectoral licenses (e.g. financial services, banking, telecoms) <i>(Various)</i>	Acquire building permit City Office (or equivalent, as coordinator) <i>2 months – one year or more</i>
		Acquire usage permit City Office (or equivalent, as coordinator) <i>1 week</i>
		Connect utilities Utility companies <i>1 week – 1 year</i>

10. Apart from the high-profile investments of the past few years, Croatia's inward investment profile has consisted more of smaller service, construction and natural resource type companies, and a few longer standing foreign investments. Foreign entrepreneurs and "returning" Croatians are only now beginning to investigate promising new sectors for investment. In so doing, they are running into a variety of administrative barriers to investment that have generally only received limited exposure until now. Figure I.1 gives an overview of the administrative procedures involved in entering Croatia and establishing and locating a company.

11. Certainly Croatia faces problems other than administrative barriers in its efforts to attract FDI, such as its high wage levels, but within the realm of administrative constraints on investment two problem areas stand out: immigration and work permit issues on the one hand, and land and construction-related issues on the other. If the Government of Croatia could make progress in these two areas, the attractiveness of the country to potential investors currently scouting around for opportunities would certainly increase.

12. Finally, before investigating in detail the administrative procedures surrounding "entering", "establishing", "locating" and "operating" in Croatia, it is valuable to highlight four suggestions for improving the administrative environment for foreign (and domestic) investment that apply to most, if not all, of these areas.

13. **Mechanisms for regular dialogue about the reform process should be initiated between policymakers, representatives of the business community, and representatives of government agencies.** Although the normal democratic process establishes the overall reform agenda, it is very useful to have the input of the "stakeholders" (i.e. those involved in, and affected by, reforms) in the development of the more detailed regulations and procedures that govern the implementation of reforms. In particular, representatives of the business community should help establish priorities for reforms, and provide feedback about their success (e.g. whether they are having the desired impact). In addition, knowledgeable members of both the business community and government agencies can be useful sources of ideas for improving procedures. That said, it is also necessary to guard against "cronism" by ensuring both diversity among the business representatives, as well as regular turnover every year or two.

14. **Progress with reforms should be monitored on a regular basis.** Such monitoring should include both hard data from the various government agencies (e.g. data about the volume of work, and the time required for processing) as well as beneficial outcomes (such as new business creation, investment volume and land readily available for investment). In addition, there should be regular surveys of the business community to document their experiences regarding the cost and time requirements involved in completing government procedures. Such data can be used to verify whether the reforms are having their desired impact, and can guide efforts to improve the reform process.

15. **Improve access to legal documents in translation.** Although some of Croatia's key laws have been translated from Croatian for the purposes of EU Association and WTO membership, these have not been made widely available. Some unofficial

translations of the laws were made available to the FIAS team by the legal departments of some companies interviewed, but this represents needless duplication of effort in many cases, and surely disadvantages serious foreign investors. While limited availability of translations of legislation, or good guides to administrative and legal procedures (in any language), may lead to greater demand for legal services, greater legal and administrative clarity in the investment environment would lead to greater demand through increased economic activity.

16. The publication of the entire legal system (Narodne Novine) since independence on the website (www.nn.hr) since independence is extremely impressive, but this should be enhanced (very easily) by adding English and other translations where available, and gradually adding other important languages. The Construction Law and the Property and Other Material Rights Act, for example, seem not to have been translated. The Institute for Informatics under the Ministry of Justice, for example, has considerable experience in preparing databases such as a “trade registry”.

17. **Prepare comprehensive official guides to investment procedures and legislation at the national and subnational levels.** The publication of detailed guides to investment procedures and legislation would go a long way to improving the investment environment in Croatia, by setting out the requirements and expectations of government departments and utilities (in the case of “locating” procedures) on the one hand, and of investors on the other. Currently, there is much confusion about who is responsible for what.

18. The Zagreb guide (*Zagreb: Guidebook for Foreign and Domestic Investors*) is good as far as it goes, but there is no mention, for example, of problems or procedures relating to land acquisition or registration, where (as in the case of construction) subnational authorities also have jurisdiction. There are also no “flags” or “tips” regarding bottlenecks or shortcuts in the procedures that the local Chambers of Commerce should be willing and able to offer. Moreover, the national Chamber of Economy should be able and willing to provide a similar *practical* (rather than promotional) guide to other aspects of the investment process.

CHAPTER II

INVESTOR ENTRY INTO CROATIA

19. This chapter focuses on the procedures necessary to gain entry into Croatia for company owners, management and expatriate labor. Along with land and construction-related issues, this aspect of doing business has been the subject of most confusion and frustration among investors.

20. The main laws and regulations guiding entry into Croatia are:

- Law on the Employment of Foreign Nationals (NN 19/92; NN 33/92; NN89/92; NN26/93; NN 52/94)
- Law on the Entry and Residence of Foreigners (NN 53/91; NN 22/92; NN 26/93);
- Ordinance on Issuing Work Permits to Foreigners (NN82/96);
- Labor Relations Act (NN38/95; NN 54/95; NN 65/95, NN 17/01); and
- Various regulations dealing with the issuance of travel and identification documents and visas.

21. The status of expatriates in Croatia is regulated by the Law on the Entry and Residence of Foreign Nationals. According to this Act, foreigners are defined as non-Croatian nationals, which implies that ethnic Croatians having other nationalities (holding foreign passports) are not considered to be foreigners, and therefore not covered by the above-mentioned Acts.

22. The procedures for the entry of expatriate workers and investors are very similar, with the most significant difference being the type of visa required for entry. There are two types of visas that are of particular concern to investors and expatriate employees: business visas and employment visas. For anyone working in Croatia, a work permit is also required. The entire process typically takes around 3.5 months.

23. In simplified form, the standard process usually includes receiving an approval from the Ministry of Labor, bundling the approval with other documentary requirements for submission to the Ministry of Interior for business visa or employment visa applications and finally, upon arrival in Croatia, for work permit applications. In practice, however, there are several more steps involved.

A. Foreign Investor Entry – Business Visa

24. According to the provisions of Article 16 of the Law on the Entry and Residence of Foreigners (National Gazette no. 53/91, 22/92, 26/93 and 29/94), a business visa can be granted to a foreign national:

- (1) performing economic activities foreseen in regulations on foreign investment and foreign trade (para. 2 of Article 16); and
- (2) performing work based on existing agreements for business and technical cooperation, long-term production cooperation, transfer of technology and foreign investment (para. 3 of Article 16).

25. Under the provisions of para. 2, a business visa can be issued to a foreign national who is a member of a company, a person authorized to represent a company, a member of the managing board, or the president or member of a supervisory board. The visa can be issued upon submission of an officially-witnessed company register certificate that is no older than six months and that shows clearly the status of the foreign national.

26. For new foreign investors, a “Resolution” from the Ministry of Labor must be obtained in advance. It is not clear whether the consulate is able to acquire the “Resolution” from the Ministry of Labor on behalf of the applicant; interviews with the Ministries of Internal Affairs and Labor and members of the private sector were contradictory on this point. However, it was widely noted that it was in the best interests of the applicant to acquire the “Resolution” ahead of applying for the business visa. It is much easier for ethnic Croatians to enter Croatia in order to establish a business. Many companies seem to use this entry route, since it is much easier for such an individual to enter Croatia, establish a company, and arrange for the entry of non-ethnic-Croatians by sponsoring an employment visa.

27. The “Resolution” from the Ministry of Labor seems to be a default requirement in the case of applicants that are not being brought into Croatia on the basis of particular professional skills at the instigation of an existing Croatian company. The equivalent documents for an applicant who will work for a Croatian company are designed primarily to vet their skills and qualifications for the post they intend to occupy. The Ministry of Labor states that the process for receiving this approval is approximately two weeks. Where a Croatian company is involved, the Ministry states that the process can be accelerated at the company’s request. There are no fees involved in this application.

28. Visas are issued at Croatian diplomatic missions and consular institutions abroad, as well as by police stations in Croatia. According to the Ministry of Internal Affairs, while Article 16 of the Law does not stipulate that the applications made to consulates or police stations have to be forwarded to the Ministry of Internal Affairs for consent or opinion, an Instruction of the Ministry of Foreign Affairs, Ref. No.: 521-03-05-02/01-99-14, Class: 217-01/99-01/42 of September 9, 1999, stipulates that applications should be submitted to the Ministry of Internal Affairs for consent, in view of previous objections from the Ministry of Labor and Social Welfare that visas were being issued unjustifiably. In the case that the applicant submits with his application the excerpt from the Register of Companies and the Resolution of the Ministry of Labor and Social Welfare, the Ministry of Internal Affairs carries out a security check only¹; in the case that the applicant submits only the excerpt from the Register of Companies, the Ministry of Internal Affairs

¹ The check-up is done by SZUP, the Office for Protection of Constitutional Order.

forwards the application to the Ministry of Labor and Social Welfare, which establishes whether the conditions specified in Article 16, paragraph 2 of the law have been fulfilled.

29. Under provisions of para. 3, a visa can be issued to a foreign national who will be performing work based on existing agreements. The application for a visa in this case must contain a copy of the agreement and the Resolution of the Ministry of Labor and Social Welfare. The Resolution is needed to confirm the desirability of the skills to be introduced. In this case, the Ministry of Internal Affairs carries out only a security check.

30. The documents required for a business visa application, accompanied by a fee of approximately US\$ 50, include :

- Completed version of an application form, which is obtained from Croatian diplomatic missions and consulates;
- “Resolution” from the Ministry of Labor;
- A notarized copy of the ID page of the applicant’s passport, or the passport itself;
- Two excerpts from the court registry for the company in Croatia;
- Decision of the founder on the appointment of the applicant as a director of the company in Croatia, if applicable;
- Additional letter from the founder addressed to the Croatian Embassy or Consulate in the applicant’s country.
- Rental agreement for applicant’s living quarters, ID card of the landlord, and proof of the landlord’s ownership (excerpt from the land registry). Presentation of this evidence is required upon registration of the business visa, which must take place within 24 hours of entry into Croatia (i.e. this evidence must clearly be prepared in advance), but some investors claimed that it was sometimes required at the time of visa application.

31. Business visas are issued for the entire period of the assignment, but for no longer than the validity of the foreign travel document (in accordance with Article 16, para. 4 of the Law on Entry and Residence of Foreigners). The Ministry of Labor and Social Welfare specifies the validity period in the Resolution. Upon issuance of the business visa, the embassy or consulate is required to notify the Ministry of Internal Affairs, in accordance with Article 28 of the Ordinance on Issuing Documents and Visas to Foreigners, and the notification is forwarded to SZUP. However, police stations are not automatically notified of the issuance of a business visa, since foreign nationals are required to report to the police upon their arrival in Croatia. Business visas are separate from the work permit, and foreign nationals in possession of a business visa must also apply for a work permit upon entry into Croatia.

32. Where a business visa is being acquired for a technical expert, for example, to work at an existing Croatian company, the Croatian employer will take care of the business technical agreement or work assignment documentation that is required.

33. **Upon Arrival in Croatia.** Within 24 hours of arriving in Croatia on a business visa, the investor or recipient of this type of visa must register with the Ministry of Internal Affairs at a designated police station. The first purpose of this registration is to inform the authorities of the applicant's residential address; and the second is to apply for an "extended residency permit" or "white card". This process has a fee of 20 Kuna, and requires the following documentation:

- Passport and copy of passport (including visa);
- Two photos;
- Copy of the company's registration and ZAP statement (clearly not possible if it is a new foreign, non-ethnic-Croatian investor);
- Completed application form for staying with a business visa; and
- Hotel's stamp or copy of ownership or rent contract of the apartment and owner's identification.

34. Registration at the police station typically takes one to two hours if the documentation is in order. It is difficult for an individual to make such arrangements (rental contract, etc.) from outside the country or upon arrival without the sponsorship of a Croatian employer (who has undertaken all the preparations) or the comprehensive services of an intermediary (like a consulting company).

35. Actually receiving the "white card" or "extended residency permit" will take two to three weeks. The applicant (or his agent) should check on progress periodically, in case the application is incomplete, and he has not been told. Once approved, the applicant must go to the Ministry of Internal Affairs to get the "extended residency permit" stamped into his passport.

B. Work Permits

36. Even though the investor may have completed the visa procedures and acquired an "extended residency permit", he is not legally allowed to work in Croatia until he has received a work permit, which is issued by the Ministry of Labor. Legally, this means that an investor cannot sign documents on behalf of the company until these procedures are completed. The Ministry of Labor states that this process takes up to one month to complete. There are no fees for this process. According to the Ministry of Internal Affairs, the delay can be reduced by having the application for a work permit submitted before the application for extended residency.

37. The type of work permit to be applied for depends on whether the individual is arriving as a technical expert to work for a Croatian employer, or as a new investor. In the former case, the "work permit requested by an employer" may be applied for on the basis of a valid business visa, or visa for the purpose of employment. The application is submitted by the Croatian employer to the Croatian Employment Institute under the Ministry of Labor.

38. A new investor, meanwhile, would apply for a “personal work permit”. A personal work permit is similarly issued on the basis of a valid business visa, and under the same terms and conditions as a business visa, as well as to foreign nationals having permanent residence in Croatia. However, it is mainly granted to individuals whose work is not performed in, or directly related to, another Croatian company. Each foreign national has to apply for it individually from the Croatian Employment Institute.

39. Documentation required for the work permit includes:

- A copy of the passport with the visa stamped by a notary (or the original passport);
- A copy of the White Card (extended residency permit);
- A letter of request from the employing company explaining the level of the job and why a suitable Croatian national could not be found to fill the job;
- Company Registration Certificate, employment contract or some other evidence of the nature of the business to be established (in the case of a new investor); and
- Standard application form (Form S-1).

40. The Croatian Employment Institute has a very small staff of about five people processing approximately 2,500 work permit applications per year. Roughly 90 per cent of applications are passed first time, and the most common reasons for rejection are “wrong reason” to stay and “labor market conditions” (i.e. labor market tightness in certain skill areas). It is not possible to refuse a work permit to someone arriving as the director of a company. According to the Law on the Employment of Foreign Nationals, the Institute must turn around applications within 30 days. Applications approved by the Institute are then passed on to the Ministry of Labor, which issues the work permit.

41. Rejected applicants can appeal to the Governing Body of the Institute, which is composed of representatives of trades unions, employer organizations and government agencies (Ministry of Small and Medium Enterprises, Chamber of Economy and others, but all appointed by the Ministry of Labor).²

42. A work permit is, as a rule, issued for a limited period of time, i.e. for the duration of specific activities or professional work up to a period of two years, but for one year in the case of a business visa since that is its maximum duration before renewal. The final work permits are issued by the relevant local office of the Ministry of Labor.

² The other key functions of the Croatian Employment Institute are to undertake the orderly administration of mass layoffs, and arrange training and seek employment for those made redundant.

C. Expatriate Labor – Employment Visa

43. The Law on the Employment of Foreign Nationals regulates the employment of foreigners in Croatia. A foreigner may be employed in Croatia only if he/she holds either a business visa or an employment visa, and a work permit.

44. The process for the business visa is described above, and, as indicated, is the most appropriate working visa for employees of Croatian companies with short-term technical assignments of less than one year's duration. If the applicant does not intend to work (e.g. entering Croatia to act as a company director), the business visa is necessary, but the work permit is not.

45. A valid employment visa is required from all employees not covered by a business visa. However, the process of acquiring both types of visa is very similar. The application for the employment visa ("entry visa for the purpose of employment") can be made to either the local embassy or consulate, or the Ministry of the Interior. Officials at the Ministry of Interior state that processing times vary from consulate to consulate. It normally takes four to six weeks to receive an employment visa, and the following documents should be submitted at the time of application:

- Completed application form;
- Two photographs;
- A notarized copy of the ID page of the applicant's passport (if applying through the Ministry of Interior in Zagreb) or the passport;
- Assignment letter or draft employment contract (translated into Croatian); and
- A short explanation from the employer of the visa applicant's qualifications for the post, and justification for employing a foreign national as opposed to a Croatian (a standard sentence or two is normally sufficient).

46. Within 24 hours of arrival in Croatia, the recipient of an employment visa must register the visa with the Ministry of Internal Affairs (MUP) at a designated police station. The recipient is required to submit an application for the extended residency permit within the period of validity of the entry visa, which is usually between one and three months. The extended residency permit is normally granted within two to three weeks. The individual can then apply for a personal work permit in the case of an employment visa (rather than a "work permit requested by the employer"), as outlined above.

D. Procedures after Receiving a Work Permit

47. The individual or his representative will receive an identification number for foreigners, while obtaining the extended residency permit. The process takes one hour or

so, and the foreign individual or his representative should present the following documents:

- Notarized copy of passport (or the passport itself);
- Copy of the Work Permit; and
- Administrative Fee (40 Kuna).

48. The individual then needs to have a “work book” endorsed by the City Economic Department (*Gradski ured za gospodarstvo*). This is the final registration with the authorities before officially being allowed to begin regular employment. Requests are accepted between 8:30am and 12:00pm, five days a week. The following documents should be submitted:

- Company’s request to employ the foreigner with justifications;
- Work book (prepared by the employer);
- Application Form;
- Copy of Foreigner ID Certificate;
- Copy of Work Permit; and
- Copy of passport (containing extended residency permit).

49. After obtaining the “work book”, the individual can begin regular employment. The entire process, from submitting the application for an employment visa to being officially allowed to take up a position, usually takes about 14 weeks. This does not include the preparation of various documents ahead of that submission and the resolution from the Ministry of Labor, where necessary. Delays beyond this can occur in the case of incomplete submissions to the Croatian Employment Institute, or when a work permit decision is appealed.

50. The employee is then in a position to sign a formal employment contract with his employer.

51. Finally, the new employee must apply for a “tax card”. The following documents need to be submitted to the tax authorities in order to obtain a tax card:

- Copy of work permit;
- Foreigner ID number; and
- Request for tax card.

E. Analysis

52. Investors and intermediaries and many government officials concurred that the overall process of acquiring all the necessary work-related permits and visas typically

took around three-and-a-half months. Legally, an investor is not permitted to take on any activities with his or her business until these procedures are complete.

53. If the system is strictly enforced, such delays would be a major barrier for foreign direct investment. Investors expect work to commence, or their expatriate employees begin working, within days rather than months of arriving in the country. In practice, foreign investors and their foreign employees get around the regulations.

54. Some employers allow their expatriate “employees” to start working even without the proper work permits or other permissions in their possession. Others kept their employees moving in and out of Croatia on business trips (i.e. on short-term stays or with no visas) for several months. Others, especially those with access to ethnic Croatians (who do not need to go through all the visa, work permit and other procedures), use that route to establish the foothold. All in all, the procedures are unnecessarily cumbersome and seem to serve little useful purpose, since many of the regulations are not rigorously enforced. Companies commonly circumvent or ignore them, and they prevent foreign investors from bringing in many qualified employees who can contribute to economic growth in Croatia.

Table II.1: The Generic Process for Foreigners to Begin Work in Croatia Legally, and Official Time Requirements and Costs

Step	Time Required	Cost (where known)	Ministry / Institution Responsible	Step
Acquiring Business / Employment Visa				
Visa Application	2 weeks (incl. Resolution from Ministry of Labor, when necessary)	\$50	Embassies; Ministry of Internal Affairs; Ministry of Labor for “Resolution” when needed.	1
Register with police upon arrival	1 day	20 Kuna	Police Station; Ministry of Internal Affairs	2
Receipt of “White Card” / Extended Residency Permit	2 – 3 weeks		Ministry of Internal Affairs	3
Acquiring Work Permit				
Work Permit Screening	4 weeks		Croatian Employment Institute	4
Issuance of Work Permit	1 week		Ministry of Labor	5

Other Steps				
Acquiring Identification No. for Foreigners	1 day	40 Kuna	Police Station; Ministry of Internal Affairs	6
Preparation and Endorsement of Work Book	2 weeks		City Economic Department (<i>Gradski ured za gospodarstvo</i>)	7
Acquiring Personal Tax Card	unclear		Tax Authorities	8
TOTAL	Typically 14 weeks			

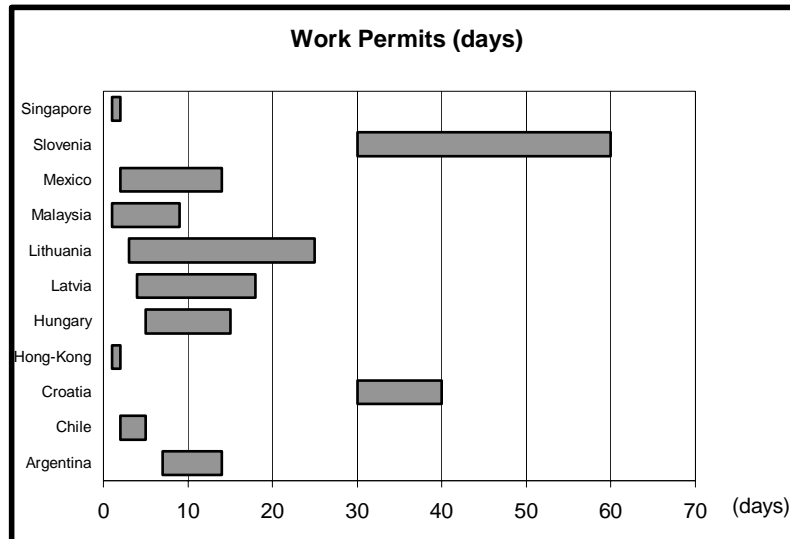
55. When employers retained employees who had not completed paperwork, they usually claimed they were within the law, and were advised by someone in one of the departments to proceed with their current course. No investors reported having been harassed by the Ministry of Interior or Labor. Investors complained more about the frequent visits to the various departments and the paperwork than about the enforcement of the laws.

56. The full set of procedures required for investors or expatriate employees wishing to work legally in Croatia includes a number of redundant steps, stemming in particular from separate and repeated interaction with several different ministries and agencies. To do this without the sponsorship of an established investor or Croatian partner or without the intermediation of a consulting company or other agent is daunting. As things stand, investors and their representatives and some government officials highlighted various specific concerns.

57. Vetting by the Ministry of Labor, for example, especially the Ministry of Labor Resolution required for the business visa, seems redundant, as this is later repeated for the purpose of the work permit. Interviews with investors suggested that few applicants are in fact rejected by the Ministry of Labor at the business visa stage.

58. Conversely, it is not clear why the applicant must wait for a work permit when the initial vetting has been done for either the business or employment visa. In other European Countries that still require a two-step process that includes the Ministry of Labor, most consider the issuance of the work permit to be a formality, and it can be done in several days at most.

Figure II.1: International Comparison of Time Required to Issue a Work Permit



Note: The bars indicate the range between the typical minimum and maximum time required to issue work permits according to investors.

59. Most countries no longer monitor the residential addresses of their investors. Those that still maintain records of residential addresses generally do not require such details as documents from the landlord, including proof of his ownership of the property. Compared to practices in most countries, Croatia requires a large amount of documentation (rental accommodation agreement, the landlord’s ID card and proof that the landlord is the legal owner), which hardly seems necessary for a simple registration of address.

60. At several stages, there are clear human resource bottlenecks in the process with departments of only a few people processing large numbers of applications. For example, the work permit applications submitted to the Croatian Employment Bureau under the Ministry of Labor (roughly 2,500 per year) are screened by a department of five people.

61. There are also bottlenecks in the Ministry of Labor for the Resolution that must be acquired for the expatriate employee or investor before applying for the visa overseas, and at the Ministry of Interior (MUP). In both cases, investors or their agents seem to have to queue up outside a particular office to present or discuss applications with one particular person (the only one dedicated to the particular step in the process) who has very limited office hours.

62. Investors also complained of very uneven interpretation of the laws and regulations from office to office, and even from one immigration officer to another.

Immigration officers, while strictly bound in many cases by precisely worded law, appear to take maximum advantage of any instances in which they have leeway. In some cases, investors stated that they were not given the full year and had to renew their visas several times in the course of one year. Others were not given multiple entry/exit visas. Some investors claimed to have required an exit permit in order to exit the country. This difference from one encounter to the next creates uncertainty and risk that reduce investors' confidence in the country.

63. According to Article 25 of the Law on the Entry and Residence of Foreigners, extended residence on the basis of employment can be approved for a period identical to the period in the employment contract, except that it cannot be longer than two years. In practice, extended residence is approved for no longer than one year, and many investors complained of not getting permits for longer than one year (and in some cases, significantly less). This increases the paperwork burden for both the investor and the government, and increases uncertainty for investors.

64. Generally speaking, investors in Croatia are heavily burdened by the need to visit several different government departments in order to complete immigration and work permit procedures. As with many administrative areas affecting foreign or domestic investment, immigration and work permit processes reveal a severe lack of coordination, both among the many government departments and agencies involved, and between those government bodies and the private sector. Only once have government officials and the foreign investor community managed to get together to discuss bottlenecks in the immigration system – at the instigation of the American Chamber of Commerce. Although systemic improvements are still to be seen, some investors now know the few key people to call to clear particular blockages in particular applications. These contacts with officials need to be regularized urgently as a way of easing bottlenecks in the current system, and identifying ways in which the system as a whole should be simplified for everyone's benefit.

65. International experience suggests that burdening the investor in this way is unnecessary, and creates opportunities for confusion and delay. Countries around the world are adopting a “one-stop” approach to the processes of Foreign Investor Entry. Typically, the investor enters the country (either with a short-term visa or no visa) and applies for a long-term permit with the Immigration Department or equivalent. The various agencies coordinate closely (especially the Ministry of Labor and the Department of Immigration), and the investor has to submit only one set of forms, and worry about one agency. Indeed, many countries have combined the work permit and employment visa into a single “working visa” vetted by both Immigration and Labor Departments. In such cases, the investor has a single interaction with one or the other of the two institutions, which then coordinate the issuance of the permit / visa.

66. Investors also argued that the short duration of employment or business visas created unnecessary paperwork for the investor, his expatriate employees, and the government officials implementing the visa regulations. Investor-friendly countries typically offer visas to investors in lengths closer to the typical time horizon of the investment itself, and/or with simplified renewal procedures. Two to three- year visas

with simple renewal process are common, and reduce the investor's risk of committing assets to a country, and then finding it difficult to extend his visa or work permit. This may be less of a problem for larger companies with faster staff turnover, but constitutes something of a barrier for smaller companies. Complicated visa procedures, such as those in Croatia, create extra paperwork burdens for the investor, and administrative burdens for the Department of Immigration.

67. Finally, investors in Croatia register a complaint heard commonly throughout the transition and developing world, namely that the government (in this case the Ministry of Labor) does not always permit companies to bring in skilled employees from outside the country, in the interim at least, if they are not available locally. The government's justification for this position is, presumably, that the companies have not looked carefully enough and that they can find such skills locally. However, employing expatriates is expensive for investing companies, and they are typically eager to "localize" positions to save money. It is, therefore, not in the financial interests of companies to request visas for expatriate labor unless they are really needed. New legislation is currently being prepared on and other areas.

Box II.1: Residence and Work Permit Procedures in the United Kingdom

In accordance with EU law, citizens of European Economic Area (EEA) countries (the EU plus Iceland, Liechtenstein and Norway) do not need a work permit to be employed in the United Kingdom. Citizens of all other countries need work permit, issued by the Department for Education and Employment (DfEE), if they wish to seek employment in England, Scotland or Wales.

For a foreigner to be employed in an ordinary business, the British employer must submit an application on the foreigner's behalf. The application must be for a specific individual who is being hired to perform a specific job on a full-time basis. A simplified procedure exists for applicants who qualify under the so-called Tier 1 category of jobs, which include intra-company transfers, board-level posts, inward investment positions, shortage occupations, and key workers. All other applicants are considered to hold Tier 2 positions, and documentation for these is considerably more than for Tier 1 category jobs.

The DfEE uses four general criteria in deciding whether to grant permits:

- Is there a genuine vacancy for an employee in Great Britain?
- What skills, qualifications, and experience are needed to do the job? Work permits are normally issued for jobs that require high-level skills. For example, a senior executive or manager with at least five years of relevant senior management experience would qualify, as would key workers who have special skills, knowledge, or experience that are not readily available within the EEA workforce. Work permits are not issued for manual, craft, clerical, or secretarial jobs.
- Is the person suitably qualified and experienced?
- Are suitably qualified and experienced resident workers available in the EEA? Applicants for Tier 1 category jobs need only to describe why the person should be employed. Others have to supply supporting documents, such as advertisements or an explanation of recruitment methods.

The procedure usually takes no more than four weeks. Work permits are issued for a maximum of four years and can be extended. Tier 1 employers are not required to perform a new recruitment search. Tier 2 employers must demonstrate the results of a recruitment search or the reasons why this is not appropriate.

DfEE's website contains detailed information about the procedure, as well as application forms (www.dfee.gov.uk/ols).

Box II.2: Residence and Work Permit Procedures in Germany

Nationals from Member States of the EEA do not need a work permit to work in Germany. With respect to employment in Germany, EEA nationals have the same rights as German nationals. Citizens from countries outside the EEA are required to obtain a residence / work permit.

Due to high unemployment in Germany, and the established right of free movement of labor within the EEA, the general employment policy in Germany is restrictive. Foreigners are allowed to work in Germany only if there are no employees for the position available in the EEA, or if the employment of a foreigner is considered as neutral to the labor market.

The German Aliens Act (Section 10) empowers the Ministry of Interior Affairs to determine for which professionals, what kind of occupations, and for which national work permits shall be issued. This gives the government a high degree of flexibility to implement the policy in ways appropriate to its needs. The following example illustrates the flexible use of this instrument: in February 2000, the German government announced its intention to recruit up to 30,000 computer specialists, mainly from India, and also from CEE countries. Germany fears losing ground in the fast growing IT sector due to lack of IT specialists. For this purpose, it is planned to issue work permits for up to 6 years.

The procedure to obtain a residence / work permit is as follows: First, the employee has to apply for an “employment visa” with the German embassy in his home country. This visa is valid for 3 months, and confirms that a specific employer is allowed to employ the applicant for a specific position in Germany. The procedure takes about 6-8 weeks, and costs less than US\$50. In order to issue the “employment visa”, the Ministry of Interior Affairs and the Ministry for Labor and Social Affairs coordinate their decision. The “employment visa” will generally be issued if there are no EEA nationals available for the position, and the foreign employee will not be employed on less advantageous conditions than would a German national enjoy. These criteria do not apply to certain applicants whose employment is considered neutral to the labor market. For example, managers of foreign parent undertakings who will work in a German subsidiary, journalists, athletes, and so on do not have to show that there is no EEA national available to fill their positions.

With the “employment visa”, a foreigner is permitted to enter Germany and receive a work permit from the local employment office valid for one year. The procedure to obtain a work permit is only a formality since it is based upon the already-issued “employment visa”. Additional documentation is not needed, and there are no costs involved. It takes only a couple of days to issue.

After obtaining the work permit, a foreigner must apply for a prolongation of his residence visa with the Authority for Foreigners. The residence visa is issued for one or more years, depending on the case-by-case evaluation.

To obtain the employment visa, an applicant must submit the following documents:

- Valid ID or passport;
- Evidence of employment in Germany; and
- Evidence of health insurance.

Box II.3: Work Permits in Lithuania and Zambia

Lithuanian's Ministry of Migration can be considered best practice in that it uses the tax authorities to confirm and monitor whether an investor has taken up the activities specified in the company formation documents. An effective monitoring system reduces the need for an initial vetting because officials are better able to identify and deal with intentional violators of the Lithuanian Laws, when problems arise.

Countries that do not monitor investors' progress must be much more thorough in their vetting, and often put investors through a great deal of initial bureaucracy.

By law, the Lithuanian government must issue the special visa or notice of rejection within 30 days of filing. Latvia has a similar law on its books to process applications within 30 days. However, many investors there disputed the claim that the process was actually completed within this period. By contrast, investors in Lithuania speak highly of the current process and indicate that it is relatively problem-free.

However, the laws governing contracts of expatriate workers tend to increase the difficulty of attracting and keeping quality foreign workers. At the time of the study, Lithuanian law allowed only for one-year contracts, with eligibility for six-month extension. Immigration also states that it does not permit families to accompany foreign workers because the permits are "short-term." This is a clear disincentive to a potential foreign expert, and reduces the skill pool from which companies established in Lithuania can draw. It is not known whether this will change with new legislation.

One country that has taken great strides to improve its climate for foreign workers is Zambia. The Zambian Ministry of Labor has worked with private industry to determine which professions and skills are not available locally. On this basis, Zambia is updating the list used by the Department of Immigration to issue visas and work permits (which are combined into a single document). In this manner, the Ministry of Labor is removing itself from many day-to-day interactions with investors, and redefining itself as a policy-making body.

F. Recommendations

68. Eliminate the duplication of procedures involved in the business / employment visa and work permit application, and shorten the overall time required for an expatriate to begin work legally. The process should be condensed into a period of one month or less, with the bulk of the time spent approving the necessary visas before the investor reaches the country. In particular, the Ministry of the Interior and the Ministry of Labor should coordinate their functions better to avoid duplication of efforts.

69. The Ministry of Internal Affairs and Ministry of Labor should integrate their procedures for business visa and work permit approval. This would require an internal investigation of procedures at the two ministries, and the establishment of policy and working-level committees to implement harmonized procedures, as well as giving consideration to new or amended legislation on the employment of foreign nationals. In deciding the future division of labor, existing bottlenecks and human resource constraints (e.g. at the Croatian Employment Institute) need to be considered. These joint working groups should also seek to identify and resolve the problems of overlapping, confusing and redundant regulations and requirements that currently exist.

70. Increase dialogue among the various government agencies, and between them and the investor community. The objective of any particular committee or task

force will be to address discrete problems, such as duplication of procedures. However, more broadly, such mechanisms will provide a basis for effective policy advocacy, a way of announcing new legislation and procedures, and a means to process particular administrative cases or problems as they arise. Currently, there is very little interaction between the various participants in the immigration and work permit approval process, and almost none with the investor community. The current unsatisfactory state of affairs stems partly from ignorance of the concerns and priorities of other groups, which could be resolved in large part by enhanced dialogue. Within the government, as mentioned above, the Ministries of Labor and Internal Affairs (Immigration Department) need to collaborate more closely, but some sort of formal public-private forum is also needed to share concerns, and to publicize / clarify new legislation or procedures.

71. **Extend the term of business and employment visas, and of associated work permits (so long as they are separate items).** It is recommended that the term of business visas be increased from the current one year to two or three years, with simplified renewal procedures to better match the term of the investment cycle. This will increase confidence among investors, and reduce the administrative burden for both investors and the government.

72. **Publish a single, comprehensive guide to immigration procedures for investors and expatriate employees.** Given the confusion that exists about procedures, and the many overlapping requirements, the Government of Croatia should also publish a single document that covers the process in its entirety. This should serve as the standard reference for investors and officials, making clear the expectations and responsibilities of each. The document should be widely published both within and outside the government, translated into appropriate languages (e.g. English, French, German, Italian and any other appropriate languages), and posted on a readily accessible internet site.

73. **Streamline / eliminate the employment vetting procedures reflected in the Ministry of Labor Resolution and Croatian Employment Institute screening requirements.** In addition to being duplicative, both requirements could be largely eliminated by the compilation of a negative list of professions that are discouraged (or a positive list of ones that are encouraged, as in the UK or Australia). The screening procedure might remain where employers wish nevertheless to argue in favor of a particular expatriate's skills. However, for professions / skills not on the negative list, applicants would be required to produce the necessary evidence of their eligibility in conjunction with their business / employment visa application.

74. **Eliminate the requirement for proof of residential address.** This serves little useful purpose, and is not required by most countries.

CHAPTER III
COMPANY REGISTRATION AND OTHER BUSINESS ESTABLISHMENT
PROCEDURES

75. The company registration process in Croatia is relatively straightforward, and does not present private enterprise (domestic or foreign) with any significant barriers. The procedures involved in incorporating a company in Croatia, for which the services of a lawyer are typically retained, are described below, along with various other registrations that are required in parallel.

76. Adopted in 1993, the Croatian Company Law (*Zakon o Trgovačkim Društvima*) is based mainly on the German and Austrian company laws, and incorporates the applicable directives of the European Commission. It is a modern law, permitting the organization of all company forms known to the European legal tradition. The philosophy of the law allows the parties substantial flexibility in the way companies are organized. It accommodates the needs of individual entrepreneurs and small companies, as well as those of large companies with substantial capital. The Law stipulates that the company must take one of the following five basic forms: (a) Limited Liability Company, (b) Joint Stock Company, (c) Limited Partnerships, (d) Unlimited Partnerships, and (e) Economic Interest Grouping.

A. Types of Economic Organization

77. **Limited Liability Company – d.o.o.** A limited liability company is defined as a company in which one or more individuals or legal persons invest their property, and thereby participate in the previously agreed share capital. The name of the firm must have an indication that it is a limited liability company in Croatian, usually by adding the letters “d.o.o.” to the name. Founders of a limited liability company may be domestic or foreign individuals or legal persons.

78. The minimum share capital of a limited liability company is the *kuna* (equivalent of 5,000 German marks). A limited liability company is obliged to keep a register of shares. Moreover, the law requires a management board and a general meeting of the participants (the partners). A supervisory board is obligatory only if this is prescribed by a law for companies performing some special activities, or if the company has more than 300 employees.

79. The management consists of one or more director(s). There are no restrictions with respect to the appointment of a foreign national as director. Members of the management are appointed during the general meeting of the partners in the company. The authority of the directors includes the management and representation of the company. With respect to managing the company, the position of members of the management of a limited liability company is less independent than that of the directors in joint stock companies. The idea behind a limited liability company is that close

relations exist between the partners, and that each of them will be actively involved in the management of the company in one form or another.

80. The general meeting or assembly is the principal forum through which the participants (partners) in the company reach decisions that they are authorized to make under Croatian Company Law (CCL) and the company's own Articles of Association. The Articles of Association may provide very broad authority for the general meeting of the partners. Unless otherwise agreed in the Articles, the partners shall have votes corresponding to their contributions to the capital. A general meeting shall reach decisions by simple majority of the votes. The Limited Liability Company is the most widely used company form in Croatia.

81. **Joint Stock Company – d.d.** The CCL defines a joint stock corporation as a company whose members (shareholders) participate in the share capital, which is divided into shares. The name of the company must have an indication in Croatia that it is a joint stock corporation, or have the letters "d.d." appended to its name. Shareholders, who may be domestic or foreign individuals or legal persons, are not liable for the obligations of the joint stock corporation.

82. The minimum share capital for establishing a joint stock company is the *kuna* (equivalent of 30,000 German marks). The Law on Securities (NN 107/95, 142/98) bans the issuance of share certificates in paper form (a common feature of modern securities laws). Instead, the owners of shares shall have accounts with the central depository agency (which, as discussed below, has yet to become fully operational). Shares may be either registered name shares, or bearer shares, and may be issued as either common (ordinary) shares, or preferred shares.

83. Common shares give the right to vote at the general shareholders' meeting, to receive dividends, and to receive a proportionate amount remaining upon liquidation of the corporation. Holders of preferred shares enjoy some preferential rights, such as the right to dividends in a previously determined amount, priority right to dividends or to payment of an amount remaining upon liquidation of the corporation, or other rights foreseen by the CCL or by the company's Articles of Association.

84. Only those persons who are registered in the share register are considered to be shareholders. The corporation's management is responsible for maintaining this register of shareholders ("book of shares").

85. A joint stock corporation must have a management board and a supervisory board, and must convene a general shareholders' meeting. The corporation's Articles of Association must specify the number of members to be on the management and supervisory boards. The management of a corporation consists of one or more directors (if it consists of more than one member, one of them must be appointed president), appointed by the supervisory board for a maximum period of five years. Members of the management may be either Croatian or foreign nationals. Rights and obligations of the management include: (i) managing the corporation; (ii) representing the corporation; (iii) preparing decisions, which are to be made by the general shareholders' meeting; (iv)

preparing contracts; (v) executing decisions of the general shareholders' meeting; and (vi) informing the supervisory board on issues regarding management of the corporation.

86. The supervisory board must have at least three members. The CCL limits the number of members of a supervisory board, depending on the stated share capital of the corporation. Members of supervisory boards are elected in a general shareholders' meeting for a maximum period of four years, and may be reelected. Members elect among themselves a president and at least one deputy president. The supervisory board is obliged to supervise the management of the corporation. It reports to the general shareholders' meeting.

87. The general shareholders' meeting of a joint stock corporation is the principal forum through which shareholders exercise their rights. All shareholders have the right to be present at the general meeting. Competencies of the general meeting are determined by the Articles of Association. Decisions at the general meeting are reached through majority voting. Dissolution and closing of a joint stock corporation are regulated through the CCL.

88. Croatian Company Law currently does not mandate representation on the management board of particular groups of shareholders, such as those holding a certain percentage of shares; neither does it expressly allow it. A proposed future amendment to the CCL may provide for mandatory representation of certain groups of shareholders (e.g. those holding five or ten per cent of outstanding shares) through the mechanism of cumulative voting, which is well established in the United States.

89. The company law in Croatia provides adequate regulation of well-established forms of business activity. In some important aspects regarding the regulation of joint-stock companies, it is amended by the Securities Law (NN 107/95; NN 142/98).

90. **Limited Partnerships.** A limited partnership is a company formed for the purpose of carrying out business on a permanent basis by the association of two or more persons, whereby at least one shall be liable for the obligations of the company with his/her own assets. Both natural and legal persons may become partners in a limited partnership. Partners bear only the risk of the business operations up to the value of his/her paid-in capital. The management of the company is entrusted to the general partners. There are no minimum capital requirements to start business.

91. **Unlimited Partnerships.** Unlimited partnerships are basically the same as limited partnerships, except that there are no limits placed on the liability of the partners with regard to paid-in capital.

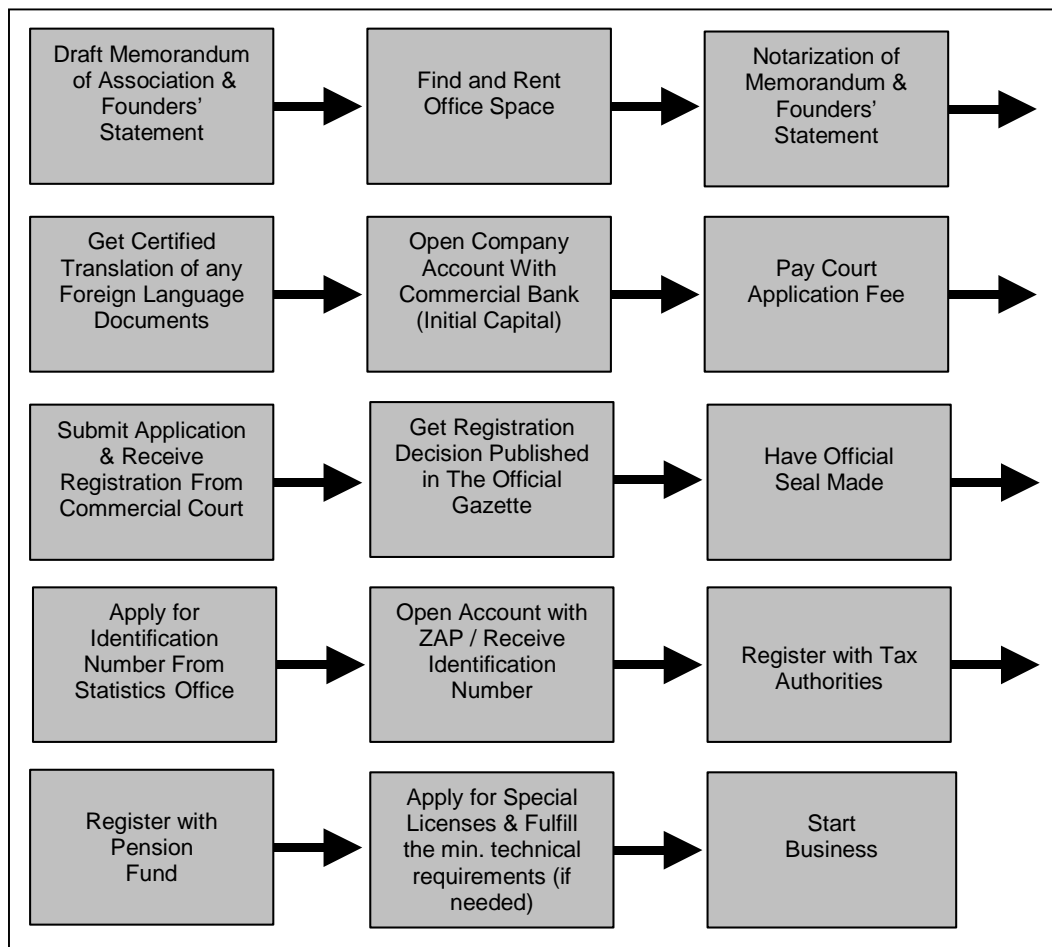
92. **Economic Interest Grouping.** An economic interest grouping is a legal entity that is not formed to make profits for itself. The grouping may be formed without any capital and the rights of members cannot be represented in securities. All members are liable for obligations and have unlimited liability with their respective assets. The Economic Interest Grouping is represented by a Management Board that is appointed by The Economic Interest Grouping is represented by a Management Board that is appointed

by the members of the grouping.

B. Establishing a Business in Croatia

93. In order to establish a business entity in the Republic of Croatia, it is necessary to register with the Commercial Court, the State Statistical Office, Agency for Payments (ZAP), the Tax Authorities and the Customs Authorities (if the company intends to participate in foreign trade). Typically, a local lawyer or other legal representative oversees these registration activities, and deals with the public notaries, commercial auditors and the registration courts. The chart below shows the sequence of registering a business.

Figure III.1: The Process of Company Registration in Croatia



1. Company Registration

94. **Memorandum of Association / Founders Statement.** The Memorandum of Association or Founders Statement should include:

- The names of the founders, i.e. name and headquarters of corporate founders, or the personal identification numbers, names and family names of physical persons;
- The corporate name and headquarters of the company being founded;
- Business activities of the company;
- The total amount of initial capital, and the amount of the founders' individual ownership stake. The value of contributions made in kind must be described in detail; and
- A statement of whether the company is founded for a limited or unlimited period of time.

95. When naming a company, founders must get special permission from the Ministry of Foreign Affairs to use "Hrvatska" (i.e. "Croatia"), or any derivation thereof, in the corporate name. It is also necessary to conduct a search to make sure the name is not already in use. The cost of checking for the existing use of a corporate name is approximately 200 Kuna (roughly US\$25), and can be completed in about one hour at the commercial court.

96. In addition to the Memorandum of Association, the lawyer will also draft a document to appoint the management of the company. Currently, the law states that at least one member of the management must be a Croatian national. Normally, the drafting of these documents is handled by a lawyer and can be completed in half a day. Local lawyers charge approximately 4,000 Kuna (roughly US\$500) for these services.

97. **Office Space.** In registering the company, it is necessary to establish an official office for the company in Croatia. Detailed discussions of real estate and land issues are covered in Chapter IV of this report, but a lawyer may use his own business address on an interim basis to register his client's company.

98. **Notarization of Documents.** A Public Notary must witness all legal documents in the Republic of Croatia. The notary public is a private official with certain public credentials and powers, whose role is to certify and verify the authenticity of certain legal documents. The profession is regulated by the Law on Public Notaries (*Zakon o javnom bilježništvu*, NN 78/93, 29/94). The cost of notarization for company registration varies, but is typically about 2,500 Kuna (roughly US\$300).

99. **Certified Translations.** If any of the documentation needed for the Memorandum or Founders' Statement is in any language other than Croatian, then the

document must be officially translated into Croatian by a registered translator. Fees are dependent on the number of documents translated, but relatively inexpensive.

100. **Company Account with Commercial Bank.** Initial share capital (equivalent to 5,000 DM for Limited Liability Companies or 20,000 DM for Joint-Stock Companies) must be deposited into a commercial bank account, and the receipt of deposit submitted for company registration purposes. The minimum ownership stake of any given partner is the domestic currency equivalent of 200 DM. The process of opening an account takes approximately an hour.

101. **Submission of Application.** The court registration process can be a lengthy process, unless it is expedited by filing a motion for “fast entry” into the registry. Worst-case scenarios can be as long as six months, while the process can take as little as two days. In addition to two notarized copies of the Memorandum of Association/Founders’ Statement, a *legal representative of the company* (i.e. someone with power of attorney, or a founder) must submit the following items:

- A list of the founders. This should contain: their names and surnames; dates of birth; personal identification numbers (or passport numbers and issuing country for foreign citizens); corporate name and headquarters, the register court and the entry number in the Register of Companies (given by the court); the amount of initial capital;
- A receipt for all cash payments, issued by the commercial bank;
- Assurance that the remaining amount of the ownership stake will be paid, if not paid already;
- A list of persons authorized for conducting the business operations of the company; their names and surnames; dates of birth; personal identification numbers; residential address; the scope of their authority to act; and their statements given before a notary public on accepting the appointment;
- A list of all members of the Supervisory Board (if the company has one); their dates of birth; and places of residence; and
- A list of the members of the Management Board.

102. The application form itself requires:

- The corporate name, headquarters and business activity;
- The amount of initial capital;
- Sworn statements by the members of management that they have been acquainted with the obligation to report to the court should the need arise; and
- The names of all company members and their personal identification numbers.

103. **Court Fees.** Apart from the fees charged by notaries and lawyers (if used), there are the direct costs of company registration, which are established by the court at the time

of application. For a limited liability company (LLC), the fee varies between 2, 000 and 3,000 Kuna, depending upon the number of activities registered (400 Kuna for the first, and 200 Kuna for each additional activity) and the number of directors. Registration costs for the lesser-used joint stock company (JSC) vary as a percentage of the company's capital.

104. **Publication of Registration Decision.** After the company has entered the Register of Companies through application to the commercial court, the court forwards the registration data to the Official Gazette (Narodne Novine) of the Republic of Croatia and the daily newspapers. Registration in the Official Gazette is obligatory and costs 810 Kuna for joint stock companies and 500 Kuna for all other types.

2. Other Procedures for Establishing a Business in Croatia

105. **Making a Company Seal.** Official seals are readily available throughout Croatia at special seal-making shops. The seal itself must contain the name of the company, and its registration number issued by the court. This seal must be used on all official documents (including invoices, receipts and so on) issued by the company.

106. **Registering with the Statistical Office.** It is required by law that the company request an identification number and an activity code from the Statistical Office. This process takes approximately two to three days and can be carried out by mail. This request must be accompanied by:

- The official court decision to register the company;
- The RPS-1 Form (available in Narodne Novine shops);
- A copy of the payment slip for the administrative fee (approximately 55 Kuna).

107. **Opening an Account with ZAP (Agency for Payments).** Companies are required to open a permanent domestic currency account with the Croatian Agency for Payments (ZAP). To open this account, the company must provide: proof of having a bank account at a commercial bank in Croatia; decision of the commercial court to register the company; notice from the Statistical Office that identifies the company and its activity; and signatures of authorized signatories on the account, which are then stamped with the company stamp. ZAP then issues an identification number (a giro account number) for ZAP internal use, which is distinct from the Statistical Office number.

108. **Registering with the Tax and Customs Authorities.** Tax registration is extremely simple in Croatia. Having registered with the commercial court and the Statistical Office, and having opened an account with ZAP, a company registers with the tax authorities. This is done at the local tax office based upon the company's registered address.

109. There is no application form involved, as information is inputted directly into an electronic system, and corporate tax registration and VAT (PDV) registration are done simultaneously. Registration for VAT is optional below estimated gross annual turnover of 85,000 Kuna.

110. The tax number issued covers both corporate tax and VAT (if applicable), and the process takes approximately ten minutes. The procedure is handled by tax officers, with only occasional problems being referred to the Head of Department. When applying for a tax number, the company should present:

- A copy of the commercial court registration;
- The Statistical Office identification number and activity code.

111. The electronic tracking system (for commercial court, statistical office and tax registration) into which the local tax office inputs the assigned tax number is coordinated by the State Informatics Office.

112. When a company elects to register for VAT, it can arrange a standing order with a commercial bank for a temporary assessment amount. Alternatively, separate payments can be made via ZAP, based upon monthly or quarterly submissions. A company's ZAP account can be blocked if it fails to make VAT payments under this option.

113. If the company is registered for performing foreign trade operations, the founders must request a customs code from the Customs Administration of the Republic of Croatia. This request must be accompanied by a copy of the company registration, the registration from the Statistics Office, and the giro account number issued by ZAP.

114. **Applying for incentives.** Under the new Investment Promotion Law enacted in July 2000, investments in Croatia are eligible for a number of new tax incentives. However, the application procedures for incentives are not set out in the law, and are as yet unclear.

115. **Registering with the Pension Fund.** When the company hires its first employee, it is necessary to register with the Pension Fund. To do so, it is necessary to have proof of company registration from the Commercial Court, the Statistical Office and ZAP. The Pension Fund must also have all relevant information on the employees, including name and surname, residence and personal identification number. For company tracking, the Pension Fund uses the number assigned by the Statistical Office.

C. Applying for Special Sectoral Licenses

116. Depending upon the industry in which it will operate, a company may need to apply for special licenses. Financial services, banking and telecommunications are the main industries where such additional registration or licensing is necessary.

117. **Financial Services.** The Croatian National Bank and the Ministry of Finance oversee the licensing of companies operating in the financial services sector. For

insurance companies, the oversight body is the Insurance Supervisory Authority (ISA). The ISA grants the licenses and supervises whether companies are operating according to the Insurance Act (NN 9/94, 20/97, 46/97, 116/99) and other governmental regulations.

118. For companies operating in the insurance sector, there are minimum initial capital requirements:

- 8 million kuna for companies dealing with life insurance;
- 4 million kuna for companies dealing with “specific types of non-life insurance”;
- 12 million kuna for companies established to deal with several groups of “non-life insurance”; and
- 12 million kuna for companies established to deal with reinsurance.

119. The appointment of the Management Board is subject to the consent of the Ministry of Finance, following a proposal from the ISA.

120. **Banking.** Banks may be established only as public limited companies with registered shares. The decision to grant a banking license is under the supervision of the Croatian National Bank. The application process typically takes about six months. The minimum amount of initial capital is 20 million Kuna. If a bank triples its capital, it can then take on domestic payment operations, foreign exchange payment and credit operations. All licensed banks are able to conduct standard banking activities, such as holding personal savings and deposits in domestic and foreign currency after a three-year waiting period.

121. **Telecommunications and Internet-related Companies.** Telecommunications and some internet-related companies (especially Internet service providers) face regulation from the Ministry of Transportation, Maritime Affairs and Communication. All licenses are issued by the Ministry, and are issued in a relatively timely manner. Regarding internet-related industries, investors mentioned the monopoly on bandwidth currently enjoyed by Hrvatska Telekom as well as problems registering domain names with foreign words or “unspecific” names using “net” or “hr”.

D. Analysis

122. **Company Registration.** Croatia’s company registration process is relatively straightforward and does not present private enterprises with any significant barriers, although it is relatively expensive, especially if a lawyer is used to expedite the process. Most of the basic registration requirements are in line with standard practice throughout the EU. It is important to note that the government seems to be trying to further normalize these processes by:

- offering expediting services at the commercial court;

- moving toward a universal identification number to be used throughout the different offices and ministries of the government; and
- privatizing the ZAP and opening the payment processing service to competition.

123. Criticism of the company registration process may be somewhat muted because immigration and land-related constraints can be far more time-consuming. Moreover, company registration is (like other procedures) intermediary-intensive, and without the services of a lawyer, the company registration process is more difficult. This is more of a problem for small and medium enterprises that often cannot afford the services of a lawyer.

124. As regards the Company Registry, Croatia is fulfilling the minimum reporting requirements established by the EU, and must be commended for doing so. Nevertheless, the registration process itself tends to be over-reliant on local legal counsel. Many investors felt that the only way they were able to register their companies promptly was to have a local lawyer with connections. With a well-connected lawyer, the registration process at the Commercial Court can take as little as two days. Companies that attempt the process on their own face delays of up to six months. Croatia does not compare particularly well with other countries in this area (see Table III.1 and Box 3.1).

125. One of the main reasons for the time-consuming standard company registration process is the overburdened commercial court system. In particular, there is a shortage of judges who must deal with simple matters such as company registration as well as actual court cases. One way to improve the process would be to reassign company registration from judges to special clerks, which could help alleviate the backlog of pending cases, and release judges for more urgent matters.

126. Croatia's company registration process is overly reliant on local legal counsel and other intermediaries. Legal counsel is not so much needed for the complicated nature of the procedures, which are in line with normal international practice, as for the connections that are needed to get the registration process "fast-tracked". The need for public notaries at many stages of the process, however, adds to the system's inefficiency and delays, and therefore creates opportunities for abuse.

127. The company registration system could also be improved by the use of better electronic systems. In Ireland, for example, the Irish Registrar of Companies has an Internet site that offers forms that can be downloaded, and name search databases at no charge. Simple improvements of this kind could permit easier information access and speedier processing of applications. By offering these services online, the reliance on local counsel would be eased, and the whole company registration process would become more transparent.

Table III.1: Company Registration Procedures: Croatia in International Comparison

Country	Authority	Length of Procedure	Cost
Austria	District court; decisions by specialized judge	2-4 weeks depending on local courts	Sole Proprietor- \$80 LLC/JSC- approx \$800
Croatia	Commercial Court	Average 4-6 weeks; can take as long as 6 months	LLC – typically \$660, including notarial and Official Gazette fees JSC- Varies with share capital
Denmark	Danish Commerce Companies under the Ministry of Trade and Industry	1-2 weeks	None
Estonia	Commercial Register	2-3 weeks	Sole Proprietor- \$20 LLC/JSC- \$170-2,800
Germany	Local Commercial Court; decisions by specialized judge	Approx. 4 weeks	Sole Proprietor- \$100 LLC/JSC - \$140
Hungary	Regional Court; decision by specialized judge	Approx 4 weeks	Sole Proprietorship- \$40; all others- percentage of share capital
Ireland	Companies Registration Office	10 days	LLC- 250 Irish pounds All others- 20 Irish pounds
UK	Private centralized Registrars	5 days; same day service is available	Flat fee- 20 pounds sterling
USA	Varies State to State	Usually within 2 weeks	\$100 for corporation \$70 for LLC
Slovenia	Local courts	1-3 months	Joint Stock- \$1,300 LLC- \$500

E. Recommendations

128. Croatia’s company registration process, although relatively straightforward, should be made more customer-friendly with particular attention paid to shortening the time required and reducing the direct and indirect costs involved. This could be achieved by focusing on the standardization of forms, moving towards a single registration number, and increasing computerization.

129. The Government of Croatia might want to consider the following specific steps in order to improve the company registration process:

- **Establish time limits.** Using Hungary as an example, Croatia could benefit from setting definite time limits for company registration, whereby if an applicant has no response from the courts within 30 days, then registration is automatic.
- **Reduce the various costs of company registration.** Compared to other countries, the costs of establishing a business in Croatia are rather high, especially the indirect costs of using a lawyer (regarded as necessary to speed the process), and having official documents notarized. Also, although the financial cost of specifying additional activities is relatively small, this is a rather cumbersome requirement, and should be eliminated.
- **Make the registration process more customer-friendly by exploiting information technology.** The Government of Croatia and its commercial courts should seek to exploit information technology in order to expedite the various procedures involved in company registration. For example, by using internet possibilities, investors could be given the possibility of downloading the necessary forms and conducting name searches. This would lower the cost of publishing forms, and reduce the number of applications submitted with invalid names, in turn easing the workload of the overburdened commercial court system.

130. **Coordinate various business establishment procedures (e.g. company, statistical, tax and pension fund registration) in order to shorten the overall process.** The registration process with the Statistical Office is not considered to be overly bureaucratic or difficult by investors. While separate statistical registration is common in much of central Europe, it is less common in Western Europe where statistical bureaus receive their information directly from the company registries, and use tax identification numbers for tracking and data purposes. Towards such simplification, the Croatian government may want to continue to emphasize the benefits of harmonizing registrations across ministries and agencies, making company registration through the courts the key step, thereby reducing the number of forms to be completed. This would decrease the time needed to register a company. Croatia could also drop the requirement to make a company seal, as it serves little purpose.

131. **Remove broad policing powers of the Agency for Payments (ZAP) in parallel with the privatization of payments processing services.** The two functions of payments processing and financial policing should not be mixed. The main criticism raised about ZAP is its policing function that is a hangover from its role under the previous government. Policing powers of this kind do not exist in most Central and Western European countries. Foreign investors will continue to be skeptical of a system where bank accounts can be frozen for all transaction purposes, for example, by a mere miscalculations of employee's withholding tax. The Government of Croatia might consider absorbing ZAP's current policing activities into the tax department's oversight function.

132. The general opinion among investors is that ZAP is very efficient as a payment clearing house, and investors satisfaction will be enhanced once the policing function is

removed. Although the government's decision to introduce private competition to the payments arena is to be applauded, and many private banks are preparing their systems to accommodate the transition, other banks, in contrast, are even considering outsourcing this function to ZAP.

133. Clarify which sectors require special authorization of business activity, and the procedures involved. Information on special sectoral licensing requirements is not available to investors in a central location. The government should prepare a list of sectors where authorization is required before (or indeed after) investing. This information should be made easily accessible to investors (including on the internet) along with general company registration information. This would help speed the process of business establishment, and make it more transparent. Where additional sectoral licensing procedures are identified, the government should then focus on simplifying them to the extent possible.

134. Investors understand that some industries require special oversight, such as banking, insurance or pharmaceuticals. In most industrial countries, enterprises in such industries are often randomly checked to ensure quality and protect the consumer. To facilitate dialogue between the government and the private industry concerning special licensing requirements and inspections, the government may want to consider using an institution such as the Croatian Chamber of Economy to act as an intermediary between the private sector and the government in publicizing and streamlining the requirements, and in making them more effective.

Box III.1: Company Registration in South Africa

South Africa has a particularly user-friendly company registration process. Procedures are completed quickly, many other registrations are automatic (despite using manual rather than computerized techniques of sending copies of applications), and in many cases investors are permitted to trade while registration is in process.

There are three main types of registration in South Africa – companies, close companies, and branch offices of foreign companies. Company registration, at the time of an “administrative barriers” study (1997), was typically completed within three to five days. A considerable backlog in the case of closed companies, a new form of company for small indigenous businessmen, meant that registration could take two weeks.

Upon completion of business registration procedures with the Office of the Registrar, the South African Revenue Service (SARS) is notified by the Registrar, and the business entity is automatically registered as a Provisional Taxpayer and issued a registration number. For income tax purposes, every enterprise must appoint a “Public Officer” to represent it in all dealings with the Revenue authorities, including annual returns.

Those required to register for VAT must do so before trading commences. The company must have an active bank account before registering. The Receiver can issue a registration number within one to two days, after which trading may commence. Full approval requires two to three weeks.

Employers must register with the local Receiver, and are issued with a registration number within one to two days, although final approval requires two to three weeks. However, trading and hiring may commence immediately. The Receiver must be notified of all new employees.

CHAPTER IV

LOCATING

135. This chapter looks at the procedures and legislation applicable to land acquisition and registration and construction in Croatia, analyses them in the light of international experience, and offers suggestions for short and medium-term improvements that will also support the longer-term reform agenda.

136. The major steps in the locating process for new greenfield investment in Croatia are: identifying and acquiring a suitable site; acquiring a location permit; purchasing the land; registering ownership of the land; acquiring a building permit; and acquiring a usage permit, and connecting utilities. Company registration must be completed before final purchase of the land. The process is shown in Figure IV.1.

137. The three key laws governing land acquisition; registration and construction procedures are:

- The Land Registration Act (NN 91/96)
- The Property and Other Material Rights Act (NN 1/96,68/98,137/99,22/00,79/00)
- The Construction Law (NN 52/99,75/99)

138. Other relevant laws include:

- The Concession Act (NN 89/92)
- Free Trade Zone Act (NN 44/96)
- Law on Real Estate Transfer Tax (NN69/97)

A. Acquiring Business Premises and Land

139. Foreign companies or individuals seeking business premises basically have three options:

- to rent or enter into short-term leases;
- to buy as a non-resident legal entity (including as an individual); or
- to purchase having incorporated as a Croatian legal entity.

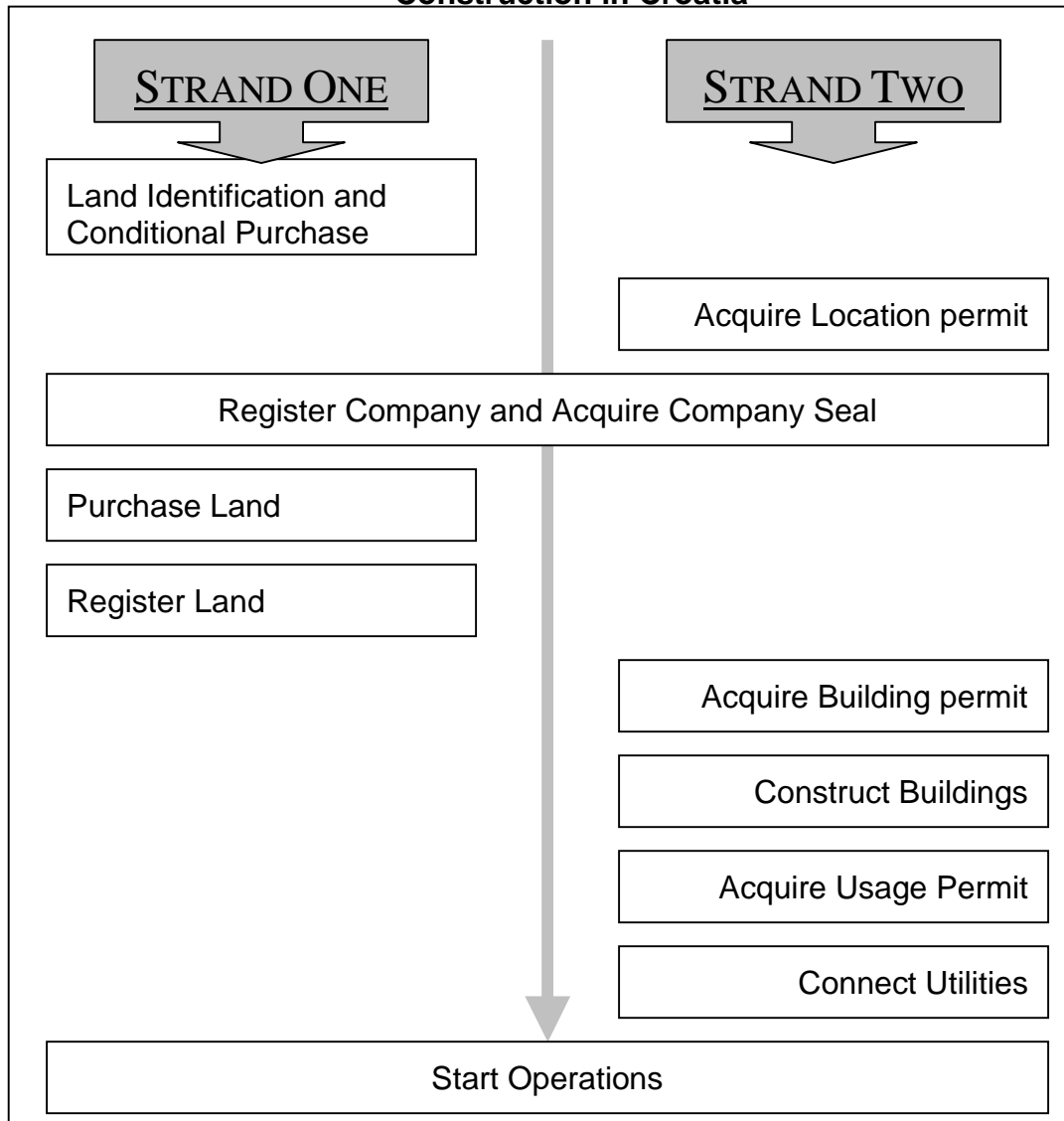
140. Most foreign companies currently operating in Croatia either rent premises or enter into short-term leases. If an investor wishes to purchase a site, he must either have incorporated as a Croatian legal entity (as described in Chapter III) or have obtained permission from government authorities to acquire the particular plot of land sought. This section focuses principally on the procedures involved in assembling and acquiring a site from the point of view of an investor that incorporates as a Croatian legal entity, but first looks briefly at the rental / short-term lease route, and the *additional* procedures involved

in purchasing land as a foreigner.

B. Renting Land and Premises

141. Perhaps 95 per cent of foreign companies currently operating in Croatia rent land and premises or enter into short-term leases of 5-10 years. Small plots and premises suitable for non-production investments are relatively easily available. Either a lawyer or real estate firm will identify such plots, and check the ownership of buildings and land in the Land Registry on behalf of the investor. Assuming that land and building ownership is clear, contract procedures can be completed within one day. Rental agreements can be arranged for definite or indefinite periods of time.

Figure IV.1: Procedures for Land Acquisition, Land Registration and Construction in Croatia



C. Additional Procedures for Purchasing Land as a Foreigner

142. Regarding the purchase of land by a foreign individual or non-resident legal entity, the right of land ownership guaranteed by the Croatian Constitution (Article 48) is also applicable to foreign persons. (A legal entity is considered a foreign person if its registered seat is abroad.) The real estate rights of foreign persons are regulated by The Law on Ownership and Other Property Rights (*Zakon o vlasništvu i drugim stvarnim pravima*, Narodne novine [NN] No. 91/96, November 28, 1996).

143. The additional procedures required have changed several times, but remain time-consuming and complicated. This route is generally avoided by business investors, and is typically used by foreign individuals acquiring residential property.

144. Until very recently, foreign persons wishing to purchase Croatian real estate had to obtain approval from the Ministry of Foreign Affairs (MoFA), issued on the basis of an opinion from the Ministry of Justice (MoJ). As of May 2000, foreigners formally no longer require the opinion from MoJ.

145. A foreign person's entitlement to purchase Croatian land is based upon the principle of reciprocity (i.e. whether Croatian individuals are allowed to purchase land in the other country), which does not exist, for example, between Croatia and Italy. The application by a particular person to buy a particular plot of land is submitted to MoFA, which will check the existence of a treaty or precedent for purchase of land by a foreign individual.

146. Clear evidence of existing ownership from the Land Book must also be submitted as part of the application to purchase. Through a lawyer or similar intermediary, the investor will probably have signed a conditional purchase contract for the property, subject to permission to purchase it granted by MoFA.

147. Under the old procedures (before May 2000), MoFA consults with MoJ, which checks the cultural status of the land and any other relevant restrictions affecting ownership. The process of acquiring approval from the Ministry of Foreign Affairs has typically taken around 6 months, but may become better with the exclusion of MoJ from the process.

D. Land Acquisition and Ownership Issues

148. A Croatian legal entity can purchase land from private owners or public institutions. Most land in Croatia is privately owned and, in principle, can be freely bought and sold. State-owned land, meanwhile, must in principle be sold by auction, as must various public institutional holdings of shares in privatized SOEs that own land (e.g. Privatization Funds). Some land of national importance, such as coastal or cultural land, is only available through concessions. Generally-speaking, there are four types of land-holding that an investor might wish to acquire:

- Privately-owned plots of land with **clear ownership**;
- Privately-owned plots of land with **unclear ownership**;
- Multiple-owned land (i.e. land parcels of varying type of ownership that must be assembled into the necessary plot);
- State-owned land (concessions of state land; land owned by quasi-public funds; and municipality-owned land).

1. State-owned land

149. **Concessions.** Investors can acquire use of state-owned land through concessions (e.g. coastal land, free zones, or other land of national significance). The original Concession Law (NN 18/90, 61/91) was repealed in 1992 in favor of a new Law on Concessions (89/92) that essentially points to individual sectoral laws governing different types of concession. These include: the Maritime Code (NN 14/94, 74/94, 43/96), the Mining Law (27/91, 26/93, 92/94, 35/95), Law on Maritime Ports (NN 108/95), the Law on Free Zones (NN 44/96), and so on.

150. Concessions are granted for a maximum of 99 years, or 40 years for agricultural land. Concessions are offered for public tender by different ministries depending upon the type of land, but must generally be approved by the Parliamentary House of Representatives, and are registered in the concession register kept by the Ministry of Finance.

151. Coastal land, for example, belongs to the state and can only be acquired as a concession from either the local municipality (for periods under 12 years) or from the Ministry of Environmental Protection and Zoning (for periods of 12 years or more).

152. Coastal land refers to land within 50m of the coastline. Within the category of “coastal land” there are subcategories that can only be used for harbors, or for swimming pools and other such hotel facilities. Investors or their agents must check with the local municipality for the appropriate land-use plan.

153. Concessions are also awarded for the establishment of Free Zones to one or more domestic persons for a maximum of 99 years (and facilities or plots presumably leased to zone users for a lesser period). The concession is granted by the Free Zones Administration of the Ministry of Economic Affairs.

154. **Land owned by municipalities.** Some municipalities have important landholdings despite the fact that most land in Croatia is privately-owned. Essentially all sale of municipally-owned land must be subject to a public invitation to tender and payment to the city of at least its market value. To this end, the Conclusion on Determination of the Starting Price of Buildable Land (NN 1/98) sets forth the minimum tender price of buildable land in Zagreb, which is calculated according to the gross

developed surface area (GDSA) *of the future structure*. Auctions are requested by investors at the time of application for location permit when outline plans for the proposed structure are available. According to government officials, the public auction process can take three to four months in all.

155. In practice, municipalities do sometimes sell land parcels outside the auction process. This can happen when a municipality owns a land parcel in a larger plot desired by an investor, where the other parcels are in private hands. Although this possibility and practice was mentioned by real estate agents, investors and government officials alike, the legislative basis for it is unclear. Based on past records, the cut-off point seems to be five per cent of the total plot to be acquired, although again legislative confirmation could not be found. The investor or his agent should apply to the Department of City Property or its equivalent, producing evidence that the purchase of most of the remaining land has been agreed. The request is normally processed at the time of application for the location permit, for which a sketch of the city-owned parcel of land must be submitted.

156. An Executive Council elected by the City Assembly (*Poglavarstvo*) must decide whether to offer the land parcel by tender or initiate direct sale procedures. This Council meets several times a year, but the decision cannot be made by executive action. If the decision is taken to offer the land by tender, the process is handed over to the Bureau for Land Auctions / Urban Development.

157. If direct sale of the land parcel is approved by the Executive Council, the Institute for the Development of the City (in the case of Zagreb) will evaluate the selling price based upon prevailing market rates, presumably also on the basis of the aggregate floor area, location and purpose, as for the auction process. The basis of the evaluation is the same as that for the Real Estate Transfer Tax.

158. **Land held by quasi-public institutions.** The Pension, Health and Bank Rehabilitation Funds also have arms managing asset portfolios that contain privatized companies and their assets, including land. An investor wishing to purchase such assets may have to go to three different funds, although they are in the process of being merged, to negotiate for shares on the same piece of property. Assets should be sold by tender announced in foreign newspapers (e.g. Financial Times) or government papers. According to officials, the process can take 14-30 days once the tender is closed.

2. Acquiring land not held by the state or quasi-public institutions

159. Most land in Croatia is privately held. However, interrelated problems of unclear ownership, land restitution, speculation, prevalence of small land parcels, and an inefficient and outdated land registration system make the acquisition of property very difficult and time consuming.

160. **The Land Registry, the Cadastre and Restitution Issues.** In ascertaining the ownership of a plot of land and eventually registering a purchased plot, an investor must interact with the Land Registry and the Cadastre, although a lawyer will typically act on

the investor's behalf. Cadastral records are located at the Local Municipality Cadastre Office while the Land Registry function is handled by the Land Registry Office of the Municipal Court.

161. As laid out in the Land Registration Act (91/96), the Land Registries constitute the only legal record of land ownership in Croatia, and they provide the certificate of ownership that is essential for preemption of other ownership claims on the land, submission as part of the building permit application, and as ownership evidence for use as collateral. That said, the current procedures and practices of the main registration system at the Land Registry (the "classical" registry) do not as yet accord with those laid down in the Land Registration Act.³

162. Investors must, however, deal with outdated land registries, with some parcel maps dating back to 1905, and none updated following land nationalization after 1945, when occupancy became the main issue. By 1992, when the process of restitution began, the old Land Book records and the Cadastre were not in accord with each other. There were differences in plot delineation and description, and the whereabouts of many original owners were unclear. The challenge of tracking land ownership has since been made more difficult by the practice of transferring land without registration in order to avoid transfer taxes.

163. The main entry in the Land Register has three sections:

- Description of the plot;
- Ownership of the plot; and
- "Burdens", including: (i) mortgages on the land; and (ii) reference to an additional entry describing building rights.

164. The "building rights" entry similarly has three sections:

- Description of the building;
- Ownership of the building; and
- Mortgage on the building (if any).

165. Investors or their agents must check both the Land and Building Rights Registers for ownership since separate ownership was possible in the past. Where land and building ownership is different, investors must negotiate with both owners, or preferably encourage one to buy out the other so the investor only deals with one owner.

³ At the Zagreb Municipal Court there are three registration systems relating to immovable property. The classical registry (referred to as the Land Registry in this report) registers land ownership. Meanwhile, the "Book of Deposited Contracts" (BDC) was legislated in 1992 to legally recognize the ownership rights of certain apartment block tenants. The third registry system – part of the Collateral Registry held at the Municipal Court – records mortgages or fiduciary transfers involving immovable property that had not been registered in the classical registry (or BDC) at the time the agreement was either judicially determined or created by the notary.

166. Applicants for land registration are often sent to the cadastral office to get the plot of land certified, due to inconsistencies between the two sets of records. The Cadastre, which serves as a record of occupancy, was updated in the post-war period, while the Land Register was not. Although the cadastral office is supposed to inform the Land Registry of changes in plot description, this does not always happen in practice.

3. Small parcels of land

167. The least complicated type of transaction would be a land purchase from a single, private, uncontested individual or company. However, such plots of 4,000 – 6,000m² for small commercial operations are rare, and larger ones essentially do not exist. Sites needed by medium-sized or larger investors are generally characterized by a patchwork of existing occupancy or ownership.

168. An investor or his agent must ascertain the ownership of each plot, and negotiate its purchase. For plots with unclear ownership, a clear succession of ownership transfers, starting from the original owner name entered in the Land Record, must be established in order to register the new title, and avoid the possibility of subsequent counter-claims.

169. In order to avoid high land parcel prices as a result of speculation, it is usually preferable for investors to use intermediaries, such as real estate agents or lawyers, to negotiate land purchases. Sometimes companies will also employ Croatian citizens or overseas Croatians for this purpose, since news that a foreign investor is interested in buying land is often enough to cause substantial price increases in a given area. The real investor often presents himself only at the final stage.

170. In addition to such simple speculation, there have also been cases of extreme speculation, whereby various small landowners were persuaded to sign options to sell land to speculators, especially in the early 1990s. When these plots are sought by potential investors, the speculators exercise these options and seek to sell the parcels needed by investors to assemble a larger plot, at enormous multiples of the fair market price. There are apparently no mechanisms to curb such speculation, although such practices seem to be on the decline, perhaps as the options expire.

E. The Process of Acquiring and Registering Land

171. The generic process for land acquisition and registration is shown in Figure IV.2. The entire process is typically contracted to intermediaries – a combination of lawyers and real estate agents, who will check the ownership pattern through the Land Registry Department (and the Cadastral Office, if necessary), negotiate with landowners, establish succession, conclude conditional purchase contracts, effect purchase, and finally register the new title.

172. In the simplest case, having established a Croatian company, an investor (typically through a lawyer with Power of Attorney) identifies a suitable site with single, clear ownership. The lawyer (or real estate agent) draws up a conditional purchase

contract. Following the acquisition of a location permit for the site, the purchase is finalized. The new title is immediately registered at the Land Registry Department of the appropriate court. However, the process is rarely this simple.

173. Foreign investors will clearly prefer to acquire land with location permit already secured, but few such plots are available, and the location permit is in any case quite precise, supposedly requiring the use of planned buildings to be specified. In other words, it seems to be rather more than a typical “zoning permit”, and it is generally accepted that both the location and building permits are investment-specific.

174. Also, the efficiency of the land registration process, in particular, varies by region, often depending upon the degree of computerization of land records. The system in cities outside Zagreb, such as Rijeka, appears to be much more efficient. Meanwhile, there seems to be a considerable lack of clarity in the ownership of land in the commercial / residential suburb of Novi Zagreb, compounded by the overload in processing faced by Zagreb Municipal Courts.

175. **Selecting Intermediaries.** An investor will typically begin the investment process by setting up a Power of Attorney in order for a lawyer to undertake the various functions relating to the acquisition and registration of land, as well as company registration and other matters. There seems to be no shortage of competent lawyers in Croatia, especially in Zagreb. A lawyer with Power of Attorney will typically provide several services:

- Company registration;
- Land Book checks;
- Notary services for public land;
- Purchase contracts for land; and
- New owner title registration in the Land Book.

176. The lawyer will typically proceed with the incorporation of a Croatian company on behalf of the investor in parallel to searching for land and property. Thus, by the time of purchase, the investor will be able to effect the transfer as a Croatian legal entity and avoid the additional requirements involved in buying land as a foreigner.

177. Either alone or in conjunction with a real estate agent, the lawyer will begin to search for an appropriate site. An investor will rarely undertake this himself, especially given the effect that this may have on prices. Larger investors may have their own agent (often a Croatian citizen) working with a real estate company.

178. **Identifying Sites.** Any investor will consider multiple possible sites for an investment, but this is particularly important in Croatia, where unclear ownership and small land parcels can often prolong the process almost indefinitely. It is not unusual for the search for a suitable site, with the need to clarify ownership and negotiate with multiple owners (including recalcitrants and speculators), to take three or more years.

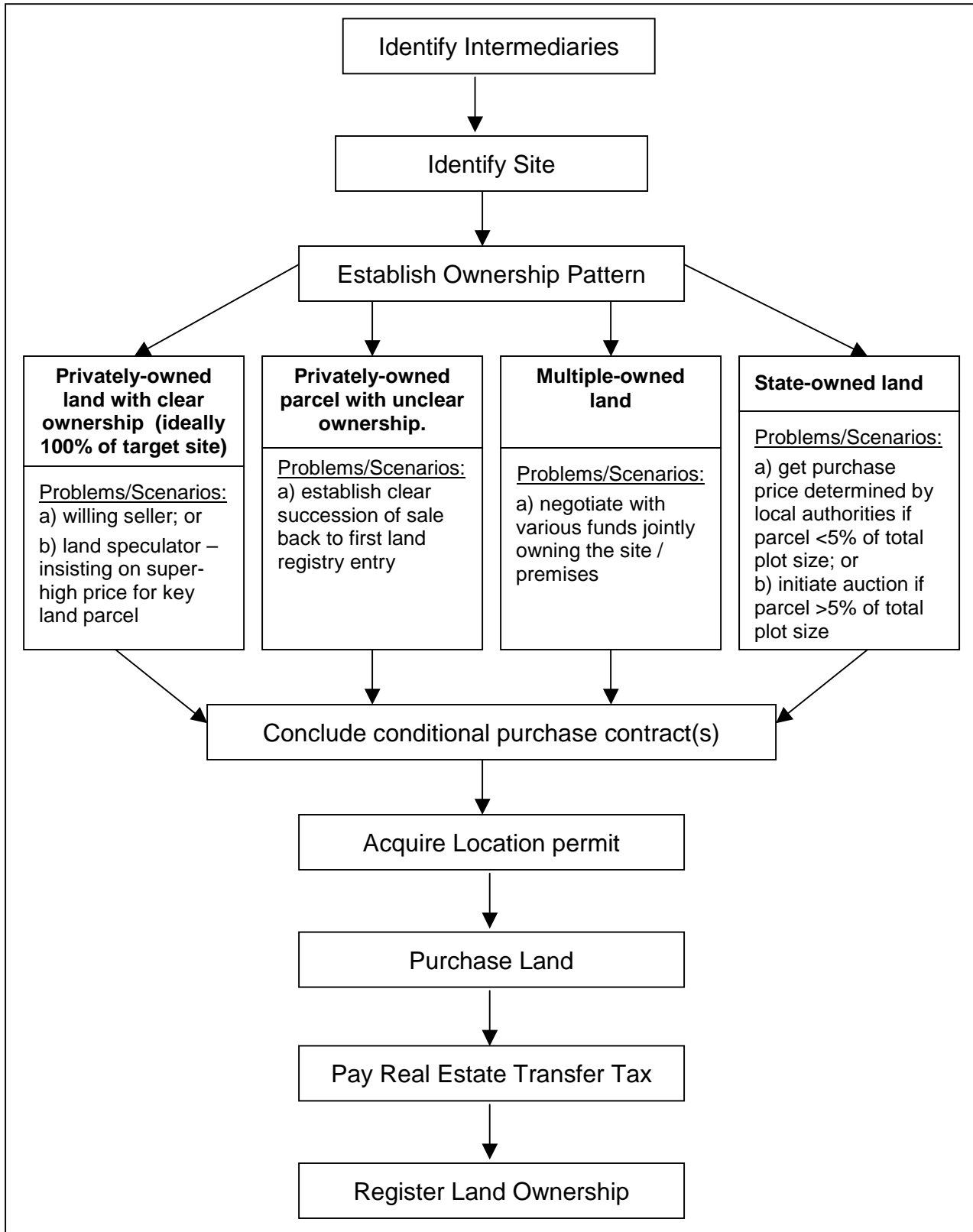
179. **Checking Ownership Patterns – Cadastre.** For each constituent parcel of a target site, the investor's agent must go to the local municipality's Cadastre office to ascertain the plot number and description. These details can also be obtained from the City Office. In any case, this takes only an hour or so in the case of Zagreb. In other municipalities, such as Rijeka where the degree of automation is higher, a Cadastre check typically takes just ten minutes, and is handled by two dedicated clerks.

180. That check, either at the Cadastre or City Office, will also indicate the current zoning status of the plot in question. Sometimes there may be no detailed zoning plan for the plot in question, in which case the investor may be left in doubt as to whether he is legally entitled to use it for his intended purposes. In such a case, the investor can request that a zoning plan be formulated.

181. If a plot of land is zoned other than for the use intended by the investor, a new zoning designation can be requested at the time of application for the location permit, and the conditional purchase contract made subject to successful changing of the zoning status.

182. **Checking Ownership Patterns – Land Registry.** The investor's agent will then go to the Land Registry Office of the Municipal Court in order to ascertain the ownership of the plot and confirm that the physical description matches that in the Cadastre. This includes checking whether the ownership of land and any buildings is different. The Land Register is a matter of public record, and no application form is required.

Figure IV.2: Property Acquisition and Registration in Croatia



183. In simple cases, the checking procedure take under one hour. Less clear-cut cases may take three days, with the most difficult cases taking up to seven days. Again in other cities such as Rijeka, where the Land Registry is smaller and 20-30 per cent computerized, an ownership check typically takes 30-45 minutes.

184. Ideally, the ownership and physical description of the site or land parcel tally with each other, and the lawyer is in a position to draw up (typically) a conditional land purchase contract. However, this is rarely the case.

185. For any land parcel in which the owner recorded in the Land Book is different from the current occupier, a clear succession of sale contracts linking the registered owner to the current seller needs to be established.

186. For any land parcels registered as having multiple (condominium-type) ownership, the investor's agent would have to negotiate conditional purchase contracts with each of the joint owners. Such joint multiple ownership of a single land or building asset might involve the Privatization Fund, the Bank Rehabilitation Fund, the Pension Institute's asset management arm (HMO), and various other funds. Some of these funds are in the process of being merged.

187. Where certain parcels are owned by the state (assuming they are not restricted to concessions), the investor should determine what proportion of the total plot these represent. Although all municipal land must in principle be sold by auction, it is common for municipally owned land parcels constituting around five per cent of the total target plot size to be made available for direct sale. The decision whether to sell directly or by auction is made by an Executive Council of the Municipal Assembly, and the application should be made at the time of application for the location permit. An application to buy a municipal land parcel should be accompanied by a sketch of the land parcel from the cadastral office, and (conditional) purchase contracts for the rest of the site.

188. If the municipally- owned parcel represents more than five per cent of the target plot, the investor must request a public tender in parallel with the location permit application. This would be administered by the Bureau of Land Auctions in the case of the City of Zagreb, and the process may take three or four months according to officials. Officials in Rijeka indicated that the municipal land auction process could take up to two years.

189. **Land Purchase.** Having negotiated conditional purchase contracts with existing owners of the site or constituent land parcels, investors can proceed to apply for the location permit (described below). Having acquired the location permit and secured approval for any re-zoning requests, the investor can go ahead and finalize purchase of the site.

190. Ownership is formally recognized only upon inscription in the Land Book and, having purchased a site or its constituent parts, an investor must therefore immediately register ownership. This is important in order to avoid the possibility of the existing

owner fraudulently selling the land to another party, and claim on ownership being registered ahead of the investor's own. Although the involvement of lawyers will generally avoid this outcome, and the court system should otherwise eventually be able to resolve the issue, the municipal courts have considerable backlog of cases, and it could actually take years to receive formal certificates of land registration. Without them, it will be either difficult or impossible for an investor to secure a building permit for the site, or to mortgage the asset. Such lengthy delays could clearly threaten the commercial feasibility of an investor's project.

191. **Real Estate Transaction Tax.** Between the time of land purchase and applying to register title to the land, an investor must pay the Real Estate Transaction Tax, as laid down in the Law on Real Estate Transaction Tax (NN 69/97). This tax is payable at five per cent of the property's value, as assessed by the Institute for the Development of the City, and is payable to the City Tax Office (in the case of Zagreb) via the central payments system (ZAP). Proof of payment of the Real Estate Transaction Tax is required for land registration and for building permit application.

192. **Book of Deposited Contracts (BDC).** A lawyer, as part of his due diligence, can also be expected to check the Book of Deposited Contracts. This registry was set up by Municipal Courts in the 1990s to help clarify ownership issues. However, the Book has a processing backlog of 80,000 cases, and it remains unclear whether a BDC filing is acceptable for the purpose of land registration.

193. **Land Registry Functions.** Land Registries are located within the Municipal Courts or equivalent county courts. In the case of Zagreb, the city's cadastral office and the Municipal Court are located very close to each other. There is a backlog of three to four years for all registration cases. The Municipal Court of Zagreb, for example, performs three functions relating to land registration.

- change of ownership / title;
- applications for changes in plot boundaries, i.e. parcelization or consolidation of land plots; and
- registration of burdens / litigation, e.g. mortgages, liens, preemption under the Land Registry Act.

194. **Land Registration Procedures.** There appears to be no official application form for land registration, so a lawyer usually drafts a formal cover letter to accompany the submissions. Following the Land Registration Act (91/96), a proposal for land registration should include the following documents (with authorized translations into Croatian, if necessary).

- Cover letter containing: a statement of the right which would be acquired, limited, encumbered or terminated through entry; the name and address of the applicant and person acting for him; the number of the land registry file in which the application should be lodged; and the designation of the plot from the existing entry.
- Proof of Power of Attorney, if the investor himself is not making the application.

- Purchase Contract, where the seller must be the registered owner OR Purchase Contract and proof of successive land transfers since last registered owner.
- Notarized copy of Company Registration Certificate OR Proof of citizenship OR Ministry of Foreign Affairs (MoFA) Certificate permitting a foreign person to purchase the particular plot(s) of land. (Presumably a separate permission must be obtained for each land parcel, underlining the desirability of establishing a Croatian company from the point of view of land purchase.)
- Court fee and nominal Land Registration Certificate Charge.
- Proof of payment of the Real Estate Transaction Tax.

195. If the description or boundaries in the Cadastre description of the plot are different from those in the Land Book entry, the investor must also apply to the Cadastre for a certificate stating the changes, and bring that to the Municipal Court with the other application documents. According to Cadastre regulations, the Cadastral Office should directly inform the Land Registry of changes as and when they occur or are identified. However, this often does not happen in practice, and the onus is on the investor.

196. The set of documents is submitted at a window in the Land Registry Department of the Municipal Court. A file is created and the documents rubber-stamped. The investor is given a receipt with an application number. Within 24 hours, other clerks will process the information, inserting the application number and details into the appropriate Land Book entry.

197. Given the chronic land registration backlogs in Zagreb, each proposal can take between three and five years to process. Until the application is approved, investors cannot use the land asset as mortgage security, nor can they obtain a building permit for any structures they intend to erect.

198. **Accelerated Land Registration Procedures.** In response to the clearly untenable delays in land registration, the Land Registration Act also allows for an accelerated land registration process. An investor must still follow the regular application procedures outlined above, but may subsequently apply for accelerated processing. In addition to the documents listed above, which must be retrieved from the window in the land registry, accelerated processing requires a written application (i.e. another cover letter stating that the accelerated process is being applied for), and a document justifying the need for faster processing (for example, a draft loan document and letter from a bank). Clearly, any investor that needs a mortgage or building permit should qualify, but it is unclear whether all applications lodged are accorded accelerated processing, and if not, what criteria are applied.

199. Applications for accelerated processing can be lodged either by mail or in person. In the latter case, the investor or his agent must form a queue outside the relevant official's office on a Monday morning during a two-hour window – only one official deals with these requests, and they are accepted at no other time. Applications for

accelerated processing can be submitted one month after the date of submission of the regular application, although the President of the Land Registry Court can exceptionally initiate the accelerated registration process immediately after the regular application is lodged.

200. From the date of entry into the accelerated registration process (if approved), registration can be completed in between ten days and one month. Thus, under the accelerated process, land registration can take from ten days to two months in total.

201. **Land Registration outside Zagreb.** In Rijeka, priority land registration can be done in just three days, but some non-priority cases can take over five years. It was unclear to the team whether specific fast-track land registration procedures in Rijeka were different from those in Zagreb.

202. **Consolidating land parcels after registration.** Once ownership of the various land parcels constituting the investor's site has been registered, they can be consolidated into a single plot in the Land Registry. However, in view of resource constraints in Zagreb's Land Registry at least, this function is seen as less urgent than registering new titles or burdens. Consequently, applications to consolidate land parcels could take many (additional) years to process.

F. Construction Permits and Procedures

203. The second strand of permissions and permits to be acquired in the process of "locating" relate to zoning and construction. The three overarching permits to be obtained by investors wishing to erect structures on land they are intending to purchase are: the location permit (also known as the "zoning permit"); the building permit; and the usage permit (also known as the "certificate of occupancy"). Figure IV.1 shows how these three permits fit into the overall pattern of "locating" procedures.

204. **Zoning.** The City Office for Zoning, Housing, Public Utilities and Transport (the City Office) is the main municipal department regulating construction and related activities in the City of Zagreb. Other municipalities and counties have an equivalent "front office". An investor or his agent will often visit the City Office prior to drawing up conditional purchase contracts, in order to ascertain the zoning status of the site, and in parallel to check the status of land (and building) ownership at the Land Registry.

205. It is not normally necessary for the investor to get the plot number from the cadastral office before going to the City Office, although he will probably have done this in any case for the purpose of checking the Land Book. For the purpose of the City Office, the address of the site will suffice, since it has copies of the cadastral records.

206. The City of Zagreb has two Physical Plans which guide the nature of construction and land use in the city: Physical Plan of the City of Zagreb (Zagreb Official Gazette 11/96) and General Zoning Plan of the City of Zagreb (Zagreb Off.Gaz.19/96). These in turn are guided by the Zoning Act (NN 30/94, 68/98, 61/00) and the Construction Act (NN 77/92, 82/92, 26/93, 33/95). Zagreb has seven zones spread out at varying distances

from the center, each with a variety of different land designations indicating the types of construction permitted (e.g. industrial, commercial, protected, residential, and so on).

207. Other parts of Croatia have a similar zoning system, with land use plans in varying detail and states of readiness. In visiting the City Office or its equivalent, the investor and his agent will check both the current designation of their target plot and the status of the land use plan governing it. Foreign and domestic investors often find that land use plans are sometimes insufficiently clear or “about to be reconsidered”, and therefore they cannot always have full confidence in the zoning status attached to the site.

208. The main construction-related procedures are as follows:

1) Location permit

209. The location permit is a preliminary document that defines the type and extent of development or reconstruction *on a designated lot*. However, it is more than just a statement of the zoning status of a particular site, since an investor must submit preliminary building plans in order to acquire it.

210. An investor will typically apply for a location permit, having signed conditional purchase contract(s) for most or all of the site. If there are municipality-owned land parcels in the plot the investor is seeking to assemble, a request to purchase it (or them) directly, or to initiate land auction procedures should also be made at this time.

211. At this juncture, or earlier, investors would also request the re-zoning of land parcels if necessary. If re-zoning of private land parcels is required, the conditional purchase contract will generally have an annex allowing cancellation of the deal if the location permit, including re-zoning request, is not approved. Re-zoning applications are submitted through the City Office, and can take anywhere from three weeks to one year to be approved.

212. The location permit can be issued by either the City Office or the branch office with jurisdiction over the site in question. According to *Zagreb: Guidebook for Foreign and Domestic Investors*⁴, the application for the location permit must be accompanied by:

- An extract from the cadastral plan. If the cadastral plan does not for any reason correctly reflect the physical make-up of the site (i.e. boundaries or structures), then the investor will have to request a re-survey of the plot.
- A description and preliminary design of the proposed structures, their location on the site, proposed site infrastructure, and so on.

213. According to the same guide, the City Office is obliged, upon receipt of an application, to obtain consents, certificates, opinions and other documents from the authorized bodies of the state administration or legal persons with public powers (e.g.

⁴ Zagreb Chamber of Commerce, *Zagreb: Guidebook for Foreign and Domestic Investors* (Zagreb: Zagreb Chamber of Commerce, 1999)

utility companies), whenever set forth under a special law. Depending upon the location (e.g. historical or industrial) and the size and nature of the proposed building, 17 or so different conditions need to be met or consents obtained. The City Office decides which of the special requirements or consents need to be obtained in each case.

- Special Requirements of the Ministry of the Interior - Department for the Protection against Fire and Explosives; Fire Protection and Civilian Defense Sector;
- Special Requirements of the sewage utility company;
- Prior Consent of the Croatian Electric Power Company - Technical Service Department; Public Lighting Department; Thermal Networks Sector of the Production Directorate;
- Special Requirements of the municipal gasworks;
- Special Requirements of the Croatian Post and Telecommunications Company;
- Special Requirements of Croatian Radio and Television;
- Special Requirements of the garbage collection company;
- Special Requirements of Croatian Railways;
- Special Requirements of the City Bureau for Protection of Cultural and Natural Monuments;
- Special Requirements of the City Office for Health Service, Labor and Social Welfare, Sanitary Inspection Department;
- Special Requirements of the Croatian water management company;
- Special Requirements of the City Office for Zoning, Construction, Public Utilities, Housing, Transport and Communications – Transport and Communications Service; Transport and Traffic Department; Department for Public Utilities, Water Resource Management and Zoning; and
- Prior Consent of the road maintenance company.

214. The various authorized state administration bodies, utility companies and other implicated institutions are obliged to provide decisions on consents, permits, certificates or other documents within 30 days of the submission of the location permit application; otherwise, the City Office is empowered to take the decisions. The *Guidebook* states that collecting these opinions and permits is the responsibility of the City Office.

215. According to City officials, however, it is in principle up to investors or their agents to collect these opinions and permits themselves. The City Office, meanwhile, is required to facilitate *local government opinions and permits* if procedures take more than 30 days. Authorizations from the *utilities*, however, must be obtained by the investor himself. Notwithstanding these complications, the standard presence of a local

intermediary (lawyer, real estate agent, or architect) makes it relatively easy to collect these permissions or opinions.⁵

216. Since the location permit constitutes an administrative act, all implicated parties (notably neighbors) can take part in the procedures. As a result, appeals can be lodged against the location permit decision through the Ministry of Zoning, Construction and Housing. However, interventions and objections by neighbors are more common and disruptive at the building permit stage.

217. Overall, investors find the location permit relatively easy to obtain, despite the numerous opinions and permits to be collected. Officials claim that, if all the documents are in order, the permit can be issued in ten days. However, assembling the various permissions and opinions takes time, and investors cite two months as the typical period between the signing of conditional purchase contracts and receipt of the location permit.

2) Building permit

218. Having acquired the necessary location permit, the investor can purchase the various land parcels constituting the site. By this stage, the investor must have incorporated a Croatian company (and acquired a company seal) or have obtained MoFA approval for the acquisition of the particular site. After purchasing the property, the investor will immediately register new ownership at the Land Registry (as described above). Since the purchase of municipally-owned land, whether through direct sale or auction, is only initiated at the location permit stage, acquisition of such parcels may remain to be settled. Once ownership has been established over all required land parcels, the investor may apply for their consolidation into a single plot at the Land Registry.

219. The next stage is to acquire a building permit for the site. Again, this is processed and issued by the City Office. By issuing the Building permit, the City Office confirms that the main project has been elaborated in accordance with the zoning permit, and that all requirements set forth by the Construction Law (52/99, 75/99) have been complied with.

220. An investor must submit the following documents with the application for a building permit:

- Proof of good title to the lot and any structures (i.e. proof of purchase);
- Architectural plans in triplicate;
- A report on the inspection of the main project conducted with regard to mechanical resistance and stability; protection against noise and vibration; savings in energy and thermal insulation; and

⁵ As explained later, the main shortcomings in utility service provision come at the connection stage after the location, building and usage permits have all been secured.

- Permits, certificates or opinions of the authorized bodies or legal persons (i.e. utilities) with regard to the main project (as per the requirements of the location permit).

221. Under the new Construction Law (52/99, 75/99), a registered architect or construction bureau is required to collect the various permits and opinions on behalf of an investor. Previously an investor might have had to visit 20 different locations in order to get approvals.

222. As part of the building permit procedure, an investor must pay a fee for the increased value of the buildable lot, and participate in the payment of public utilities contributions (for financing of the construction of public utility structures and equipment). These requirements are laid down in:

- Conclusion on Determination of the Rent for Construction on the Buildable Land Owned by the Investor (Zagreb Official Gazette 4/98); and
- Decision on the Amount of Public Utilities Contributions (Zagreb Off.Gaz.3/98).

223. The amount of the former fee for the increased value of the buildable lot is based upon the gross developed surface area (GDSA) of the structure to be built, minus that of any structure to be demolished. It is also determined by the location of the plot. In the case of Zagreb, there are seven zones and the city center. It is not clear whether investors would get a refund if a smaller building were to be erected. Public utilities contributions were 530 Kuna/m² for 1998/9. Indicative fees for the increased value of the buildable lot are as follows:

- up to 350m² GDSA: from 189 Kuna/m² for the central area to 18 Kuna/m² for Zone 7;
- 350-500m² GDSA: from 566 Kuna/m² for the central area to 53 Kuna/m² for Zone 7; and
- above 500m² GDSA: from 943 Kuna/m² for the central area to 89 Kuna/m² for Zone 7;

224. These building-related fees and contributions are contained in the various local government regulations, and they can therefore be amended by the local government assembly. The fees accrue directly to the municipality.

225. Given that building permits constitute part of the public planning process, the Construction Law *requires* statements of approval from all occupants of adjoining land, and the City Office is obliged to listen to or assess all such complaints. Neighbors are therefore in a position to deliberately block the process by making themselves unavailable for the required consultation.

226. That said, it is possible to build without the ex-ante approval of neighbors if the new construction is more than a certain distance from the adjoining property. However, neighbors (industrial or domestic) can still complain ex-post to the Ministry of Zoning and Environmental Protection.

227. According to *Zagreb: Guidebook for Foreign and Domestic Investors*, if all the requirements set forth by the Construction Law have been complied with, the City Office will issue a building permit within 30 days of the receipt of the application. City officials, meanwhile, indicate a delay of two months, citing insufficient resources, the neighbor consultation requirement, and delays in getting approvals from the various government authorities and utilities. Finally, investors indicated that the process might take three months if all documents are in order, but that it often takes one year or longer. Indeed, many projects get stuck between the location and building permit stages, and investors eventually give up.

3) Usage Permit

228. Once construction of the planned building is complete, it can only be used or occupied upon issuance of a usage permit or “Certificate of Occupancy”. This is also issued by the City Office.

229. Following completion of the structures, the investor requests a technical examination of the premises. The City Office will assemble a team of officials from the applicable local government departments and other experts, and assess the final structure against the technical drawings submitted for the building permit. If satisfied, the City Office issues a usage permit, typically within about one week of the submission of the request.

230. If minor problems are found in the final inspections, the city can issue a temporary usage permit, with the changes specified to be undertaken within one year. A small fee is charged for the issuance of the final usage permit and any temporary usage permits.

4) Construction Permit Procedures Outside Zagreb

231. The location permit and building permit processes appear more efficient in the much smaller City of Rijeka and the surrounding county. Officials at the County Construction Office claim it can take just a few days to issue the location permit if the site is covered by a detailed urban plan, but otherwise could take up to one month. Officials estimated that perhaps 15 or 16 different permits are required for the location permit, but that the County Construction Office, and not the investor, is obliged to acquire them.

232. The building permit process appears also to be more efficient. The County Construction Office provides separate lists of the permits and opinions required for each type of construction. Although some 90 per cent of building permit applications are apparently incomplete, investors, or the architects representing them, are informed of missing documents within three days of submission. County officials claim to issue building permits typically within 30 days, once submissions are complete.

5) Utility Issues

233. This section covers the connections to utility services, including telephones, water and sewerage, electricity and natural gas. Two of these services (electricity and telephones) are provided by national companies operating with standard nationwide procedures, while gas and water are provided by either local municipalities or companies with local coverage.

234. Generally speaking there are three possible scenarios for utility connection:

- In the case of existing buildings, reactivating an existing connection. This may require only a simple visit to the utility company with proof of ownership of land and buildings;
- Connecting a new building to an existing grid or network (that already extends to the site boundary or further) with sufficient capacity;
- Connecting a new or existing building to the existing grid where capacity is insufficient.

1. Electricity Connections

235. Electricity is provided by Hrvatska Elektroprivreda D.D., the national supplier. Although power generation by other companies is allowed by law and a few cases have been reported of private companies producing electricity and selling the excess to other companies, Hrvatska Elektroprivreda has effectively a monopoly for most consumers.

236. When applying for electricity for a new facility (as in the case of all other utilities), the investor is required to present building plan approvals. While it is recommended that the investor contact Hrvatska Elektroprivreda earlier in the building process, no action can be taken by the utility until building plans have been approved.

237. For new connections (and in certain cases of reconnection, as described below), the process begins with the investor requesting a letter/document that describes the fees and procedures. Fees are dependent upon the type of construction, the required supply and the existing capacity of the local infrastructure, and other factors. The fee for this letter is 200 Kuna. The letter can be issued only after final building approval, and may take up to 30 days to be issued.

238. The connection fee specified in this letter is either:

- A price based on the projected usage of electricity; or
- The actual cost, if Hrvatska Elektroprivreda's actual costs of making the connection (including materials and labor) are 30% higher than the price based on usage.

239. At this stage, investors must pay 50% of the connection fee, and the balance of the cost is spread over one year's billing cycle.

240. The connection time depends on the level of infrastructure at the site. Hrvatska Electropriroda states that these connections typically take less than two weeks, and are often finished within two days. Connections that involve upgrades to the infrastructure or laying of new lines will take considerably longer.

241. A connection where power already exists (typically registered in the name of a previous tenant or owner of the facility) takes only several minutes, according to officials, and no fees are charged. Documents required include a standard form plus a notarized agreement for transfer of ownership of the building. The changeover amounts to a simple change of name only. However, if power has been disconnected due to non-payment, or if the connection needs to be reestablished and there are past bills still outstanding, the new tenant is required to settle the bills before the connection is made.

242. If the outstanding bills exceed the costs of a connection fee (based on the estimated power consumption, as described in para. 236), the investor may choose to establish a new connection and pay the connection fee (as in the case of a new investment). Therefore, an investor's liability for a previous owner's obligation is limited to the cost of the connection fee.

2. Fixed-Line Communications Services

243. Communications services, including telephone and high-speed data, are provided by Hrvatska Telekom (HT). Currently, it enjoys a monopoly in fixed-line telephone services and ISDN, and is the owner of one of two government licenses for mobile telephones. The exclusivity on fixed-line communications expires sometime in 2003.

244. Investors applying for a fixed line may apply through either letter or form supplied by HT. HT takes 2-3 days to determine the technical requirements of the investor (number of lines, etc.) and prepares a contract. For larger companies, different contracts, known as "special solutions", are prepared, and specific account representatives will be designated to deal with the user.

245. Upon signing the contract, the investor is required to pay a connection fee of 500 Kuna, plus VAT of 22% per line. ISDN lines require a 800 Kuna fee, plus VAT.

246. According to officials of HT, although the contract stipulates that the connection will be made within 30 days, this process usually takes no longer than 10 days, regardless where the investor is located.

247. Investors that request connections that require infrastructure investment have two options. Either they wait for HT to build its network as part of its investment plan, or they agree to share in the costs of the infrastructure development. Investors choosing to wait have an option of getting fixed GSM (which uses mobile phone frequencies). Under this option, HT installs an antenna near the facility until fixed lines are available. HT states that such connections can be made within 30 days of a request, and that charges are the same for fixed lines.

3. Water and Sewerage

248. Water and sewerage connections are typically provided by the local municipalities, under widely varying regimes. As a result, it is not possible to list all of the procedures, or to distinguish between the different municipalities. In the case of Zagreb, a joint stock company has been established by the municipal government to provide services to investors. As a result, the procedures do not take long for connections to existing infrastructure, but officials confirmed that problems do exist where infrastructure is not in place.

249. An investor wishing to get connected where an existing connection already exists must prove ownership through a land registry certificate. If the investor is a tenant paying rent on the land, then the owner establishes the connection, even though the investor is able to pay for it directly to the utility. There are no fees for connecting to an existing supply.

250. Submission requirements for Zagreb include:

- Local application form;
- A notarized copy of the Land Registry Certificate;
- Building permit for a planned structure, or an occupancy permit for a finished facility; and
- Ownership documents, including a sales contract.

251. If this connection simply represents a change of ownership, the transfer can be done within five minutes, as this is essentially only a change of records. However, if there will be significant changes in the usage, requiring changes to either infrastructure or equipment, then a survey must be conducted. A survey is conducted by the utility for changes to existing water supplies and new connections. The client's only responsibility is to prepare a hole for the water gauge. Surveys typically take place between 7 and 10 days after a request, although during summer, which is the high season, they may take up to one month.

252. Investors pay for the survey costs, comprising materials, including the gauge, and labor to install the gauge. If there is a need for additional infrastructure, the investor must pay, unless the investments are already included in the plans of the utility. The contract states that the installation must be completed within 90 days, but officials of Zagreb municipality stated that installation is often completed within 20-30 days after receipt of the client's payment. All in all, city officials estimate that the whole process typically takes less than 50 days, assuming all is in order with the application.

4. Gas

253. Similar to water and sewerage services, natural gas is provided by local suppliers who are contracted by INA, the national gas company. Many of the suppliers are already

privately- owned and operated, and most of those which remain state-owned today are going through privatization. Each supplier has its own procedures.

254. INA can supply natural gas directly to large users, and users of more than 8 million cubic meters per annum may negotiate rates on a case-by-case basis. Any user wishing to purchase large quantities directly must first complete an environmental impact assessment.

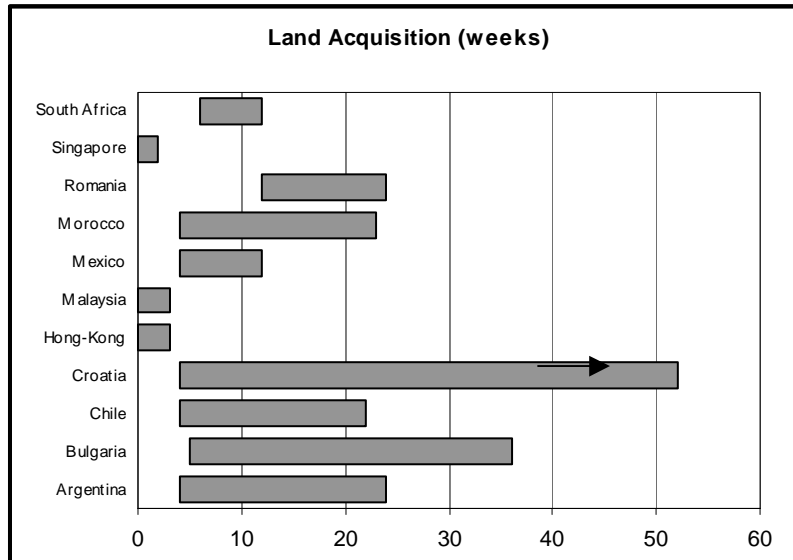
255. There are new laws under consideration in parliament to establish a gas regulatory agency, which will institute a gas permit system. The new law will harmonize Croatian law with energy laws within the EU.

L. Analysis

256. Land acquisition, registration and site development are the most complicated parts of the investment process in Croatia, and compare very unfavorably with those procedures in other countries. (See figure IV.3.) There are problems of restitution, predatory land speculation, unnecessary and time-consuming bureaucratic procedures, and discriminatory application of regulations common to many transition and other economies.

257. Although the land restitution problems are well known and common to most transition countries, other land-related issues have, with some exceptions, received rather little attention in Croatia. This is because there is currently very little greenfield foreign (or domestic) investment, and much of the manufacturing and service sector is dominated by former or current SOEs that have established landholdings, or by smaller local companies that may also have learned to deal with the system's problems. However, the Ministry of Environmental Protection and Zoning has indicated that impending changes to the Law on Zoning and the Law on Construction will address many of these issues, and provide guidance on procedures to be adopted by local authorities.

Figure IV.3: International Comparison of Time Required for Land Acquisition



Note: The bars indicate the range of typical minimum and maximum times required to acquire land. The arrow indicates that it can take even longer in Croatia, depending upon land ownership patterns.

258. The foreign investors that have started to look at greenfield investments in recent years, especially after the election of the new government, are now having to deal with these land issues head on, and do not have the advantages that established Croatian companies have. The constraints identified in this report are very serious barriers for foreign companies and local SMEs alike.

259. Incumbent operators (the supermarket business for example) are likely to have far fewer problems in securing a suitable site. Although there is nothing wrong with geographical incumbents using their comparative or competitive advantages, there is a real risk that land issues serve as a very effective, but artificial entry barrier, which could support anti-competitive practices and keep prices unnecessarily high for local consumers. The current situation is clearly not desirable, either for attracting foreign operators that can raise productive efficiency or for realizing the benefits of competition.

260. The difficulty of ascertaining the ownership of land and property and purchasing land (especially larger plots) in a way that establishes clear legal title is a regular complaint of many investors now assessing the investment potential of Croatia. These issues will quickly become a major impediment as Croatia seeks to expand foreign investment and the number of potential investors grows, especially since the practices conflict with the Association Agreement with the European Union and WTO accession. Solving some of the key land acquisition and registration problems will go a long way to improving the investment climate in Croatia.

261. The government realizes the enormity of the problem, and is taking many appropriate steps to address it, as efforts to update and computerize the land registry and

cadastre demonstrate. However, these efforts address the long-term agenda, and there are shorter-term initiatives that can be taken by the government to immediately improve the land- and construction-related environment in Croatia, as suggested below.

262. The majority of land in Croatia is privately owned, and can, in principle, be freely bought and sold. However, the simple scenario of purchasing a plot of land in single, clear ownership is rare, and investors face numerous land-related constraints:

263. **Inconsistencies between Land Registries and cadastral records due to the outdated nature of Land Book records.** Harmonization of the Land Book and Cadastre has happened in some places, but in most cases inconsistency prevails. For example, only eight of Zagreb's 50 or so cadastral wards have seen the two sets of records harmonized. Thus, a plot of land may have a building dating from the 1960s that is reflected in the Cadastre, although it is still registered as a field in the Land Registry.

264. **Land restitution issues.** The restitution process – seeking after 1992 to return socialized land to its original owners – is progressing very slowly, and the many inconsistencies that remain make the acquisition of land with secure tenure extremely difficult. Deadlines for resolving issues have come and gone, although the Land Registration Act sets a deadline for claims in 2003.

265. **Complications in acquiring the use of state-owned land, and consolidating larger plots of land.** State-owned land may be available either as a concession or through the sale of municipally owned land. In principle, municipal land must be sold by auction, often at the request of an investor, and after a location permit has been obtained. Moreover, the base price is set at the estimated market value of the land with the planned building erected. The FIAS team received different opinions about the readiness or efficiency with which local governments dispose of their landholdings. Officials suggest the process can take anything from several months to several years. In theory, investors cannot apply for a building permit until all land on a plot has been acquired.

266. In practice, investors have been able to buy directly from the municipal authorities small parcels of land to complete a larger site, but the request is submitted at the time of the location permit, and must be approved by the municipal assembly. This represents useful flexibility in the system where small parcels of land are at stake. However, the criteria for allowing the direct sale of municipal land rather than requiring an auction process are unclear and present opportunities for unofficial payments and bribery.

267. **Considerable time is required to establish legal ownership due to both unclear ownership and chronic processing backlogs at some municipal courts.** Given the chronic backlogs in Zagreb, each land registration proposal can take between three and five years to process. The existing accelerated registration system in Zagreb shows that the process can be accelerated, although the current design is highly non-transparent and seemingly characterized by unofficial payments.

268. Until the land registration is completed, investors cannot use the land asset as mortgage security, nor can they obtain a building permit for any structures they intend to erect. This clearly makes the investment process difficult, in particular for smaller investors, who need loan capital, and has led many investors to erect buildings illegally (i.e. without a building permit). The recent strengthening of building permit enforcement makes substantial improvements in the land registration system all the more important.

269. **The process of land and property acquisition, registration and construction in Croatia is also intermediary-intensive.** For these procedures, just as for company registration, intermediaries, such as law firms, notaries, realtors, construction agents and consultants, fill an important role in practice. Indeed, recent changes to the Construction Law *require* registered intermediaries to apply for building permit. This goes against the direction of reform, which should simplify and reduce the costs of the process.

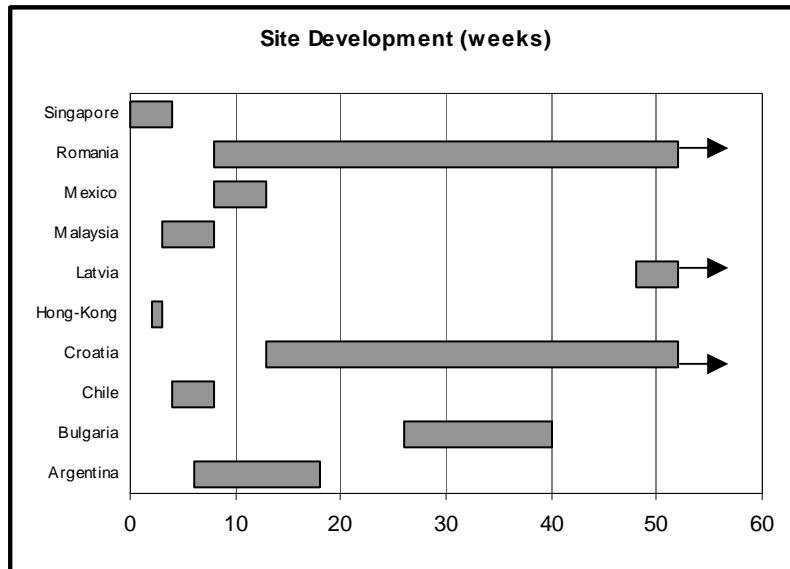
270. Apart from the *bona fide* intermediaries, there is also a layer of “facilitators” who serve as a channel for unofficial payments. The presence of many *bona fide* intermediaries, along with the preponderance of smaller foreign operations content with relatively short-term land use arrangements, is another reason why land-related constraints receive less exposure. It is not in Croatia’s long-term interests to create and sustain a “facilitation industry”.

271. Investors also face problems in negotiating construction-related procedures, especially building permits. Principally as a result of considerable delays that can occur during the building permit process, Croatia compares unfavorably with other countries.

272. **Location permit.** Overall, investors find the location permit relatively easy to obtain, despite the apparent plethora of opinions and permits to be collected. Officials claim that, if all the documents are in order, the permit can be issued in ten days; investors speak of two months as an effective minimum. The (relative) speed of the location permit process may be due to the fact that investors or their agents must visit the same government departments and utilities again for the purpose of the building permit.

273. The ease or difficulty of obtaining a location permit varies considerably within Croatia. In Rijeka, officials claim the process can take just a few days if the site is covered by a detailed urban plan, but otherwise up to one month. Meanwhile, in Nove Zagreb where much new construction takes place, some realtors have spent months trying to get location permits, and often failed to get their if they refused to bring in “unofficial” facilitators.

Figure IV.4: International Comparison of Time Required for Site Development Approvals



Note: The bars indicate the range of typical minimum and maximum times required to obtain site development approvals. The arrows indicate that it can take even longer in Romania, Latvia and Croatia.

274. **Building permit.** Of the three construction-related permits, the building permit is the most problematic and expensive to secure, involving numerous approvals from different local and central government departments and utilities. At this stage, an investor is also more “vulnerable” to the whims of government and utility officials, and to pressures for unofficial payments. The procedures need to be reviewed and simplified, with clear guidelines and objective criteria drawn up for the use of officials and investors. Opportunities for unofficial payments need to be attacked through greater transparency and other means.

275. Many projects run into difficulties between the location permit and building permit stages, and it appears that some investors simply abandon projects due to frustration and mounting costs of protracted administrative delays. Other (predominantly local) investors may proceed with construction in the absence of a building permit. Consequently, according to one estimate, perhaps 50 per cent of structures in Zagreb currently have no building permit.

276. Risk-averse foreign investors, in particular, will hesitate to undertake construction without a building permit, and hence to undertake a project at all. Moreover, since the authorities are beginning to take a firmer stance against illegally erected structures, city authorities need to redouble their efforts to encourage legal construction that supports economic activity by streamlining and clarifying associated procedures.

277. The building permit process can be considerably delayed or stalled by the requirement that the City Office and the investor consult with all neighbors and get

written approvals. This requirement creates considerable opportunities for neighbors, officials and speculators to demand unofficial payments.

278. **Usage Permit.** Investors generally found local governments to be quite efficient and flexible in the granting of usage permits, which certify that the new buildings are ready for occupation and operation. However, the actual connection of utility services is highly problematic. In the absence of unofficial payments that can be several thousand dollars, investors report delays of up to several years. Improving this highly unsatisfactory situation would require the involvement of local authorities and utilities, as well as, to some degree, relevant line ministries and regulators at the central level.

Box IV.1: Building permits in South Africa

Building permits are issued by the municipal authority with jurisdiction over the particular site. Each municipality has its own application process. Most applications must meet both the building codes of the municipality, and the national codes set out in the National Development Act. The Act specifies that each structure conform with over 20 requirements. Approvals include the following areas: fire, pollution control, health impact, frontage works, elevation control, drainage and coastal engineering, roads, sanitation, and sewage treatment. Decisions to consult with exterior bodies such as the Department of Health, local fire department, and Ministry of Environment and Tourism are made by the engineer in the local authority.

Once the plans are approved, the municipality conducts a minimum of five inspections of the building site. Some municipalities conduct more, especially in the case of a multiple-story building. Other inspections may be carried out from time to time, depending upon the specifics of the building.

Some municipalities offer a “one-stop shop” approach. In Durban, two copies of the plan are submitted to the city engineer’s office. The plans are then evaluated by each of the relevant parties, co-ordinated by the engineer’s office. This process would usually take a minimum of 30 days. In other municipalities such as Cape Town, the investor can walk the plans through each of the processes himself, thereby reducing the time of approval to within one week.

Box IV.2: Building permits in Tanzania

The story of Tanzania’s building permit approval process in the capital, Dar Es Salaam, is one of remarkable transformation. Previously, backlogs of several years were significant deterrents to investment, and encouraged the building of illegal and, in many cases, unsafe structures.

The Dar Es Salaam City Commission has worked to streamline the building permit process. The Commissioners now meet weekly, which has been an important step in reducing a backlog of applications from previous years. Once an application is submitted, various departments within the City Commission examine it. Town Planning ensures that the proposed activity is in line with zoning and plot coverage restrictions and checks the validity of title. City Health officials examine the plans for water, drainage, sewerage and other health issues. The City’s architects and engineers check the plans to ensure that the proposed design is structurally sound.

By law, the time taken to approve building permits should be less than 60 days. City officials state that most applicants now face a delay of one to two months, with a maximum of three months. Delays have been reduced in recent years as approvals are now granted by Commissioners, who meet every Friday to decide such issues.

Commissioners must now come to the meetings prepared to either approve applications or give valid reasons for rejecting them. In many cases, architects and engineers work directly with the various commissioners’ offices to iron out any problems that might arise in meetings.

Croatia can learn from this example. In particular, it should be noted that the various commissioners are expected to come to the regular meetings prepared to give their recommendations on projects (for approval or rejection) on the date scheduled. This forces the various departments to be more efficient in their procedures and analysis.

Box IV.3: Site Development Approval Procedures in Germany and Ireland

In **Germany**, a location permit is not required. However, if an investor feels uncertain about some construction issues critical to his project, he can ask the authority (Vorbescheid) for its opinion before starting project planning. The time taken to receive an opinion from the authority depends upon the questions asked. Opinions obtained are not binding on the authority, but the investor can usually rely upon them, and they offer a high degree of planning certainty.

An investor needs a building permit before starting construction. It takes about three months to receive the building permit, which will be issued by the regional building authority with participation of the municipality.

After completion of construction, an official from the building authority will visit the site to verify that the construction is in compliance with the building permit (Gebrauchsannahme).

In **Ireland**, local authorities, such as county councils, county boroughs, and borough corporations are responsible for approving building permits. Local authorities have “reserved” and “executive” functions. “Reserved” functions are performed directly by elected members of a local authority; all other functions are performed by the manager and the manager’s executive staff. The manager is bound by decisions taken by elected members, and while entitled to attend meetings and take part in discussions, he is not entitled to vote.

Local authorities must grant or deny permission for any projected development that includes building or other construction work within two months of the local authority receiving a construction application. Any person may appeal a local authority’s decision within a month after the decision has been made. Appeal boards must make their decisions within a four-month period, and their decisions are final.

279. **Utility Issues** There are considerable differences between the estimates of wait times given by the utilities and clients. Most investors interviewed complained about the time taken and the bureaucracy involved in obtaining connections.

280. Moreover, connections are reported to require substantial unofficial payments in addition to official fees. The public utility contribution of 530 Kuna/m² in 1998/9 paid after the building permit is issued is presumably supposed to cover the necessary improvements in utilities to the boundary of a property. In the case of a 6,000m² GDSA building, these contributions amount to a substantial \$350,000. Yet, investors claim that it is still necessary to spend time in negotiations for immediate connection and to make unofficial payments in the order of several thousands of dollars, with payments often channeled through “facilitators” or “consultants”. As an example, an investor might either pay a thousand dollars or so for an immediate increase in the amperage of a new building’s electricity supply, or leave it to official channels and wait for a year or more. Investors, however, report that once payments have been made, the work is done more or less immediately.

281. Under normal procedures, the wait for new utility connections (as opposed to reactivation of existing connections) is said to be longer than one year. In the case of gas utility provision, for example, if no gas supply exists to the border of the property, the local gas distributor is obliged to make the connection within two years. As a result, investors either choose a site with gas links to the property boundary, or negotiate for an immediate connection. Investors expressed concerns about the way in which the utilities select their priorities for infrastructure build-outs.

282. Investors expressed concern about the requirement to settle previous owners' obligations when electricity invoices remain unpaid. Since Hrvatska Elektroprivreda does pursue non-payers through the courts after a building is vacated, investors question why the company attach the fees to both the physical property and the previous owner. This is an unusual practice internationally, and one that causes particular frustration to investors.

M. Locating: Recommendations

283. **Since land and construction-related issues are administered by subnational governments, reform efforts at both national and subnational levels are crucial.** In other words, central government needs to make available financial and technical resources to subnational regions that are attractive to investors and have local leadership committed to improving the investment environment. Moreover, a more detailed analysis of land and construction-related procedures in various subnational regions is necessary, in order to clarify procedures and identify best practice within the country. Subnational governments should, for example, be encouraged to draw up detailed land-use or zoning plans.

284. **Improve coordination and cooperation among local government departments and utilities involved in land- and construction-related procedures, and between them and investors.** Institutional coordination and collaboration is generally weak in Croatia, but land acquisition, land registration and construction procedures are particularly complicated. This is because so many different groups are involved: local parliaments, local bureaucracies, local judiciaries, utilities, landowners and the private sector. Moreover, at the subnational level, there are fewer resources, and officials are perhaps less used to initiating collaboration themselves than to being directed from above.

285. National and local governments in Croatia will have to be imaginative on how they attempt to bring these disparate groups together, and it is probably best done around functional concerns, such as land acquisition or construction permits. In many countries and subnational regions (e.g. states in the US), local Chambers of Commerce have served as the secretariat bringing together investors, local government and utilities, for example, at weekly or fortnightly breakfast meetings to discuss issues of common concern. In subnational regions in Europe, influential and determined County Chief Executives have often forged a local partnership (local government, central government field offices, utilities, trades unions, and so on) in order to attract a particular large investment. The interplay between shared vision and very tangible results is actually a particular strength at the local level, and such local partnerships have often formed the basis of long-term institutional collaboration. In fact, there are numerous ways in which subnational regions could improve coordination in Croatia. The most suitable strategy is likely to emerge through case-by-case considerations, but vastly improved institutional collaboration is fundamental to promoting more domestic and foreign investment.

1. Land ownership-related recommendations

286. Generally speaking, the supply of larger commercial sites with clear ownership needs to be increased in Croatia, and the time required to establish clear ownership reduced. To improve this situation over the medium to long-term, the Government of Croatia needs to **speed the land restitution process by enforcing time limits on claims, clarify ownership issues, and harmonize the Land Books and Cadastre**. Although these are longer-term agendas, the government must identify ways of fast-tracking improvements.

287. In the **shorter-term**, subnational governments, supported by the national government, could focus efforts on solving restitution problems, clarifying ownership, harmonizing Land Books and Cadastre and increasing the supply of readily available land in certain commercially attractive areas, and then rolling the reforms out to the whole country. Currently, investors are severely constrained in their choice of location because of these pervasive land ownership problems. Even for those investors that are happy to rent or enter into short-term leases, the supply of suitable sites is limited because Croatian investors themselves may not invest in and develop land where they do not have clear ownership rights. Thus, there is a lack of appropriately prepared and serviced land for different types of investments, and investors cannot gain access to more convenient locations whether they want to buy or rent.

288. **Streamline and clarify municipal-land sale procedures.** Inefficient auction procedures for land owned by counties and municipalities need to be shortened and clarified. In particular, the situation regarding when and under what conditions a local government can sell land directly needs to be clarified.

289. **Make the procedures for foreigners to acquire land more transparent.** The decision to remove the Ministry of Justice from the process of approving land purchases by foreigners is an encouraging move. Although most foreign investors do not take this route (since it is relatively easy to establish a company, and many smaller businesses may rent or lease land, rather than buy it), the Ministry of Foreign Affairs' procedures should be made transparent through the publication of assessment criteria, adherence to time limits, and other conditions.

290. **Consider laws to permit faster assembling of plots through the exchange of land parcels.** Land speculation can be a significant problem in Croatia, with land speculators acquiring key land parcels in a large, attractive plot and refusing to sell them, except perhaps for several hundred times the market price. Where the majority of plot for a clearly defined investment project has been acquired and a land speculator is blocking progress by refusing to sell, the Government of Croatia may wish to consider legislation that allows the acquisition of such parcels by other means. The legislation should ensure prompt, adequate and effective compensation, for example, by permitting the exchange of key land parcels for others of equal or greater value, or their sale for some premium to the market price (based on the likely new valuation). Such a system exists for roads in Croatia, and for private projects in some European countries.

291. **Consider establishing Pilot Commercial Zones.** The establishment of a network of pilot commercial zones or industrial parks could be very helpful to new foreign investors and SMEs alike. Ireland has had considerable success with this approach (see Box IV.4). In some countries, national governments, through development agencies, have taken the lead, while elsewhere subnational governments have been the initiators; management has also often been entrusted to private operators. In addition to offering plots of land with clear ownership (for long lease or sale), such zones would also offer streamlined construction-related procedures, and various improvements in infrastructure provision. A Pilot Commercial Zone does not mean an EPZ, although it might eventually contain one; neither does it mean a zone with a concentration of generous incentives to attract investors. The overriding emphasis is on a zone regime in which administrative, legal and institutional constraints to investment are addressed through experimental or pioneering reforms, and where land access is less problematic.

Box IV.4: The Role of Industrial Parks in Ireland's Development

The Ireland Development Agency (IDA) has for decades actively promoted industrial parks as an effective way of promoting investment. Today, IDA owns approximately 150 industrial estates and business parks of various sizes, located throughout the country. IDA has an ongoing policy of developing flagship business/technology parks to the highest international standards. It also forms joint ventures with municipalities and private investors to develop new parks.

IDA owns 1,700 hectares that are exclusively available for new FDI and domestic manufacturing industries, and 50,000 square meters of factory and office space. Its annual property budget is about US\$40million. 65 per cent of FDI activity and 50 per cent of manufacturing industry in Ireland are located in IDA-owned parks.

Nearly 125,000 people are directly employed by foreign-owned industries, and 200,000 are employed in domestic manufacturing industries. Some very large investment projects, such as those of Intel, Hewlett Packard and Xerox, are located on stand-alone sites.

292. **Improve coordination between land acquisition and construction permit procedures.** Currently, the requirements and timing of various land and construction-related procedures are problematic, resulting in illicit solutions or extremely prolonged investment process. For example, an investor requests the auction or direct sale of a municipally-owned land parcel at the time of location permit application, but by then will have signed conditional purchase contracts for other land parcels. An investor may have to extend these if the auction or sale procedure of the municipal parcels takes a long time. The building permit cannot be acquired until the entire site is under the investor's ownership. Clearly, the procedures for the disposal of municipally-owned land need to be streamlined and clarified.

293. Some units of local government or appropriate agencies should establish, with solid political backing, institutional mechanisms to bring together the various local government departments and utilities for the purpose of coordinating their investment-related procedures. The City Office is clearly one possibility, but, given the importance of utilities, these too need to be involved with the support of line ministries / regulators. As "end users", investors must participate.

2. Land registration-related recommendations

294. **Make the accelerated land registration process standard.** In the case of Zagreb, land registration (assuming clear existing ownership) can be speeded to a matter of weeks. Although this process is very opaque, inefficient in many ways, and encourages unofficial payments, it shows that local administrative systems are capable of processing land registrations very quickly. In contrast, the standard process can take many years and leads to other significant problems, such as, for example, preventing the use of the asset as mortgage collateral.

295. The Government of Croatia should promote a land registration system whereby accelerated procedures become standard. To this end, the current accelerated land registration process needs to be cleaned up, made more transparent to reduce opportunities for unofficial payments, and established as standard practice in Zagreb and elsewhere. Subnational governments could begin with commercially attractive areas within their jurisdiction and then roll out the improved procedures once more officials have been trained and the procedures disseminated.

296. **Continue to focus on training more judges and clerks for Land Registry Courts.** Croatia needs to continue its efforts to train more judges and officials for the Land Registry Court. Although the registration of title transfers and burdens has been correctly identified as the most important area, increased expertise in the consolidation of land parcels should not be overlooked.

3. Construction-related recommendations

297. **Conduct a detailed internal review at the subnational level of the different permissions and opinions required in order to find ways of simplifying construction-related permits.** In contrast to company registration procedures, which are relatively straightforward, the procedures for obtaining location and building permits are complicated, non-transparent and repetitive. The focus of responsibility for obtaining the many approvals should be clarified, procedures better explained, and response times from the various approving departments improved through enforceable time limits. The duplication of efforts involved in getting permissions twice (the second time for the Building permit) from the same departments and utilities needs to be reviewed.

298. The number of different permissions and opinions required is criticized, even though professional intermediaries (lawyers, real estate agents or construction bureaus) almost invariably act on behalf of investors (and are now required to do so by law). This clearly implies that the problem lies with the construction approval system and lack of clarity in technical requirements, rather than with misinformed or careless investors. An indicative example is the unclear burden of land clearance in the case of former polluting factories being taken over. Is the former owner, the government or the new investor responsible? Such liability issues must be clarified in order to remove potentially huge risks for investors.

299. Construction-related procedures are the responsibility of municipal or county governments. Thus, the investigation of procedures and impediments must be carried out at that level, with national-level bottlenecks (e.g. the release of land parcels owned by the central government, or certain concessioning arrangements) and legislative reform needs highlighted where appropriate. Subnational governments may initiate this review process, but it may be necessary for the central government to prompt their cooperation and promote best practices. The local authorities' perspective clearly needs to be contrasted with the experience of local and foreign private investors using the system.

300. **Prepare subnational guides for construction-related procedures.** Municipalities and counties should prepare a guide for all land and construction-related procedures under their jurisdiction. It should make quite clear which government departments are responsible for each stage of the process, and should serve as the standard and common reference for government officials and investors alike. It should be easily accessible both in printed form and on the internet, and clarify, for example, whether the City Office or the investor is responsible for obtaining permits / opinions from other government departments or utilities.

301. **Building permits should be made the main focus of construction-related approvals in Croatia.** As things stand, there is considerable overlap of location permit and building permit procedures, and some local authorities may approve the location permit relatively quickly, given that they must again be approached for the building permit at a time when there are perhaps greater rent-seeking possibilities. The need for a location permit (i.e. to ensure correct zoning, natural and cultural heritage preservation, environmental protection, neighborhood consent, and so on) is legitimate, but these concerns should be largely addressed in zoning and spatial plans, and not at the stage of investment project development. The perceived need for a location permit is often rooted in inadequate spatial planning.

302. **The Location permit should ultimately be de-emphasized in favor of improved spatial planning.** In the meanwhile, if the location permit is maintained, local authorities should ensure that it does not overlap with the building permit. In particular, it should be more generic (i.e. deals with general zoning, heritage and environmental issues), and leave specific construction-related issues for the building permit application stage. Within the EU, Germany and Ireland, for example, do not require a location permit, but rely upon zoning plans (see Box IV.3).

303. **Create detailed Zoning Plans beginning with key areas.** The quality of zoning plans varies considerably across the country. As things stand, the absence of clear zoning plans in some areas creates opportunities for corruption among officials and confusion among investors. Where detailed zoning plans do not exist, local governments need to prepare them, beginning perhaps with areas most likely to be attractive to investors.

304. **Establish a clear focus of responsibility, and time limits for responses, for gaining approval from the various local authority departments for the Location / Building permit.** Currently, investors are often unsure whether it is their responsibility or that of the construction department of the local authority to get the necessary

approvals. Typically, the construction department of the local authority should be responsible for soliciting opinions or approvals from other departments / utilities where necessary, or for distributing the building permit application (and the location permit, if retained). Those other departments should be obliged to approve or provide a reason for rejecting an application within a given time period.

305. One successful model has been for the relevant construction or planning department to convene an obligatory weekly meeting of other relevant departments, at which department heads or commissioners must give their approval or reasons for rejecting an application. Combined with time limits on responses, such an approach can speed up building application procedures, provided the lead department (e.g. construction) has been given the necessary authority (see Box IV.1). There are examples of time limits being used successfully in developed countries (e.g. Germany and Ireland) and developing countries (e.g. Tanzania).

306. **Local authorities should also make clear appeals procedures for applications that have been turned down** (see Box IV.3). In Croatia, with registered architects being required to submit building plans and interact with local authority construction departments, an appeals procedure is likely to be reasonably effective.

307. **Drop the requirement that the City Office must consult with all neighbors for the Building permit.** The requirement that the City Office *must* consult with all neighbors in considering building permit applications should be dropped, and replaced by an announcement with fixed period for objections. Under current procedures, neighbors are in a position to block the building permit process by making themselves unavailable for consultation.

4. Utility-related recommendations

308. Securing access to utility services appears to be a highly problematic area for investors. Although improvements are clearly necessary the FIAS team unfortunately did not gain detailed information on these issues. Our recommendation is thus somewhat general, but nonetheless extremely important.

309. **Local authorities, central government and utility companies must work together to improve utility connection performance, which would probably include some regulatory reform and some privatization.** After land has been acquired and registered, and the various construction permits obtained, investors face formidable problems in getting utility services connected. Despite the substantial public utilities contribution paid at the time of the building permit, investors find it difficult to realize the connection or service upgrade they are expecting, and must often make large unofficial payments in order to have services connected (usually very quickly).

310. **Pricing for utility connections, including necessary upgrades and expansions, urgently needs to be addressed in a comprehensive manner.**

311. **Investors should not be required to settle the outstanding bills of previous tenants before receiving connections.** It is believed that this practice has deterred some investors.

312. **Investors should be allowed to get basic survey work for utility connections done while building permit procedures are under way.** Currently, a building permit is required before any survey work can be started, and the building permit process is very lengthy. This would require a change in the law.

313. **The formation of regulatory bodies could help control some of the corrupt practices reported by investors.** These bodies should create specific mechanisms for investors to report irregularities in the request for utility services.

CHAPTER V OPERATING

314. Once a firm begins operating, there are a number of routine interactions that occur between businesses and government agencies. The most important of these steps relate to tax reporting and tax inspections, import/export procedures, labor issues, and inspections.

A. The Taxation System in Croatia

315. Companies in Croatia face two major types of taxation: profit tax and value-added tax (VAT). Other taxes that firms will come into contact with are customs duties, real estate tax, excise tax, and social security tax. In addition, municipalities have been granted the right to levy some taxes in addition to the portion of the income and profit tax that they receive from the central government. The following laws govern the various taxes:

- Income Tax Law, NN 127/00;
- Profit Tax Law, NN 127/00;
- Value-added Tax Law, NN 47/95, 106/96, 164/98, 105/99, 54/00, 73/00;
- Law on Real Estate Transaction Tax, NN 69/97; and
- Law on Funding Units of Local Government and Administration, NN 117/93, 69/97, 73/00.

1. Corporate Profit Tax

316. Under the Profit Tax Law (NN 127/00), Croatian companies (companies formed or registered in Croatia) and physical persons engaged in trading are subject to profit tax on their worldwide income. (For the purpose of this report, companies and persons engaged in trading will be grouped into general categories of “companies” or “firms”.) Non-resident companies (companies not registered in Croatia) and persons may be subject to profit tax only on their Croatian income.

317. Croatia calculates its tax base on the difference between revenues and expenditures. Until recently, Croatia calculated its tax base on the difference in equity between the beginning and the end of the year and used a unique concept of “protective interest”, which was a deduction for the imputed cost of equity finance intended to ensure tax neutrality between debt and equity financing. By the new law, this concept has been abolished.

318. Most enterprises face a profit tax rate of 20%. Companies classified as “small” operate under a separate tax structure. Taxpayers who pay fees for the use of intellectual

property rights (rights to reproduction, patents, trade marks, designs or models, production proceedings, production formulae, designs, plans, industrial or scientific experience or other, similar, rights), fees for market research services, tax advice, auditor services and similar, dividends, shares in profits and interest to non-resident persons who are not natural persons, are bound to withhold a profit tax at the rate of 15% at the time of payment of the fee.

319. **Tax incentives.** Investments in Free Economic Zones (which are sanctioned by law to exist, but most of which are not formally in operation yet) are entitled to pay profit tax at a 50% concession from the normal profit tax rate. Companies that participate in the development of infrastructure in excess of HRK 1,000,000 in a zone are exempt from profit tax for the first five years of operation. Taxpayers that carry on their business in the free economic area of the Vukovar/Srijem county shall be exempted from paying profit tax for the next five years after the beginning of the implementation of this Act, and after that shall pay profit tax at 25% of the prescribed rate. Also, additional tax incentives were given to taxpayers from the area of special national concern in terms of reduced tax rate by 25%, 50% and 75% of the prescribed rate; taxpayers that carry on their business in the area of the city of Vukovar and employ more than five employees for an indefinite period of time are exempted from paying profit tax during the period 2000-2005, and after that shall pay profit tax at 25% of the prescribed rate. The tax base could be additionally reduced on the basis of the wages of new employees, that is, by the amount of wages and employers' contributions that are calculated for the period for which the tax is assessed, and is paid out up to the date of submitting the tax return. Also, a taxpayer founded under special regulations for purposes of carrying out occupational rehabilitation and the employment of persons with disability shall pay profit tax of 25% of the prescribed rate. Additional tax incentives are given by Law on investment promotion (NN, 73/00) in terms of reduced profit tax rates and subsidized employment.

2. Value-Added Tax

320. Value-added tax was introduced on 1 January 1998. Value-added tax is levied at a single rate of 22%, with a small scope of exemptions (renting of housing premises, banking and insurance, special games of chance, medical services, social and child and adolescent care, education, religious services, culture and art). Zero rate has been introduced for the first time in 1999, and at the moment is applied to bread, milk, books printed on paper or on other media, drugs listed by the public Health Insurance Institute, orthopedic devices, scientific journals, cinematography, and organized tourists' stays paid from abroad. VAT is applied to the added value created and sold in manufacturing, service provision, and trading/importing. Companies with sales revenues under HRK 85,000 *may register* as VAT payers, make VAT payments, and become eligible for VAT refunds. Companies with sales revenues over HRK 85,000 *are required to register* as VAT payers.

321. Currently, foreign legal entities (those that have not been legally registered in Croatia) cannot be registered as VAT payers, and are not eligible for VAT refunds.

322. The VAT payer obtains a VAT (PDV) form in an official Narodne Novine (NN) shop that sets out all the basic rules and which is used to effect the refund. The Tax Administration states that it issues VAT refunds within 15 days after the tax return is submitted. Interest is paid on VAT refunds.

323. A VAT invoice must contain the following data:

- invoice number;
- place of issue and date;
- information on the seller - company name, address
- information on the buyer - company name, address and VAT registration number;
- quantity and commercial name of goods delivered or services performed;
- date of delivery of goods or services performed;
- amount of VAT; and
- total amount (price of goods delivered or services performed including the amount of VAT).

324. Invoices for cash payments must contain at least the following data:

- invoice number;
- place of issue and date;
- information on the seller - company name, address and VAT registration number;
- quantity and commercial name of goods delivered or services performed; and
- the total amount (price of goods delivered or services performed including the amount of VAT).

325. VAT must be reported and paid monthly, or quarterly for smaller accounts. VAT returns are due on the 30th day of the following month. Annual VAT returns covering the previous calendar year are due by 30 April. Where businesses pay an estimated monthly amount by standing order, an actual assessment is made at the time of the annual return.

3. Social Insurance

326. For all payrolls, both employees and employers must make contributions to various social insurances. The percentages are detailed in Table V.1:

Table V.1: Social Insurance and Other Contributions

Contribution	Employee's Contribution	Employer's Contribution
Pension	10.75%	8.75%
Health	9.00%	7.00%
Unemployment	0.85%	0.85%
Chamber of Commerce	0	0
Totals	20.60%	16.60%

327. Employees must be registered at each of the various institutions responsible for collecting the various types of contribution. This includes casual labor as well as full-time, permanent labor.

328. Payments for each of the various funds must be made by the 15th of the following month. Payments are made at the central payments (ZAP) office, which takes money from the account of the employer.

4. Real Estate Transaction Tax

329. The Law on Real Estate Transaction Tax (NN 69/97) that regulates taxation in the transfer of real estate was enacted in mid 1997. With this law, real estate has now been brought into accordance with the Value- Added Tax Law. Before the enactment of the Real Estate Transaction Tax and the Value- Added Tax Law, all real estate transfers were taxed at a rate of five per cent. With the introduction of VAT, new construction is taxed at a VAT rate of 22 per cent. All other real estate transfers are taxed at a rate of five per cent.

5. Tax Reporting

330. Profit tax is assessed at the end of a calendar year, or at the end of the companies' fiscal year, if different. Taxpayers are required to prepay their taxes, the amount thereof being calculated on the basis of the previous year's income tax return. The Tax Administration determines the amount for taxpayers who have just started their business operations on the basis of estimated profit. This estimate is made on the basis of financial results for the first three months of operations. Prepayment is made on a monthly basis.

331. Each taxpayer must file a profit tax return for each tax year. Taxpayers must submit the tax return with the assessed tax, accompanied with a proof that the tax was paid. This must be done not later than four months after the end of the respective tax year.

6. Tax Audit and Inspection

332. Two bodies are responsible for tax supervision: an inspectorate that falls under the Tax Department, and the Financial Police. The Tax Administration's auditors are under the control of the various regional tax offices, and conduct regular audits. There are no legal requirements for a specified time period between audits, but the Tax Department states that it tries to conduct audits every three years, depending on circumstances.

333. The Financial Police do not fall under the Tax Department and are responsible for seeking violations on taxes and customs. Their powers of search and seizure are considerably greater than the auditors under the Tax Department. They are given police powers, and are permitted to search and close premises.

B. Taxation Analysis

334. Investors voiced few concerns about the taxation system in Croatia, and the FIAS team found tax and VAT registration procedures to be straightforward. The main issues raised by investors and facilitators regarding the tax authorities in Croatia had to do with the role of the Financial Police and the Tax Department's auditors; and the willingness of the tax authorities to give opinions on legal questions raised by investors and facilitators. Attitudes toward tax authorities tend to be more positive among larger firms, including well-established Croatian firms and larger foreign investors. Smaller or newer firms, meanwhile, tend to be more critical. While this divergence in opinion is not uncommon, the Croatian government should be aware that larger or well-established firms do have some advantages in dealing with tax authorities. This perceived or real imbalance needs to be addressed in order to foster the small and medium-sized enterprises that will be crucial to Croatia's economic development and job creation efforts.

335. Some of the most frequently heard complaints were directed at the Financial Police, who are often confused with the Tax Department's auditors. The Financial Police and the Tax Department share responsibility for tax supervision, and, at times, have overlapping responsibilities.

336. Some companies (especially smaller ones) and facilitators suggested that the Financial Police were entirely unreasonable, often appearing unannounced, and occupying company records and various clerks for many days at a time. They have been known to seize computers and records for long periods, effectively crippling businesses.

337. Some interviews also indicated that the analytical ability of the Financial Police is inadequate. It was often remarked that the Financial Police tend to concentrate on identifying improper personal expenditure and record keeping rather than more sophisticated violations which are likely to cause the government significantly greater revenue losses.

338. There were also complaints about the seemingly automatic audit by the Financial Police following any claim for VAT refund. This had the (probably intended) effect of

reducing the number of VAT refund claims, as most investors chose to apply balances to the following months' payments instead of claiming cash refund. That said, some investors and other interviewees felt that the situation had improved.

339. Overall, although there was much criticism of the Financial Police, some auditors or accountants, in particular, felt that they did not act irresponsibly, or exceed their authority. These interviewees felt that the Financial Police carried out their job professionally, and acted reasonably, if handled properly.

340. As for the Tax Department of the Ministry of Finance, some newer investors, in particular, claimed that the Tax Department was unwilling to give clear written opinions regarding unclear tax issues. It was claimed that written responses often simply restated the laws, despite the fact that the law's lack of clarity had prompted the request for clarification in the first place. Another area of contention was that, since opinions are issued by the various regional offices rather than from a central office, there has been a pattern of regional offices overturning or contradicting each other's opinions.

341. Audit firms, on the other hand, felt that the government made an effort to give clear opinions on tax issues, which are then published in the Tax Journal. Auditors added that the opinions have proven to be binding.

342. It was also pointed out that the Financial Police did not always abide by written decisions from the tax authorities. The Tax Department noted that the merging of the Financial Police with the Tax Department, currently under discussion, would probably make such incidents less common.

343. One of the main difficulties encountered with VAT concerned VAT refunds for foreign entrepreneurs receiving various kinds of services in Croatia. Foreign entrepreneurs who should add Croatian VAT to their invoices also face problems, as there is currently no mechanism for them to register solely for VAT purposes.

344. The general absence of fora where foreign investors can have a say in the governance of the country also applies to the area of tax. Such a forum would be useful to raise concerns such as the apparently automatic VAT inspections following VAT refund claims. While this practice has declined in frequency, a better communication mechanism might reduce the animosity caused by those inspections.

C. Taxation Recommendations

345. **Address the perceived overlapping of responsibilities between the Financial Police and the Tax Department in the Ministry of Finance by merging the two bodies.** The Tax Department clearly needs to somehow fulfill the function of chasing down corrupt and fraudulent practices, as exists in every country. The FIAS team understands that the idea of merging the Financial Police and the Tax Department is being discussed in the government. In line with that proposal, this report supports the idea that the functions of the Financial Police should come under the control of the Tax Department in order to avoid the current overlap in tax supervision. Such a move would

also help harmonize the functions and objectives of the departments (which currently sometimes seem to be at odds), and ensure both accountability and technical competence in the enforcement function.

346. **The government should investigate the reportedly predatory policing powers of the Financial Police, perhaps as part of the merger process.** The existing authority/practice of the Financial Police to suspend or hamper a business operations, because of minor tax disputes or investigation of VAT refund claims, is unacceptable.

347. **The tax authorities should develop a strategy to rely more on independent audits prepared by certified auditing / accounting firms.** This would relieve some of the administrative burden on the Tax Department, and would help open a channel for greater dialogue between government tax authorities, auditors and businesses to resolve issues of concern.

348. **The tax authorities should ensure timely public and professional dissemination of all relevant changes to tax legislation, procedures, instructions on interpretation, and other information.** Holding seminars to discuss such changes, and learn the concerns of auditing companies and businesses, is a useful strategy that should be expanded.

349. **Introduce procedures to allow foreign entrepreneurs to reclaim VAT on services received in Croatia.** Investors complained that foreign entrepreneurs are currently not able to register solely for VAT purposes. Such issues could be discussed in public-private tax seminars of the kind proposed above.

350. **Improve training of government tax auditors.** Many investors questioned the level of technical ability of the Financial Police in particular. Greater interaction with private auditing firms, along with the possible merger with the Tax Department, could help improve technical capacity.

351. **Establish tax assistance centers to help smaller, newer companies.** Many countries have set up tax assistance centers, responsible for assisting smaller and newer companies.

D. Import, Export and Trade

352. The new Customs Code, which came into force on 1 January 2000, was designed to be in full harmony with the appropriate requirements of the European Union. Croatia is also a signatory to the International Convention on the Simplification and Harmonization of Customs Procedures. Also, the Customs Tariff Law complies with the Harmonized Commodity Descriptions and Coding System enforced by the World Customs Organization.

353. The governing laws and regulations on the import and export of goods include:

- Customs Tariff Law (NN 61/00, 117/00);

- Customs Law (NN 78/99, 94/99, 73/00);
- Decree on the Enforcement of the Customs Law (NN 144/99,48/00,49/00,77/00, 12/01); and
- Regulations on the Forms for the Enforcement of the Customs Law (NN 147/99).

354. Customs duty is the only import duty payable when importing goods; there are no duties for exports. The duties are set out in the Customs Tariff, and range from 5 to 25 per cent. Duties are assessed on the value of the merchandise using the *ad valorem* principle. For certain agricultural products and foodstuffs, customs duties are assessed based on their quantity using the applicable unit of measurement. Customs states that it typically uses the invoice price as a guideline – in lieu of which it can use its database of catalogues for commonly imported goods.

355. The average tariff load for all paragraphs of the Customs Tariff is 12.10 per cent. The average for agricultural products and foodstuffs is 33.44 per cent. At the time this research was conducted, Croatia was in free trade agreements with Slovenia and Macedonia, while, during the finalization of the study, it has signed FTAs with Bosnia & Herzegovina and Hungary. Preferential rates are determined under the terms and conditions set out in each individual agreement for imports from these countries.

356. Only Croatian legal entities may import or export goods (either physical or legal). The new Customs Code defines a number of different procedures. They include:

- Import for Free Circulation;
- Transit;
- Inward Processing Under Suspension System;
- Inward Processing Under Drawback System;
- Import to Customs Warehouse Storage;
- Processing Under Customs Control;
- Temporary Admission;
- Outward Processing; and
- Export

357. **Import Procedures for Free Circulation.** All consumer goods must be declared and cleared. The following documents must be presented, together with the Single Administrative Document (SAD), when clearing consumer goods:

- An import license or permit, if prohibitions or restrictions are applied to the import of goods;
- A certificate of origin, if preferential duties are established for the goods being imported;

- Sanitary, veterinary, hygiene and quality certificates, if the goods are of a type which may be imported only after presenting documents certifying that their quality meets established requirements;
- A customs invoice. Under the new Customs Code not all firms must present customs documentation at time of importation; “reliable” importers have the option of batching customs documentation, and submitting payment at a later date.
- Purchase and sale documents (contracts, invoices); and
- Transport documents (waybill, CMR waybill, CARNET TIR book).

358. **Applying Customs Transit Procedures.** When goods enter Croatia under Customs transit procedures, a deposit must be paid equal to the import duties and taxes for the goods. More commonly, a guarantee for the relevant sum of duties and taxes is presented. Guarantees may be in the form of long-term or general guarantees, or single shipment guarantees issued by a bank or insurance company, as chosen by the executor of the customs transit procedure. If TIR Carnet is not used for the guarantee, the Single Administrative Document has provisions for guarantees.

359. Firms have the option of clearing goods at the border posts or at customs warehouses within the country. Currently, there are two warehouses around Zagreb, either of which can be used to clear goods. Customs reports that clearance times are almost always less than 24 hours, and usually less than 3 hours.

360. **Customs Warehouses and Terminals.** The customs warehouse is new to the Customs Law. No customs duties or taxes are imposed on merchandise stored in a customs warehouse until it leaves the warehouse for the purpose of free circulation. This procedure is termed a “suspensive” arrangement.

361. The provisions of the law distinguish between two classes of customs warehouses: public customs warehouses, which are available for use by any person for the warehousing of goods, and private customs warehouses, which are reserved for the warehousing of goods by the warehouse keeper.

362. Customs warehouses are further classified as follows:

- A public customs warehouse in which the warehouse keeper is responsible for all obligations;
- A public customs warehouse in which every person using the warehouse (depositor) bears sole responsibility for the goods placed in the customs warehouse as per the customs warehousing declaration;
- A private customs warehouse in which the warehouse keeper is the user, but not necessarily the owner of the goods;
- A private customs warehouse where the warehouse keeper is the user of the warehouse but not necessarily the owner of the goods, and from which the imported goods can be released for free circulation prior to the

submission of an appropriate declaration. In this case the amount of customs duty is determined based on the elements of customs duty assessment effective at the time the goods were placed under the customs warehousing procedure;

- A private customs warehouse in which the warehouse keeper is the user, but not necessarily the owner of the goods, and where storage of goods in the warehousing areas belonging to the holder of the authorization is permitted; and
- A public customs warehouse operated by a customs office.

363. The authorization for opening a customs warehouse is granted by the regional customs office with responsibility over the location of the customs warehouse. Authorization can be issued to a company that “meets the conditions for the proper conduct of operations of the customs warehouse, provided that an economic need for warehousing exists”. This means that Customs will not grant authorization if the cost of maintaining the warehouse would not be economically viable for customs authorities.

364. When a private customs warehouse is opened, the customs office authorizes the type of goods approved for storage. The authorization is granted for an unlimited period of time, and operations can start as soon as authorization is received, and a security deposit submitted to the customs office. The customs warehouse keeper must keep records of the goods stored in the warehouse. There are no limits on the period of time goods can be stored.

365. While under the customs warehousing procedure, goods can be handled as usual for the purpose of preservation, improvement of appearance or marketable quality, and preparation for further distribution or resale. When the circumstances so dictate, the goods can be transferred to another customs warehouse without the customs warehousing procedure being completed.

366. At the time of research, there had been only one instance of a private customs warehouse being established. Many of the Customs agents and freight forwarders were still working with Customs to understand the implications of the new laws.

367. **Export Procedures.** Goods for export must be declared. Declarations are made by an economic entity registered in Croatia with ownership rights to the goods; the sender of the goods or its agent; the carrier of the goods; or a Customs clearance agent.

368. When declaring goods for export, the following documents must be submitted in addition to the Single Administrative Document (SAD):

- A customs invoice, if export duties and taxes are assessed;
- A sale-purchase document (contract, invoice);
- Transportation documents (waybill, CMR waybill, CARNET TIR book);

- An export license or permit, if restrictions or prohibitions are applied to the export of goods;
- Documentary evidence of the country of origin, if preferences are applicable to the exported goods; and
- Sanitary, veterinary, hygiene or quality certificates, if the exported goods are food products with quality requirements for their export.

369. **Inward Processing.** Another procedure used by Croatia to relieve duties for exporters are those that fall under Inward Processing. Certain raw materials and semi-finished products are exempted from duties, provided that the processed goods are re-exported.

370. The following goods can be admitted for inward processing:

- Goods of foreign origin on which no customs duty is payable and to which no trade measures apply and which are intended for re-export in the form of compensating products (suspension system); and
- Goods intended for free circulation under payment of customs duty for which the refund or relief from customs duty can be granted, provided that the goods are re-exported (drawback system).

371. Inward processing implies the following:

- Manufacturing, including erection and assembly, and fitting the imported items to other goods;
- Processing and finishing of goods;
- Repair, including restoration; and
- Consumption of consumable products.

372. The following goods are not considered as auxiliary material in inward processing:

- Fuel and other sources of energy, except those necessary for testing the compensating products or for establishing faults on export goods to be repaired;
- Lubricants, except those necessary for testing, calibration and any adjustment of the compensating products; and
- Equipment and tools, including components of equipment and tools for the manufacture of compensating products, and components of equipment or tools subject to rapid wear and tear (such as emery paper, emery boards, casting sand, knives, etc.).

373. The request for inward processing authorization is submitted to the local customs office. When processing or manufacturing operations are carried out on the basis of a contract concluded between two persons residing in Croatia, the ordering party is

responsible for the request, and must ensure submission of all necessary documentation. Originals and one copy of all documents are necessary.

374. Customs authorities can grant authorization in this manner, but also through a simplified procedure, where customs authorities accept the declaration without the authorization being drawn up on a separate form. This simplified procedure only applies to:

- Processing on the basis of job-processing contracts (the foreign entity settles manufacturing costs only);
- Goods of a non-commercial nature;
- Improvement of goods, including their restoration during customs warehousing;
- Operations relating to goods, the value of which does not exceed HRK 40,000 per tariff item; and
- Additional operations carried out on goods for which authorization has already been granted.

375. In addition to the other documents necessary for inward processing operations, the request should also include:

- Name and address of the applicant, if the applicant is not the declarant;
- Name and address of the manufacturer, if the manufacturer is neither the applicant nor the declarant;
- Type of processing operation;
- Description of the processed goods;
- Foreseen rate of yield or, if more appropriate, the method for determining such rate; and
- Period until re-export.

376. Customs authorities may request additional information. Authorizations are typically granted to residents who provide all guarantees necessary for the intended export under customs-approved treatment. Exceptionally, when goods that are not the subject of commercial import are in question, authorization can be granted to persons residing outside Croatia.

377. Inward processing under application of the drawback system may be used for all goods, except those which:

- are subject to quantitative import restrictions;
- fall within preferential duty as per Article 21 of the Customs Law;
- are subject to agricultural policy restrictions, or are subject to specific arrangements applicable to processed agricultural products; and

- benefit from various export incentives set out for compensating products.

378. Permission to use the drawback system may be requested if the goods in the form of compensating products, or in unaltered condition, are:

- Exported; and
- placed, with the intention of being exported, under:
 - transit procedure;
 - customs warehousing procedure;
 - inward processing procedure; and
 - the jurisdiction of a free zone or free warehouse.

379. **Free Economic Zones.** There are several laws that govern Free Zones. Customs Laws define the handling of goods for purposes of duties within the free zones. The Law on Free Zones (NN44/96), meanwhile, governs the organization and operations of free zones. However, some overlap exist between the two laws.

380. The free-zone areas are under customs control. Goods, means of transport, and persons entering or leaving a free zone area are consequently under customs control, and can be subject to customs inspection. There is no time limit for goods in a free zone. Goods of foreign origin placed in a free zone can be:

- released for free circulation under the conditions set forth for such procedure;
- placed, without any specific approval from the competent customs office, under the standard common procedures relating to either preservation, or improvement of utility and commercial features, of the goods for distribution and resale;
- placed under inward processing under the conditions laid down for such procedure;
- placed under “processing under customs control” in accordance with the conditions laid down for such procedure; or
- temporarily admitted under the conditions laid down for such procedures.

381. Companies or people carrying out storage, finishing or processing, purchasing, or selling operations in a Free Zone, must keep records of the movement and storage of goods available for Customs inspections.

382. In determining the value of goods leaving the free zone for general circulation, the customs value is determined on the basis of the actual price paid for the goods. The cost of storage and keeping the goods during their stay in a free zone cannot be included in the customs value of the goods, if the cost is separated from the actual price paid for the goods.

E. Import, Export and Trade – Analysis

383. The Government of Croatia took the very positive step in implementing a new Customs code on 1st January 2000. The short implementation period so far makes detailed comment difficult. Indeed, most of the comments from investors concern uncertain application of the new code by the various customs points in the country. In particular, it was noted that several customs offices have been interpreting the codes differently.

384. One complaint voiced by many expatriate employees was the retroactive imposition of VAT on personal effects imported by them into Croatia. This is a highly irregular taxation, particularly given its retroactive implementation. Investors see this issue as indicative of how the government authorities ignore their concerns about administrative procedures in Croatia.

385. Investors, for the most part, spoke highly of customs authorities, and their ability to process documents swiftly. Customs authorities claim to be able to process documents in three hours or less (including the case of goods that require inspection), and investors do not disagree with this assessment. With such processing timeframe, Croatia ranks among the most efficient customs regimes in the world. Moreover, there were no complaints from investors about valuation, which are a frequent cause of disagreement in many other countries.

386. Many of the new procedures within the Customs Code have not yet been implemented, but investors hope for continued efficiency in administrative procedures. One example of the new procedures in progress is the new rules regarding private ownership of customs warehouses. At the time of this writing, only one privately owned customs warehouse was in operation, and many freight forwarders and importers were taking a wait-and-see attitude.

Box V.1: Customs Reform in Mexico

In the late 1980s, Mexico initiated a major program of customs reform to accompany its new policy of trade liberalization. In addition to reducing tariffs, Mexico completely abolished official reference prices on all imports and almost all exports. From mid 1989, a radical reform was begun to modernize and improve efficiency of the customs process. The excessive costs of clearing customs were effectively another barrier to trade, because customs procedures did not keep pace with the trade reforms. Traders faced long processing delays and substantial undocumented costs in clearing merchandise. The authorities had effectively lost control of the customs process and revenues, and the system had become bogged down in a mire of bureaucracy, ad hoc decision-making, and corruption. Customs regulations implied that every merchandise transaction had to be inspected individually, and hundreds of regulations could be applied. Enormous discretion and negotiating power were given to customs officers, with the predictable result that the authorities effectively lost control of the process.

Importers used private customs brokers to find their way around the myriad statutory obligations and provisions, but customs brokers were generally considered to be major accomplices in customs irregularities. Entry to the profession had been tightly controlled by means of licenses, and the number of customs brokers had remained roughly constant for over a decade.

As of January 1, 1990, Customs was integrated with general tax collection, which was based on voluntary declaration of tax liability. Similarly, customs duties in Mexico are now paid in advance of clearance procedures, and are made through commercial banks rather than directly to customs officials. A basic premise of the new system was that meaningful individual inspection of each transaction is impossible. A computer-generated random selection process now determines which trade transactions are inspected. The authorities refined sampling techniques, based on lessons learned from the information being gathered - for example, more frequent inspections where higher irregularities are found.

The number of steps in the customs process was reduced by two-thirds, and the reduction in processing time has been a major source of savings for both authorities and traders. Entry to the formerly tightly controlled customs brokers' profession was freed-up, and fees are now determined by market competition. The random inspection system is complemented by stiff fines and penalties for all parties involved if irregularities are discovered during the inspection. The normal processing time per transaction was cut from around 3 days to 20 minutes, or a maximum of 3 hours if selected for merchandise inspection. The volume of operations increased by 50% after six months at some of the main entry points, while daily collections adjusted for trade increased by over 10 %.

Source: The World Bank

F. Import, Export and Trade - Recommendations

387. Having only recently enacted the new Customs Code with its many new provisions, the Government of Croatia and the customs authorities should concentrate on its smooth implementation. This would be helped by increased efforts to listen to the concerns of investors about its provisions and implementation problems. Seminars to explain new procedures and discuss pertinent issues with foreign and domestic investors are desirable.

388. The one specific customs-related recommendation offered at this early stage is to repeal immediately the imposition of VAT on personal effects imported by expatriate personnel. Such a provision makes it difficult for firms to attract quality talent from overseas, and will deter investment. This misapplication of the Istanbul Treaty should be rectified without delay.

G. Labor

1. Labor Legislation

389. Most labor issues are governed by the Law on Labor (NN 38/95, 54/95, 65/95, 17/01).

390. The Law on Labor establishes the general procedures for drawing up, altering and terminating employment contracts. Contracts must contain the following details:

- Parties to the contract and their residence or headquarters;
- Place of work, and if there is no permanent or main place of work, then a note that work is performed in different places;
- Name, nature and type of employment, or a short list or description of tasks;
- Date of commencement of the employment contract;
- Duration of the paid annual leave to which the employee is entitled. In cases where it is not possible to provide such data at the time of concluding the contract, the manner in which the duration of leave will be determined should be stated;
- Basic salary, bonuses and periods of payment of income to which the employee is entitled; and
- Duration of the regular working day and week.

391. In practice, employment contracts are very often short and consist of the basics as described above. Basic guidelines that impact employment contracts include the following:

- Working hours are limited to 40 hours per week. If not otherwise specified, the working week is assumed to be 40 hours;
- A daily break of at least 30 minutes per day is required;
- Employees are entitled to a minimum of one continuous break of 24 hours per week;
- All employees are entitled to at least 18 working days of leave – employees performing dangerous tasks are entitled to 30 working days and minors to 24 days;
- Employees are entitled to paid holidays (to be determined by the employer, through a collective bargaining agreement, or by means of the employment contract) and up to seven personal days leave; and
- The Law provides the Government with a possibility to determine a minimum wage in the event that a collective bargaining agreement is not in place.

392. The law provides for a probation period for new employees “upon mutual agreement of the parties”. The probation period may not normally be more than three months. If an employer is not satisfied with an employee’s performance during the probation period established to assess his or her competency, the employer has the right to dismiss the employee before the end of the period. In this case, the employer need not adhere to the usual termination requirements (described below), and the employee is not given severance pay.

393. Employees must be given written notice of planned changes in working conditions no later than one month prior to the introduction of such changes. If the changes are related to production technology, the employer must provide conditions for the employees to improve their qualifications or change their specialization, so they will be able to work after the changes in production or production technology are introduced. Any collective agreement in place may stipulate a longer notice period, as well as additional obligations for improving employees’ ability to prepare for work under the new arrangements.

394. Regarding temporary lay-offs, Article 24 of the Law on Labor (NN 38/95) provides for payment equal to two-thirds of the employee's average hourly wage received before the lay-off, but not less than the minimum hourly payment, approved by the State for every hour of the lay-off.

395. The Law also describes grounds for termination of an employment contract. These include:

- Dismissal for business reasons;
- Personally-caused dismissal; and
- Dismissal caused by offensive behavior of the employee.

396. Dismissal on the former two grounds is permitted only if the employer is unable to provide the employee with alternative work. In the event that an employer dismisses an employee for business reasons, the same work must not be given to any other employee for a period of six months. These rules only apply to firms with more than ten employees, and only when the employment contract has been in force for longer than six months.

397. The Law also lays down other specific procedures for terminating employment, even if it is mutually agreed upon by the employer and employee. For example, employers must issue warnings to employees before dismissal on grounds of employee behavior, except under certain extraordinary circumstances.

2. Layoffs and Downsizing

398. The Law on Labor also provides for the layoff of a group of employees for business reasons. The Law’s provisions refer to firms with over 20 employees that terminate the contracts of 10% of its staff (a minimum of five employees). The duration

of the notice is determined by law, and is between two weeks and six months.

H. Labor - Analysis

399. Investors complained considerably about terminal benefits prescribed under the Law. This is, of course, not a problem unique to Croatia, but still remains a concern for entrepreneurs establishing a business in the country. It is likely that investors coming from other Western European countries will be more comfortable and familiar with the laws, than those coming from America or Asia.

I. Inspections – The State Inspectorate

400. Croatia has taken the unique step of consolidating many of the inspections an investor is likely to encounter under one roof – the State Inspectorate. Although the Inspectorate does not undertake every inspection to which an investor may be subject, it manages a significant proportion of them. The main inspections conducted by the State Inspectorate, along with other relevant ones, are covered below.

401. The State Inspectorate became an autonomous agency in 1999, having formerly been a department of the Ministry of Economy under the Assistant Minister – Head of Trade Inspection. The State Inspectorate is currently responsible for 11 inspections and three “technical” inspections, including those previously conducted by the Ministries of Economy, Forestry and Agriculture, Tourism, and Work and Social Welfare.

402. The State Inspectorate system not only reduces the number of different inspections that an investor is likely to encounter, but also saves considerable money for the Government of Croatia. The number of units that conducts inspections has been reduced from 110 to 49, and the number of county offices from 22 to five.

403. Inspectors are required to complete reports for each inspection, regardless of whether violations have been found. Investors receive a copy of inspection reports. Both the investor and the inspector sign the inspection reports. There is room on the inspection report for investors to make comments. Inspectors are required to report daily to the State Inspectorate.

404. As for the criteria for conducting inspections, the Inspectorate is divided into regional groups that design their own inspection programs. Some of the criteria include:

- The regional group’s inspection cycle;
- Complaints filed by the public, workers, or other stakeholders. Firms to be inspected are determined by the volume of such complaints; and
- The number of signed complaints. Signed complaints are accorded particular attention by the State Inspectorate, as compared with unsigned complaints.

J. Inspections - Analysis

405. For reasons including transparency, the State Inspectorate argues that the body issuing licenses should not be the one conducting inspections. This is a compelling argument, but not the strongest justification for the existence of the State Inspectorate. The greatest advantage of this arrangement come from the reduced number of inspections needed, a streamlined approach that benefits both the state and the investors. Meanwhile, the separation of agencies responsible for licensing on the one hand, and inspections on the other, is only possible or effective if communication between those agencies is efficient.

406. The State Inspectorate has over 150 laws under its purview, and intends to expand the scope of its coverage. The benefits of the system, as noted, include less duplication of activities, fewer inspections for investors, and fewer inspection offices and officers. The risks, meanwhile, include pressure on the abilities of the inspectors to remain current with the various technical disciplines that they are required to understand. This risk seems to be managed reasonably well in Croatia, with all inspectors being college-educated and very capable, and technical instructions being provided by the relevant ministries and agencies.

407. On the other hand, keeping inspections within a ministry can also offer several advantages. One is that officers can specialize more easily in a particular discipline, and stay on top of developments in their area. Another advantage is that inspector feedback is given directly to the ministry or agency concerned, and may be better reflected in new policy formulation. In order to maintain the advantages that would come from dispatching inspectors directly from ministries, the State Inspectorate must ensure close consultation with the various ministries and agencies it represents.

408. The efficiency with which this exchange of information occurs in Croatia is of some concern, since it has already been noted in other administrative contexts that the quality of communication between ministries and agencies ranges from mediocre to poor. Until such communication is improved through functional committees or interministerial working groups, there is some danger that the inspection function may not be as technically proficient as necessary over the coming years, and that feedback to ministries for policymaking purposes may be less than optimal. Nevertheless, from the perspective of streamlining procedures, the State Inspectorate is a positive step.

409. Investors experience with the previous system of unclear jurisdiction of regulatory institutions was very bad, and they welcome the unified inspectorate. However, it will take some time for the previous system's shortcomings to be fully resolved.

K. Inspections - Recommendations

410. Overall, the State Inspectorate is a positive development, and it is recommended that the agency be maintained and given the various mandates it seeks, in order to further consolidate the number of inspections that take place. The agency makes a major

contribution to improving the quality of interaction between the government and the private sector that should be valued and enhanced. At the same time, the issue of communication within the government structure needs attention.

411. Formal communication mechanisms should be created jointly between the various ministries and the State Inspectorate. These could include regular meetings including technical training; regularly scheduled feedback reports designed jointly between the inspectorate and the ministries; and others.