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Decentralisation, Corruption and Supervision of Local Budgets in Croatia

Local authorities have the third-highest perceived level of corruption in Croatia, after the judiciary and health care. Most counties, including the City of Zagreb, do not collect their revenues in a timely manner, fail to comply with public procurement regulations, and to manage their public utilities efficiently.

1. Decentralisation and Corruption

Advocates of decentralisation argue that it facilitates the satisfaction of the local population's needs, whereas the "sceptics" point to many deficiencies of the local provision of public services which can obstruct the obtaining of the benefits of decentralisation. Particularly interesting is the correlation between decentralisation and corruption, although there are no unequivocal theoretical or empirical findings of this (Fisman and Gatti, 2002). *Decentralisation can reduce corruption*, by improving oversight over local officials, because it is easier to identify and monitor their personal responsibilities. Naturally, decentralisation should not lead to the emergence of numerous new levels of government,

which would make it much more difficult to determine direct responsibilities for successes or failures. Decentralisation can further reduce corruption by encouraging competition among local government units. In order to attract population, local authorities avoid behaviours which are likely to discourage production activities and employment, and this also includes avoidance of corruptive activities. *On the other hand, decentralisation can increase corruption*, because central government jobs are more lucrative than those in the local government, so the local government units employ lower-quality staff. Moreover, decentralisation results in the dispersion of decision-making which, given a poor coordination among bureaucrats, can increase the propensity for corruption or manipulation of economic environment rather than create value added.

The decentralisation process in Croatia began in 2001, as the government transferred part of its powers and responsibilities relating to the financing of education, health and social welfare to local government units ready to assume them. Since then, little progress has been made

The Institute of Public Finance deals with economic research and analysis related to various forms of public finances such as the budget, taxation and customs duties. Its orientation is thus to the various economic, legal and institutional topics that are important for the sound long-term economic development of the Republic of Croatia. So that the public should be able to have a better insight into certain issues, the Institute of Public Finance is launching its Newsletter, in which it will from time to time publish informed and independent analysis of economic questions. The views expressed in the articles published in the Newsletter will reflect the opinions of the authors, which do not necessarily coincide with those of the Institute as institution. Full text of Newsletter is also available on Institute's Web site: <http://www.ijf.hr/newsletter>.

towards decentralisation. What is more, Ott (2008:25) argues that in Croatia, we can even speak about some sort of centralisation, i.e. further “governmentisation” of the country, because, given the large number of territorial units and inefficient bureaucracy at all levels of government, as well as the existence of the areas of special state concern, it is impossible to lessen the dominant influence of government bodies on decision making. Another important cause of a slow decentralisation progress is a lack of effective supervision at the central government level (Maletić, 2008:44). Decentralisation brings more independence and responsibility to local authorities, but also requires strict supervision and control by the central government. In view of the current level of corruption which affects local authorities as well, the idea suggests itself that a slow pace of decentralisation can be advantageous. In fact, without previously meeting some requirements, centralisation might (further) increase arbitrariness of local officials. As a result, the alternative to a strong centralised public sector would be a weak local government managed by only a few members of the local elite. Such a regime would be unattractive to investors and its impact on economic growth would be negative.

2. Corruption at the local government level

The Transparency International organisation issues a Corruption Perception Index (CPI) reflecting the stances of business people and analysts on the prevalence of corruption among government officials and politicians. The index varies from 0 to 10, where 10 is the best score signifying a highly “clean” country. The 2008 CPI for Croatia is 4.4, the best score since 1999, when it stood at 2.7. However, despite the improvement, the index has increased only slightly and at a relatively slow pace. As concerns Croatia’s neighbours, the CPI ranges from 6.7 for Slovenia, 5.1 for Hungary and 4.8 for Italy, to 3.4 and 3.2 for Serbia and Montenegro and Bosnia and Herzegovina respectively. Unfortunately, the index does not distinguish between the central and local government corruption.

The State Attorney’s Office of the Republic of Croatia (DORH) has only disclosed total data for all levels of government. According to a DORH’s report, there were 611 notifications of criminal offences of corruption, of which almost 70% related to power abuse by public officials. A year before, the number of reported corruption-related offences stood at only 138. In 2007, charges of bribery, constituting a criminal offence of corruption

in the narrow sense, were brought against 88 persons, (compared to only 50 in 2006). Of the reported 88 cases, 53 criminal charges were dropped for lack of well-grounded suspicion. In the remaining cases, investigation was carried out and 16 persons were indicted and 8 of them were sentenced to prison. Most of the notified cases related to “genuine” bribe-taking¹.

According to the DORH’s Report, among those reported for offences there was a head of division in a municipality administration, a council member, a city government member and a deputy mayor. As indicated by a survey (TIH, 2005), over 70% of respondents believed corruption was widespread (36%) or very wide spread (37%) in the local government sector. Based on this, local administration was perceived as the third most corrupt sector, outstripped only by the judiciary and health care. This perception is obviously at variance with the number of criminal charges filed, which is probably an indicator of citizens’ reluctance to react to corruption cases, and of a lack of reliable evidence, as corruption is difficult to prove. Maybe, the citizens believe that there is no use in filing charges, knowing that the judiciary is not only corrupt but inefficient as well.

Concerning local government, the National Anti-Corruption Programme 2006-2008 (NN 39/06) envisaged the following:

- 1) monitoring the legality of operations of local services;
- 2) intensifying measures to create special, locality-specific methods to prevent corruption;
- 3) amending the legislation governing elections to the bodies of local government;
- 4) strengthening the autonomy and responsibility of local government units in the decentralisation process;
- and 5) closer monitoring of local funds utilisation.

The document does not specify how these measures would be carried out and what they precisely imply. However, some changes have been introduced so far concerning item 3), in the form a new Act on the Election of Municipality Heads, Mayors, County Prefects and the Mayor of the City of Zagreb (NN 109/07), providing that they are elected directly, and the Act on the Amendments to the Act on the Procedure for Transfer of Authority (NN 17/07). Changes have also been observed in the area of the closer monitoring of local funds utilisation (to be discussed later).

¹ “Genuine” bribe-taking is a situation where a perpetrator accepts or requires a gift or another benefit in exchange for performing an action within his/her respective powers which he/she may not perform, or for refraining from performing an action he/she is obliged to perform. In contrast to this, “non-genuine” bribe-taking relates to a case when a person requires or accepts a gift or another material benefit for performing a business action he/she is normally obliged to perform.

3. Supervision of local budgets

Transparency of public finance is of crucial importance for combating corruption and improving the efficiency of public services, as it facilitates control over public authorities, which again has a positive impact on their responsibility to citizens. Exercising oversight over the budget requires transparency of budgetary documents and processes, or, to be more precise, timely, reliable and accurate data. Or, applied to decentralisation: if the government does not have enough information about the spending of money transferred to local government units, it cannot delegate more responsibility or grant more independence to local authorities.

As shown by the State Audit Office reports (2007) for counties and the City of Zagreb for 2006, as well as their budgets, financial documents and financial operations, most of these units' budgets were adopted pursuant to the Budget Act, and revenues and expenditures were reported in accordance with the Budget Chart of Accounts. Similarly, most local units complied with the orders of the audit issued for the previous year, with the following exemptions:

- certain expenditures were executed in larger-than-planned amounts;
- budget revenues were not collected in full and in a timely manner;
- irregularities were detected in the record-keeping of total assets and liabilities;
- there were instances of non-compliance with the public procurement regulations;
- part of funds was used for financing current and budgetary needs, instead of being allocated for specified purposes;
- the provisions of the Utility Services Act were not complied with, and there were often no programmes adopted for the construction of utility infrastructure facilities and equipment.

Table 1 sums up irregularities established in individual counties and in the City of Zagreb, indicating that most problems facing the local units relate to compliance with public procurement regulations, collection of budgetary revenues and utility management. Concerning the City of Zagreb, irregularities were most pronounced in keeping records of expenditures for the procurement of non-financial assets, and in reporting non-financial and financial assets, whereas the off-balance sheet records contained doubtful receivables and contested claims to the amount of HRK 467 million. The largest shares in this amount were accounted for by receivables for ren-

tals (HRK 304 million) and utility fees (HRK 150 million). The report for the City of Zagreb reiterates the lack of coordination among the city government bodies, which also includes the non-existence of a unified accounting system capable of reducing the probability of errors. At this point, it should be noted that the European Commission (European Commission, 2008, p. 68), in its Croatia 2008 Progress Report, pointed to little progress made in the area of external audit, which creates the need to strengthen the legal framework necessary to achieve independence of the State Audit Office functions.

In addition to the State Audit Office, the central government, i.e. the Ministry of Finance, should also play an important role in the local budget oversight. The Ministry's Budget Supervision Division supervises the legality, purposefulness and timeliness of budget fund utilisation, which also applies to local government units. Despite the Division's activities, Maletić (2008:43) argues that the central government's supervisory function over the local units' budgets is not well defined and organised, and is therefore relatively poor. The legislation is underdeveloped, with inadequate institutional capacities, human resources and funds, and no desire for a real change.

A good thing is the progress achieved with regard to the legislation governing internal financial control. Late in 2006, a new Public Internal Financial Control Act was passed (NN 141/06), and a year later, the Government adopted separate strategies of development of Public Internal Financial Control for the central government and for local government units (Vlada RH, 2007). The strategy implementation has been entrusted to the Central Harmonisation Unit of the Ministry of Finance, and its application at the local level is planned by end-2010. A new Anti-Corruption Strategy (NN 75/08) is aimed at strengthening the current internal and external financial control structures, in order to improve and promote the operations of all budget users, the strengthening of accountability and transparency of operations of budget users at both central and local levels, and improving the legal framework for budget supervision². In accordance with the Action Plan (Ministarstvo pravosuđa, 2008), a new Budget Supervision Rulebook has been adopted (NN 79/08), prescribing that budget supervision should no longer be exercised on the basis of adopted plans, but on the basis of petitions submitted by citizens and the requests of central and local government

² Special prominence within the Strategy is given to public procurement, bearing a high corruption risk, and in this respect, a number of anti-corruption goals have been set out.

Table 1. Main irregularities in local budgets for 2006

Counties	Public procurement	Utility services	Record-keeping of assets and liabilities	Certain expenditures higher than planned	Revenue collection	Misallocation of funds	Total "YES" by county
County of Bjelovar-Bilogora	YES	YES	YES	YES	YES	YES	6
County of Slavonski Brod-Posavina	YES	NO	YES	NO	YES	NO	3
County of Dubrovnik-Neretva	YES	YES	YES	YES	YES	YES	6
The City of Zagreb	YES	YES	YES	YES	YES	YES	6
County of Istra	YES	YES	NO	YES	YES	NO	4
County of Karlovac	YES	YES	YES	NO	YES	NO	4
County of Koprivnica-Križevci	YES	YES	NO	YES	YES	YES	5
County of Krapina-Zagorje	YES	YES	YES	NO	YES	YES	5
County of Lika-Senj	YES	NO	NO	NO	YES	NO	2
County of Međimurje	YES	NO	YES	YES	NO	NO	3
County of Osijek-Baranja	NO	YES	NO	YES	YES	YES	4
County of Požega-Slavonija	YES	YES	YES	NO	YES	YES	5
County of Primorje-Gorski Kotar	YES	YES	YES	YES	YES	NO	5
County of Sisak-Moslavina	YES	NO	NO	NO	YES	YES	3
County of Split-Dalmacija	YES	YES	NO	NO	YES	NO	3
County of Šibenik-Knin	YES	YES	NO	NO	YES	NO	3
County of Varaždin	YES	YES	YES	NO	YES	NO	4
County of Virovitica-Podravina	YES	YES	YES	YES	YES	YES	6
County of Vukovar-Srijem	YES	NO	NO	YES	YES	YES	4
County of Zadar	YES	YES	NO	YES	NO	NO	3
County of Zagreb	YES	YES	YES	YES	YES	YES	6
Total "YES" by irregularity	20	16	12	12	19	11	

Source: State Audit Office (2007)

bodies or other legal persons, where there is suspicion of irregularities or fraud, as well as by order of the Minister of Finance. The Action Plan also prescribes the obligation "to disclose at the Ministry of Finance's website various possibilities to report irregularities, and an e-mail address for reporting irregularities relating to EU funds or budget funds". Such an e-mail address is really available on the Ministry of Finance's website (www.mfin.hr), but is not conspicuous enough. It can be found by following the link "Supervisory activities", then "Budget Supervision" and it reads as follows:

nepravilnosti@mfin.hr. Other possibilities of reporting irregularities are not make visible. A positive thing is that the Government makes efforts to include citizens in the budgetary process. Why is this important? Because, as taxpayers, citizens contribute to the government budget and should therefore be involved in making decisions on the allocation of these funds. Moreover, the budget is too important to be left only to government officials and parliaments as they are liable to the influence of various interest groups (Ott, 2008).

4. The role of citizens

The Open Society Institute's Local Government and Public Service Reform Initiative organised and financed a project on budget supervision exercised by non-governmental organisations and citizens. The results for Croatia suggest that the participation of citizens in the budget process is inadequate and that they are insufficiently aware of initiatives to support the local budget supervision (Maletić, 2008). The legal prerequisites are met, but citizens seem to be passive and poorly organised. In addition to this, one gets the impression that citizens perceive the budget as a "mystical" document which is beyond their access.

An increasing number of local government units in Croatia, particularly those that are better-off and more developed, promote printing and dissemination of guides to the budget, and organise public debates (Ott, 2008). Despite their efforts, citizens are still insufficiently aware of the need to participate in the budgetary process. In most units of local self-government in Croatia, there are public discussions about budget execution, and it is examined (mostly through mass media) how satisfied the public is with the local community programmes and services. However, a certain number of units still cherish secrecy: financial reports can only be obtained at a special request (Maletić, 2008).

How can citizens supervise the budget? Citizens should participate in all stages of the budgetary process (Ott, 2008:31). In the budget preparation phase, they should participate in making decisions on programmes. This would improve their understanding of the work and goals of the local governments. Furthermore, they should supervise the execution of the budget and be informed about the results. This would reduce the inefficiency of public funds utilisation, the incidence of fraud and irregularities. In the financial reporting phase, citizens should comment on, request simple reports and compare the financial results of their own local units with those of others. In short, citizens should ask more questions, communicate with their local units in writing, file requests for the improvement of public services, offer concrete advice, try to improve their knowledge of the budget and promote changes.

In order to be able to comment on local budgets, citizens first must have access to them. Local budgets by county are available at the Ministry of Finance's website at: <http://www.mfin.hr/hr/lokalni-proracun-arhiva>, but it is questionable how clear they are to the public. The Government has started publishing some kind of guides

to the budget, but not all local government units follow this example. The general public should have access to clear and understandable financial statements of local government units. Local government units are legally obliged to publish their budgets, but citizens should also be reminded that, for more details, they may invoke the Act on the Right of Access to Information (NN 172/03). In this respect, it is reasonable to suspect that local authorities would ignore citizens' inquiries, or that civil servants would be hostile towards them. Nevertheless, it pays to try and to be persistent. Finally, there is a possibility to address the mass media which would probably be interested in a story about, for example "irresponsible spending by a municipality"³. The ways in which citizens can directly participate in decision making pursuant to the Act on Local and Regional Self-government (NN 125/08) are set out in Box 1.

Citizens can also participate through civic organisations. It is worth mentioning the result of a survey conducted by ten civil society organisations (BURA, 2008), within the CARDS project "Civic Society Anti-Corruption Response".⁴ The survey covered the following towns: Čakovec, Karlovac, Osijek, Sisak, Split, Udbina, Vukovar and Zagreb, and dealt with the quality of budgetary reporting, as well as the transparency and credibility of public procurement data. It was concluded that, at the local level, public procurement still remains a "grey zone" of management, showing serious irregularities, as also confirmed by the findings of the State Audit Office. Concerning budgetary spending, the analysts focused on the item "other", for 2006. The most critical results were recorded for Vukovar, Zagreb and Split. Vukovar reported almost 40% of its expenditures under the item "other", without an adequate argumentation, whereas Zagreb reported about 17% of its city budget or over HRK 1 billion under the item "other". Most of these funds were spent on the category "other construction projects". A cause for concern is the fact that analysts trying to collect data in the field are sometimes blackmailed and threatened by local authorities.

³ The question is, of course, how independent the media can be, if they are owned by local authorities, as is often the case. Even in the case of privately owned media, there may be a certain financial relationship with the local authorities, which can influence the degree of self-censorship in mass media.

⁴ The members of BURA are: Autonomous Centre (Čakovec), Dalmatian Solidarity Committee (Split), Partnership for Social Development (Zagreb), Initiator (Korenica), Civil Rights Project (Sisak), Association ZORA (Čakovec), Association for Development of Civil Society And Promotion of Women's Rights DOMINE (Split), Women's Association (Vukovar), Women's Group KORAK (Karlovac), and Women's Association IZVOR (Tenja).

Box 1. Citizens' participation pursuant to the Act on Local and Regional Self-government

“Citizens may directly participate in taking decisions on local government activities through referenda and local citizens' meetings. A referendum can be called for the purpose of deciding on a proposal to amend the statute, on a proposal for a general bylaw or another issue from the representative body's scope of activities, as well as on other issues determined by the law and statute. Pursuant to the provisions of the law and statute, a referendum shall be called by the representative body at the proposal of one third of its members, at the proposal of a municipality head, a mayor or a county prefect, and, in a municipality or a town, at the proposal of half of the local committees in the territory of the municipality or town, or at the proposal of 20% of the voters registered on the electoral list of the municipality or town. Citizens shall have the right to propose to a representative body to pass a certain bylaw or to resolve a certain issue from its scope of activities. The representative body must discuss such proposals, provided that they are endorsed by signatures of at least 10% or voters registered on the electoral list of a municipality, or town or county, and send replies to the submitters no later than three months following the receipt of a proposal. The bodies of local and regional self-government shall enable citizens and legal entities to file petitions and complaints about their work and the work of their administrative bodies, and about the incorrect behaviour of the employees of these bodies when they apply to them for the realization of their rights and interests or fulfilling their civic duties. The head of the body of a local self-government unit, or of an administrative body of this unit shall reply to the filed petitions or complaints no later than 30 days following the date of filing a petition or complaint.”

Source: NN 125/08*

Conclusion

In Croatia, nominal decentralisation is taking place in parallel with the fight against corruption, with very little and slow progress made in both areas. The very serious publicly perceived levels of corruption of local authorities and inadequate supervision of local budgets lead to a conclusion that the slow pace of decentralisation is actually a good thing. This is corroborated by the fact that a large majority of counties, including also the City of Zagreb, fail to collect their revenues in full and in a timely manner, do not comply with the public procurement regulations and report serious irregularities in their public utility management. Moreover, in some units certain expenditures exceed the planned amounts,

part of funds is used for financing current and budgetary needs, instead of being allocated for specified purposes, and there are irregularities in keeping records of assets and liabilities.

In addition to continuing efforts in the area of government administration reforms, aimed at, particularly, depoliticisation, avoiding conflicts of interest, and employment based on competence, it is necessary to strengthen the external audit and internal control mechanisms, and, most of all, to encourage citizens' active participation in the supervision. Without this, giving more independence and responsibility to local authorities would increase the arbitrariness and corruption of local government officials. A weak local government managed by only a few members of the local elite is a poor alternative to a large, centralised public sector.

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