Croatia
Country Procurement Assessment Report

March 2005

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Europe and Central Asia Region
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January 1 – December 31

ABBREVIATIONS & ACRONYMS

B2B Business-to-Business
B2C Business-to-Consumers
B2G Business-to-Government
BEEPS Business Environment and Enterprise Performance Survey
BER Bid Evaluation Report
CARDS Community Assistance for Reconstruction, Development and Stabilisation
CAS Country Assistance Strategy
CPAR Country Procurement Assessment Report
CPF Croatian Privatisation Fund
DFID Department for International Development, United Kingdom
EBRD European Bank for Reconstruction and Development
e-GP Electronic Government Procurement
EU European Union
FIDC International Federation of Consulting Engineers
FINA National Finance Agency
GDP Gross Domestic Product
GVA Gross Value Added
HRK Croatian Kuna
HT Croatian Telecom
HZ Croatian Railways
ICB International Competitive Bidding
ICT Information and Communication Technology
IFA Institutional Fiduciary Assessment
IMF International Monetary Fund
LPP Law on Public Procurement
MOF Minister of Finance
NCD National Competitive Bidding
NGO Non-Governmental Organization
OIDD Office for Internet Infrastructure Development
PAL Programmatic Adjustment Loan
PIU Project Implementation Unit
PPC Public Procurement Commission
PPU Public Procurement Office
RDCI Registry of Digital Certificates
SAO State Audit Office
SBD Standard Bidding Documents
SIGMA Support for Improvement in Governance and Management
SME Small and Medium-sized Enterprises
SWAP Sector-Wide Approach
UNCTIAL United Nations Commission on International Trade Law
USAID United States Agency for International Development
USD United States Dollar
USKOK Office for Fight against Corruption and Organized Crime
VPN Virtual Private Network
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Executive Summary

Introduction

Since Croatia gained its independence from Yugoslavia in 1991, the country’s rules, regulations and institutions for awarding government contracts have been under regular development. A number of Government decrees on public procurement were enacted in 1995 and 1996; a Law on Procurement of Goods, Services and Works – based on the UNCITRAL Model Law – was passed in December 1997; and a further new Law on Public Procurement (LPP) was enacted in 2001, which fundamentally redirected the legal framework for procurement away from UNCITRAL and towards the European Union (EU) Procurement Directives, mindful of Croatia’s ever-closer relationship with Europe and its obligations under the Stabilization and Association Agreement with the EU.

The World Bank last conducted a fiduciary assessment of public procurement in Croatia in 1999. Given the time that has elapsed since the assessment, as well as the Bank’s continuing commitment to assisting Croatia with the development of its public procurement system and the Bank’s own need to assess the fiduciary risk associated with its lending portfolio in Croatia, including with potential new lending modalities such as Sector-wide Approaches (SWAps), the Bank’s management has authorized the conduct of the current procurement assessment in Croatia. This assessment is an integral part of the Bank’s Country Assistance Strategy (CAS) for Croatia, which sets for this assessment and for the simultaneous Country Financial Accountability Assessment (CFAA) the objective that “building on the recommendations of the Bank’s forthcoming CPAR and CFAA, over the medium term, public procurement and financial management systems should improve to the point that the practice of ‘ring-fencing’ Bank-financed projects is no longer considered necessary.”

Given that the European Commission recommended, on April 20, 2004, that the Council of the European Union should open accession negotiations with Croatia and gave a broadly favorable opinion on Croatia’s application for EU membership, reform of the country’s public procurement system and its alignment with the EU acquis is expected to be an increasingly pressing priority for the Government. However, the Commission’s opinion highlights the country’s public procurement legislation as one of a number of not fully harmonized areas that are in need of further reform.

Key Findings and Risk Assessment

On average, Croatia spends some 35 billion Kunas (about US$5.5 billion equivalent) on public procurement annually. That represents about 29 percent of total public expenditure or 19.5 percent of GDP, somewhat higher than the EU average of 16.7 percent. Therefore, public procurement is a high-value government activity, with substantial scope for waste, if done badly, and substantial room for efficiency gains and savings, if done well. The experience of public procurement reform in other countries indicates that improving efficiency and competition in

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1 The report is based on the review conducted in early 2004 and may not reflect all changes which were undertaken in the country towards improvements in the public procurement system in the year 2004.

2 Source: estimates by the World Bank based on published consolidated general government budget and public enterprises. It should be noted that the Croatian law on public procurement applies to some 1,100 companies which perform economic-commercial activities but that consolidated expenditure data from such companies was not available at the time of this report.
public procurement can yield savings of 20 to 25 percent of expenditures. It is clear that improving the efficiency of public procurement expenditures would deliver a major contribution to improved economic performance by Croatia’s public sector.

Yet Croatia’s public procurement system exhibits a number of weaknesses, which run the risk that these efficiency gains may require a longer period of time and additional efforts to be achieved. To its credit, the new management team of the Public Procurement Office recognizes this situation and is committed to enacting an amendment to the Public Procurement Act, as recommended in this report, in order to remedy the most egregious weaknesses in the law and to bring it closer to alignment with the EU acquis.

Till late 2004 development in public procurement was taking place without a clear strategic vision, adequate prioritization of actions and with little or no assessment of the resources required to meet the challenge of EU alignment. A positive development in this area has started at the end of 2004 when EU-funded technical assistance in a form of twinning arrangements was provided to the PPO and the State Commission.

The legal framework for public procurement remains incomplete and the current law on Public Procurement is not fully aligned with the EU Directives. Chief among the weaknesses of the current procurement law are the excessive scope of the exemptions from its application and the deficiencies in the provisions dealing with legal remedies. The PPO has stated its intention to enact amendments to the procurement law in order to bring the range of exceptions allowed under the current Public Procurement Act in line with the exceptions in the new EU Consolidated Directive (2004/18/EC). Also, although two implementing regulations were published in February 2002, the full set of implementing regulations, which are necessary to complete the legal framework, have not been enacted yet.

Observations of public procurement practices in Croatia, undertaken as part of this assessment, found that, while compliance with the procurement law has been improving the longer it has been in effect, there remain some areas in which practice remains to be weak. In some cases, the origins of these weaknesses can be traced to provisions in the procurement law, such as those on the assessment of bidders’ qualifications, which overemphasize documentary checks and do not require stringent requirements for bidders’ financial and technical qualifications to be assessed in light of the specific demands of the contracts for which they are bidding.

That said, some significant and encouraging gains have been made, particularly in the legal requirements for the notification of bidding opportunities contract award notices and the publication of these notices in the Official Gazette online edition is working well. The LPP has fairly comprehensive requirements on the minimum contents of invitations to bid and this is reinforced by a Government decree of February 7, 2002, “On Public Procurement Notices and Records,” which stipulates the mandatory forms of such notices and is modeled on the requirements of the EU Procurement Directives. One of the strengths of Croatia’s public procurement system is that all such advertisements are published in the online edition of the Official Gazette (www.nn.hr), and this arrangement work very well.

The Government has also made a modest but successful start to the launch of electronic government procurement (e-GP) which has yielded savings of as much as 60 percent on some products but has yet to take advantage of the savings and lower transaction costs offered by rolling e-GP out across state and local government.
With regard to the institutional arrangements for regulatory oversight of public procurement and for the review of procurement proceeding, Croatia has also made significant progress recently. Particularly welcome is the establishment, in July 2003, of the State Commission for the Control of Public Procurement Procedures as an autonomous and an independent body reporting directly to the Parliament; and, in November 2003, of the Public Procurement Office (PPO). Both of these institutions, however, are relatively new, have yet to establish a credible record of operation and enforcement and are facing resource constraints which inhibit fully effective operation. Of the two key institutions in the public procurement area, the Public Procurement Office (PPO) lacks the true independence from the Government which it needs to ensure enforcement of the procurement law. It is still physically housed in the Ministry of Finance building and is under-resourced in terms of staffing and technology, although it is encouraging to note that some new staff have recently been brought in and a new Director of the PPO was appointed in October 2004 and plans are well-advanced to relocate the PPO to the new premises outside of the MOF in 2005. The assessment found that the PPO spends too many of its resources in granting bureaucratic approvals to various procurement transactions, when it should be focusing on developing good procurement practice among the contracting authorities and on completing the legal framework for procurement. Success of both new institutions is absolutely critical to the effective enforcement of the procurement law and to ensuring the accountability of public officials in their decision-making related to procurement.

The control environment for public procurement has been insufficiently developed to date. Most public institutions do not have functioning internal audit and control systems yet. The State Audit Office, although it has a legal mandate to assess the efficiency and effectiveness of public expenditure, has yet to develop the capacity to conduct performance audits, which would be an invaluable tool for informing both Government and Parliament on the cost-effectiveness of the country’s substantial expenditures on procurement. Also, there is little scrutiny by the public, civil society and non-governmental organizations (NGOs) of public procurement is ineffective in making public institutions enforce the procurement legislation effectively, largely because of the scarcity of publicly available information about public procurement operations. The Government does not publish any statistics on procurement. While rumors of wrongdoing and corruption are commonplace, the absence of hard data and of any tangible measures of performance make it difficult for interested stakeholders to hold public officials accountable for their actions. An encouraging sign in this area is that the EU CARDS (Community Assistance for Reconstruction, Development and Stabilization) program is currently financing the development of a system of internal audit in state bodies, which should lead to significant improvements in the control systems applicable to public procurement transactions.

In its annual audit report for 2002, the SAO found many serious misapplications of the procurement legislation and abuses of procurement procedures, including use of the Direct Negotiations procedure without the necessary prior approval of the PPO, the use of the Restricted Procedure for contracts where the financial threshold in the law requires the use of the Open Procedure, bid evaluations that were conducted using criteria other than those specified in the bidding documents, inadequate record-keeping and recording of procurement proceedings and failure by the contracting authorities to collect from bidders the bid securities, which are required to offer public purchasers contractual protection and which yield public revenues when called.

As in many countries, corruption poses a threat to public procurement operations in Croatia. Although the Government has made significant advances in legislating in the anti-

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3 State Audit Office is planning to introduce performance audits in 2005
corruption area, the institutional arrangements for combating administrative corruption related to procurement is undeveloped, as the Government focuses mainly on combating organized crime, rather than on administrative corruption, such as that related to public procurement.

Overall Assessment
Based on the CPAR’s analysis of the legislative framework, procurement practices, institutional capacity and the opportunity for corruption, the assessment found that the environment for conducting public procurement in Croatia is average.

Recommendations
This report makes a series of recommendations designed to strengthen the public procurement environment of Croatia, including legislative reform, improving procurement procedures and practices, institutional reform, capacity building and the development of electronic procurement.

The legal framework for public procurement should be reformed by, in the short term, amending the current legislation (both the Public Procurement Act and the Law on the State Commission for Control of Public Procurement Procedures) to address the identified weaknesses and, in the medium term, enacting a new Law on Public Procurement, aligned with the EU Procurement Directives. Short-term measures are designed to address weaknesses in the current legislation that require urgent attention, including introducing specific procedures for the procurement of consulting services, clarifying and improving the provisions on the submission of an objection to a contracting authority, introducing requirements for filing an objection, and opening to all participants the opportunity to object to the contracting authority’s selection of procurement method. The longer-term recommendation is for the enactment of an entirely new Law on Public Procurement, aligned with the new EU Consolidated Procurement Directives (2004/17/EC and 2004/18/EC) and covering the award of concessions. The new law should be harmonized with Law on State Commission for Control of Public Procurement Procedures and should clarify the respective roles, duties and powers of the PPO and the State Commission. The new procurement law should be complemented by a comprehensive set of implementing regulations, in order to clarify the application of the new law and to complete the legal framework for procurement.

The report also makes several recommendations to improve the efficiency, effectiveness and transparency of public procurement practices, most importantly in improving areas such as procurement planning, the assessment of bidders’ qualifications and the evaluation of bids.

Several important recommendations are made to improve the independence and effectiveness of PPO and the State Commission as the key regulatory and review bodies for public procurement. The Government should provide both the PPO and the State Commission with dedicated office space outside of the Ministry of Finance building, in order to underscore their separateness from the MOF. The budgets and staffing of both the PPO and the State Commission should be increased, in order to provide them with the human and technical resources they need to perform their mandated functions effectively. The status of the PPO should be reviewed: in order to enable it to act objectively in taking the lead in developing procurement policy and legislation and in overseeing its enforcement, the PPO should be independent from Government. The PPO should relinquish the function of clearing all uses of procurement procedures other than the Open Procedure and the conditions for use of the other procedures should be more clearly defined in a new procurement law. To increase public-sector procurement capacity, which is essential both to improve the effectiveness of public expenditure on procurement and to improve enforcement of the legislation, the Government should develop a
local training institution for public procurement, which would be able to conduct procurement courses for public officials on a regular basis.

**Recommendations are also made for the development of electronic procurement.** First, the Prime Minister should appoint an e-GP “champion” who would be responsible for moving forward the e-GP agenda and should also identify the lead agency to develop an e-GP strategy and implementation plan. The Public Procurement Act will need to be revised (or new public procurement law shall include relevant provisions) to provide the enabling legal environment for the application of e-GP, in line with the new consolidated EU Directive. The use of the existing software application should be extended and piloted both vertically (the implementation of the online tendering functionality with the same group as is participating in the current consolidated ICT procurement) and horizontally (for procurement beyond ICT and related equipment and services).

**Transparency in public procurement and the accountability of Government for the effective management of procurement should be enhanced** by publishing comprehensive information on procurement operations—current legislation, invitations to bid, contract award notices, data on procurement expenditure broken down by level of government, by institution, by different procurement procedures (open, restrictive and direct negotiation) on a web-based electronic public procurement bulletin. It is also essential that the State Audit Office should start to undertake value-for-money assessments of major public investment projects, in order to inform parliamentarians, the Government and the public about the efficiency of such expenditures. The Government should also initiate a formal benchmarking and performance measurement system for public procurement, which would enable Croatia to establish the current state of development of its public procurement regime, track progress as it implements reforms in the future and record and report on performance outcomes. There is currently a substantial effort underway by the international community, including the World Bank and the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD-DAC) to develop new tools for benchmarking and performance measurement in public procurement. The World Bank can assist Croatia to adopt and apply these tools.
A. Preface

Date and Basis for Report: The date of this report is March 25, 2005 based on the draft CPAR dated November 9, 2004 as presented to the government counterparts at the dissemination workshop in Zagreb, Croatia, in November 2004. The draft report was further modified in March 2005 to reflect extensive additional comments received from the PPO and information presented by the Government at the dissemination workshop to make a reference to rapid positive changes occurring in Croatia since late 2004. Presentations made by the Government representatives at the dissemination workshop assured that most of the key recommendations of this report have being considered for inclusion in the future plans and strategies. Implementation of these plans, however, presents a real challenge.

Acknowledgments: The mission members wish to acknowledge the extensive cooperation and assistance received from officials and staff of the Croatian public organizations, state-owned entities, NGOs and private companies interviewed during this assessment. In the World Bank, Mr. Anand Seth, Country Director and Ms. Indira Konjhodzic, Country Manager, offered invaluable guidance on the scope and overall direction of the assessment. The staff of the Bank's Zagreb office offered the mission invaluable assistance. Mr. Johannes Stenbaek Madsen, Financial Management Specialist, who led the related Country Financial Accountability Assessment (CFAA), provided essential inputs to the report on the control environment. Mr. Enzo De Laurentiis, Senior Procurement Specialist, Latin America and Caribbean Region (LCOPR) and Mr. Piotr-Nils Gorecki, Principal Administrator-Public Procurement, OECD/SIGMA acted as peer reviewers for the report. Clearance of the report within the World Bank was provided by Ms. Françoise Bentchikou, Chief Counsel, Procurement and Consultant Services Unit, Legal Vice-Presidency (LEGPR); Ms. Pamela Bigart, Lead Procurement Specialist, Procurement Policy and Services Group (OPCPR); and Mr. Sunil Bhattacharya, Regional Procurement Manager, Europe and Central Asia Region (ECSPS).

Government Counterpart Organizations: This report is based on information collected during two missions to Croatia undertaken by the World Bank and EBRD during October 2003 and February 2004. During both missions, an extensive series of meetings was held with Government officials of the relevant institutions, particularly the Ministry of Finance, Public Procurement Office and the State Commission for the Control of Public Procurement Procedures, as well as several other ministries, public enterprises, NGOs, private-sector firms, both local and foreign, and with other international financial institutions active in Croatia.

Information in the section on e-Procurement is based on meetings with the Central State Administrative Office for e-Croatia, as well as with current private-sector suppliers of ICT to the government.

The key counterpart officials participating in the assessment on the Government’s part were the former Director of the Public Procurement Office and Assistant Minister of Finance, Mr. Jure Bajic, the current Director of the Public Procurement Office Mr. Mato Regvar, and the Chairman of the State Commission for the Control of Public Procurement Procedures Mr. Goran Matesic. A first draft version of this report was discussed with the Public Procurement Office, the State Commission for the Control of Public Procurement Procedures and the Ministry of Finance in June 2004.
Following discussion of the first draft of the CPAR, written comments were received by the Bank from the Public Procurement Office, State Audit Office, the Directorate of Legal Harmonization of the Ministry of European Integration, the Directorate of EU Financial Assistance and Projects of the Ministry of Finance and from the Directorate of Economic Affairs of MOF. These comments have been reflected to the fullest extent possible in the second revised version of the report, dated November 9, 2004 which was further amended following presentation at the dissemination workshop in Zagreb in November 2004 and extensive additional comments from the PPO and the State Commission. The final round of consultations took place in April 2005 via video conference meeting between Zagreb and Washington with participation of the representatives from the PPO, the State Commission, E-Croatia, the MoF and the Ministry of European Integration.

**World Bank-EBRD Team:** This report was written by a joint World Bank-EBRD team comprising Shaun Moss, Lead Procurement Specialist, Operations Policy and Services Department, Europe and Central Asia Region (Task Team Leader till December 4, 2004); Roch Levesque, Senior Counsel, Procurement and Consulting Services Unit, Legal Vice-Presidency; Knut Leipold, Senior Procurement Specialist, Procurement Policy and Services Group; Clifford Birch, Procurement Manager, EBRD; Ljiljana Tarade, Program Assistant, World Bank Country Office in Zagreb; and Kristijan Galic, Legal Consultant. Srebenka Gudan, Consultant to the Bank Country Office in Zagreb, contributed the data on public procurement expenditures in Section 5. The report was finalized in March 2005 by Maria Vannari, Senior Procurement Specialist with assistance from Devesh Mishra, Senior Procurement Specialist, both from Operations Policy and Services Department, Europe and Central Asia Region.
B. Context

Since Croatia gained its independence from Yugoslavia in 1991, the country’s rules, regulations and institutions for awarding government contracts have been under regular development. A number of Government decrees on public procurement were enacted in 1995 and 1996 and a new Law on Procurement of Goods, Services and Works, based on the UNCITRAL Model Law, was passed in December 1997, coming into force in March 1998. The World Bank assisted Croatia with the development of this legislation by making a grant available from the Institutional Development Fund (IDF).

Subsequent to the enactment of the 1997 law, the Bank conducted its first formal assessment of Croatia’s public procurement system in 1999. The CPAR that resulted from that assessment, gave Croatia an average risk rating, having found that much commendable progress had been achieved, but made a number of recommendations for the further development of public procurement in the country. Table 1 summarizes the progress the Government has made in the intervening five years with implementing those recommendations.

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Action Taken</th>
<th>Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enact implementing regulations to resolve specific weaknesses identified in the LPP</td>
<td>Partial</td>
<td>Regulations have been enacted on some topics (small-value purchases, standard forms) but not in all areas.</td>
</tr>
<tr>
<td>Prepare a procurement manual for contracting authorities</td>
<td>Partial</td>
<td>Since 2001, three public procurement manuals have been published by consulting firms, which are in use by public bodies. Further work to develop procurement manuals is planned under the EU CARDS program for 2005.</td>
</tr>
<tr>
<td>Prepare standard pre-qualification and the standard bidding documents</td>
<td>No</td>
<td>Not done so far. Development of standard pre-qualification and the standard bidding documents is planned under EU CARDS program for 2005.</td>
</tr>
<tr>
<td>Implement a training program for contracting authorities</td>
<td>Partial</td>
<td>Until 2004 PPO provided 4-5 short courses each year. Starting 2004 training has intensified: in 2004, over 27 seminars on public procurement were conducted by the PPO, as well as expert meetings at the request of procuring entities. However, provision of procurement training does not yet approach the demand throughout the country.</td>
</tr>
<tr>
<td>Train selected procurement staff as trainers and involve them in delivering training for contracting authorities</td>
<td>No</td>
<td>Not done so far. Is planned to begin in 2005 under EU CARDS program.</td>
</tr>
<tr>
<td>Disseminate information on public procurement opportunities to the private sector, e.g., by information brochures, seminars.</td>
<td>Partial</td>
<td>In addition to 27 seminars mentioned above, the PPO provides a telephone advice line, which is open every business day and which any interested party may call for advice. A more far-reaching dissemination program for bidders is planned for 2005.</td>
</tr>
</tbody>
</table>
Better define the role of the PPO and strengthen its staffing and physical resources. | Partial | The 2002 LPP provides a clearer definition of the role of the PPO. However, during most of the period since the completion of the last CPAR, the staffing and technology resources of the PPO have been insufficient for it to operate effectively. Some encouraging developments have emerged in late 2004, as a new PPO Director has been appointed and additional staff hired. Also, twinning arrangements with German and Slovenian PPOs were entered into to revise an organizational structure and develop a development strategy.

Start the publication of a public procurement bulletin. | Partial | There is no bulletin dedicated to public procurement. According to the PPO it is now planned for 2005. Procurement notices are regularly advertised in the print and online editions of the Official Gazette.

Include the procurement profession in the civil service framework; prepare job descriptions for procurement staff | No | Not done so far. Is planned for 2005 as a part of CARDS program.

Encourage educational institutions to start procurement courses | No | Not done so far and has been limited to the staff of both PPO and State Commission for Control of Public Procurement Procedures providing lecturing and advisory services on an occasional basis.

Although the recommendations of the 1999 report were discussed and agreed with the Government at the time the report was written, only several of them have been partially implemented by 2004. Reasons for this may lie partly in changes of government in the interim, as well as in the technical complexity of some of the tasks, such as writing standard bidding documents and a procurement manual, which take considerable technical and legal expertise. In addition, given the modest resources which the Government has allocated to public procurement, it is likely that the Public Procurement Administration within the Ministry of Finance simply did not have the manpower to deliver such a challenging agenda. Finally, it must also be admitted that there has not been a continuing dialogue between the Government of Croatia and the World Bank on public procurement reform in the intervening five years, which might have allowed the Bank to follow up on progress with implementation of the report’s recommendations.

The most significant development in the intervening period has been the enactment of a new law on public procurement (Public Procurement Act) in 2001, which came into force in 2002. Section 1 of this report provides a detailed assessment of the new law (LPP). This law fundamentally redirected the legal framework for procurement away from UNCITRAL and towards the European Union (EU) Procurement Directives, mindful of Croatia’s ever-closer relationship with Europe and its obligations under the Stabilization and Association Agreement with the EU. As can be seen from Table 1, the law also addressed some of the concerns raised by the Bank in its 1999 report.

Given the time that has elapsed since the last assessment, as well as the Bank’s continuing commitment to assisting Croatia with the development of its public procurement system and the Bank’s own need to assess the fiduciary risk associated with its lending portfolio in Croatia, including with potential new lending modalities such a Sector-wide Approaches (SWAs), the Bank’s management has authorized the conduct of the current procurement assessment in Croatia.
This assessment is also an integral part of the Bank’s Country Assistance Strategy (CAS) for Croatia, which sets for this assessment and for the simultaneous Country Financial Accountability Assessment (CFAA) the objective that “building on the recommendations of the Bank’s forthcoming CPAR and CFAR, over the medium term, public procurement and financial management systems should improve to the point that the practice of “ring-fencing” of the Bank-financed projects is no longer considered necessary.” It is evident, therefore, that the Bank looks forward to seeing the improvements in Croatia’s public procurement system that this report recommends, in order that it will be able to rely in future on the country’s own public procurement legislation and system, rather than requiring the application of the Bank’s procurement guidelines to Bank-financed operations in Croatia.

With regard to the country’s relationship with the EU, the European Commission recommended, on April 20, 2004, that the Council of Europe should open accession negotiations with Croatia and gave a broadly favorable opinion on Croatia’s application for EU membership. However, the opinion highlights Croatia’s public procurement legislation as one of a number of non-harmonized areas, citing the following specific topics:

- excessively broad exemptions from the scope of application of the LPP;
- excessively broad exemptions from the scope of the Negotiated Procedure;
- deficiencies in the remedies system;
- implementing measures need to be adopted;
- regarding administrative structures, both the PPO and the State Commission need to become fully operational and establish credible enforcement records.

It should be noted here that, at the time of finalization of this report, the PPO is in the process of getting approval of the drafted amendments to the Public Procurement Act, as recommended by this report, the primary objective of which is to address the issues described above and to bring the law much closer into alignment with the EU acquis.

The Commission’s concerns expressed in April 2004 mirrored some of those expressed by the Bank in the 1999 CPAR, particularly regarding the need to complete the legal framework by enacting implementing regulations with comprehensive coverage and regarding the absence of an independent review body (which has since been addressed by the enactment of the Law on the State Commission for Control of Public Procurement Procedures of July 16, 2003). It is hoped that this new CPAR will not only update the diagnostic assessment of the state of Croatia’s public procurement system but that it will provide the Government with a clear agenda for completing the procurement reforms necessary not only for accession to the EU but also to complete the construction of an efficient, transparent and cost-effective public procurement system.

World Bank Portfolio in Croatia

Croatia joined the World Bank in early 1993. Since then, the Bank has supported 23 projects totaling US$1.23 billion in value (based on original commitments). Twelve projects have been completed, including two adjustment lending operations (Enterprise and Financial Sector Adjustment Loan and Structural Adjustment Loan). The current portfolio comprises twelve projects (US$452.8 million), which are summarized in Table 2, below. Initially, lending was mainly focused on investments in

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infrastructure to support the country's substantial needs for post-war reconstruction. Towards the end of the 1990s, the Bank’s assistance expanded to include health, agriculture and forestry sectors, enterprise and financial sector reforms, as well as judicial and pension system reforms.

The Bank engaged in a dialogue on a new mid-term strategy shortly after the new Government took office in December 2003. Hence, a new Country Assistance Strategy/Development Partnership Strategy (CAS/DPS) was prepared jointly by the Bank and the Government. The lending scenario of the new CAS/DPS reflects the Government’s commitment to its policy reform program, as supported by the proposed Programmatic Adjustment Lending (PAL). The PAL program aims to support the Government in continuing its structural reform agenda, particularly in the areas of governance, business environment, judiciary and human development. Parallel to the consultations on the new CAS and PAL program, the Bank, together with the Government, is moving forward on four projects in an advanced stage of preparation with an indicative amount of US$156 million.

Table 2: Composition of the World Bank Portfolio in Croatia as at May 31, 2004

<table>
<thead>
<tr>
<th>Project Name</th>
<th>Approval Date</th>
<th>Closing Date</th>
<th>Loan Amount (US$m)</th>
<th>Amount Disbursed (US$m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eastern Slavonia Reconstruction</td>
<td>18-Jun-98</td>
<td>31-Dec-04</td>
<td>40.6</td>
<td>26.9</td>
</tr>
<tr>
<td>Municipal Environment Infrastructure</td>
<td>18-Jun-98</td>
<td>30-Jun-06</td>
<td>36.3</td>
<td>15.7</td>
</tr>
<tr>
<td>Railway Modernization &amp; Reconstruction</td>
<td>12-Jan-99</td>
<td>31-Dec-04</td>
<td>101.0</td>
<td>66.9</td>
</tr>
<tr>
<td>TA for Institutional Reform &amp; Regulatory Reform of PSD</td>
<td>20-Apr-99</td>
<td>30-Jun-05</td>
<td>7.3</td>
<td>3.9</td>
</tr>
<tr>
<td>Health System</td>
<td>5-Oct-99</td>
<td>30-Jun-05</td>
<td>29.0</td>
<td>12.7</td>
</tr>
<tr>
<td>Trade &amp; Transport Facilitation in SEE</td>
<td>26-Oct-00</td>
<td>31-Mar-05</td>
<td>13.9</td>
<td>12.3</td>
</tr>
<tr>
<td>Court &amp; Bankruptcy Administration</td>
<td>16-Jun-01</td>
<td>31-Jul-05</td>
<td>5.0</td>
<td>0.7</td>
</tr>
<tr>
<td>Pension System Investment</td>
<td>18-Jul-02</td>
<td>31-Dec-06</td>
<td>27.3</td>
<td>9.4</td>
</tr>
<tr>
<td>Real Property Registration &amp; Cadastre</td>
<td>29-Aug-02</td>
<td>30-Sep-08</td>
<td>25.7</td>
<td>1.5</td>
</tr>
<tr>
<td>Rijeka Gateway</td>
<td>8-Jul-03</td>
<td>30-Sep-09</td>
<td>156.5</td>
<td>15.8</td>
</tr>
<tr>
<td>Karst Ecosystems</td>
<td>23-May-02</td>
<td>21-Dec-07</td>
<td>5.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Energy Efficiency</td>
<td>7-Oct-03</td>
<td>30-Jun-10</td>
<td>5.1</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td></td>
<td></td>
<td><strong>452.8</strong></td>
<td><strong>166.8</strong></td>
</tr>
</tbody>
</table>
C. Discussion and Analysis of Findings:

Public Sector

C.1 Legal and Regulatory Framework for Public Procurement

1.1 Introduction

The Croatian legal system is rooted in civil laws common to the Central European countries, particularly to the Austrian and German legal systems, where statutes are considered as formal sources of the law but judgments are not. One part of the legal framework has its origin in the domestic codification, either of the past when Croatia was a part of former Yugoslavia, or after gaining independence in 1991, while another part of the legislation has been developed since independence by adhering to internationally accepted models, in order to create a legislative framework suited to a market economy.

The Public Procurement Act (hereinafter referred to as the Law on Public Procurement or “LPP”) represents a major piece of legislation governing the public procurement process and, as a first attempt to follow EU standards, represents a significant departure from the previous legislation, dating from 1997, which had been based on the UNCITRAL Model Law on Procurement of Goods, Construction and Services (1994). Other laws that have an important bearing on public procurement operations in Croatia are the Law on the State Commission for Control of Public Procurement Process and the Law on Obligations. The content of these laws, together with the other laws having an impact on public procurement, is summarized in Annex A.

1.2 The Law on Public Procurement

The LPP provides for the major principles of the public procurement process, identifies parties to which it applies, defines the scope of authority of the Office for Public Procurement (PPO) and the State Commission for the Control of Public Procurement Procedures (hereinafter referred to as the “State Commission”) and outlines the stages in the procedure. The principal categories of institutions to which the LPP applies are (i) State and other entities that are users of the State Budget, (ii) legal entities in which the Republic of Croatia has a predominant interest or participation and (iii) the utilities sector.

Among the strong points of the LPP are:

- it provides for a decentralized procurement system in which all users of budgetary funds, central and local, are made responsible for conducting their own procurement;
- it requires adequate notification of bidding opportunities to suppliers and contractors, both at home and abroad;
- it requires publication of various categories of procurement notices in the Public Procurement section of the Official Gazette, which is also available on the Internet (www.nn.hr), together with quite comprehensive mandatory forms and contents for the various categories of notices;

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5 Zakon o javnoj nabavi; Official Gazette No. 117/01.
6 Zakon o državnoj komisiji za kontrolu postupaka javne nabave; Official Gazette No. 117/03.
- it envisages a two-tier system of administrative control of the procurement process by the Office for Public Procurement and the State Commission, an appeal body and, ultimately, judicial control by the Administrative Court.

However, the LPP has been criticized from many quarters. A major flaw of the LPP is the vagueness of certain provisions and poor drafting of others, which may result from inadequate translation into the Croatian language of models of other laws used in drafting process. The LPP also suffers from inappropriate structure, in that it is not organized systematically; this leads to uncertainty in its interpretation and application by the relevant parties. The most serious comments relate to the following:

The provisions dealing with legal remedies (Articles 70 and 71), are neither sufficiently elaborated, nor structured in conformity with the overriding principle of equality established in Article 3, which lays down the "General Procurement Principles." In addition, the LPP does not provide efficient protection to all participants in a bidding process:

- the selection of a procurement method is not opened to objection to all participants;
- there is no possibility to complain during the bidding process, although a complaint ("request for administrative supervision") may be lodged with the PPO which may take preventive action and require the procuring entity to eliminate any irregularity in the procurement procedure;
- it is not possible to object to the ordering party against the decision on annulment of the procurement process; however, the right of appeal directly to the State Commission exists;
- third parties or an administrative body itself are not entitled to appeal;
- it is not possible to appeal to the State Commission before the objection (i) has been filed with and (ii) dismissed or not responded by the Client (Article 71 (1)).

The authority of the ordering party to reject any bid wherein a third country, with which Republic of Croatia does not have a reciprocal trade agreement, is participating with 50 or more percent of the bid price (Article 60 (4) could lead to discrimination against foreign bidders and against bids submitted by joint ventures between local and certain foreign bidders. Furthermore, it could lead indirectly to a preference being given to domestic bidders.

The definition of some fundamental legal terms is poor, such as those of "goods," "works" and "services," which are not sufficiently comprehensive, as many procurement requirements do not fall within their scope (Article 2). Draft amendments to the public procurement law address this issue, however, the amendments have not been passed yet.

The LPP does not acknowledge the unique characteristics of consulting services and other professional and intellectual services, such as audit, training and certain computerization assignments. These services may not lead to measurable physical outputs and, as such, require specific criteria for the selection of consultants and for service contracts that emphasize the overriding importance of the technical quality of the services during evaluation. The existing provisions of the LPP may result in circumstances where the lowest price may be given primary consideration with much less regard for technical quality. The development of distinct rules and criteria for the procurement of consulting service contracts would help ensure the use of appropriate selection methods. These could include technical quality, combined with consideration of cost; technical quality only; and technical quality within the limitations of a fixed budget.
Although the award of concession contracts is excluded from the LPP, the approach of the PPO and their interpretation of the LPP is that the LPP not only applies to procurement for construction, but also to construction concessions. This leads to a lack of coherence on the legislative principles guiding concessions. Even though there is a separate Law on Concessions, greater transparency in the award of concessions could be achieved if the clear and detailed provisions on concessions were to be addressed in a single document: either the LPP itself or the Concession Law. If it is the latter, the Law on Concessions should include clear rules for the bidding of the concession contract or refer to the LPP.

Article 6 of the LPP, which generally prescribes exemptions from launching a public procurement process, fails to prescribe the adequate criteria and the purpose of application of such exemptions in sufficient detail. Thus, in practice, it may contradict Article 12 (2), which enumerates cases where direct contracting without an invitation for bids is allowed. In a related weakness, the conditions for use of direct contracting, contained in Article 12 (2), are too broad and should be curtailed, in order to prevent abuse and to increase competition. The various categories of exemptions from the scope of application of the LPP, provided for in Article 6, are also excessively broad and it is planned to more clearly define them through amendments to the Public Procurement Act in 2005.

The procurement procedures, particularly the negotiated procedure and the direct contracting procedure, are poorly drafted and need to be clarified. These two methods, due to the structure of the LPP and the associated provision (Article 12), overlap to a certain extent. Also other provisions such as bid evaluation, bid selection and other associated provisions are scattered elsewhere throughout the LPP and shall be re-grouped.

Article 53 provides for submission periods which are realistic, however Article 53.6 sets an unrealistic timeframe by setting a much lower deadline for public availability of information and preparation of bids setting up a minimum of 10 days from the date of the advertisement in the Official Gazette. Emergency circumstances under which 10 days advertisement is allowed are not defined, thus, allowing a wide use of this provision. A widely spread practice to justify application of this provision is to delay procurement process to start late into the budget year or not properly plan to have contracts in place by the required date.

In addition to the bid evaluation criteria specified in Article 46 (2) 1 (the lowest price bid) and in Article 46 (2) 2 (the most favorable bid in economic terms, determined by price and a number of non-price criteria), the LPP also allows the application of “additional criteria” in bidding documents giving examples of some additional criteria but without specifying or placing any limitation on how these shall apply. Without the implementing regulations to be adopted pursuant to Article 46.6 and absence of standard bidding documents, this provision leaves the process of bid evaluation open to abuse and error, particularly in the hands of public officials who may be inexperienced in public procurement.

The process of determination of abnormally low bids, mentioned in Article 58 does the article define the possible legal consequences of the submission of an unusually low bid, nor whether the procurement process is to be continued or not. This is discussed in more detail in Annex B.

As for the development of Croatia’s legal framework for public procurement, full alignment with the EU acquis is clearly the overriding priority. This reflected in the Decision of the (EC) Council COM (2004) 275, which deals with, among other topics, the principles, priorities
and conditions contained in the European partnership with Croatia, according to which one of the short-term goals of Croatia is to ensure that “an efficient and transparent public procurement system become fully applicable with the adoption of all necessary by-laws”.

A full list of the legislation applicable to public procurement in Croatia, which was reviewed for this assessment, is attached at Annex C.
C.2 Public Procurement Procedures and Practices

This section provides a step-by-step commentary on the application of the procurement law in practice, from planning, through tendering, to contract administration. It highlights how weaknesses and gaps in the legislation, as well as the absence of effective enforcement of the law, translate into diminished levels of transparency, competition and fairness in the procurement process.

2.1 Procurement Planning

Procurement planning, if done at all, is generally weak, with plans reviewed for this assessment consisting of little more than a list of contracts with budget numbers attached. They are essentially financing plans, with no consideration given to timing, contract packaging, the most appropriate procurement method or the interdependence between different contracts on the critical path of a project. The single greatest weakness of procurement planning in Croatia, as evidenced by the audit findings of the State Audit Office, is that such planning as is done generally does not start until half-way through the fiscal year. This gives rise to a number of negative outcomes, including it restricts the contracting authority’s choice of procurement method as there is often insufficient time to conduct the Open Procedure, it reduces the margin for error or delay before fiscal year-end and, according to the audit findings of the State Audit Office, it leads to many procurement procedures not being completed before the end of the year, which means that financial resources remain unused.

Several major ministries complain about disconnect between financial planning and budgeting, on the one hand, and procurement procedures, on the other. Many go out to tender for civil works contracts even before they have taken over the site, simply because they have the funds and are concerned about losing them if they have not spent them by fiscal year-end. This often results in the commencement of works being delayed, as the site is not ready for the contractor to take over, utilities connections have not been arranged. One of the largest ministries reported that all its works contracts run late and over-price for these reasons.

In its comments on the draft of this report, the State Audit Office corroborated the report’s finding on procurement planning, reporting that “The State Audit Office has also perceived the problem related to insufficiently elaborated procurement plans and lack of their consistency with financial plans”.

2.2 Eligibility to Participate in Public Procurement

While the provisions of the LPP on non-discrimination are, at first sight, relatively strong, they are undermined by the opportunity which they give contracting authorities to reject a bid submitted by a consortium where the membership of firms from countries with which Croatia does not have reciprocal trade agreements exceeds 50 percent of the value of the bid. The procurement authorities report never having encountered a case where this provision was applied.

2.3 Assessment of Bidders’ Qualifications

The provisions of the LPP dealing with the assessment of bidders’ qualifications are ill-defined, as they provide only for broad categories of requirements (business capacity, financial and economic capability etc.) and there is no secondary legislation in place to guide contracting authorities in how to apply them. The problem is exacerbated by the requirements of the LPP for “qualification proofs” - that is, the list of documents which a bidder must submit to demonstrate
his qualifications - which contain vague provisions, such as “adequate bank statements.” Many contracting authorities expressed dissatisfaction with this aspect of the law, as the vagueness of the provisions facilitates subjective decision-making by on which unqualified bidders are allowed to bid and qualified bidders which excluded. In the absence of clear guidance, the assessment of bidders’ qualification is usually misapplied by requiring bidders to submit a long list of papers, some of dubious relevance to the contract, and acceptance or rejection of a bid turns on which bid contains all the required papers, without any proper assessment being made of whether the bidders possess the qualifications, experience and resources necessary to perform the contract satisfactorily. Contracting authorities also require that all such papers have to be notarized, even for relatively low-value contracts, which bidders complain is expensive and unnecessary.

As a result of these provisions, many public contracts are won by companies that are incapable of executing them or qualified companies are not bidding on relatively small value public contracts due to high overheads in preparing and submitting the bids which require notarized multiple papers.

2.4 Procurement Procedures and Financial Thresholds

The range of procurement procedures available under the LPP is similar to those contained in the EU Procurement Directives: Open, Restricted and Negotiated (called “Direct Negotiation”) procedures, although the conditions for use of the various methods vary somewhat from those in the EU Directives. Other than the threshold of HRK200,000 (US$31,700 equivalent) below which the separate procedures for small-value procurement apply, no financial thresholds apply to the procedures in the LPP: they may be used regardless of the estimated value of the contract, provided that the conditions for use of the procedure are met. Given that the new EU Consolidated Directives, which have recently come into force, contain a revised range of procedures, including a Competitive Dialogue procedure, the Croatian law will need to be updated to reflect these changes. Box 1 provides a more detailed look at the procedures under the LPP and at the conditions under which they may be used.

2.5 Solicitation of Participants in Procurement Procedures

The LPP requires the advertisement of public notices for prior procurement notifications, invitations to bid, contract award notices and, in the case of entities in the utilities sector, for invitations to qualify and periodical notifications. In the second stage of a Restricted Procedure and in the case of Direct Negotiations with a single bidder, a public advertisement is not required. Among the procedures for the procurement of goods, works and services of small value (<HRK200,000), advertising in a newspaper – rather than in the Official Gazette – is required only for the Public Invitation for Bids procedure. Under the Limited Invitation procedure, the invitation for bids must be sent to a minimum of five bidders which are awarded by the Small-Value Procedure. Additional advertisement in daily newspapers is a commonly used practice. The LPP has fairly comprehensive requirements on the minimum contents of invitations to bid and this is reinforced by a Government decree of February 7, 2002, “On Public Procurement Notices and Records,” which stipulates the mandatory forms of such notices and is modeled on the requirements of the EU Procurement Directives. One of the strengths of Croatia’s public procurement system is that all such advertisements are published in the online edition of the Official Gazette (Narodne Novine, www.nn.hr) and this arrangement seems to work very well.
All contracts

In addition, following Croatia’s accession to the EU, contracts above thresholds stipulated in Article 77 of the Public Procurement Act, would have to be advertised in the Official Journal of the European Union (OJEU). This is inline with EU Directives.

### 2.6 Technical Specifications

The LPP contains a requirement that the technical description of procurement requirements in bidding documents should be objective and not result in an advantage being given to a specific bidder. It allows the use of brand names only in cases where no other description can be made but requires that such instances be accompanied by a specification that an equivalent product may also be bid.

Many contracting authorities report that this is one of the most problematic areas of the LPP to apply in practice. For example, state-owned enterprises that own and operate large fleets of buses and trams, or operate large industrial plants report that they find it impossible to buy the proprietary spare parts needed for the maintenance and operations of their existing equipment. This is because they are forced to use the Open Procedure and award on the basis of the lowest price in every case and the PPO will not allow them to buy from the original manufacturer of the capital equipment or to specify the brand name of the parts in the bidding documents, in cases where they use the Open Procedure, even though the LPP clearly allows such a provision. The PPO has commented that there are no reasons to avoid public bidding because there are enough bidders/suppliers who sell spare parts of the same manufacture.

### 2.7 Bidding Documents

The LPP has fairly detailed requirements in terms of the mandatory contents of bidding documents. However, because the PPO has not yet issued any standard forms of bidding documents, the application of these requirements by contracting authorities is often patchy. For example, an SOE in the transport sector does not include the proposed form of contract in its bidding documents, even though this is clearly required by the LPP. A sample of bidding documents reviewed for this assessment revealed wide variability in the quality of bidding documents issued to bidders, with most being particularly weak in explaining how bids would be evaluated. The President of the State Committee expressed the opinion that if the contracting entities would observe the requirements of the LPP on the mandatory contents of bidding documents, it would probably result in a 60 percent drop in the number of complaints the State Commission receives.
The price contracting authorities charge for the sale of bidding documents is usually around 100 Kunas (US$16), which is reasonable.

2.8 Bid Submission and Opening

The LPP requires that the period allowed to bidders to submit their bids should be not less than 36 days from the date of submission of the Invitation to Bid to the Official Gazette for publication, in the case of the Open Procedure. For the Restricted Procedure, the periods are 36 days in the first stage and 26 days in the second stage. In the Direct Negotiation procedure, the minimum period is 26 days. However, the LPP also permits these time periods to be truncated in exceptional circumstances, for example, for the Open Procedure from 36 days to 15 days and for the Negotiated procedure from 26 days to 10 days in cases of urgency. The LPP also includes what appears to be an overriding provision that the bid submission deadline should not be less than 10 days from the publication of the Invitation to Bid in the Official Gazette, a provision that appears to undercut all the other provisions and which is open to abuse. It is clear that 10 days is a wholly inadequate period of time for bidders to prepare and submit their bids, other than in cases of the simplest of procurement requirements.

The LPP contains strong provisions on public opening, which clearly require the Public Procurement Commission to open the bids in public immediately following the expiry of the deadline for submission of bids. The law also establishes the right of the bidders to be represented at the public bid opening as well as request the copies of the minutes.

2.9 Evaluation of Bids

The LPP contains provisions on contract award criteria similar to those in the EU Procurement Directives, namely:

- the lowest-priced bid; or
- the economically most advantageous bid, identified by applying price and a number of different criteria.

By far the most commonly used method of bid evaluation is award to the lowest-priced bid, which is used in 70-80 percent of all transactions. Contracting authorities prefer to use this criterion because it offers the simplest method of evaluation, which is also the most easily defended in the case of a complaint. Also, because the level of skills and experience in procurement is low, most public officials shy away from the complexity of the economically most advantageous approach. For most contracting authorities, the use of price only also precludes the need to undertake a detailed technical evaluation of the bids submitted.

Another factor driving this is the fact that the LPP provides contracting authorities with very little guidance on how to apply non-price criteria in bid evaluation. The LPP provides that non-price criteria should be specified in terms of their “importance in proportion to the overall evaluation system (ranging from 1 percent to 100 percent), as well as the calculation method.” However, as can be seen from the example in Table 4 below, most contracting authorities apply only merit points to the evaluation of price and non-price criteria and fail to define the required “calculation method.” The State Commission is of the opinion that this procedure is illegal and reports that it accounts for the great majority of appeals lodged before it. Despite the prevalence of this illegal practice, in the two and a half years since the LPP came into force in January 2002, the PPO has not taken any steps to enact the implementing regulation on bid evaluation which Article 46.6 of the LPP specifically foresees and which is clearly greatly needed.
It is clear that a specific implementing regulation on bid evaluation, dealing particularly the application of price and non-price criteria, is needed.

While awarding the contract to the lowest-priced bid is an adequate approach for simple procurement requirements, it has severe limitations when applied to complex plant and equipment, for example. In such cases, other criteria, such a life-cycle costs (i.e., the cost not just of purchasing an asset, but also of owning and operating throughout its useful life) are also important. However, such criteria are not applied in Croatia.

Where non-price criteria are used, they are usually expressed in terms of relative importance using a merit points system, such as the following bid evaluation methodology, which was applied to a recent evaluation of bids for the supply of nickel cadmium batteries:

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>50</td>
</tr>
<tr>
<td>Quality</td>
<td>30</td>
</tr>
<tr>
<td>Maintenance</td>
<td>12</td>
</tr>
<tr>
<td>Delivery</td>
<td>5</td>
</tr>
<tr>
<td>Technical Advantages</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

It is clear that this is a very subjective method of evaluating bids, as the criteria other than price can be applied in a discretionary manner, which leaves the process of bid evaluation open to manipulation and reduces the accountability of the members of the Public Procurement Commission (PPC) conducting the evaluation. Given the considerable leeway allowed to the evaluators by such an evaluation system, it would be very difficult to prove wrongdoing on the part of an evaluator.

Some unusual and non-transparent practices were noted in the evaluation of bids. For example, in the award of civil works for the construction of social housing (apartments of standard design), the Ministry of Public Works holds an Open Procedure, inviting bidders to quote their price for the construction of a single unit. Then it asks all qualified bidders to reduce their prices to match the lowest price-per-unit submitted from among all the bids received and it shares the construction work out among the bidders, contracting with each for as many units as it is qualified to build. The Ministry claims that Article 61.2 of the LPP specifically authorizes this approach.

In a further configuration of this methodology, when procuring the architectural design services for social housing, the Ministry imposes a ceiling (for example, €640 per square meter) with which the contractor, who is subsequently awarded the construction contract, must be able to build the housing units. The Ministry then takes a performance guarantee of 5 percent from the designer and, if it subsequently transpires that the contractor is unable to construct the buildings within that price, encashes the designer’s performance security.

2.10 Notification of Contract Award and Entry into Effect of Procurement Contracts

The LPP requires that the contracting authority must publish a contract award notice within 30 days of the conclusion of the contract, except in cases where the public interest or the business interests of the contractor would be damaged by such a notice. The LPP also specifies the
minimum contents of such notices and the Decree on Public Procurement Notices and Records specify the mandatory form. This, again, is one of the strong points of Croatia's public procurement system, as the publication of contract award notices is an essential element of transparency.

2.11 Records of Procurement Proceedings

The LPP has relatively good provisions on record-keeping. The problem is they are largely ignored by the contracting authorities and, in some cases, not enforced by the PPO. Among the latter category is an LPP provision requiring all contracting authorities to submit to the PPO, by March 31 of each year, an annual report of all procurement transactions they have conducted during the previous year. However, the PPO does not appear to press the contracting authorities to submit these reports and there were none on record at the PPO at the time of this assessment.

2.12 Procurement of Consultant Services

The procurement procedure mostly commonly used for the procurement of consultant services is the Open Procedure, combined with the evaluation of bids based simply on the lowest-priced bid. This is a very unsatisfactory way to procure consultant services, where the emphasis should be on getting high-quality advice, rather than on low cost. Using the Open Procedure means that there is no shortlist and, therefore, no effective means of ensuring that firms are qualified, as participation is open to both qualified and unqualified bidders. This also has the undesirable effect of dissuading qualified consulting firms from bidding, as they know that the use of the Open Procedure will likely result in their being undercut on price by low-cost competitors who pay less attention to providing quality advice. Contracting authorities interviewed for this assessment expressed strong dissatisfaction with having to use an Open Procedure for the procurement of consulting services, given the poor results this approach yields. Consulting firms interviewed for the assessment complained that the Requests for Proposals issued by contracting authorities are of poor quality; that the Terms of Reference are usually not fully developed; that, because the RFP fails to specify the estimated number of man-months required for the assignment and given the lack specificity in the TOR, writing a responsive proposal is rendered very difficult, as the firm cannot tell whether the assignment is large or small. These weaknesses in the procurement process also make the evaluation of proposals problematic, as different bidders make different assumptions about the scope of work and their proposal are not easily compared one with the other. Some firms expressed the view that contracting authorities leave the TOR vague on purpose, so that they can either extract more work from the consultants once they have them under contract or more easily amend the contract and increase the contract price during implementation. Several firms, particularly well-known firms with international practices, reported that, because of these abuses, they never bid on government contracts.

2.13 Review of Bid Protests

Before the establishment of the State Commission, the Public Procurement Administration in the MOF had undertaken the administrative review of procurement procedures in response to bid protests. This was a wholly unsatisfactory situation, given that the PPA was part of the MOF which itself was a contracting authority under the LPP and, therefore, PPA did not enjoy the independence necessary to ensure impartial review of bidders’ complaints. During the first nine months of 2003, the PPA/PPO received some 600 appeals, of which it upheld 70 percent. Most complaints related to mistakes made by contracting authorities in the way they conducted procurement proceedings. The State Audit Office’s annual report for 2002 found that the PPA
had made some incorrect decisions in its review of complaints but did not specify the nature of their findings.

Box 1: Procurement Procedures and their Conditions of Use

The following procurement procedures are provided for under the LPP:

- **Open Tendering:** The main procurement procedure, which requires public advertisement of the invitation to bid.

- **Restricted Tendering:** A two-stage procedure: the first stage is an open call for all interested firms to submit requests to participate, following which the contracting authority selects the qualified bidders and, in the second stage, invites all qualified bidders, with a minimum of at least five, to submit a bid. The Restricted Tendering procedure may be used when:
  
  - there is a limited number of bidders who are qualified to perform the contract;
  - use of the Open Tendering procedure would jeopardize the public interest in terms of confidentiality;
  - use of the Open Tendering procedure would impose costs on the contracting authority disproportionate to the value of the contract; or
  - use of the Open Tendering procedure would be inappropriate because of the complex nature of the procurement requirement.

- **Direct Negotiations:** This procedure may be used for negotiations with at least 3 qualified bidders, following the advertisement of an invitation to bid, when:
  
  - a previous Open or Restricted procedure resulted in bids that did not allow the contracting authority to award a contract;
  - the type of service or the risk associated with it precludes the preparation of a cost estimate for the contract;
  - the type of service does not allow it to be precisely defined (particularly for intellectual, financial, insurance, banking or investment services).

Alternatively, **Direct Negotiations** may be conducted with a single bidder, without publication of an invitation to bid, when:

- after a repeated Open or Restricted procedure, no acceptable bid or a single bid was received;
- only one bidder can perform the contract, because of exclusive rights;
- the requirement is urgent and the urgency was not caused by the contracting authority, where lack of time makes holding another procedure infeasible;
- there is an urgent need for additional delivery of goods, works or services under a contract previously awarded by an Open or Restricted procedure, provided the additional requirement does not exceed 25 percent of the value of the original contract;
- for standardized works supplied under the same terms and conditions as under an earlier contract awarded by an Open or Restricted procedure, within three years of the completion of the original contract;
- for research or development activities not aimed at commercial application;
- to take advantage of unusually low prices that are available in the market place for a limited period of time or because the supplier is facing liquidation.

**Procedures for the Procurement of Goods, Works and Services of Small Value for the procurement of < Under HRK200,000 (US$31,700 equivalent),** the available procurement procedures are Public Invitation for Bids, Restricted Invitation for Bids and Direct Contracting. In the Public Invitation procedure, the invitation to bid is published in a newspaper of the choice of the ordering entity and can be also published in the Official Gazette. Most prefer the Official Gazette as it is the cheapest. Under the Restricted Invitation procedure a minimum of 5 bidders of the ordering entity choice shall be invited to submit the bids (tenders).
C.3 Organization and Resources

This section looks at how responsibility for the conduct and oversight of public procurement is apportioned to the various institutions in Croatia. In addition, it examines the organization and functions of the Public Procurement Office (PPO) and the State Commission for the Control of Public Procurement Procedures. Finally, it assesses the organization of the procurement function in contracting authorities.

3.1 Public Procurement Office (PPO)

While the LPP passed in December 2001 provided the legislative basis for the operation of the PPO as a “professional service of the Government of Croatia authorized for the execution, supervision and application of this law and procurement by-laws,” in fact the PPO was not established until the enactment of a Government Ordinance “On Establishing the Office for Public Procurement” on November 6, 2003. In the intervening period of almost two years, the Public Procurement Administration within the Ministry of Finance performed the functions accorded to the PPO under the procurement law.

The authorized functions of the PPO are that it:

- implements, controls and applies the LPP and sub-legal acts on procurement;
- issues approvals, instructions and opinions to contracting authorities on the application of the LPP;
- collects and analyzes data on public procurement;
- refers to the State Attorney’s Office requests to initiate misdemeanor proceedings against any party it finds has breached the provisions of the LPP (see 4 below);
- participates in drafting laws and sub-legal acts on procurement;
- implements a training program for contracting authorities on public procurement;
- cooperates with international institutions on public procurement matters.

The Director of the PPO is appointed by the Government, upon the nomination of the Prime Minister, and reports to the Office of the Government in his day-to-day work.

The PPO, which is still physically housed in the MOF building, has a staff 14, of whom 10 are professionals, some of whom have been transferred to the recently-established State Commission. The PPO’s budget for 2005 was increased and recruitment of additional staff started to expand the team. This should address the PPO’s workload which is quite heavy given that the LPP imposes on it the duty of reviewing all instances of the use of the Restricted and Direct Single Source Procurement procedures – some 2000 applications annually. The requirement for PPO approval of the use of these procedures has a centralizing effect within what is designed to be a decentralized procurement system and placed on the PPO a heavy bureaucratic burden that it is not resourced to bear. Prior to the establishment of the State Commission, the Public Procurement Administration also reviewed bid protests but it has now transferred that work to the State Commission.

While the authors of the LPP built in a number of procedural safeguards against abuse of the law’s provisions, those safeguards continue to impose a bureaucratic burden on all participants in the system, which the PPO is not equipped to handle and which the contracting authorities find adds little value. There is also a considerable opportunity cost to the PPO of devoting so much of its slender resources to transactions clearances instead of completing the legal framework with
much-needed implementing regulations, writing user’s manual and training the staff of the contracting authorities in their use. According to the PPO, it is planned to amend the LPP to re-direct its function to institutional and legal areas of the public procurement system.

3.2 State Commission for the Control of Public Procurement Procedures

Although the State Commission was provided for in the LPP passed in December 2001, it too was not established straight away. Rather, it was created only by the Law on the State Commission for Control of Public Procurement Procedures of July 2003 (Official Gazette No. 117/03) and started its work in November 2003. As of February 2004, the State Commission had completed its decision on 107 cases, having taken over 68 cases from the former Public Procurement Administration of the MOF.

The State Commission is an independent body charged with reviewing complaints submitted to it by bidders in cases where a bidder has already submitted a complaint to a contracting authority and has received no response or is dissatisfied with the response. The LPP contains time limits within which the various parties have to act and imposes on the State Commission an obligation to rule on a given complaint within 15 days. The Commission is authorized not only to decide on cases files with it but also to apportion the costs of the complaint proceeding between the parties to the complaint.

The State Commission reports to the Parliament and is financed by the State budget. Its five members, most of whom are former judges and lawyers, are nominated by the Government and appointed by the Parliament. It is required to report at least annually to the Parliament.

The establishment of the State Commission represents an important step forward for Croatia’s public procurement system and moves it closer to alignment with the EU Remedies Directive. It created a possibility for a legal protection of the bidders through an appeal procedure and contributed to building the integrity of the public procurement system.

The operations of the State Commission in its first few months have been severely hampered by the fact that it was establishment half-way through a fiscal year. Therefore, it was initially allocated only a modest budget by the Government.

From the earlier perspective of its first few months of operation, the State Commission has identified the following as the main challenges facing it:

- lack of clarity in the LPP on the division of duties and responsibilities between the PPO and the State Commission, both of which perceive themselves as being responsible for certain aspects of “supervision” and “control” of public procurement;
- poor definition, in the Law on the State Commission, of the duties and powers of the Commission;
- absence from the LPP and the Law on the State Commission of procedural rules governing the operations of the PPO and the State Commission. Under Croatian law, procedural rules are to be found in the Law on General Administrative Procedure but these are rather general in nature and not sufficiently specific to public procurement;
- lack of clarity over which Committee of the Parliament will oversee the State Commission;
- under-development of the legislation for public procurement, particularly the absence of implementing regulations in key areas such as the application of criteria other than price in bid evaluation;
• limitations on the right of bidders to appeal at certain stages of the procurement procedure and for third parties to protest (these are explored in the Bank's review of the law in Section 1.2 above);
• lack of clarity and consistency between the LPP and other bodies of law, such as the Law on Ownership and Other Real Estate Rights and the Law on Obligations, many of which predate even the first enactment of procurement legislation in Croatia;
• lack of understanding of the correct application of the LPP among staff in contracting authorities.

The role of the State Commission is becoming more prominent, number of appeals is on the rise, additional staff has been hired and the annual budget increased. In 2004, the State Commission issued decisions on 779 cases, out of which 31 cases (or 4% of the total number of settled claims) were then referred to the Administrative Court of the Republic of Croatia. About 48% of the filed complaints were accepted. Total value of filed complaints in 2004 was 8,952,449,000.00 HRK.8

3.3 Public Procurement Operations in Contracting Authorities

The LPP requires the contracting authority to establish, by written decision and prior to the commencement of the procurement procedure, a Public Procurement Commission (PPC) comprising at least three staff. While the PPC conducts the procurement procedure, it reports to the contracting authority, and the “responsible person” of the contracting authority, usually a Minister or a Director in a public enterprise remains responsible under the law for the choice of procurement procedure use for a particular contract.

The LPP places on PPC members an obligation to withdraw themselves in cases of conflict of interest, but does not provide an adequate definition of what comprises conflict of interest.

Just as the LPP places a high bureaucratic load on the PPO, it imposes a similar burden on contracting authorities, which complain about having to conduct full-scale open tendering procedures for even relatively small-value requirements (over HRK 200,000/US$31,700) that do not meet the conditions for use of Direct Single Source Procurement). As an example, a large state-owned enterprise in the energy sector reported that it has to hold more than 600 tenders each year and that it maintains a Procurement Department with a staff of 130 employees handling some 5,000 procurement transactions at any one time. The Director responsible for the procurement function is of the opinion that at least half of those 600 tenders, 5,000 transactions and 130 staff are imposed on him unnecessarily by the bureaucratic provisions of the LPP.

The level of technical skill in procurement in most contracting authorities is fairly low. Although the PPO conducts around five training events each year, these are mostly short (2-3 days) seminars intended to help contracting authorities to correctly apply specific aspects of the procurement legislation. There is no source of comprehensive technical training in public procurement in Croatia.

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8 Source: Information from the State Commission for the Control of Public Procurement Procedures, provided to the World Bank in April 2005
C.4 Audit and Anti-Corruption Measures

This section reviews auditing arrangements in Croatia, examines the Government’s anti-corruption program and looks at available measurements of corruption in Croatia. The section on auditing draws on the Country Financial Accountability Assessment (CFAA) recently undertaken by the World Bank.

4.1 Audit

External auditing functions are performed by the State Audit Office (SAO) (www.revizija.hr), which operates under the Law on State Audit (Official Gazette 49/03) and is directly responsible to the Croatian Parliament (Sabor), which approves its annual work program.

The SAO is headed by Auditor General, supported by a deputy and six assistants. Its work is organized through eight departments, organized around the different levels of the public administration and different types of transactions (e.g., state budget users, local and regional self-government units, funds, privatization of state-owned entities) and operates through the headquarters in Zagreb and 20 regional offices. The SAO’s responsibilities include the annual audit of the state budget, national-level funds and the budgets of local and regional self-government units. The scope of the SAO’s work extends to assessing the efficiency and effectiveness of public expenditures, which is potentially an important activity in respect of public procurement. However, the SAO has not yet developed the capacity to conduct performance audits. In its comments on the draft CPAR, the SAO pointed out that it is constrained by its governing Act to hiring only graduate economists and lawyers, whereas, to conduct performance audits, it would require access to technical skills in pertinent disciplines, such as road construction, water supply and electrical power supply. In the performance of performance audits, the SAO would need to hire experts with such technical qualifications on a temporary basis.

One of the key vulnerabilities of the SAO is that it is financed by the State budget, rather than having an independent budget voted by the Parliament. Therefore, the SAO is subject to the same ex-ante reviews, controls and budget supervision by the Ministry of Finance as other budget users, which puts the independence of the SAO in jeopardy.

The Government administration generally does not have either well-established internal control systems or Internal Audit Units. Consequently, the SAO typically does not rely on the work of internal audit or internal administrative control units. Assessments of internal control and accounting systems are not an integral part of the SAO’s financial audits, but appear to be undertaken as separate exercises only where internal control or internal audit units have produced reports on physical control, inspection or auditing activities.

4.2 Anti-Corruption Measures

Croatia has taken a number of legislative measures in the fight against corruption, in that it has:

- signed and ratified UN Convention against Trans-national Organized Crime (the Palermo Convention 2000), in which it assumes an international obligation to introduce effective anti-corruption measures;
- signed the UN Convention against Corruption;
- ratified the Council of Europe Criminal and Civil Law Convention on Corruption;
adopted a special Law on Office for Fight against Corruption and Organized Crime;
adopted an Law on Prevention of Conflict of Interests in Performance of Public Duties;
to honor the above obligations, amended the Criminal Code, notably the specific provisions regarding corruption (receiving (Article 347) and offering (Article 348) bribes, abuse of state administration powers (Article 338) and abuse of position and official powers (Article 337) and the introduced sanctions for these criminal offenses;
amended the Law on Criminal Procedure to make the procedure more efficient;
the Croatian Parliament has adopted the National Anti-corruption Program with its Action Plan pledging all the three branches of power to take adequate measures for efficient fight against corruption.;
enacted in October 2003 the Law on the Prevention of the Conflicts of Interest in the Exercise of Public Office, which regulates the prevention of conflicts between private and public interests in the exercise of public office and establishes the principle that Government officials shall not place their private interest above their public duty. It regulates the receipt of gifts, the amount of which is to be determined taking into account the value of the average salary paid in Croatia during the previous year. The provisions on the receipt of gifts could have been stricter and would no doubt have been more effective had they specified an absolute financial limit for the amount of such gifts - for example, 300-400 Kunas - instead of referring to a percentage of the average salary, which has the effect of allowing the value of such gifts increase year on year;
within the LPP itself, there is also a provision requiring a contracting authority to reject a bidder’s bid if it finds that the bidder has tried to influence the procurement procedure by offering a bribe or has provided false information. The effectiveness of this provision is undermined by the fact that it is not accompanied by any penalty, other than the rejection of the bid. The Ordinance on the PPO, however, specifically authorizes the PPO to refer to the State Attorney’s Office a request to initiate minor offence proceedings against any party which it finds has breached the provisions of the LPP.

The Criminal Law also includes provisions on “Criminal Offenses Against Official Duty” which are relevant to procurement-related fraud and corruption. Table 5 summarizes the offenses defined in these provisions and the relevant penalties:

<table>
<thead>
<tr>
<th>Article</th>
<th>Provision Relating to</th>
<th>Penalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>337</td>
<td>Abuse of office and official authority</td>
<td>A fine or imprisonment not exceeding three years</td>
</tr>
<tr>
<td>338</td>
<td>Abuse in performing government duties, including “preferential treatment in contracting business, giving, obtaining or contracting jobs”</td>
<td>Imprisonment of six months to five years</td>
</tr>
<tr>
<td>344</td>
<td>Attempt to procure an unlawful pecuniary gain by submitting a false statement, deception of an authorized person into making an illegal disbursement</td>
<td>Imprisonment of three months to three years</td>
</tr>
<tr>
<td>347</td>
<td>Soliciting or accepting a bribe</td>
<td>Imprisonment of three months to five years</td>
</tr>
<tr>
<td>348</td>
<td>Offering a bribe</td>
<td>Imprisonment of three months to five years</td>
</tr>
</tbody>
</table>
The Minister of Justice, in her address to the High-Level Political Conference for the Signature of the U.N. Convention Against Corruption, pointed out that:

“All these legislative measures, international or national, do not have much of the meaning if not followed by effective implementation.”

In order to begin the process of enforcement of this formidable body of legislation, the Government established the Office for Fight against Corruption and Organized Crime (USKOK) in 2001, which operates under the auspices of the Public Prosecutor's Office. USKOK is a small, modestly-resourced office that focuses almost exclusively on the criminal investigation of organized crime. It does not have the resources to focus on administrative corruption, including corruption related to public procurement transactions, although the Director of USKOK recognizes that this is an important area and one to which his office should pay greater attention in the future, resources permitting. As the PPO and the State Commission have no specific remits in for anti-corruption work related to public procurement, the problem appears to go largely unattended. The Evaluation Report on Croatia by the Council of Europe Group of States against Corruption (GRECO) noted that:

“In recent years, Croatia has invested outstanding efforts in anti-corruption measures and their introduction in the legislation and practice is accompanied by a growingly effective and constructively critical civil society..... Some State institutions, presently undergoing complex reorganization, responsible for areas where the risk of corruption is usually high, still do not have proper capacities, programs and, in some cases, awareness to address...corruption. The same applies to the current public procurement system.”

an observation which GRECO backed up by recording that the Public Procurement Administration, then under the Ministry of Finance, had not by that stage (May 2002) uncovered a direct case of corruption.

One of the most recent measurements of procurement-related corruption in Croatia was undertaken as part of the Business Environment and Enterprise Performance Survey (BBEPS) survey in 2002. Based on a sample of 187 firms, the survey found that 94 percent reported making unofficial payments of up to 5 percent of the contract value to win a government contract, while just under 6 percent reporting making payments of more than 5 percent (see Figure 1).

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9 Text available at: www.un.org/webcast/merida/statements2/croa031210eng.htm
In the same survey, when asked how frequently they make unofficial payments, 60 percent reported that they never make such payments, while the remaining 40 percent reported doing so with varying degrees of frequency (see Figure 2).
C.5 Public-Sector Performance

Data on the value of public procurement expenditures in Croatia are difficult to access, given the large number and different categories of public institutions and entities governed by the LPP. Analysis of the budget for the years 2000 to 2003 (see Table 6), indicate that expenditures on procurement are running at about 20-25 percent of total public expenditure, with the figure for 2003, the latest year for which data are available, being at the high end of that range. Expressed as a percentage of Gross Domestic Product (GDP), public procurement accounts for about 12 percent. This is consistent with the levels of public procurement expenditures in neighboring countries but below the EU average of 16.7 percent.

The total value of public procurement expenditures in 2003 amounted to HRK 23.6 billion (US$3.7 billion), of which 57 percent (HRK13.5bn/US$2.1bn.) comprises goods and services, with the remaining 43 percent (HRK10.1bn./US$1.6bn.) comprising capital expenditures.

Table 6: Expenditure on Public Procurement 2000-2003

<table>
<thead>
<tr>
<th>(in HRK thousands)</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Consolidated General Government</strong>¹</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Expenditures and Net Lending</td>
<td>83,939,082</td>
<td>87,301,413</td>
<td>89,651,018</td>
<td>95,364,990</td>
</tr>
<tr>
<td>of which: Goods and Services²</td>
<td>12,753,125</td>
<td>12,422,333</td>
<td>12,413,906</td>
<td>13,547,045</td>
</tr>
<tr>
<td>Capital Expenditures³</td>
<td>5,066,954</td>
<td>4,873,041</td>
<td>7,710,718</td>
<td>10,081,501</td>
</tr>
<tr>
<td><strong>Total Procurement Expenditures</strong></td>
<td>17,820,079</td>
<td>17,295,374</td>
<td>20,124,624</td>
<td>23,628,546</td>
</tr>
<tr>
<td>as % of Total Expenditures</td>
<td>21.2</td>
<td>19.8</td>
<td>22.4</td>
<td>24.8</td>
</tr>
<tr>
<td>as % of GDP</td>
<td>11.7</td>
<td>10.4</td>
<td>11.2</td>
<td>12.3</td>
</tr>
<tr>
<td><strong>Public Enterprises</strong>⁴</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>37,535,371</td>
<td>32,192,438</td>
<td>30,461,978</td>
<td>N/A</td>
</tr>
<tr>
<td>of which: Goods and Services⁵</td>
<td>16,053,593</td>
<td>14,699,964</td>
<td>14,747,731</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Total Procurement Expenditures</strong></td>
<td>16,053,593</td>
<td>14,699,964</td>
<td>14,747,731</td>
<td>...</td>
</tr>
<tr>
<td>as % of Total Expenditures</td>
<td>42.8</td>
<td>45.7</td>
<td>48.4</td>
<td>...</td>
</tr>
<tr>
<td>as % of GDP</td>
<td>10.5</td>
<td>8.9</td>
<td>8.2</td>
<td>...</td>
</tr>
<tr>
<td><strong>TOTAL PUBLIC EXPENDITURE</strong></td>
<td>121,474,453</td>
<td>119,493,851</td>
<td>120,112,996</td>
<td>95,364,990</td>
</tr>
<tr>
<td><strong>TOTAL PROCUREMENT EXPENDITURES</strong></td>
<td>33,873,672</td>
<td>31,995,338</td>
<td>34,872,355</td>
<td>23,628,546</td>
</tr>
<tr>
<td>as % of TOTAL EXPENDITURES</td>
<td>27.9</td>
<td>26.8</td>
<td>29.0</td>
<td>24.8</td>
</tr>
<tr>
<td>as % of GDP</td>
<td>22.2</td>
<td>19.3</td>
<td>19.5</td>
<td>12.3</td>
</tr>
<tr>
<td><strong>GDP</strong></td>
<td>152,518,827</td>
<td>165,639,462</td>
<td>179,000,000</td>
<td>192,000,000</td>
</tr>
</tbody>
</table>

¹ Includes Central State Budget, Extra-budgetary Funds, Government Agencies and Local Governments.
² Approximated at 65% of total purchases of goods and services as per 2000 detailed budget data.
³ Acquisition of fixed capital assets and purchases of stocks.
⁴ Croatian Railways, Croatian Electricity Company, Croatian Forests, Jadrolinija (coastal shipping company), Croatian Post, Official Gazette, INA (oil comp.), Plovput (navigation and maritime radio-traffic).
⁵ Costs of raw materials, consumables and charges for services.
5.1 Enforcement of Public Procurement Legislation

In its annual audit report for 2002, the SAO found the following errors and abuses of procurement procedures in the institutions it audited:

- in the Restricted Procedure, which requires a minimum of five bids to be submitted, the number of was often lower than that, usually three;
- the use of the Restricted Procedure for contracts where the financial threshold in the LPP requires the use of the Open Procedure;
- use of the Direct Negotiations procedure without the necessary prior approval of the MOF Procurement Administration;
- bidding documents containing "irregular" terms and conditions that breach the provisions of the LPP;
- bidding periods (the period of time allowed to bidders to submit their bids) which were shorter than the minimum number of days specified in the LPP;
- inaccurate use of the provisions of the LPP relating to the assessment of bidders' qualifications;
- failure by the contracting authorities to collect from bidders the bid securities required by the LPP;
- bid evaluation was conducted using criteria other than those specified in the bidding documents;
- inadequate record-keeping and recording of procurement proceedings.

While the SAO does not give specific information about the contracting authorities committing these instances of non-compliance with the law nor offer any indication of the prevalence of such practices, they do suggest that enforcement of the LPP is not as strong as it should be.
C.6 Procurement Performance on Bank-financed Projects

The performance of procurement on Bank-financed projects is generally satisfactory and there have been no declarations of misprocurement since the last CPAR.

The following areas have been identified as problematic in the procurement area:

- The cross-cutting issue seems to affect most projects, and especially those that finance civil works, is the difficulty in obtaining the various types of permits needed to enable completion of the civil works. Implementing agencies have consistently reported to the Bank that obtaining these permits is unnecessarily prolonged and involves cumbersome, lengthy procedures. The experience on Bank-financed projects supports the findings of the FIAS study in this respect (see below).

- It is claimed to be a customary practice in Croatia not to consider VAT as tax for the purposes of preparation of the bid. This, however, is not a good practice as, in most cases, this is neither properly recorded at the time of bid opening nor at the time of contract signing. This, in turn, reduces the transparency of the procurement process and delays disbursement.

- For large IT procurements implemented through Supply & Installation contracts, there is a practice of using change orders, which appears to be driven mainly by decisions of Government officials to restructure the beneficiary organization during implementation of the contract (e.g., Customs Directorate in Trade & Transport Facilitation). It is clearly desirable that the Government avoid major reorganization of beneficiary institutions during the implementation of complex IT projects, as this seriously threatens the success of the investment.

- Lack of expertise of newly established PIUs in preparing bidding documents (e.g., terms of reference and technical specifications). This is mainly attributed to the shortage of Government procurement professionals and lack of networking among PIU staff.

6.1 Impact of Decentralization

In September 2002, the Bank decentralized the procurement function for some projects in Croatia to its Bulgaria Country Office. The Procurement Unit that has been established in Sofia comprises one Senior Procurement Specialist, two Procurement Analysts and a Procurement Assistant and serves about 50 percent of Bank's portfolio in Bulgaria, Romania and Croatia. The Croatia projects that have been decentralized are listed in table below:

Table 7: Current Decentralized Procurement World Bank Portfolio in Croatia

<table>
<thead>
<tr>
<th>Project Name</th>
<th>Currency</th>
<th>Principal</th>
<th>Effective Date</th>
<th>Closing Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Railway Modernization &amp; Reconstruction</td>
<td>EUR</td>
<td>85,400,000</td>
<td>Jun-99</td>
<td>Dec-04</td>
</tr>
<tr>
<td>Trade &amp; Transport Facilitation</td>
<td>EUR</td>
<td>14,800,000</td>
<td>May-01</td>
<td>Mar-05</td>
</tr>
<tr>
<td>Court &amp; Bankruptcy Administration</td>
<td>USD</td>
<td>5,000,000</td>
<td>Jan-02</td>
<td>Jul-05</td>
</tr>
<tr>
<td>Karst Ecosystem Conserve. Grant</td>
<td>USD</td>
<td>8,400,000</td>
<td>Sept-2002</td>
<td>Dec-07</td>
</tr>
<tr>
<td>Rijeka Gateway</td>
<td>USD</td>
<td>156,500,000</td>
<td>Oct-03</td>
<td>Sep-09</td>
</tr>
</tbody>
</table>
Procurement decentralization has been perceived positively by the Government, which has benefited from improvements in the following areas:

- improved timeliness of responses to procurement queries from PIUs;
- improved performance against the Bank's service standards for prior reviews;
- coordination of activities with decentralized disbursement hub, which accelerates the resolution of disbursement problems related to procurement translations;
- regional and local training seminars have been organized for PIUs and government officials.
C.7 Electronic Procurement

7.1 Government Leadership

With the change of the Croatian government at the end of 2003, the former Government Office for the Internet Infrastructure Development (OIID), which had previously taken the lead in the development of electronic applications for public procurement in Croatia, was replaced by the Central State Administrative Office for e-Croatia. To this end, the new Government has the opportunity to develop and support an e-GP program as part of the e-Croatia initiative. The new Program of the Government of the Republic of Croatia for the 2003-2007 Mandate, dated December 23, 2003, points out three priority areas under which e-GP can play a major role:

- the fight against corruption;
- the reform of the government;

In the context of government reform, the Government has stated its intention to offer taxpayers a public administration system with increased efficiency and savings (Program of the Government of the Republic of Croatia for the 2003-2007 Mandate, chapter 9.8). This will include a fully computerized public administration and a central control system for public spending, including all public financial transactions in Croatia to improve accountability, efficiency and transparency of government operations.

Under the e-Croatia 2007 initiative, the Government aims at stimulating the use of new technologies to build a strong information and communications network across the whole country. However, the program seems to focus its activities on services for citizens including education, health, and other public services and on the stimulation of science and businesses. While these areas are very important, e-GP is not explicitly mentioned in this context (Program of the Government of the Republic of Croatia for the 2003-2007 Mandate, chapter 8).

According to the Ministry of Science and Technology’s national report on the ICT strategy implementation (November 2003), the Government established the Strategic Planning Office in 2000, under which a task force for Information and Communication Technology, consisting of academics and representatives of private business, developed an ICT strategy for Croatia.

The proposed role of the Government in this strategy is, among others, to stimulate the development of e-Business and e-Administration, including e-Procurement, in line with the appropriate legislation, and to improve government applications.

The Government Office for the Internet Infrastructure Development (OIID) was established in 2001 to play a key role in providing resources for the introduction of the Internet in all spheres of life, including public administration. With regard to e-Government, the OIID, in cooperation with the Ministry of Justice, Public Administration and Local Self-Government; the Ministry of Science and Technology and the Ministry of Finance coordinated and defined actions and priorities. The ICT strategy implementation report points out the leading role of OIID, since replaced by the e-Croatia Office, in the transition process of central and local government to e-

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10 [http://www.vlada.hr/Download/2004/02/04/VRHProgramVRHeng_ft.htm](http://www.vlada.hr/Download/2004/02/04/VRHProgramVRHeng_ft.htm)
Administration, with priority to be given to e-Procurement due to its key influence on the development and transparency of e-Business administration in the public and private sectors.

The Central State Administrative Office for e-Croatia ("e-Croatia") is the successor organization to OIIID) considers itself as occupying a coordinating role with regard to the implementation of the Government’s ICT development strategy. However, with its limited resources and budget, this Office does not seem to be able, at the moment at least, to take an effective lead in the design and implementation of an e-GP program.

According to the Office, the Public Procurement Office may be involved in the initiation of such a program. The Public Procurement Office, in turn, does not see itself as an agency with operational responsibility for e-GP and points out that such a lead government agency may be appointed by a decision at a high governmental level. The PPO also does not currently have staff with the technical skills necessary to play a lead role in the development of e-GP and would need to hire such staff if it is to play the lead role expected of it.

Although the new Program of the Government of the Republic of Croatia announces the e-Croatia initiative as one of the new Government’s priority areas and the ICT strategy implementation report reflects the awareness of the importance of e-Government including e-GP, these seem to be very general considerations. Specific e-GP leadership by an established strategy and defined action items are not explored in detail in the program.

The impression of a lack of clear Government leadership in the context of the design and implementation of e-GP is reinforced by the fact that an outline of ICT-related projects by government bodies in the national report on the ICT strategy implementation does not show any e-GP project among the 65 listed projects of 17 different ministries and 2 state directorates.

7.2 Legal Framework for e-GP

Croatia has already developed a comprehensive legislative framework supporting the development of ICT in the public and private sectors. Several components of this framework can contribute to the establishment of the legal platform for the adoption of e-GP in Croatia.

The Law on Electronic Signature (No. 10/02) and the Law on Electronic Commerce (No. 173/03) published on January 30, 2002, and on October 31, 2003, respectively, are in place to regulate information services, responsibilities of service providers and the provisions for issuing electronic contracts. Several Ordinances regarding Electronic Signature Certification complement the Law on Electronic Signature.

Croatia shows much awareness of the importance of harmonizing legislation in the field of e-Business with international legislation. According to the ICT Strategy Implementation Report, whenever possible, international legislation must be accepted and applied whenever introducing laws and subordinate legislation in this context. New regulations shall be drafted by taking into consideration the requirements of e-Administration and communication in accordance with legal provisions of the EU. Furthermore, the report requires that international standards in ICT shall be adopted and applied in line with the harmonization with the WTO and the EU.

Under the Ministry of Science and Technology, Croatia has already started to harmonize its ICT-related legislation with the relevant EU legislation. The Law on Electronic Commerce is a good
example, which, according to a joint review by the OECD and the European Union, has been largely harmonized with the Directive 2000/31/EC.

The Ministry of Maritime Affairs, Transport, and Communications is responsible for creating the legislative framework to encourage the private sector to build the information society. This includes ICT infrastructure development as well as broadband and mobile Internet access. In this area, the Law on Electronic Commerce has already contributed to moving towards e-Commerce and stimulating SME's to use the Internet.

Other legal provisions which are of greater or lesser relevance for the design and implementation of an e-GP program include the Law on Telecommunications, the Law on Electronic Media, the Law on Data Protection, the Law on the Right to Information Access, and the Law on Finance Agency, on the basis of which the National Finance Agency (FINA) assumed the responsibility for the support and development of application services and e-government solutions with a focus on security techniques.

While a law with regard to electronic documents, electronic payment, and electronic money is still pending enactment, the current LPP is not yet prepared to promote and support e-GP, as it does not contain any reference nor legal requirements with regard to e-GP. This may not appear surprising since the LPP dates from 2001. In the meantime, however, the EU provides a legislative framework for e-GP in its recently-promulgated Consolidated Directive. This framework refers to different methods of using electronic systems for public procurement, such as e-Tendering and e-Purchasing, including e-dynamic purchasing systems and e-reverse auctioning. It is essential, therefore, that any future development of the public procurement legislation in Croatia should bring it into line with the EU Consolidated Directive, including the relevant provisions on e-GP.

7.3 Technology and Infrastructure

The current position on technology and infrastructure is similar to the situation with regard to the legal framework: Croatia has achieved a lot in introducing and developing an appropriate infrastructure in general, which is a solid basis for e-GP but not an e-GP infrastructure per se.

A lot of efforts are visible in terms of computerization, liberalization of the telecommunications market, and connectivity (including the Public Administration Computer and Communication Network, PACCN, several Virtual Private Networks, VPN's, and increased broadband services) on all government levels and within the private business community. A national Smart Card project is under planning to integrate ICT ID cards, e-signature cards, health insurance cards, budget user cards, and public services cards. The projects for 2004 intend to improve the connection between central and local administration.

The conceptual model of the national information system aims at e-Government development (legislation, networking of central and local government bodies, e-mail system, electronic data exchange system, national registries and records, database system with open access, creation and exchange of digital documents, analysis of existing solutions, databases in particular and possibilities of their integration). To this end, county offices as well as regional and local government offices have already been computerized and connected to the network.

FINA was established in 2001 and signed a contract with the government in 2003, taking responsibility as a Digital Certification Authority. FINA's Registry of Digital Certificates (RDC) is the only qualified certificate provider registered with the Ministry of Economy as the highest
certifying authority in Croatia. To this end, secure electronic access to information and services is provided through public-private key infrastructure (PKI) and electronic signature technology. Since 2003, about 30,000 companies have used PKI technology in money transfers through electronic banking.

One of the most important e-GP requirements is connectivity to the Internet. While the use of e-GP can result in increased competition, this can be achieved only if suppliers have access to the Internet. Otherwise, e-GP may even lead to the exclusion of suppliers from competition, thus increasing the digital divide, rather than realizing the intended objective of increasing participation by bidders in public procurement. Internet connectivity does not seem to be a problem for the Croatian supplier community. Even small enterprises are well equipped and very often use card-reader devices to authorize financial transactions online. These card-reader devices are usually linked to an office PC at the supplier’s location and can be purchased from commercial banks at reasonable cost (about US$25).

The Croatian Internet service market is divided between seven major Internet Service Providers. According to the ICT Strategy Implementation Report, the total number of Internet users has grown from an estimated 200,000 in 1998 to 789,000 in 2000 (see Table 8). In 2003, the estimated number of business users was 82,954 companies. Although the ICT Strategy Implementation report proposes the implementation of broadband access at the national level, many SMEs complain about the high costs (e.g. about US$320 monthly) for relatively slow Internet access (e.g. 28-64k bandwidth).

![Table 8: Information Technology Indicators (number)](Image)

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2002</th>
<th>Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal computers</td>
<td>500,000</td>
<td>760,000</td>
<td>52%</td>
</tr>
<tr>
<td>Internet hosts</td>
<td>9,507</td>
<td>29,644</td>
<td>211%</td>
</tr>
<tr>
<td>Estimated Internet users</td>
<td>200,000</td>
<td>789,000</td>
<td>295%</td>
</tr>
</tbody>
</table>

Source: International Telecommunications Union Yearbook of Statistics

Part of Croatia’s ICT Strategy is to initiate the development of an e-Business infrastructure to assure basic e-Business functions, introduce simplified electronic administrative procedures, and to provide free Internet access to local communities through public centers. To this end and taking into consideration the achievements so far, Croatia seems very well prepared in terms of Technology and Infrastructure to move forward into the design and implementation of e-GP.

### 7.4 Capacity Development

Croatia attaches much importance to the development of appropriate ICT skills and capacity in the context of the ICT strategy implementation. The new Government Program intends to include the ICT capacity building in the curricula throughout the public education system. In the context of the preparation of new teaching programs, the project “ICT Curriculum” has catalogued ICT teaching programs for primary and secondary schools. ICT learning programs are also in the focus of higher education and research in the field of ICT is encouraged by several measures, such as providing the appropriate infrastructure or launching new research projects around ICT. To foster mutual confidence and develop e-Business relevant skills, Croatia supports the idea of
partnerships between the government, consumer representatives, private industry, and the academic community.

A very good example of ICT capacity building is the setting up by the Ministry of Trades, and SMEs of entrepreneur centers with free practical information on e-Business and training programs. This has helped to increase the total e-Business volume, including Business-to-Consumers (B2C) and Business-to-Business (B2B) from US$49.24 million in 2002 to 99.72 in 2003. Private industry seems to be aware of the benefits of e-GP and has developed the capacity and readiness to start online business transactions with the government.

In terms of Technology and Infrastructure, Croatia can be proud of its achievements to date in terms of building capacity in the area of ICT in general. The challenge is to build on the existing ICT awareness and capacity and use this momentum to design and implement a successful e-GP program.

7.5 Applications for e-GP

In line with its efforts to develop an appropriate ICT infrastructure for a modern and efficient public administration system, the OIID designed and partially implemented a software application for a computer-based requisition system which is used for the aggregation of the procurement of ICT-related equipment and services for all Ministries and State Offices. Prior to the introduction of the system in 2001, the Ministries and State Offices were responsible for their own procurement of ICT equipment. At that time, the Government’s efforts to achieve savings on ICT equipment were undermined by the small procurement volume of each procuring entity.

The software application development was contracted out to a Croatian private company. The application is fully web-based and runs on a Microsoft Windows platform with Microsoft SQL Server. The scope of functionality can be divided into two major components:

- a requisition module for internal use by government entities; and
- an e-Procurement module supporting online transactions with the private-sector supplier community.

The requisition module works on the basis of an electronic catalogue that includes all standard ICT and related equipment (e.g. personal computers, workstations, servers, printers, monitors, etc.) as line items with prices. These prices are based on the previous consolidated contract with ICT suppliers and subject to control and correction along analytical findings from data provided by www.pricewatch.com. In addition, a technical expert group of the OIID has provided technical support regarding technological changes.

By using the Government intranet, authorized staff in the Ministries and State Offices can select the items they want to buy into an online “shopping cart.” In doing so, the application offers an automatic budget control mechanism, i.e. a cross-check with a budget list imported as a spreadsheet from the Ministry of Finance. In this way, the system will not allow the Ministries and State Offices to exceed their total budget allocated by the Ministry of Finance on the basis of previously submitted budget plans.

After all Ministries and State Offices have forwarded their requirements for ICT and related equipment and services to the OIID electronically through the system, a public tendering procedure for their aggregated requirements is launched by OIID, usually once or twice a year. While the requisition by each Ministry and State Office, including the submission to the OIID, is
an online process by using the software application, the public tendering is an offline process conducted by OIID in traditional paper format. Since this office was replaced by the Central State Administrative Office for e-Croatia, the latter is now conducting the process of the requisition, public tendering and reverse auction as the final phase.

Bidders can submit their bids for different lots. During 2001 and 2002, the contracts were awarded as a result of the bid evaluation process using the Open Tendering procedure under the LPP. From 2003 onwards, the procurement process has resulted in a shortlist of those bidders who are qualified to take part in a reverse auction, i.e., who accept the proposed price in the tender requirements which, at the same time, is the ceiling price of the reverse auction. The reverse auction is also an off-line process taking place with participants in a defined location at a defined time conducted by a professional auctioneer.

While the electronic requisition system is mandatory for use by all Ministries and State Offices on the basis of a Government Decision, it is open to voluntary participation by any local government entity. However, most of the local governments have not yet used the system. Lack of local government coordination, as well as their independence in allocating their budgets may explain this situation. So far, the system has been used for ordering a total of about 12,000 personal computers and large quantities of related equipment and services. Besides a considerable increase in transparency, savings in price have been achieved of up to 16% for personal computers, 60 percent of presentation equipment, 50 percent of uninterruptible power supplies (UPS), 50 percent for ink-jet printers and 47 percent for off-the-shelf software. These price savings were not only triggered by larger purchasing volumes, due to the aggregation of demand, but also by the use of reverse auctions after the Open Tendering process. To this end, the electronic requisition system has not only generated price savings but also supported the process of aggregation. It is also probable that the Government's transaction costs (that is, the cost of placing a public contract) have been reduced by doing the requisition and aggregation electronically instead of manually, but no data are currently available to quantify this saving.

Concerning the web-based e-Procurement module of the software application that has not been used so far, it offers the functionality of online tendering. To this end, online transactions with the private supplier community could include the electronic distribution of bidding documents and the electronic submission of bids. Until the bid submission deadline, only bidders would have access to their bids for any modification or update. No other party, including government staff, would have access to the bid information before the opening. The security mechanism used for this function is based on crytography.

For the bid opening process, each bidder would have to attend the public bid opening in person and use a smart card to decrypt his bid, thus authorizing the opening of the bid. As the smart card does not yet include the functionality of digital signature, bidders would have to manually sign a paper documenting the results of the bid opening.

This second software application module, however, is not yet functional due to lack of the appropriate legal provisions and government decisions. Besides the enactment of the law regarding electronic documents, electronic payment, and electronic money. The current LPP needs to be amended in order to establish the legal basis for online public procurement transactions. In addition, the Government may take a decision on implementing the second software application module through an initial pilot.

Besides the partially-used application software for web-based government procurement, the functionality of publishing online procurement information, including procurement notices, is
available through the website of the Official Gazette in Croatia. This website is being used by private suppliers in addition to paper-based procurement information. It may be explored as a potential website for providing not only online procurement information but also transactions, such as electronic distribution of bidding documents, electronic submission of bids, or electronic reverse auctions.
C.8 General Risk Assessment

Procurement risk arises from various aspects of the public procurement regime in Croatia, including the legislative framework, the procedures and practices of procurement, the institutions entrusted with enforcement and review, the capacity of the contracting authorities to conduct procurement and, finally, the threat of corruption.

The legislative framework for public procurement is remains incomplete. The LPP, while it approximates the EU Procurement Directives, is not yet fully aligned, contains too many exemptions to its scope of application and is particularly lacking in its provisions on legal remedies. The PPO has stated its intention to enact amendments to the procurement law in order to bring the range of exceptions allowed under the current Public Procurement Act in line with the exceptions in the new EU Consolidated Directive (2004/18/EU). Also, two implementing regulations were published in February 2002, the full set of implementing regulations, which are necessary to complete the legal framework, have not been enacted yet.

There are several deficiencies in procurement practices in Croatia, particularly with regard to inadequate procurement planning and to the truncation of bidding periods allowed to bidders to prepare their bids, which reduces both transparency and competition. There are also serious problems with the way in which contracting authorities assess bidders' qualifications, reducing this important step in the procurement process to little more than a paper-checking exercise and thereby allowing unqualified bidders to win contracts which they cannot implement. The practice of bid evaluation is also under-developed and, in instances where merit points are used, it is particularly opaque. Finally, the procurement procedures used for procuring consultant services are wholly unsuited to that task. That said, there are some good points – particularly the arrangements for advertising invitations to bid and contract award notices in the Official Gazette.

The institutional framework for public procurement is also just beginning to develop, with the establishment of the Public Procurement Office and the State Commission for the Control of Procurement Procedures in November 2003. While the PPO is a successor organization to the Public Procurement Administration in the Ministry of Finance and, therefore, has some retained experience, nevertheless it is under-staffed and mired in granting a plethora of bureaucratic clearances, rather than focusing on developing the public procurement system and promoting good procurement practice. At the end of 2004 EU-funded twinning arrangements with German and Slovenian public procurement authorities have been set up to provide badly needed technical assistance to the PPO to strengthen its capacity and assist in developing institutional strategy. The work started in early 2005. Establishment of the State Commission was an essential and welcome addition to the institutional framework. Both institutions, though still facing difficulties of the transitional period (such as getting sufficient office space outside of the MOF, operational budget and staffing) have started to demonstrate rapid improvements in the progress of improving the public procurement system and establish a credible profile and track record for enforcement. Recent external audits conducted by the State Audit Office have found many serious breaches of the LPP, which underscores the current weakness of enforcement. With only a few exceptions, the capacity of contracting authorities to apply the LPP correctly and to implement procurement efficiently is weak. Both the PPO and the State Commission are facing big challenges in the years preceding to the EU accession as the country would need to demonstrate a proven implementation record.

Finally, as in many countries, the risk of public procurement-related corruption in Croatia remains high. While the problem is not as severe as in other countries in South-East Europe,
nevertheless firms are willing to make illegal payments to public officials to win government contracts and many admit having done so.

Overall Assessment

Based on the CPAR’s analysis of the legislative framework, procurement practices, institutional capacity and the opportunity for corruption, the assessment found that the environment for conducting public procurement in Croatia is average.
C.9 Recommended Supervision Plan and Identification of Unacceptable Practices for use in Bank-Financed Projects

9.1 Recommended Supervision Plan on World Bank-financed Projects

The following thresholds are recommended for application to Bank-financed projects in Croatia.

Table 9: Applicable Thresholds by Procurement Method

<table>
<thead>
<tr>
<th>Procurement Method</th>
<th>Threshold (in million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICB: Works</td>
<td>above EUR3.0</td>
</tr>
<tr>
<td>NCB: Works</td>
<td>below EUR3.0</td>
</tr>
<tr>
<td>ICB: Goods</td>
<td>above EUR0.5</td>
</tr>
<tr>
<td>NCB: Goods</td>
<td>below EUR0.5</td>
</tr>
<tr>
<td>Shopping</td>
<td>below EUR0.06</td>
</tr>
</tbody>
</table>

Assuming that the recommendations of this report are accepted by the Government and implemented and that the planned improvements in the country’s public procurement system result, the Bank should move quickly to a greater reliance on Croatia’s own public procurement system, rather than on World Bank procurement guidelines.

In preparation for new modalities of lending to Croatia, such as SWAPs, this assessment attempted to assess the readiness of specific sectors – including education, health, infrastructure and transport – and specific institutions for such lending. It is unfortunate that the timing of the assessment followed closely after the new Government came into office and, as a result, a number of the ministries visited for this assessment were still in the process of handover from one leadership team to another and, as a result, it proved impossible to obtain an accurate picture of their readiness to conduct procurement financed by the Bank under the Croatian LPP. Attempts to assess the capacity of certain public-owned companies proved more fruitful, as they were less directly affected by the change in government which preceded this assessment. Some of these institutions, such as Croatian Motorways, Ltd (Hrvatske autoceste d.o.o.) and Croatian Waters (Hrvatske Vode) have built up experienced teams of public procurement specialists, who have both first-rate technical expertise relevant to their sector and considerable experience of conducting procurement not only under the Croatian LPP but also under the procurement rules of several different international financial institutions, including the World Bank, EBRD and European Investment Bank. These institutions look like they are ready for a SWAP-based approach to lending.

For other institutions, however, should a SWAP be proposed for Croatia, it is recommended that the institutions proposed to undertake implementation should be separately assessed by an Institutional Fiduciary Assessment (IFA).

9.2 Unacceptable Practices on World Bank-financed Projects

When National Competitive Bidding (NCB) is used on Bank-financed projects in Croatia, the following procedural waivers should apply to the Croatian LPP.
Procedures

The Public Bidding procedure shall be followed in all cases. Invitations to bid shall be advertised in the Official Gazette (Narodne Novine) and on the web-site of an implementing agency, allowing a minimum of 30 days for the preparation and submission of bids.

Assessment of Bidders' Qualifications

When pre-qualification shall be required for large or complex works, invitations to pre-qualify for bidding shall be advertised in the Official Gazette and at least one widely circulated national daily newspaper a minimum of 30 days prior to the deadline for the submission of pre-qualification applications. Minimum experience, technical and financial requirements shall be explicitly stated in the pre-qualification documents, which shall be determined by a “pass/fail” method, not through the use of a merit point system. Where pre-qualification is not used, the qualifications of the bidder who is recommended for award of contract shall be assessed by post-qualification, applying minimum experience, technical and financial requirements, which shall be explicitly stated in the bidding documents.

Participation by Government-owned Enterprises

Government-owned enterprises in the Republic of Croatia shall be eligible to participate in bidding only if they can establish that they are legally and financially autonomous, operate under commercial law and are not a dependent agency of the Government. Furthermore, they will be subject to the same bid and performance security requirements as other bidders.

Bidding Documents

Procuring entities shall use the appropriate standard bidding documents for the procurement of goods, works or services, which shall contain draft contract and conditions of contract acceptable to the Bank.

Bid Submission, Opening and Evaluation

a) Bids shall be submitted in a single envelope containing the bidder’s qualification information, technical and price bids, which shall be opened simultaneously at the public bid opening.
b) Bids shall be opened in public, immediately after the deadline for submission of bids. The name of the bidder, the total amount of each bid and any discounts offered shall be read aloud and recorded in the minutes of the public bid opening.
c) The evaluation of bids shall be done in strict adherence to the monetarily quantifiable criteria specified in the bidding documents, and a merit point system shall not be used.
d) Extension of bid validity shall be allowed once only for not more than 30 days. No further extensions should be requested without the prior approval of the Bank.
e) Contracts shall be awarded to qualified bidders having submitted the lowest evaluated substantially responsive bid.
f) No preference shall apply under National Competitive Bidding.

Price Adjustment

Civil works contracts of long duration (e.g., more than 18 months) shall contain an appropriate price adjustment clause.
Rejection of All Bids

All bids shall not be rejected and new bids solicited without the Bank’s prior written concurrence.

When the number of bids received is less than two, re-bidding shall not be carried out without the Bank’s prior concurrence.

Securities

Bid Securities should not exceed 2 percent of the estimated cost of the contract; performance Securities, not more than 10 percent. No advance payments shall be made to contractors without a suitable advance payment security. The wording of all such securities shall be included in the bidding documents and shall be acceptable to the Bank.
C.10 Private Sector

Croatia’s private output to GDP ratio at 60 percent is one of the lowest in Eastern Europe (see Table 10). When it came to power in early 2004, Prime Minister Sanader’s government embarked on an extensive privatization program. However, privatization remains largely incomplete, and Croatia, in common with some of its neighboring countries, has a long way to go to catch up with the countries of Central Europe in this respect.

10.1 Enterprises

One of the most severe problems obstructing the effective implementation of the LPP is the slow pace of the privatization program, which has left a large number of entities still within the scope of the LPP, including more than 100 large companies, whose activities are mainly commercial in character. For such entities, the LPP is a straightjacket that inhibits their business operations and adds unwelcome cost, time and bureaucracy.

The state-run Croatian Privatization Fund (CPF), with its three sectors in tourist facilities, agricultural enterprises, and industrial commercial firms, continues to make progress, particularly with small- and medium-sized enterprises. The tourism sector accounts directly for about 5 percent of GDP and, indirectly, as a source of foreign exchange receipts around 23 percent of GDP, making privatization in this sector an important consideration. Approximately one dozen large state-owned companies remain in the state sector, including shipbuilding.

Table 10: Private Sector Share of GDP, 1995 and 2003

<table>
<thead>
<tr>
<th>South East Europe</th>
<th>Private Sector Share of GDP, 1995</th>
<th>Private Sector Share of GDP, 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>60</td>
<td>75</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>n/a</td>
<td>50</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>45</td>
<td>75</td>
</tr>
<tr>
<td>Croatia</td>
<td>45</td>
<td>60</td>
</tr>
<tr>
<td>Macedonia</td>
<td>40</td>
<td>60</td>
</tr>
<tr>
<td>Moldova</td>
<td>30</td>
<td>50</td>
</tr>
<tr>
<td>Romania</td>
<td>40</td>
<td>65</td>
</tr>
<tr>
<td>Serbia and Montenegro</td>
<td>n/a</td>
<td>45</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Selected Central European Countries</th>
<th>Private Sector Share of GDP, 1995</th>
<th>Private Sector Share of GDP, 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>70</td>
<td>80</td>
</tr>
<tr>
<td>Hungary</td>
<td>60</td>
<td>80</td>
</tr>
<tr>
<td>Slovakia</td>
<td>60</td>
<td>80</td>
</tr>
<tr>
<td>Slovenia</td>
<td>45</td>
<td>65</td>
</tr>
</tbody>
</table>

10.2 Infrastructure

Telecommunications: The state-owned fixed-line operator Croatia Telekom (HT) became majority privately owned with its acquisition by Deutsche Telekom in 2001.

Energy: Parliament approved the partial privatization of the electric power utility company HEP in 2002. It has been necessary to "unbundle" the company into generation, transmission and distribution units.

Transport: The government established two new state-owned companies in 2001: Hrvatske Autoceste d.o.o. (Croatian Motorways Limited, or "HAC") and Hrvatske Ceste d.o.o. (Croatian Motorways Ltd.) for the development and maintenance of state highways and roads, which replaced the Croatian Roads Authority. Both HC and HAC have independent sources of income (vehicle registration fees, dedicated fuel tax, and – for HAC only – motorway tolls and land rents, which has made the financing of road constructions and maintenance more reliable).

There are plans to separate Croatian Railways (HZ) into infrastructure, freight and passenger services, which are intended to serve as the basis for the privatization of some of the services provided by HZ.

10.3 Construction Sector

Physical damage to Croatia's infrastructure done by the 1991-95 war was estimated by the Government at US$27 billion. An extensive post-conflict reconstruction program acted as the main driver of a rapid increase in construction during the second half of the 1990s. However, that boom tailed off from 1999 onwards, when gross value added (GVA) in the construction sector fell by 10.1 percent, as the incoming HDZ government was forced to cut back on capital expenditure and fell a further 4.5 percent in 2000, as private-sector investment also fell away.

From 2001 onwards, a recovery in construction activity got underway, with GVA growing by 33 percent in 2002 and 23 percent in 2003, as investments in new infrastructure replaced reconstruction as the main engine of growth in the construction sector. One of the high-profile programs undertaken by the government is an ambitious road-building program, with new highways being built to link the capital, Zagreb, with Rijeka, on the Istrian peninsula, and with the southwestern hinterland, including Split. Most construction contractors interviewed for this assessment reported that demand in the domestic market is now so buoyant that they no longer actively seek opportunities outside the country. However, many anticipate that, as the road-building boom peters out, they will have to start looking for work outside Croatia in the coming years.
10.4 Consulting Industry

Croatia's consulting industry has been badly hit by the unrest and isolation of the past decade, with many of its most qualified engineers, designers and architects leaving to practice their profession abroad, mostly in the European Union. The sector now comprises mostly very small firms, of three or four professional staff and very low capacity, and freelancing individuals.

The use of the Open Procedure (open tendering) for the procurement of consulting services has had a very negative impact on Croatia's consulting industry, as the incentives all point towards low price and low quality, rather than to the necessity for putting quality first.

The Chamber of Engineers and Architects, which is member of FDIC, comprises individual members, rather than consulting firms, most of them consulting engineers. Its work is mostly aimed at achieving mutual recognition of Croatian technical qualifications in other countries, which is an important consideration, given the country's application to join the EU.

The Law on the Chamber forbids its members from competing against each other on price. In addition, the Chamber sets minimum prices (usually expressed as a percentage of the capital cost of the investment project) below which its members should not accept work. However, most consultants have openly broken from this restriction and regularly bid for work below the minimum fee rates specified by the Chamber: for example, they agreed to undertake a design assignment for 1 percent of the cost of the investment, where the Law on the Chamber specifies a minimum fee of 1.8 percent for that type of investment.

10.5 Banking Sector

Croatia's banking sector is large by eastern European standards. In 2003, bank assets totaled HRK183 billion (US$27.3 billion), a nominal increase of 60 percent over 2000 and the equivalent of 90 percent of GDP, one of the highest assets/GDP ratios in the region (see Figure 4). The retail banking sector is dominated by two banks: Zagrebacka Banka, with 30 percent market share, and
Privredna Banka Zagreb (PBZ). Between them, the two banks hold almost half of the country’s banking assets.

Other sections of Croatia’s financial system are less well developed. For example, the insurance sector is relatively under-developed, comprising only 26 insurance companies: in 2002, they wrote premiums equal to 3.2 percent of GDP, compared to a European average of 9 percent.

10.6 Operating Environment for Private-Sector Companies

The Foreign Investment Advisory Service (FIAS) report on “Administrative Barriers to Foreign Investment” in Croatia (June 2002) produced fairly positive findings in several areas which are important for private-sector firms operating in Croatia, particularly from the perspective of potential foreign investors.

The report found that Croatia’s company registration process is fairly straightforward and does not present private enterprises with any significant barriers. Registration requirements are in line with standard practice throughout the EU.

However, the FIAS report found that significant barriers exist in obtaining the three construction-related permits which are required. Of these, the building permit is the most problematic and expensive to obtain, involving numerous approvals from different local and central government departments and utilities and often requiring unofficial payments. Securing connections to utilities services was also found to be highly problematic and required facilitation payments amounting to several thousand dollars.

10.7 Private Sector Companies’ Perspective on Public Procurement

Of companies interviewed for this assessment, the majority indicated that they regularly follow up on public procurement opportunities but were, almost without exception, at best only partially satisfied with the public procurement system. The most common causes for concern among private-sector firms were:
**Law on Public Procurement:** Companies now often feel worse off because the LPP no longer includes a provision for domestic preference, thus reducing the chances against foreign competition. It should be noted, however, that the discontinuation of price preference is a requirement for alignment with the EU *acquis*.

**Notification:** Many firms believe they are deliberately not being informed about public sector procurement opportunities whenever there is a likelihood state-owned companies will be submitting tenders.

**Documentation:** Firms were dissatisfied with:

- The use of subjective requirements for pre-qualification and subjective criteria in the evaluation of bids, based on points systems, makes it difficult for firms to understand how their bids will be evaluated and reduces their confidence in the fairness and transparency of the procurement process.
- The financial qualification stipulating that Croatian companies submit proof of creditworthiness ("BON 1" rating) is perceived as unduly burdensome compared to the criteria to be met by their international counterparts.
- Technical specifications are sometimes too narrow and inhibit competition by making unnecessary reference to brand names. On other occasions essential requirements were found to be missing from the technical specifications contained in bidding documents for public contracts. Also, technical specifications sometimes contain requirements that are in reality superfluous to the end-user's real needs, but may favor a particular firm.
- The design of contract packaging inhibits the participation of some firms: for example, where the bidding documents require a large number of products, the contracting authority may prohibit firms bidding on a lot-by-lot basis, which would facilitate participation by small firms. On the other hand, some firms complained about the subdividing of requirements into lots without any clear rationale.
- A bias towards awarding contracts to public sector entities.
- Opportunities for smaller firms to participate in public tenders are often limited by their inability to obtain bank securities when they are required by the tender process.

**10.8 Evaluation Procedures**

- The evaluation criteria often focus too heavily on price when there are other important factors to consider.
- Tender validity periods are extended by unacceptable periods and without any price adjustment provisions when there is a delay in contract award. One large company mentioned delays of more than one year before contract award.

- The process leading to contract award can appear to be arbitrary and even include post tender negotiations, including downward negotiation on price.

**10.9 Contract Implementation**

Frequent payment delays in breach of the terms of the contract — for example 260 or 350 days instead of the 180 days stated — and without compensation.
In its written comments on the draft CPAR, the Directorate of Economic Affairs of the Ministry of Finance confirmed the findings of this assessment, recording that there is “general discontent of all participants” with the LPP, particularly with the way in which it is applied in practice.

10.10 Performance of Private Companies in the Public Sector

The shortfalls in the public procurement system highlighted by the firms interviewed demonstrate a sound knowledge of the fundamental principles and practices governing public sector procurement. Nonetheless, obstacles will remain as long as the legal framework for public procurement remains incomplete, most notably with the absence to date of any standard bidding documents. Consequently, there is often the perception that no unified approach has been adopted across the public sector.

10.11 Commercial Practices

Commercial procurement and purchasing practices tend to be determined by sector, size of company and contract values.

The private companies interviewed for this assessment were found to embrace procurement structures and procedures aligned for the most part to good international commercial practice. These companies demonstrate they meet overall the EBRD requirements under its Procurement Policies and Rules in the private sector for arm’s length transactions and achieving fair market value. Most large companies have dedicated procurement or purchasing departments, of which some are subdivided along product lines (raw materials, components, etc.) and fixed assets (buildings, manufacturing facilities, etc.). About 600 firms in Croatia have ISO 9000FF certification for their quality management systems. The majority of firms have purchasing arrangements and practices that share the following characteristics:

- a set of corporate ethics, policies and procedures, including published internal purchasing guidelines or rules for purchasing for employees;
- computerized purchasing management systems, mainly SAP;
- contract awards are usually by means of a competitive tender, typically inviting three to five firms (more for higher-value contracts), based on a combination of several or all of the following evaluation criteria: price, quality, delivery and commercial conditions;
- post-tender negotiations with two or more “front runners”;
- standard forms of published contract conditions.

Some large companies regularly carry out formal purchasing training courses for employees. Topics include “just in time procurement,” negotiation skills, supply chain management and global sourcing.

Companies source the majority of new suppliers primarily through trade journals, the Chamber of Commerce, and the Internet. Some companies periodically advertise new tender opportunities in national newspapers with a view to finding potential new suppliers and thus achieving competition with their established business contacts. Smaller companies often favor awarding contracts by direct negotiations without a tender process. Purchasing via the Internet was not at all widespread across the sectors. In the food sector, “value analysis” is commonplace; a process entailing a rigorous pre-screening of firms, followed by a stringent quality testing of their products for an initial trial period prior to being considered for contract award.
C.11 Recommendations

This section sets out a series of recommendations designed to address the various weaknesses in the public procurement environment of Croatia, as identified in the preceding sections. The recommendations are grouped to address the major areas of focus, including legislative reform, improving procurement procedures and practices, and institutional reform, capacity building and the development of electronic procurement.

11.1 Recommendations for Reform for the Legal Framework

These recommendations are grouped into two categories: a number of recommended short-term measures designed to address weaknesses in the current legislation which require urgent attention, and a longer-term recommendation on the enactment of an entirely new Law on Public Procurement. Having considered the many amendments to the current LPP, which would be necessary to bring it into alignment with the EU Procurement Directives, it is considered a more effective option to write a new procurement law, rather than to attempt what would be an extremely complex task of amending the current law.

Short-term Recommendations (for 2005)

As an interim measure, it is recommended that amendments be made to the LPP as follows:

- prepare a Strategic Plan for Public Procurement;
- enact an amendment to the LPP;
- adopt implementing regulations under the amended LPP, to address priority issues, such as the methodology for evaluation of bids;
- introduce specific procedures for the procurement consulting services and services of an intellectual nature;
- redraft Article 70 of the LPP to clarify and improve the provisions on the submission of an objection to a contracting authority;
- introduce the requirements for filing an objection;
- introduce mandatory mediation in case of dispute between the participants;
- open to objection the selection of a procurement method to all participants.

Medium-term Recommendations (for end 2005 - 2006)

- the PPO should take the lead in drafting an entirely new Law on Public Procurement, aligned with the EU Consolidated Procurement Directives (2004/17/EC and 2004/18/EC). The new law should be harmonized with Law on State Commission for Control of Public Procurement Procedures and should to clarify the respective roles, duties and powers of the PPO and the State Commission.
- the new procurement law should be complemented by a comprehensive set of implementing regulations, in order to clarify the application of the new law and to complete the legal framework for procurement.
Long-term Recommendations (for 2007-2008)

- when the new procurement law has been enacted and the implementing regulations completed, the PPO should develop and promulgate, for mandatory use by all contracting authorities, standard bidding documents (SBDs) and standard forms of contract consistent with the new legal framework;
- finally, the new law, regulations and SBD should be accompanied by a user’s manual for public procurement, to provide contracting authorities with detailed instructions on the correct application of the legislation and standard documents.

The PPO commented that these recommendations have already been included in the National Program and a long term strategy of the Public Procurement Office.

11.2 Recommendations for Reform of Procurement Practices

The following recommendations should be made to the practice of public procurement in Croatia. As they deal with the detail of how procurement is conducted, these changes can be implemented through the amendment to the LPP, the new procurement law, implementing regulations, SBDs and user’s manual.

- **Procurement Planning:** An obligation should be placed on all contracting authorities to draw up annual procurement plans, with procurement procedures which are in compliance with the law and based on realistic cost estimates, efficient contract packaging and timetables for the start and completion of procedure procedures.
- **Assessment of Bidders’ Qualifications:** Bidders’ qualifications should be assessed in relation to the value and complexity of the contract, in order to ensure that they have the necessary technical, financial and human resources, as well as the relevant experience, to execute the contract efficiently.
- **Evaluation of Bids:** For the procurement of goods and works, the evaluation of bids should be done on the basis of objective criteria, quantified in monetary terms to the greatest extent possible. Evaluation systems based on merit points should not be applied in the procurement of goods and works.
- **Procurement of Consulting and Intellectual Services:** A separate procedure should be developed for the selection of consultants, based on shortlisting only qualified firms and giving technical quality appropriate emphasis in the evaluation of bids. The use of open tendering for the procurement of consulting services should be discontinued.

11.3 Recommendations for Institutional Reform

These recommendations are intended to improve the independence and effectiveness of PPO and the State Commission as the key regulatory and review bodies for public procurement, as well as to provide a sustainable method of delivering technical training in public procurement to public officials.

- the Government should provide both the PPO and the State Commission with dedicated office space outside of the Ministry of Finance building, in order to underscore their separateness from the MOF;
the budgets and staffing of both the PPO and the State Commission should be increased, in order to provide them with the human and technical resources which they need to perform their mandated functions effectively;

the status of the PPO should be reviewed: in order to enable it to act objectively in taking the lead in developing procurement policy and legislation and in overseeing its enforcement, the PPO should be independent from Government;

the PPO should relinquish the function of clearing all uses of procurement procedures other than the Open Procedure and the conditions for use of the other procedures should be more clearly defined in the procurement law;

the Government should develop a local source of training in public procurement to meet the needs of public officials for this type of training. This would likely involve developing a public procurement syllabus and training courses at introductory, intermediate and advanced stages and conducting this courses regularly in a local institution.

11.4 Recommendations on the Development of Electronic Procurement

• When the provisions of the LPP have been amended and implementing regulations adopted, the Prime Minister should appoint an e-GP "champion" responsible to move forward e-GP and identify the lead agency to develop an e-GP strategy and implementation plan.

• The Law on Public Procurement should be revised and modified in order to provide the enabling legal environment for the application of e-GP, in line with the new consolidated EU Directive, and clearly define regulations under which e-GP would be accepted.

• The use of the existing software application should be extended and piloted vertically i.e., the implementation of the online tendering functionality with the same group as is participating in the current consolidated ICT procurement Such pilot may be conducted by the Central State Administrative Office for e-Croatia and be open to local government procuring entities.

• After that, use of the software application be extended and piloted horizontally, i.e., for the procurement beyond ICT and related equipment and services. Initial product groups may include straightforward goods with clear specifications, such as medical equipment and office supplies, offering the potential for testing and piloting electronic Requests for Quotations and electronic Reverse Auctions.

• Public procurement information (including all public procurement notices and awarded contracts) should be provided in an electronic public procurement bulletin on a central website which may be either the extension of the already existing website of the Official Gazette or a government website operated by a government agency or a third-party service provider controlled by the e-GP lead agency. The decision whether to use the Official Gazette online or another website may be taken as a result of a study on the acceptance and benefits of the Official Gazette’s website.

11.5 Recommendations on Benchmarking and Performance Measurement

• The State Audit Office should start to undertake value-for-money assessments of major public investment projects, including their procurement components, in order to inform parliamentarians, the Government and the public about the efficiency of such expenditures.
• The PPO should also initiate a formal benchmarking system for public procurement to establish the current state of development of the public procurement regime and track progress with the implementation of future reforms. The results should be shared within Government and discussed with Croatia’s development partners, including the World Bank and the EU.

• The PPO should also launch a performance measurement system. This would entail developing a standard set of indicators for public procurement, disseminating these among contracting authorities, collecting and analyzing the information and publishing the results regularly.

11.6 Measures to be Taken by Government and Timetable

Table 11 below reflects the above recommendations, identifies the lead agency to take action on each and proposes the indicative timing for the reforms to be implemented.

Table 11: Action Plan and Timetable

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Lead Body</th>
<th>Timing</th>
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<tbody>
<tr>
<td><strong>Legal Framework for Public Procurement</strong></td>
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<tr>
<td>Amend the current LPP</td>
<td>PPO</td>
<td>2005</td>
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<tr>
<td>Draft new Law on Public Procurement</td>
<td>PPO</td>
<td>End of 2006</td>
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<tr>
<td>Promulgate implementing regulations under new LPP</td>
<td>PPO</td>
<td>2007</td>
</tr>
<tr>
<td>Promulgate standard bidding documents (SBDs) and standard forms of contract</td>
<td>PPO</td>
<td>2007</td>
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<tr>
<td>Issue a user’s manual for public procurement (a)transitional, (b) final for</td>
<td>PPO</td>
<td>(a) July 2005, (b)</td>
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<td>the new law</td>
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<td>2007</td>
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<tr>
<td><strong>Institutional Reform</strong></td>
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<tr>
<td>The PPO and the State Commission should be relocated outside the Ministry of</td>
<td>Government</td>
<td>2005</td>
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<td>Finance</td>
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<tr>
<td>The budgets and staffing of the PPO and the State Commission should be raised</td>
<td>Government</td>
<td>starting from FY2005</td>
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<td>to adequate</td>
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<td>The PPO should relinquish the function of clearing all uses of procurement</td>
<td>PPO</td>
<td>2005</td>
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<td>procedures other than the Open Procedure and the conditions for use of the</td>
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<td>other procedures should be more clearly defined in the procurement law. (to be</td>
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<td>implemented under the new procurement law)</td>
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<tr>
<td>Develop a syllabus of public procurement training at a local institution</td>
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<td>end-2006</td>
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<td>MOF</td>
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<tr>
<td><strong>Development of Electronic Procurement</strong></td>
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<tr>
<td>The Prime Minister should appoint an e-GP “champion” and identify the lead</td>
<td>PM</td>
<td>2005</td>
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<td>agency to develop an e-GP strategy and implementation.</td>
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</table>
Recommendation | Lead Body | Timing
---|---|---
The new LPP should provide the enabling legal environment for e-GP, in line with the new consolidated EU Directive, and clearly define regulations under which e-GP would be accepted (implement under the new procurement law). | Government | 2006-2007

The use of the existing software application should be extended and piloted vertically, i.e., the implementation of the online tendering functionality with the same group as is participating in the current consolidated ICT procurement. Such pilot may be conducted by the Central State Administrative Office for e-Croatia and be open to local government procuring entities. | e-Croatia | 2006

After that, use of the software application be extended and piloted horizontally. | e-Croatia | 2006

Public procurement information (including all public procurement notices and awarded contracts) should be provided in an electronic public procurement bulletin on a central website. | PPO and e-Croatia | January 2006

### Benchmarking and Performance Measurement

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<tr>
<td>State Audit Office to start conducting value-for-money assessments of major public investment projects, including their procurement components.</td>
<td>SAO</td>
<td>Starting 2006</td>
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<tr>
<td>Undertake a benchmarking exercise for public procurement and update the benchmarks quarterly.</td>
<td>PPO</td>
<td>During 2005</td>
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<tr>
<td>Launch a performance measurement system and publish the results.</td>
<td>PPO</td>
<td>December 2005</td>
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#### 11.7 Technical Assistance and Sources of Financing

The EU’s CARDS program is currently preparing a €1.0 million Technical Assistance (TA) for Public Procurement for Croatia, which is likely to finance twinning relationships between the country’s key procurement institutions – the PPO and the State Commission – with counterpart institutions in the Member States. These relationships will provide the PPO and State Commission with invaluable guidance and support in planning and implementing the reform necessary to bring themselves up to full effectiveness. The EU and the World Bank are in consultation on the design of this TA program.

In relation to the development of e-GP in Croatia, the World Bank is ready to facilitate the process of knowledge exchange and learning in the field of e-GP. Possibilities include the invitation of Croatia to the planned 3rd International e-GP Conference, hosted by the World Bank, the Inter-American Development Bank, and the Asian Development Bank at the end of October 2004 in Manila, Philippines; the active participation of Croatia in the online discussion forum of the e-GP working group of the Multilateral Development Banks; and the identification of possible e-GP learning events to be sponsored by the World Bank. Financing for the development of e-GP developments may also be discussed between the Government and the Bank in the preparation of the new Knowledge Economy Project.
The World Bank will follow up on the implementation of the recommendations proposed in this report through its supervision of the Programmatic Adjustment Loans (PALs) currently being prepared for Croatia (see below).

11.8 Monitoring and Follow-up Plans

The World Bank is currently preparing a series of three annual Programmatic Adjustment Loans (PALS) to Croatia, which will form the main vehicle for continuing dialogue between the Government and the Bank on procurement reform and for ensuring that the recommendations contained in this report are implemented. In addition, Croatia’s continuing dialogue with the EU, particularly the European Commission’s Annual Reports on Croatia’s readiness for membership, will provide regular monitoring and feedback to the Government of the pace of reform.
Annex A: Overview of Legislation Related to Public Procurement

I. **Law on State Commission for Control of Public Procurement Process**: This Law provides the legal basis for incorporation of the State Commission, and also governs its status and scope of activities, the requirements for appointments of its members, as well as the modality of coverage of the appeal costs and the State Commission's relationship with the Croatian Parliament. The mandate of the State Commission is to rule on appeals against the decisions of the ordering parties and of the Office for Public Procurement made pursuant to Article 71 of the LPP.

II. **Law on Obligations**: This Law, which is based on Swiss legislation, is quite elaborate (1109 Articles) and constitutes the piece of legislation that exclusively governs contract law. It is composed of two parts: general provisions applicable to all relations arising from an obligation, including provisions on creation, legal effect and cessation of an agreement and unilaterally binding statements, as well as special rules that regulate particular agreements (inter alia Sales, Sales Order, Work, Construction, Transport, License, Deposit etc.).

III. **Law on General Administrative Procedure**: This Law regulates the modus operandi of administrative bodies when deciding parties' rights and obligations in an administrative procedure. It predominantly governs the associated procedural aspects, such as initiation of the procedure, jurisdiction, delivery of statements, duties of the administrative body, submission of evidence, hearings, rendering Decrees and appeal procedure, while using both regular and extraordinary legal remedies. It is a framework regulation and, therefore, applies as a secondary source of legislation to the procurement procedure, particularly in governing relationships between third parties and the Office for Public Procurement, and the objections against its decisions issued in the form of decrees, as well as appeals to the State Commission.

*Interaction with the LPP*: The Law on General Administrative Procedure applies by virtue of its own provisions to any administrative relationship, i.e. a relationship where the administrative body decides, officially or pursuant to the party’s request, on interests of the party or certain public interest. In the absence of special procedural rules in the LPP, the associated procurement process is governed by general rules contained in the Law on General Administrative Procedure. However, there are some discrepancies between the LPP and the Law on General Administrative Procedure relating primarily to the system of legal remedies. These are also not regulated in sufficient detail and are even too restrictive in terms of defining the requirements for their use. As a result, they prevent certain parties from participating in the appeal procedure.

IV. **Law on Administrative Disputes**: This Law regulates the procedures of the Administrative Court when it considers an appeal against a decision issued in the second instance in the form of a decree by an administrative body, i.e. the State Commission, pursuant to Article 72 of the LPP.


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11 *Zakon o općem upravnom postupku;* Official Gazette No. 53/91.
12 *Zakon o upravnim sporovima;* Official Gazette No. 53/91, 77/92.
13 *Zakon o arbitraži;* Official Gazette No. 88/01.
internationally. It applies to all arbitration between parties governed by public or private law if the arbitration is held in Croatia or abroad, if the parties agree to apply the Croatian Arbitration Law. However, contrary to usual practice, the arbitration costs are not shared by the parties. The arbitral tribunal decides which party and in which proportion one party has to reimburse the other party for the costs of arbitration (including expenses of representation and costs). It also governs issues pertaining to recognition and enforcement of the arbitral awards and distinguishes institutional from temporary (ad hoc) arbitration. Croatia is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958).

VI. Labor Law: The Labor Law governs working relations in Croatia, both those created on a permanent and a temporary basis and other associated issues, such as creation, cessation and legal effect of labor agreements, probation work, working time, vacancy and leave, salary, competition, by-laws, collective agreements, association into syndicates etc. Recent amendments to the Labor Law harmonized the major labor issues with the International Labor Organization (ILO) Conventions.

VII. Law on Concessions: This Law provides the framework legislation dealing with concessions, whereas concessions for particular business activities (e.g. maritime, telecommunications) are dealt with in separate laws. The Law is very brief, comprising only ten Articles. It only identifies which concessions are under Croatian law and leaves a gap for building concessions, which are mentioned in the LPP.

IX. Law on Protection of Market Competition: This Law regulates the conduct of resident and non-resident legal entities and individuals engaged in the sale of goods and services which affect the domestic market, as well as various forms of concentrations thereof. It prohibits a number of activities which distort free market competition in cases where an action prevents or restricts trade of goods and services through implicit or explicit contractual arrangements, monopolistic practices or merger.

X. Ordinance on the Procedure of Procurement of Goods, Work and Services of Small Value: This Ordinance regulates the public procurement procedures for contracts of goods, works and Services up to the value of 200,000 Kunas without the value-added tax (around US$31,700 equivalent).

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14 Zakon o radu; Official Gazette No. 36/95, 54/95, 65/95, 17/01, 82/01, 114/03, 30/04.
15 Zakon o koncesijama; Official Gazette No. 89/92.
16 Zakon o zaštiti tržišnog natjecanja; Official Gazette No.122/03.
Annex B: Related Issues on the LPP and Discussion of Remedies

1- Abnormally Low Bids

As mentioned in Section 1, the process of determination of abnormally low bids mentioned in Article 58 does not define the possible legal consequences of the submission of an unusually low bid, nor whether the procurement process is to be continued or not. The solution where only a request for a written explanation (which is even optional) may be demanded by the ordering party does not seem to be the most appropriate legal sanction, as it discriminates against other participants.

The LPP does not envisage a mechanism dealing with the consequences of the submission of unusually low bids, such as the authority to annul the tender as the most severe one; this is also a general comment related to all provisions stipulating prohibition of certain action. While Article 74 defines the minor offences resulting from certain acts or omissions during the procurement process, provisions dealing with the legal consequences as a matter of (administrative) procedure and civil (contract) law are missing.

2- Remedies

a) The provisions of the LPP on legal remedies are not aligned with the fundamental principles embodied in the associated EU Public Remedies Directive 89/665/EEC, specifically in respect of (i) the right to appeal against national laws, but also the EU Directive (Article 1, Paragraph 1), (ii) the prohibition of discrimination in terms of the use of legal remedies based on the nationality of the appellant (Article 1, Paragraph 2), and (iii) the broad scope of parties entitled to exercise the remedies (Article 1 Paragraph 3).

It is also the case with respect to the right to reimburse and hold harmless any participant that has suffered damage through the perpetration of an unlawful act (as defined by Article 2 Paragraph 1 Point c of the EU Directive 89/665/EEC). Under Croatian law, a damage claim would have to be addressed to and resolved by regular courts, not the first controlling authority (which is equivalent to the Office for Public Procurement), as is the case under EU Directive (Article 2 Paragraph 5 of the EU Directive 89/665/EEC).

b) The LPP does not envisage the possibility to apply for issuance of a temporary or interlocutory measure by the parties or the administrative entities involved in the procurement process, since the jurisdiction remains with the regular courts. It represents another example of non-conformity with EU Directive (Article 2 Paragraph 1 of the EU Directive 89/665/EEC).

c) It is also unclear whether the process of mediation defined in Article 70 (5) is a requirement for filing an objection to the Office for Public Procurement or not, as well as who is supposed to participate in the process: all participants, or just the ordering party and the selected bidder. Furthermore, it is also unclear what should be the duration of the mediation proceedings.

d) The very brief and vague provision of Article 70(6) imposing an obligation on the ordering party to respond to the objection within 8 (eight) days opens numerous issues, such as (i) whether such a response is a formal requirement or not, as well as whether a failure to respond may result in a violation of procedure, thereby forming grounds for an appeal, (ii) why the mandatory content of such a response does not have to be specified, (iii) why there are no rules defining the course of procedure once the objection is filed, nor the ordering
party’s authorities and obligations, and (iv) whether the undertaken procurement procedure may be re-opened, supplemented with another one, annulled upon the objection or not.

e) The right to appeal mentioned in Article 71, deals with the issue so specifically that provisions of the Law on General Administrative Procedure, prescribing the duties of the administrative body of second instance, are completely inapplicable, despite the fact that the LPP is silent on the subject.

It is also unclear whether the administrative body of second instance may amend a decision (i.e. a decree) issued by the first-instance administrative body. The LPP is also silent on whether a party missing the deadline for filing an appeal may apply for the extension of time to file it, and on the duties of the administrative entity in case the appeal is not properly served, as required by the Law on General Administrative Procedure.
Annex C: List of Legislation Applicable to Public Procurement in Croatia

1. The Law on Public Procurement (Zakon o javnoj nabavi; Official Gazette No. 117/01, 197/03);

2. Law on the State Commission for Control of Public Procurement Process (Zakon o državnoj komisiji za kontrolu postupaka javne nabave; Official Gazette No. 117/03);

3. Law on Obligations (Zakon o obveznim odnosima; Official Gazette No. 53/91, 73/91, 3/94, 7/96, 112/99, 88/01);

4. Law on General Administrative Procedure (Zakon o opcem upravnom postupku; Official Gazette No. 53/91);

5. Law on Administrative Disputes (Zakon o upravnim sporovima; Official Gazette No. 53/91, 77/92);

6. Law on Arbitration (Zakon o arbitraži; Official Gazette No. 88/01);

7. Labor Law (Zakon o radu; Official Gazette No. 36/95, 54/95, 65/95, 17/01, 82/01, 114/03, 30/04);

8. Law on Concessions(Zakon o koncesijama; Official Gazette No. 89/92);

9. Law on Protection of Market Competition (Zakon o zaštiti tržišnog natjecanja; Official Gazette No.122/03);

10. Ordinance on the Procedure of Procurement of Goods, Work and Services of Small Value (Uredba o o postupku nabave roba, radova i usluga male vrijednosti; Official Gazette No. 14/02).

11. Ordinance on the Publishing and Bookkeeping of the Public Procurement (Uredba o objavama i evidenciji javne nabave; Official Gazette No. 14/02, 18/02);

Annex D: Electronic Government Procurement – A Short Overview

Definition

Electronic Government Procurement (e-GP) is the use of Information & Communication Technology (ICT), especially the Internet, by governments in conducting their relationships with suppliers for the acquisition of works, goods, and consultancy services required by the public sector.

The level of e-GP implementation comprises three basic phases:

- Online disclosure of information (e.g. publication of procurement notices, awarded contracts, and procurement law & regulations),
- Online procurement transactions (e.g. electronic distribution of bidding documents and RFP/RFQ documents, electronic submission of bids/proposals/quotations, electronic bid opening), and
- Online procurement integration (e.g. integration of e-GP with systems for financial management, tax administration, and others).

Along the lines of traditional tendering and purchasing procedures, e-GP can be divided into e-Tendering and e-Purchasing:

- e-Tendering can be defined as a solution designed to electronically handle the process of public tender for the acquisition of specialized works, goods, and consulting services that are of high value and low volume. Contracts are usually awarded on the basis of price and other criteria (e.g. performance, quality, efficiency).
- e-Purchasing is a solution designed to electronically facilitate the acquisition of low-value and high volume standard goods and services. Contracts are awarded on the basis of price as the only evaluation criterion.

Examples of such systems include Mexico’s e-Tendering system Compranet17, and Brazil’s e-Purchasing system Comprasnet18. Chile’s ChileCompra19, Korea’s GePS20, Romania’s Electronic System for Public Acquistions21, and Western Australia’s Government Electronic Market22 are examples of systems supporting both, e-Tendering and e-Purchasing.

17 http://www.compranet.gob.mx/
18 http://www.comprasnet.gov.br
19 http://www.chilecompra.cl/
20 http://www.g2b.go.kr/
21 http://www.e-licitatie.ro/
Benefits

Breaking down the physical barriers of space and time, e-GP allows a more transparent and efficient information flow as well as improved access to information and services. Beneficiaries include not only governments and suppliers but also the public at large, who can have access to transparent information on the public expenditure of taxpayers’ money.

Many countries around the world are investing in the design and implementation of more or less complex e-GP systems as part of the modernization of their public procurement systems. Transparency, efficiency, and improved quality of government procurement are among the main benefits.

In feeding all relevant data and information into a securely operated electronic system and automating public procurement processes, governments can reduce corruption or collusion by minimizing the risk of data manipulation or misuse. At the same time, procurement data and information can be made transparent to government decision-makers who, by using these data, can improve the quality of their decisions in the context of public procurement.

Besides transparency, e-GP provides for efficiency gains in terms of costs and time. As competition can be increased by opening up access to online procurement notices to more suppliers – provided an appropriate infrastructure is in place – and transaction costs of the procurement process drop considerably (usually between 50 to 75%), prices of bids and proposals can be cut by usually 15 to 20%. These savings include time savings due to automated procurement procedures.

As the public procurement volume of a country amounts to a considerable percentage of the GDP, the use of e-GP may have a considerable impact on the economy, not only due to the considerable savings on offer but also due to the encouragement of small and medium enterprises to use technology and build the appropriate capacity.

Key Success Factors

Designing and implementing projects with major ICT components in the public sector have one thing in common: while ICT is widely available and can be used in many ways to improve government performance, there are some human factors which are critical to the success of any such ICT project including e-Government Procurement.

Experience in many countries, no matter the level of income, has shown that government leadership is the most important key success factor of e-GP. A strong champion (some countries have seen the President in this role) needs to give the mandate of leading the e-GP initiative to an agency which is able to bring about collective commitment for change, inter-government coordination, and partnership with the supplier community.

Appropriate government leadership can contribute to meet the requirements of other e-GP key success factors, namely:

- set a supporting policy and legal framework, including a clear e-GP vision and strategy, the definition of roles and responsibilities, the legal enabling environment with sufficient flexibility not to become obsolete within the short innovation cycle of ICT;
• awareness and capacity building among government, suppliers and the public at large, including a well thought through communication and outreach strategy, comprehensive training programs, and user help-desk facilities;
• institutional change including procurement process re-engineering and appropriate organizational structures;
• technological infrastructure development, including improved connectivity to promote equal access to online procurement data and information, interoperability based on common standards, appropriate security techniques, and clearly defined e-GP business models.
<table>
<thead>
<tr>
<th>Annex E: Benefits and Beneficiaries of e-GP</th>
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<thead>
<tr>
<th><strong>Public</strong></th>
<th><strong>Supplier</strong></th>
<th><strong>Government</strong></th>
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</thead>
<tbody>
<tr>
<td>Access to public procurement information</td>
<td>Increased fairness/competition</td>
<td>Anti-corruption</td>
</tr>
<tr>
<td>Monitor public expenditure</td>
<td>Improved access to govt. market</td>
<td>Better integration and interaction</td>
</tr>
<tr>
<td>Participation</td>
<td>Open the government market to new suppliers</td>
<td>Professional procurement management</td>
</tr>
<tr>
<td>Government accountability</td>
<td>Stimulation of SME participation</td>
<td>Higher quality of procurement decision and statistics</td>
</tr>
<tr>
<td>Redistribution of fiscal expenditures</td>
<td>Improved access to public procurement information</td>
<td>Political return from the public</td>
</tr>
<tr>
<td>Communication anywhere/time</td>
<td>Shorter procurement cycle</td>
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</tbody>
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<table>
<thead>
<tr>
<th><strong>Transparency</strong></th>
<th><strong>Costs</strong></th>
<th><strong>Efficiency</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Anti-corruption</td>
<td>Lower prices/transaction costs</td>
<td>Simplification/elimination of repetitive tasks</td>
</tr>
<tr>
<td>Increased number of suppliers</td>
<td>Staff reduction</td>
<td>Communication anywhere/time</td>
</tr>
<tr>
<td>Better integration and interaction between governments</td>
<td>Reduction in fiscal expenditure</td>
<td>Shorter procurement cycle</td>
</tr>
<tr>
<td>Professional procurement management</td>
<td>Simplification/elimination of repetitive tasks</td>
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<tr>
<td>Higher quality of procurement decision and statistics</td>
<td>Communication</td>
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<tr>
<td>Political return from the public</td>
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| **Time** | |
|----------| |
Annex F: Examples of e-GP Benefits

- By using the national education portal www.feonline.net in Great Britain, some 500 schools achieve price reductions of up to 100 million British Pounds per year and time reduction of about 90% in order processing. 
  
  Source: Public E-Procurement, Gehrmann/Schinzer, 2002

- With the phased introduction of the Government electronic Procurement System (GePS), Korea is able to save some US$ 2.7 billion of all government procurement (US$ 17.1 billion) as compared to US$ 26 million investment. Between 1998 and 2002, staff of the Public Procurement Service PPS were reduced from 1,058 to 935, while the total government procurement volume increased by some 30% (from US$ 12.8 billion to US$ 17.1 billion). Payments to suppliers are electronically transferred which usually takes no longer than 4 hours.
  

- Romania uses a government-wide e-Procurement system bringing together about 1,000 public agencies and 8,000 suppliers. During the first 4 months of 2003, more than 60,000 transactions were completed. According to the Ministry of Communications and Information Technology, the savings through this e-GP platform amount to some 22% (US$ 35.5 million) of the volume of purchased goods and services (US$ 161.4 million).
  
  Source: IDA, 2003

- During the first three years of the procurement portal COMPRASNET, the Federal Government of Brazil spent about US$ 7 million on system development and maintenance. During the first two years of on-line reverse auction use, the Federal Government is estimated to have saved up to US$ 1.5 million. While the normal procurement process takes more than two months, the on-line reverse auction may be completed in less than 15 working days. The use of on-line procurement has also increased the participation of small businesses in government supplies.
  
  Source: http://www.egov4dev.org/brazeproc.htm, 2002