

# Fiscal Decentralization in Croatia

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The Fiscal Decentralization Initiative  
for Central and Eastern Europe



# Fiscal Decentralization in Croatia

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## Conference Proceedings

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F D I P R O C E E D I N G S

*The Fiscal Decentralization Initiative for Central and Eastern Europe (FDI–CEE)* is a grant program established to assist transition economies carrying out intergovernmental reform. It is designed to provide institutions (central governments, parliaments, sub-national governments, research institutes, universities and associations of local authorities) with technical and financial resources to analyze problems, develop solutions and implement improvements in local government policy and management.

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*For further information please contact:*

Local Government and Public Service Reform Initiative–Open Society Institute

Mr. Ondrej Simek  
FDI–CEE Secretariat

P.O. Box 519, H–1397 Budapest, Hungary

Telephone (+36-1) 327-3862/ext. 2402 • Fax (+36-1) 327-3105 • Email [osimek@osi.hu](mailto:osimek@osi.hu)

Internet <http://lgi.osi.hu/fdi> or <http://www.decentralization.org>

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*For additional information, please contact:*

Institute of Public Finance

Katančičeva 5, 1000 Zagreb, Croatia

Tel: (+385 1) 481 9363 • Fax: (+385 1) 481 9365 • E-mail: [office@ijf.hr](mailto:office@ijf.hr)

Internet <http://www.ijf.hr>



The Fiscal Decentralization Initiative  
for Central and Eastern Europe



# **Fiscal Decentralization in Croatia**

## **Conference Proceedings**

Editors

**Katarina Ott, Anto Bajo and Mihaela Pitarević**

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## Preface

The Institute of Public Finance, in collaboration with the Fiscal Decentralization Initiative for Central and Eastern Europe (FDI)–Budapest, organized a Fiscal Decentralization Forum in Zagreb from November 14–15, 2002. The objective of the Forum was to determine the existing state of affairs in fiscal relations between central government and local government in Croatia.

It was the intention of the Forum to spur an exchange of ideas and opinions among all those interested in fiscal decentralization processes in the Republic of Croatia (RC). Approximately 90 people attended from various sectors, including the academic community, the non-governmental sector, the central and local government, international donor programs, and the media.

The Forum was divided into seven thematic units. The first unit included a discussion on “fiscal decentralization in the RC.” Katarina Ott and Anto Bajo from the Institute of Public Finance analyzed what had been done in the way of change over the previous year in the local finance and budget system, while Maja Lukes-Petrovic from the Ministry of Finance shared her outstanding insight into the process and effects of fiscal decentralization of the public sector in practice.

In the second unit of the Forum, Teodor Antic from the Ministry of Justice, Administration and Local Self-Government, gave a very useful presentation on decentralization and democratization in the central administration and local self-government. The same unit included a presentation entitled, “The legal and administrative framework for fiscal decentralization in the Republic of Croatia,” in which Ivan Koprivic of the Law Faculty in Zagreb shared his thoughts on existing opportunities and myths related to decentralization in Croatia.

The theme of the third unit of the Forum was “Decentralization in transitional countries.” Since Stanka Setnikar-Cankar from the School of Public Administration in Ljubljana was unable to attend, her work on the experience of other countries and oppor-

tunities for fiscal decentralization in neighboring Slovenia was instead presented by Predrag Bejakovic from the Institute of Public Finance. Serdar Yilmaz of the World Bank gave a rather provocative presentation of his paper on the measurement and influence of fiscal decentralization. One of the basic hypotheses of his work was that the degree of fiscal decentralization is not currently measured in a suitable way.

The day ended with two interesting presentations during the fourth and final thematic unit for the day. Ronald Hackett of USAID Barents Group presented his paper on fiscal decentralisation and revenue sharing in Croatia, followed by Mihaela Pitarevic from the Institute of Public Finance, who discussed whether grants in the RC are allocated in line with criteria for horizontal fiscal equalization.

On day two of the Forum, Dubravka Jurlina Alibegovic of the Economics Institute in Zagreb presented the results of a wide-ranging investigation into the financing of local self-government, part of a project of the Croatian Law Center entitled, “The Decentralization of Public Administration.” Within the same unit of the Forum, the topic of which was “Local financial management,” Bojan Pecek from the School of Public Administration, Ljubljana presented Srečko Devjak’s very interesting paper on the introduction of control and the development of the budgetary process in the Slovene municipalities in his absence. The sixth also very interesting unit of the Forum, on “Fiscal transparency and accountability,” started with an address from Katarina Ott, from the Institute of Public Finance, followed by the mayor of Crikvenica, Ivica Malatestinic, who spoke of the positive experiences of his city in involving the public in the budgetary process. After that, Jerka Kezele, head of the Administrative Committee for Economics, Finance and Public Revenue, presented a very praiseworthy publication of the city of Varaždin, *The Pocket Guide to the Budget of the City of Varaždin*.

Within the last unit of the Forum, “Additional opportunities in financing for local units,” Goran Vuksic

from the Economics University in Vienna spoke about foreign investment and fiscal decentralization, followed by Anka Masek and Sandra Zbodulja from the Economics Faculty in Osijek, who presented a paper on the balance sheet and financial policy of units of local administration and self-government.

On both days there was serious discussion of the current situation and the problems of fiscal decentralization in the Republic of Croatia. Special thanks is due

to the large number of participants from the local government level for raising the quality of the debate. They attended the Forum looking for solutions to problems they encounter on a daily basis.

All the papers presented at the Forum can be found at [www.ijf.hr/fiskalni-forum/program.html#2](http://www.ijf.hr/fiskalni-forum/program.html#2).

*Mihaela Pitarević*  
Institute of Public Finance



# Fiscal Decentralization in Croatia

## Introductory Paper for the Proceedings of the FDI Forum

**Katarina Ott and Anto Bajo**  
*Institute of Public Finance, Zagreb*

### Summary

*This paper serves as the introductory chapter for the Proceedings of the Fiscal Decentralization Forum organized in Zagreb by the Fiscal Decentralization Initiative for Central and Eastern Europe, Budapest and the Institute of Public Finance, Zagreb. It briefly describes the main issues of fiscal decentralization in Croatia, analyzes the recent administrative changes, the way government has tried to tackle the problems, and finishes by giving some conclusions and recommendations.*

**Key words:** fiscal decentralization, Croatia

The intention of this text is to briefly describe fiscal decentralization in Croatia by explaining the recent administrative changes as well as how the government has approached problems, and finally, to offer some conclusions and recommendations. In addition to sharing the views of the authors, this paper tries to reflect on the ideas presented at the Fiscal Decentralization Forum<sup>1</sup> by independent researchers (both from Croatia and neighboring Slovenia), government officials (both

from the central and the local level), representatives of international organizations (World Bank Institute), the organizers (Fiscal Decentralization Initiative and Institute of Public Finance) and the representatives of the media, NGOs and other participants at the Forum.

### Description of the Fiscal Decentralization in Croatia

Citizens of the Republic of Croatia have the constitutional right to local government, which includes the right to take part in decision-making about local needs and issues. For this reason the country is divided into cities, communes (local administration units) and counties (local government and administration units).

Croatia has 20 counties (plus the city of Zagreb), 425 communes and 122 cities. Unfortunately, 29 cities and 82 communes are within the areas of special national concern (areas damaged by the recent war).

Each local unit has its own budget. The revenue of the local unit's budget is recorded in the same way as that of the national budget. All the revenue of the local units is divided into tax revenue, non-tax revenue, capital revenue and grants (Table 1).

*Table 1. Revenue of Local Units in Croatia in % of Budgetary Revenue*

Revenue	1995	1996	1997	1998	1999	2000	Plan 2001
Tax revenue	66.2	55.9	52.7	55.9	51.8	55.7	51.1
Non-tax revenue	22.7	31.4	33.3	29.3	30.9	31.5	34.2
Capital revenue	4.8	4.9	6.3	5.1	7.1	6.7	8.6
Grants	6.3	7.8	7.7	9.7	10.2	6.1	6.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IMF, 2001.

<sup>1</sup> Organized by the Fiscal Decentralization Initiative for Central and Eastern Europe (FDI)–Budapest, Hungary and the Institute of Public Finance (IPF)–Zagreb, Croatia on November 14–15, 2002 in Zagreb.

As seen from Table 1, taxation is the leading item in the budgets of local units, although there is an evident downward trend, from 66 percent in the total revenue in 1995 to 51 percent as planned in 2001. The second most important local government revenue is non-tax revenue, the share of which has been on the increase, from 23 percent in 1995 to 34 percent in 2001<sup>2</sup>. The share of capital revenue has also increased, and in 2001 it represented over 8 percent of all local government revenue. Grants from the central government to local governments were growing from 6 percent in 1995 to their peak of 10 percent in 1999, but they suddenly fell and came to around 6 percent both in 2000 and 2001.

Defining the criteria for transferring grants from central to local government is a constant problem in Croatia. There is an understanding that it is necessary to make transfers to local government units with a below-average fiscal capacity, but we still lack the criteria for evaluating fiscal capacity. As a consequence we have ad hoc grants from the Ministry of Finance and the sharing of taxes, particularly the income tax (Table 2).

The basic source for the financing of local government is the legally defined sharing of common taxes between the central government and the lower levels of government, i.e. the local units. Table 2 shows the common taxes in 2003: personal income and corporate

income tax, and the real estate commerce tax, all of which are divided among central government, county and city or commune.

Unfortunately, reliance on tax sharing and the constant changes in the shares going to particular local government units, without any clear-cut criteria, contributes to the confusion and proves that even for the tax sharing mechanism we need reliable fiscal capacity indicators. We must admit here that there are some positive signs—in the years 2001 and 2002 the Ministry of Finance tried to calculate fiscal capacity using per capita income estimates (Tables 3a and 3b).

Local public expenditure is largely financed by joint taxation, mostly income tax and surtax<sup>3</sup>. This is shown by the extent to which income tax and surtax account for overall taxation: 63 percent in counties, 66 percent in communes, 69 percent in cities and almost 74 percent in the city of Zagreb. Furthermore, the share of income tax and surtax is growing in all local units. Other taxes have varying roles. Profits tax is in second place in the counties, around 23 percent, and in the city of Zagreb is around 16 percent. Real estate commerce tax is in second place in communes, 22 percent, and 16 percent in cities. Other common taxes are less important. It will be very interesting to see the data for 2001 and 2002 where we could expect the effects of the latest changes

Table 2. Common Taxes and Their Division in % Among the Levels of Government (2003)

Kind of tax	Central government	County	Commune or city	Decentralized functions*	Fire brigade**	Equalization fund***
Income tax	24.6	10	34	9.4	2	21
Income tax (Zagreb)	21.6	—	47	9.4	2	21
Profit tax	70	10	20			
Real estate commerce tax	40	—	60			

\* goes to the commune or the city which is financing its decentralized functions, otherwise goes to the county.

\*\* goes to the commune or the city that has established and is financing a regular operation of the public fire-service.

\*\*\* the state-level fund from which transfers are sent to those local units that cannot finance their public functions.

Source: *Local Government and Administration Financing Law, NN 150/02.*

<sup>2</sup> The most important reasons for this growth are the collection of illegal utility fees and the fact that local governments do not have substantial control over the tax bases and tax rates and turn instead towards non-tax revenues. More in Ott and Bajo, 2001.

<sup>3</sup> Surtax is an additional tax levied on top of income tax. The tax base for surtax is the amount of the income tax paid. Surtax is the revenue of the local authorities. From 1994 to 2001 cities with more than 40,000 inhabitants had the right to introduce surtax. The rate of surtax usually ranged between 6 and 7.5%, but in Zagreb it was 18%. Since July 2001 all local units have been allowed to prescribe surtax on the income tax. The rates are determined by the local authorities and may not be higher than: 10% for communes, 12% for a city with a population of less than 30,000, 15% for a city with a population of more than 30,000, and 30% for the city of Zagreb.

Table 3a. The Main Sources of Taxation Revenue of Local Units in Croatia in % of Total Taxation Revenue

Taxes	Counties			Communes		
	1998	1999	2000	1998	1999	2000
Income tax and surtax	54.1	50.6	62.9	54.1	63.5	66.4
Profits tax	32.7	33.8	22.9	32.7	9.4	8.8
Real estate commerce tax	1.3	0.8	0.5	1.3	23.6	21.5
Inland tax on goods and services	11.9	14.2	13.7	11.9	3.3	3.0
Other taxes	0.0	0.6	0.0	0.0	0.2	0.2
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Finance, 2001.

Table 3b. The Main Sources of Taxation Revenue of Local Units in Croatia in % of Total Taxation Revenue

Taxes	Cities			Zagreb		
	1998	1999	2000	1998	1999	2000
Income tax and surtax	64.8	62.9	69.1	66.6	67.8	73.9
Profits tax	16.0	16.8	11.8	24.6	23.5	16.6
Real estate commerce tax	16.8	17.1	16.3	7.1	6.8	7.4
Inland tax on goods and services	2.5	2.6	2.7	1.6	1.9	2.1
Other taxes	0.0	0.5	0.1	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Finance, 2001.

Table 4. Expenditure of Local Units, a Functional Classification [%]

Expenditure	1998	1999	2000	Plan 2001
General public services	20.2	21.3	22.4	21.3
Law and order	0.4	0.5	0.8	0.9
Education	11.1	11.3	11.9	10.7
Health care	1.0	1.1	0.8	1.0
Social insurance (welfare)	3.3	3.1	2.9	3.1
Municipal services	25.4	23.5	23.9	26.1
Recreation, culture and religion	13.8	16.2	14.3	12.8
Agriculture, forestry and fisheries	0.6	0.7	0.7	0.8
Mining, trades and construction	4.5	3.7	2.6	3.1
Transport and communications	13.5	13.2	13.3	12.8
Other economic affairs	4.8	3.5	3.9	4.8
Miscellaneous expenditure	1.1	1.7	2.1	2.0
Total expenditure	100.0	100.0	100.0	100.0

Source: IMF, 2001.

in the percentages in which the common taxes are shared (Table 4).

Table 4 shows what local units used their resources for. The biggest item was municipal services (utilities), accounting for 25 percent on average, followed by general public services (21%). After that came expenditure on recreation, culture and religion, as well as transport and communications, both averaging around 13 percent.

If we look at the consolidated general government (according to Ministry of Finance and Government Statistics Office data), we can see that the share of the local government revenues and grants in GDP was on the increase from 4.4 percent in 1995 to 5.4 percent in 1999. The share of expenditures was on the increase, from 4.2 percent in 1995 to 5.8 percent in 1999. Unfortunately, we do not have any newer data, but the changes were not substantial anyway and we can only conclude that Croatia is, despite all efforts to the contrary, quite a centralized country.

### Recent Administrative Changes

During the year 2001, Croatia undertook a reform of the financing of local units. The functions of education, health care and welfare have been partially decentralized. After the reform, these expenditures began to be financed from the budgets of the local units, but also from the equalization fund and from the increased share in income tax going to the local unit.

The legal status of all local units is now the same, and all can carry out administrative functions. In spite of the wish to reduce the numbers and to unite some small local units, there is still a trend towards the foundation of new units. Unfortunately, they tend not to be founded on a realistic estimate of their fiscal capacity.

It is as yet too early to estimate the real effects of the reform measures. Nevertheless, it is obvious that the additional income tax sharing and the equalization grants are now the basic instruments for financing the decentralized functions of education, health care and welfare. Unfortunately, no account has been taken of the state of the fiscal capacity of individual local units. Zagreb, the capital, for example, did not need to have an increased share in income tax because in all categories of revenue Zagreb is capable of financing decentralized functions. Interestingly, not a single commune has taken on the decentralized functions, although a considerable number of communes introduced surtax. Proper fiscal capacity indicators would show us if these communes are really in a poor financial position, i.e. incapable of financing the decentralized functions.

In principle, the reform provided the conditions for the consolidation of local units' budgets. Local units can now draw up numerous performance indicators concerning the execution of their jobs. There is now no reason for local units or for the Ministry of Finance not to publish complete information about local unit budgets. Nevertheless the consolidation of the local unit's budgets will depend on the definition of the budgetary beneficiary. Unfortunately, the lack of any clear definition could make the consolidation questionable.

Formally, control of borrowing and the issue of guarantees has been strengthened, and it is now possible to obtain a picture of borrowing and of the structure and size of guarantees. However, we cannot expect any major change at the local level until the central government proves it is capable of controlling the spending of its own budgetary beneficiaries at the national level.

So, we can stress that the government should decide upon one of two possibilities—first, decentralization of both authorities and finances, or second, decentralization of authorities and centralization of finances.

If the government wants decentralization of both authorities and finances, then it must to a greater extent leave some of the taxes within the jurisdiction of the local units. If the government wants the decentralization of authorities and the centralization of finances, then it should say so clearly, and work on the improvement of the existing model of fiscal equalization. In this case, fiscal capacity indicators should be calculated for all levels of government as well as all categories of revenue and expenditure.

Further progress of the reform will to a great extent depend on the capacity and knowledge of individuals at all government levels. Every mistake could be a step backward with respect to the main objective the government should have in mind—providing a simple, user-friendly and responsible system for the financing of local units.

### Tackling the Problems

The main problems of fiscal decentralization in Croatia are related to the number and size of the local units, the budget itself and the budgetary process.

Croatia is a small country, in which there are too many local government units. This situation causes an oversized administration at several tiers of government as well as inadequate division of functions and responsibilities. Unfortunately, the situation has been aggravated by the foundation of the areas of special national concern after the war.

A change in the number and shape of local government units is more a political than an economic problem, and as such it is something we cannot influence. Thus, the attitude of the Institute of Public Finance has been to concentrate on budget and budgetary process-related problems like classification, consolidation, methodology, transparency, revenue and expenditure analysis.

In line with this reasoning, in one of the previous texts (Ott and Bajo, 2002), we enumerated the most important problems and gave particular suggestions for improvements. Comparing our suggestions with recent trends we can now make some conclusions

There have been *no substantial positive changes* regarding:

- territorial organization;
- oversized administration at several tiers of government;
- areas of special national concern;
- public investment planning;
- revenue structure;
- insufficient shared taxation;
- the central government's control of the local government units' utility contributions and charges;
- frequent founding of new local government units without secured funds;
- classification by program and subprogram;
- the position of utility companies;
- evaluations and rewards for the work of employees;
- internal controls;
- audits of joint stock companies owned by local units;
- guidelines of the Ministry of Finance.

We witnessed *partial changes for the better* regarding:

- inadequate division of functions and responsibilities;
- classification of budgets;
- fiscal capacity indicators;
- financial equalization and allocation of grants;
- consolidation of local government units' budgets;
- complicated accounting;

- plans and estimates of the budget;
- national treasury system;
- reporting on the local government units' own tax revenue;
- participation of citizens;
- long-term capital project planning;
- financial control of the local government units' borrowing;
- recording potential obligations (guarantees).

Despite many problems, in some aspects, the situation is slightly improving. Positive changes are particularly visible in budget-related problems generally (regarding classification, consolidation, accounting, the national treasury system), and also, to a slightly lesser degree, with respect to expenditure side problems, (regarding long-term capital project planning, controlling borrowing, recording liabilities). Almost no improvements could be noted regarding the problems connected with the number and size of the local government units (territorial organization, oversized administration on several tiers of government, areas of special national concern) and the problems connected with the budgetary process (internal controls, audits, guidelines of the Ministry of Finance). Only slight improvements could be seen in connection with revenue side problems (reporting on the local government units' own tax revenue, control of the local government units' utility contributions and charges).

The explanation probably lies in the political sphere—in the decision to change the territorial organization of the country and the related hesitations about engaging in problems regarding the budgetary process and the assignment of revenues. General problems like classification, consolidation, accounting, the treasury, or expenditures are problems that could seriously obstruct the functioning of the country, so it comes as no surprise that the Ministry of Finance and other relevant agencies are keen to make some improvements.

## Conclusions

In several of our previous texts<sup>4</sup> we drew various conclusions stemming from the experience of our own research and we will not repeat them here. Let us rather

<sup>4</sup> Op. cit for example.

see what we can conclude from the experience of the Fiscal Decentralization Forum.

An increase in the interest in fiscal decentralization issues in Croatia is more than obvious. More and more people are writing about and discussing this issue, as well as attending various fiscal decentralization issue gatherings, including this Forum.

The diversity among the participants is also obvious. They come not just from the ministries and other central government agencies, but more and more from the local level, and from the wider academic community, the media and NGOs. This mixture of participants shows a great inclination towards extremely constructive discussion.

We should also stress the importance of the participation and collaboration between participants from Slovenia. Croatia and Slovenia shared the same history for so many years that even today as separate countries they have a lot of issues and problems in common, and it is very useful to share experiences, disseminate knowledge and try to implement the best possible practices.

Although it might seem that we are stuck in the same position—the same people, the same approaches—the step forward is visible. Issues are more expertly addressed in writing, while more and more people outside of the government and the academic community are showing an interest in the field.

It seems that the majority of participants have drawn attention to the problem of the high number of local government units and the consequently ensuing inefficiencies. Changes in the number of local government units are inevitable, but they necessarily involve changes in the political sphere, and so it is impossible to predict when they might occur.

What can we do in the meantime?

We can try to improve that which can be improved.

We should probably narrow our field of interest and research and deal only with the few most important issues. This could, for example, mean concentrating on developing high quality databases, improving the calculation of the fiscal capacities of local government units, educating all participants in the process, including the citizens, improving the transparency of the process, government accountability, and participation of the citizens.

In her discussion at the Fiscal Decentralization Forum, Dubravka Jurlina-Alibegović emphasized the importance of the regulated minimum criteria for local government units. Although we are in complete

agreement, we also want to bear in mind the growing differences between local government units. More developed units will be able to produce citizens' budget guides, organize public debates, and issue charters; their politicians will try to win the next elections, and they—the more developed, richer units—will be able to implement new ideas and new public management. At the same time, the less developed units will be more and more dependent on transfers from the central government. Perhaps some of the poorest units will in time cease to exist.

Ivica Maletistinić stressed in that context that local government units are not supposed to expect everything to be prescribed by the central government but could go a step further and show possible new approaches (e.g. fire brigade financing or public debates) through their own examples.

Gábor Péteri summarized the Forum by suggesting that at this stage of fiscal decentralization development in Croatia we should probably establish a kind of task force consisting of persons and institutions representing different interests and concentrate on policy design improvements. Priorities could evolve around (1) developing a grant allocation formula, which also requires fiscal capacity indicators and fiscal data improvements, (2) improving fiscal transparency both at the national and at the local level, and (3) the importance of local taxes within the framework of tax policy, of course having in mind that they are not supposed to increase the total tax burden.

We conclude that both the researchers and the policy makers should consequently concentrate on:

- developing and calculating fiscal capacity indicators;
- developing the system of transfers and grants;
- vertical, but also horizontal equalizations;
- indebtedness problems—pertaining to the regulation and role of the central government;
- analyses of revenue and expenditure, but also of the efficiency of revenue and expenditure, administrative and compliance costs of revenue collection and benefits arising from the expenditure made;<sup>5</sup>

<sup>5</sup> In this context we could mention the project “Administrative and compliance costs of taxation in Croatia” run by the Institute of Public Finance and co-funded by the CERGE, Prague, Czech Republic.



- costs of the government (both central and local) per capita, per types of costs, per local government units, etc.;
- education of government employees but also of all participants in the decision-making process (national Parliament and local assemblies) and all the citizens;
- improving transparency, accountability and participation in budgetary process at all levels of government.

And finally, although it is questionable when Croatia will become eligible to join the European Union, we should continue at all times to bear in mind the requirements of the Union regarding taxation, the scale of the public sector and particular regional development policies.

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**Part I.**  
**Fiscal Decentralization**



# On the Measurement and Impact of Fiscal Decentralization

Robert D. Ebel and Serdar Yilmaz<sup>1</sup>

World Bank Institute

## Summary

*The typical post-Bretton-Woods era development approach that puts great emphasis on central government efforts to promote development, has changed dramatically and local governments have now emerged as important players in development policy. Now, the concept of requirements for achieving the development objectives is changing and many countries around the world are now implementing fiscal decentralization reforms. Within this context a number of studies attempted to quantify the impact of decentralization by relating a certain measure of decentralization to the economic outcomes of fiscal stability, economic growth, and the size of the public sector. However, decentralization is surprisingly difficult to measure. In nearly all cases those examining the relationship between decentralization and macroeconomic performance have relied on the government finance statistics of the IMF. But despite its many merits, GFS falls short of providing a full picture of fiscal decentralization. Yet for some countries there are data that more accurately capture the fiscal responsibilities of different types of governments.*

## Introduction: Scope and Purpose

Political and economic liberalization in the transition economies have opened up possibilities or at least revived claims for greater decentralization—transfer of authority and resources from the central government to sub-national governments. While we do not yet understand in a systemic way where the impetus for decentralization is coming from, limited evidence suggests that decentralization holds great promise for improving the delivery of public services, but the outcomes depend on its design and the institutional arrangements governing its implementation. In our earlier work, we show that although there is a high degree of political decentralization in the transition countries, the picture of fiscal decentralization is very general (Ebel and Yilmaz, 2002).

## Scope

For much of the post-Bretton Woods era, the typical development approach emphasized central government plans and programs. The idea was that if a poor country could come up with a national plan for generating and investing a sufficient amount of funds by observing the principles of macro-stability, then that country would meet the pre-conditions for development. It would be a state (central government) applied strategy whereby the “flexibility to implement policies devised by technocrats was accorded a pride of place, and accountability through checks and balances was regarded as an encumbrance” (World Bank, 1997a). Until perhaps the mid-1990s, this was the main message of not only the two Bretton Woods institutions—the International Monetary Fund and the World Bank—but also of other multilateral and many bilateral institutions.

It was not an unreasonable strategy. Bretton Woods reflected a world emerging from the ravages of war, when much of the developing world was gaining its political independence. Development seemed a surmountable and largely technical challenge: good advisors would devise good policies, and technically assisted and institutionally capable governments would implement those policies.<sup>2</sup> There could even be stages, from the first “*mission*” to an “*exit strategy*”—words that reflect so well the thinking of the time.

There was some progress, especially in infant mortality rates, life expectancy, and adult literacy. There were also many failures (Vinod *et al.*, 2000). The failures did not only result from the inability to demonstrate sustained growth rates. They also resulted from environmental deterioration, loss of civil liberties, corruption, and a very poor record of delivering “local”

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<sup>1</sup> World Bank Institute, Washington, D.C., USA.

<sup>2</sup> Ibid.

public services—clean water, sanitation, education, health, housing, safety nets, and, as some argue, poverty alleviation (Pauly, 1973). These were failures in an era when the scope of central government expanded enormously.<sup>3</sup>

Now, the idea about what is important to achieve development objectives is changing, dramatically so in some countries. Writing in 1994, W. Dillinger reported (in what has become one of the most quoted World Bank reports) that of the 75 developing countries with populations greater than 5 million, all but 12 claimed to have embarked on some form of transfer of fiscal authority from central to local governments. This transfer of power has been occurring even in “inherently centralized” countries, such as the Kingdoms of Jordan and Morocco (Ebel, Fox and Melhem, 1995; Vaillancourt, 1997; World Bank, 1999), Central and Eastern European countries that were under the Soviet-type fiscal system (Dunn and Wetzel, 2000; Bird, Ebel and Wallich, 1995), the People’s Republic of China (Wong, 1997), military regimes like Pakistan (Shah, 1996; Pakistan NRB, 2001), countries like Thailand that view decentralization as an efficient strategy for improving local service delivery in reaction to financial crises (World Bank, 2000); nation-states that are trying to avoid the centrifugal forces of separatism, like Russia (Wallich, 1994; and Martinez-Vazquez and Boex, 2001) and Indonesia (Ahmad and Hofman, 2001; Bird et al., 2001), and Latin America, where participatory budgeting is taking hold (Stein, 1997; Burki, Perry and Dillinger, 1999).

The World Bank is very explicit about the importance of all this: the World Development Report on *Entering the 21<sup>st</sup> Century* notes that along with globalization (continuing integration of countries worldwide), localization—the desire for self-determination and the devolution of power—is the main force “shaping the world in which development will be defined and implemented” in the first decade of this century. The report argues that these “defining forces of globalization and localization,” which at first glance may seem countervailing, often stem from the same factors and reinforce one another (WDR, 1999/2000).

The theme that emerges is that “good governance” matters, where “governance” is about how people determine collectively which government should deliver

services, and do so by establishing a set of transparent and competent public institutions they can understand and control. It is a theme that is tied to “getting right” what Bird refers to as the fundamental questions of intergovernmental finance: Who does what? Who levies which taxes (and is there a place for borrowing)? How can the resulting imbalances be resolved? What is the institutional framework to deal with the technical and political problems of decentralization? (Bird, 2000).

### *Purpose*

Within this context a number of studies attempted to quantify the impacts of decentralization by relating some measure of decentralization to the economic outcomes of fiscal stability, economic growth, and public sector size (Davoodi and Zou, 1998; DeMello, 2000; Ehdiaie, 1994; Fukasaku and DeMello, 1998, Oates, 1985).<sup>4</sup> Nearly all of these studies draw on Government Finance Statistics (GFS) issued by the International Monetary Fund as the basis for measuring “decentralization.”

As emphasized by Bird (2000), however, measurement is surprisingly difficult. And, if one cannot be confident in measuring an independent variable, then one cannot state with much confidence that decentralization is associated with one or more outcomes.

The purpose of this paper is to take a critical look at the nature and implications of measuring the fiscal dimension of decentralization. Recognizing that “a curious combination of strong preconceived beliefs and limited empirical evidence” characterizes all too much of the discussion (Litvack *et al.*, 1998; Bird, 2000), we look at two policy issues: (1) the extent to which fiscal decentralization is occurring and (2) the fragility of estimation results depending on how one measures fiscal decentralization (and, therefore, the danger in drawing sweeping conclusions that often have important policy implications).

The measuring is based on GFS data, and later supplemented with other considerations that recognize more fully local autonomy and discretion in expenditure and taxation arrangements. We find substantial differences between GFS indicators and those that capture more accurately fiscal responsibilities among different types of government. We estimate the impact of these various measures of decentralization on economic

<sup>3</sup> Central government expenditure, 15 percent of GDP in 1960, double that by 1985 (World Bank, 1997).

<sup>4</sup> The question of social outcomes (e.g., literacy rates, immunization and school enrollment) is not considered here..

stability, economic growth, and public sector size. Not surprisingly, we find that the different indicators have markedly different effects on economic performance.

### The Framework for Measurement

The conceptual framework of fiscal decentralization is well established, drawing largely on the contributions by Stigler (1957), Musgrave (1959), Oates (1972), and Brennan and Buchanan (1980). The core logic is the following one: if growth and poverty issues are to be taken into account, one should be concerned about efficiency—supplying services up to the point at which, at the margin, the welfare benefit to society matches its cost. In the private sector, the market-price system is the mechanism. When the market fails in this objective, there is a case for the public commandeering of resources to supply the activity. Once the public sector intervenes, the efficiency logic is in favor of some form of fiscal decentralization. The argument is that spatial considerations make sub-national governments necessary conduits for setting up a system of budgets that best approximates the efficient solution of equating benefits and costs. This leads to the decentralization theorem: The governments closest to the citizens can adjust budgets (costs) to local preferences in a manner that best leads to the delivery of a bundle of public services that is responsive to community preferences. Sub-national governments thus become agencies that deliver services to identifiable recipients up to the point at which the value placed on the last (marginal) amount of services for which recipients are willing to pay is just equal to the benefit they receive.<sup>5</sup> To implement this, sub-national (local) governments must be given the authority to exercise “own-source” taxation at the margin and be in a financial position to do so. This is the essence of fiscal decentralization.

How, in practice, does one say that a country is decentralizing? While there is no set of prescribed rules, we draw on Bahl and others to identify 11 characteristics, which range from the requirement for open local elections to the fundamental “essence” question of whether sub-national governments have (at least) tax rate-setting authority over locally assigned revenues (Bahl, 1999). A checklist for 10 transition countries

<sup>5</sup> The benefit model in public finance is particularly appealing to economists, but it faces two practical problems: it is often difficult to implement appropriate pricing policies and, since it requires acceptance of a “hard budget constraint,” can be politically difficult to achieve (Bird, 1993).

(Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, Slovak Republic) serves to explain our selection of countries that we can point to as politically “decentralized” for the purposes of making some statements about whether decentralization matters in terms of its promised benefits.<sup>6</sup> We also have access to new data that go directly to the point of own-source financial autonomy (OECD, 2001; 2002).

### Empirical Discussion

The literature on the relationship between decentralization and different macro indicators is growing. Most of these studies are cross-country analyses using the Government Finance Statistics (GFS) of the International Monetary Fund, and all describe the degree of fiscal decentralization as the sub-national share of total government spending/revenue or of Gross Domestic Product (GDP).<sup>7</sup>

Comparing the degree of fiscal decentralization across countries is a complex task that requires identification of sub-national autonomy and discretion over expenditure and revenue arrangements. Although it is widely accepted that sub-national share of total government spending/revenue is an imperfect measure of fiscal decentralization and that the need to standardize the fiscal variables in GFS inevitably eliminates details about the design of fiscal systems, many researchers use these measures to represent the degree of fiscal decentralization.

#### *What Are We Trying to Analyze?*

Recognizing that GFS has served well as a product of the central government forces of the post-Bretton Woods development model, three major problems emerge when using the data in an empirical study on fiscal decentralization:

- First, although GFS provides a breakdown of expenditures by function and economic type, it does not identify the degree of local expenditure autonomy. Thus, local expenditures that are mandated by the central government or are spent

<sup>6</sup> This checklist is in the form of a multi-page matrix and is available at <http://www.worldbank.org>.

<sup>7</sup> See Fukasaku and DeMello (1998) and DeMello (2000) on the impact of fiscal decentralization on macroeconomic stability; Oates (1985) and Ehdai (1994) on the relationship between the government size and fiscal decentralization; and Davoodi and Zou (1998) on the impact of fiscal decentralization on economic growth.

on behalf of the central government appear as sub-national expenditure.<sup>8</sup>

- Second, GFS does not distinguish the sources of tax and non-tax revenues, intergovernmental transfers, and other grants. Hence, there is no information on whether revenues are collected through shared taxes, piggybacked taxes, or locally determined “own-source” revenues.
- Third, GFS does not disclose what proportion of intergovernmental transfers is conditional as opposed to general-purpose, and whether transfers are distributed according to an objective criteria or a discretionary measure. We will argue that this distinction between conditional/objective formula grants versus more centrally tied “discretionary”/specific purpose grants can be a useful variable as a country makes the transition from deconcentration to devolution.

These aggregation problems limit the use of sub-national statistics in the GFS data set. Thus, although GFS has consistent definitions across countries and over time, the sub-national expenditure and revenue figures have little relevance in the decentralization context because the data fail to address properly the intergovernmental fiscal structure of countries and ignore the degree of central government control over local tax rates and tax bases. Thus, with GFS, the sub-national revenue and expenditure share in total government revenue/spending ends up being an overestimate of fiscal decentralization.

This overestimation of the fiscal decentralization indicator can be illustrated by analyzing the revenue structure of sub-national governments. Until recently, such a comparison was impossible due to lack of data that would be both disaggregated and would fit what we identified above as the essence of public sector decentralization—the ability of local governments to set the tax rate at the margin. Such data are available now for a set of EU accession countries from the Organization for Economic Cooperation and Development (OECD)’s survey *Fiscal Design Across Levels of Government* (OECD, 2001; 2002).<sup>9</sup>

OECD identifies three sources of sub-national revenues—tax revenues, non-tax revenues, and inter-

governmental grants—for the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Bulgaria, Romania, the Slovak Republic, and Slovenia (Table 1). Tax revenues and intergovernmental grants are further divided into two groups. If sub-national governments have total or significant control over a tax as defined by an “own” control over tax rate or a revenue tax base and rate, this is listed as “own tax revenue.” If sub-national governments have limited or no control over the rate and base of a tax and the central government determines how to split revenues, it is listed as “revenues from tax sharing.”<sup>10</sup> Non-tax revenues include income from business operations and property, administrative fees and duties, and fines (Table 2).

Intergovernmental grants are further classified as either general purpose or specific. For expenditure purposes, general purpose grants can be used like own revenues, but they may be allocated based on either objective criteria or the central government’s discretion. Specific grants are earmarked for certain purposes, and the allocation may or may not be conditional across sub-national governments. Therefore, general purpose and specific grants are identified as separate subgroups.<sup>11</sup>

Table 1 provides a comparison of fiscal statistics reported both in the Government Finance Statistics of the International Monetary Fund and Fiscal Design across Levels of Government of the OECD. The first three columns of Table 1 report the aggregate figures of sub-national expenditures and revenues for the ten

<sup>9</sup> There are three reports: Flip de Kam, *Taxing Powers of State and Local Governments*, prepared for the Working Party on Tax Policy Analysis and Tax Statistics, OECD Committee on Fiscal Affairs (Paris, 1999), OECD Tax Policy Studies No.1; Leif Jensen et al., *Fiscal Design across Levels of Government, Year 2000 Surveys*, prepared for the Working Group on Fiscal Design across Levels of Government, Central and Eastern European Countries (Paris, 2001), OECD Tax Policy Studies No.7; Leif Jensen et al., *Fiscal Design across Levels of Government, Year 2000 Surveys*, prepared for the Working Group on Fiscal Design across Levels of Government, Central and Eastern European Countries (Paris, 2002), OECD Tax Policy Studies No.8.

<sup>10</sup> In order to identify sub-national governments’ control over revenue sources, taxes are subdivided into categories based on the degree of tax autonomy (Table 3 lists these categories in a descending order starting with the highest degree of local autonomy). Own-tax revenues are the sum of the first three categories listed in Table 3 (taxes for which sub-national governments have the power to determine both tax rate and base or either one of them); tax sharing revenues are the sum of the last four categories.

<sup>11</sup> All of these characteristics have implications for the degree of decentralization in a given country..

<sup>8</sup> This is especially relevant in the context of developing countries, where an important portion of sub-national expenditures is either mandated or spent on behalf of central government.

Table 1. Comparison of GFS Data with Fiscal Design Survey of OECD (1999) [%]

County	GFS <sup>1</sup>	Expenditure Share <sup>2</sup>	Revenue Share <sup>2</sup>	Composition of Sub-national Revenues					
				Tax Revenue		Non-tax Revenue <sup>5</sup>	Grant		Total
				Own-Taxes <sup>3</sup>	Tax-Sharing <sup>4</sup>		General Purpose <sup>6</sup>	Specific <sup>7</sup>	
Czech Rep.	21.0	18.3	20.8	3.9	43.8	36.3	0	16.0	100.0
Hungary	23.0	23.7	26.7	16.3	16.8	17.0	1.7	48.2	100.0
Poland	31.0	27.6	28.8	10.6	14.4	24.6	30.5	19.9	100.0
Estonia	21.0	19.7	22.1	6.3	62.1	9.1	13.4	9.1	100.0
Latvia	24.0	23.1	25.0	0	66.2	14.1	5.8	13.9	100.0
Lithuania	20.0	19.6	22.8	0	91.0	4.8	2.3	1.9	100.0
Bulgaria	23.1	18.8	18.6	0	47.2	13.4	32.4	7.1	100.0
Romania	12.0	9.6	11.7	6.1	64.1	14.9	0	14.9	100.0
Slovenia	12.7	11.6	11.9	10.6	49.3	17.5	15.9	6.6	100.0
Slovak Rep.	7.5	7.1	5.0	22.8	39.6	19.3	0	18.4	100.0

<sup>1</sup> Sub-national expenditures in total government expenditure.

<sup>2</sup> as reported in OECD, 2001 & 2002.

<sup>3</sup> Sub-national government sets tax rate and/or tax base.

<sup>4</sup> Central government sets tax rate and base and determines revenue split.

<sup>5</sup> Revenues such as fees and user charges that are assessed by sub-national governments.

<sup>6</sup> General purpose grants are those that can be treated like own-source revenue. General purpose grants can be distributed according to objective criteria (such as tax capacity, expenditure needs) as well as at the discretion of the central government.

<sup>7</sup> Specific grants are tied sources of revenue. Specific grants are given to cover a certain amount of costs of a service mandated by the central government or a function that is performed on its behalf.

transition countries for 1999. The GFS column presents the sub-national governments' share in total government expenditure as used in most empirical studies. Comparison of the GFS data with the aggregates reported in the OECD study shows very little discrepancy between them. The detailed sub-national revenues reported in the OECD study, however, tell a very different story.

The composition of revenues reveals that sub-national governments in these ten countries have very little control over their revenues. Therefore, aggregate revenue figures overrepresent the degree of fiscal decentralization. For example, in Lithuania, 91 percent of sub-national governments' revenues come from shared taxes for which the central government sets the rates and bases and controls revenue split. Sub-national governments in Lithuania have control over only 4.8 percent of their revenues. Thus, almost all local revenues are under the control of the central government, and the aggregate revenue (expenditure) figure grossly overrepresents the degree of fiscal decentralization. But the

aggregate data tell a very different, and misleading story (columns 2, 3 and 4).

Table 2 provides further details of sub-national revenues in all ten-transition countries for all years that fiscal surveys were carried out. In general, their sub-national governments have very little revenue autonomy, especially in Baltic countries. Table 3 presents the percentage of sub-national own revenues in total sub-national revenues. The first column presents own revenues over which sub-national governments have policy control. This control is essential for effective decentralization. Sub-national governments in the Slovak Republic have the highest percentage share in own-source revenues, which is only 60 percent of total revenues.

The next two columns report intergovernmental grants. One might argue that general purpose grants and specific grants cannot be own sources of revenue, and we recognize the merits of this view. Nevertheless, for the reasons stated above and for a limited purpose here,



Table 2. Composition of Sub-national Revenues [%]

	Tax		Non-tax	Grants		Total
	Own taxes	Tax sharing		General purpose	Specific	
1996						
Hungary	11.0	14.0	16.0	1.0	58.	100
1997						
Lithuania	0	66.0	5.0	11.0	18.0	100
Latvia	0	54.0	21.0	4.0	21.0	100
Estonia	6.0	58.0	13.0	15.0	8.0	100
Poland	15.0	23.0	28.0	21.0	13.0	100
Hungary	12.0	16.0	18.0	1.0	53.0	100
Czech Rep.	4.0	50.0	26.0	0	19.0	100
1998						
Lithuania	0	74.0	4.0	12.0	10.0	100
Latvia	0	54.0	21.0	5.0	20.0	100
Estonia	6.0	61.0	9.0	13.0	10.0	100
Poland	13.0	23.0	28.0	23.0	13.0	100
Hungary	13.0	17.0	18.0	1.0	50.0	100
Czech Rep.	5.0	51.0	27.0	0	18.0	100
Bulgaria	0	53.0	10.0	34.0	3.0	100
Romania	7.0	45.0	13.0	0	35.0	100
Slovenia	0	58.0	21.0	17.0	5.0	100
Slovak Rep.	21.0	38.0	21.0	0	19.0	100
1999						
Lithuania	0	91.0	5.0	2.0	2.0	100
Latvia	0	56.0	20.0	4.0	20.0	100
Estonia	6.0	62.0	9.0	13.0	9.0	100
Poland	10.0	14.0	24.0	30.0	21.0	100
Hungary	16.0	17.0	17.0	1.0	49.0	100
Czech Rep.	4.0	44.0	36.0	0	16.0	100
Bulgaria	0	47.0	13.0	32.0	7.0	100
Romania	6.0	64.0	15.0	0	15.0	100
Slovenia	11.0	49.0	18.0	16.0	7.0	100
Slovak Rep.	23.0	40.0	19.0	0	18.0	100
2000						
Bulgaria	0	46.0	14.0	33.0	7.0	100
Romania	5.0	65.0	14.0	0	17.0	100
Slovenia	10.0	48.0	18.0	15.0	9.0	100
Slovak Rep.	21.0	39.0	19.0	0	21.0	100

Table 3. Share of Sub-national Own Revenues in Total Revenues (1999) [%]

	Own taxes + Non-tax revenues	General purpose grants (with objective criteria)	Specific grants (not conditional)	Total
Czech Rep.	40.2	0	6.5	46.7
Hungary	33.3	0.3	0.8	34.4
Poland	35.2	30.5	0	65.7
Estonia	15.4	13.4	0	28.8
Latvia	14.1	5.8	0	19.9
Lithuania	4.8	2.3	0	7.1
Bulgaria	13.4	25.4	0	38.8
Romania	21.0	0	0	21.0
Slovenia	28.1	15.9	0	44.0
Slovak Rep.	42.1	0	18.4	60.5

Source: OECD, 2001; 2002.

we risk the overestimation bias and treat general purpose grants with objective criteria and non-conditional specific grants as own source revenues. Therefore, they are included in the decentralization variable. The argument is that sub-national governments have at least expenditure autonomy over these grants. On the other hand, sub-national governments have no control over discretionary and conditional grants that cover all or parts of services mandated by the central government; thus these revenue items are not treated as own source revenues. But, even with this liberal interpretation of the disaggregated sub-national revenue data, the case remains strong against using aggregate revenue/expenditure figures to measure decentralization.

Tables 1 through 3 make a strong point that cross-country studies which do not capture the variation in intergovernmental fiscal design misrepresent the degree of fiscal decentralization in transition countries. On the other hand, in other countries where sub-national governments have discretion over revenues and expenditures, aggregated figures might be appropriate in representing the degree of fiscal decentralization (see Table 4, next page).<sup>12</sup> Table 4 shows the significant variation in degree of tax autonomy for sub-national governments in developed and developing countries.

<sup>12</sup> In both Davoodi and Zou (1998) and DeMello (2000), there is a clear dichotomy in the estimation results for developing and developed countries. In both of them, the impact of fiscal decentralization on macro indicators is positive in developed countries and negative in developing countries. Overrepresentation of the degree of fiscal decentralization in the aggregate figure for developing countries might be the reason for the negative relationship.

Sub-national governments in developing countries get a significant portion of their tax revenues from tax sharing, whereas sub-national governments in developed countries either have control over tax rate and base or must approve any changes in the revenue-split of shared taxes.

#### *The Question of Macro Indicators*

At first, the revenue structure of a country may seem just a detail that has no bearing on the empirical analysis. The revenue structure of sub-national governments, however, has important implications for the outcome of the fiscal decentralization process (Bird, 2001, p.9.). The coordination failures arising from an improperly designed revenue system may induce sub-national governments to spend inefficiently and endanger macroeconomic stability by aggravating fiscal imbalance. A key to the success of decentralization is to design a system of multilevel public finances to provide local services effectively and efficiently while maintaining macroeconomic stability (DeMello, 2000). Accountability at the margin is an important characteristic of a revenue system that fosters prudence in debt and expenditure management. It is impossible for a sub-national government not to have control over revenue margins and still be fully accountable.

These points have been overlooked in most of the empirical studies. Studies using variables that misrepresent the degree of decentralization find an implausible impact of fiscal decentralization on macroeconomic stability, economic growth, and public sector size. For example, in recent cross-country studies using GFS data, DeMello (2000), Davoodi and Zou (1998), and

Oates (1985) analyze the impact of fiscal decentralization on budget balance, economic growth, and public sector size, respectively.

DeMello (2000) looks at the impact of fiscal decentralization on budget balance, measured as the ratio of the fiscal deficit to GDP, and argues that decentralization promotes fiscal imbalance. He uses several independent variables that explain budget balance, including sub-national tax autonomy (ratio of tax revenue to total sub-national revenue), sub-national fiscal dependency (ratio of intergovernmental transfers to total sub-national revenue), and sub-national spending share (ratio of sub-national government spending to total government spending). Similarly, Davoodi and Zou (1998) look at the relationship between economic growth and fiscal decentralization, measured as the sub-national share of total government spending, and argue that fiscal decentralization is associated with slower economic growth. On the relationship between fiscal decentralization and total public sector size, Oates (1985) reports no supporting evidence for the “Leviathan” hypothesis.<sup>13</sup>

In order to explore how the fiscal decentralization variable selection affects the estimation results—and how important the selection is—we replicated the DeMello, Davoodi and Zou, and Oates models using OECD data and ran the analyses for the ten transition countries listed above.<sup>14</sup> As presented below, the estimation results with a fiscal decentralization variable that represents sub-national revenue structure of sub-national governments are very different from those reported for the other three models.<sup>15</sup>

<sup>13</sup> If greater decentralization increases the number of alternative fiscal jurisdictions, any attempt to increase tax rates in one jurisdiction would result in migration of its residents to another (Tiebout, 1956). In Tiebout’s analysis, taxpayers migrate in order to avoid higher taxes and interjurisdictional competition, thereby limiting excessive taxing power of the governments. Along the lines of Tiebout, Brennan and Buchanan (1980) developed the “Leviathan” hypothesis, which argues that fiscal decentralization serves as a constraint on the behavior of the revenue-maximizing government. The “Leviathan” hypothesis predicts that the overall size of the public sector should vary inversely with fiscal decentralization; fiscal decentralization increases competition among local governments, which ultimately limits the size of the public sector.

<sup>14</sup> We are aware of the shortcomings of their approach discussed in different studies such as Martinez-Vazquez and McNab, 1997.

<sup>15</sup> A summary of descriptive statistics and data sources is given in Annex 1.

### *Economic Stability*

In the DeMello (2001) study, budget balance measured as the ratio of the fiscal deficit to GDP is the dependent variable, and sub-national tax autonomy is an independent variable. In his estimations, the coefficient of the sub-national tax autonomy variable is positive and statistically significant. Thus, he concludes that sub-national tax autonomy “worsens fiscal positions.” As we have argued, however, a close look at DeMello’s independent variables shows that they do not represent what he intends to test. GFS data do not allow him to identify the degree of local tax autonomy; i.e. whether the governments have control over the tax rate or tax base. As discussed previously, the new data set prepared by the OECD allows us to identify the types of tax revenues over which sub-national governments have control, either with regard to the rates or the bases (or both). We define tax autonomy as the ratio of own taxes (taxes whose rates and/or bases are set by sub-national governments) to total sub-national revenues (the first column in Table 2).

We present our estimation results in Table 5. The coefficient of the tax autonomy variable is negative and statistically significant at one percent. Therefore, by following DeMello’s lead, we argue that sub-national tax autonomy improves the fiscal position of sub-national governments. Another variable that DeMello uses to explain the sub-national budget balance is fiscal dependency. He uses the ratio of total transfers to total sub-national revenues as the fiscal dependency variable. In his study, the impact of fiscal dependency on sub-national fiscal positions is statistically insignificant. In our replication, the fiscal dependency variable is positive and significant. Therefore, again following DeMello’s lead, we argue that intergovernmental transfers “worsen fiscal positions” of the sub-national governments.

Finally, we analyze the impact of sub-national non-tax autonomy and sub-national tax sharing on budget balance. Since non-tax revenues and tax sharing are at opposite ends of the revenue autonomy scale, they are expected to have opposite signs. The estimation results in the last two columns of Table 5 show that they do have opposite signs, but of unexpected directions. The positive sign of the sub-national non-tax autonomy variable suggests that the increase in non-tax revenues of sub-national governments has a negative impact on their fiscal positions. On the other hand, the negative sign of tax-sharing variable implies that the increase in shared taxes would help sub-national governments balance their budget. However, the coefficient of the



Table 4. Sub-national Government Taxes as Percentage of Total Tax Revenue "Tax Autonomy"

	Own tax revenue			Revenue split may be changed with consent of SNG	Tax revenue sharing		
	SNG sets tax rate and base	SNG sets tax rate only	SNG sets tax base only		Revenue split fixed in legislation (may be changed unilaterally by the central government)	Revenue split determined by the central government	Central Government sets rate and base of SNG tax
<i>Developing/Transition Countries</i>							
Bulgaria (98)	0	0	0	0	41.0	59.0	0
Czech Rep. (95)	2.0	5.0	3.0	0	90.0	0	0
Hungary (95)	0	30.0	0	0	0	0	70.0
Poland (95)	0	45.0	1.0	0	54.0	0	0
Estonia (97)	0	9.8	0	0	90.2	0	0
Latvia (97)	0	0	0	0	0	0	100.0
Lithuania (97)	0	0	0	0	0	0	100
Romania (98)	0	8.6	4.6	0	0	66.9	19.9
Slovenia (99)	16.85	0.6	0.26	0	82.29	0	0
Slovak Rep. (98)	7.4	28.2	0	0	0	64.4	0
<i>Developed Countries</i>							
Austria (95)	5.9	6.0	0	88.1	0	0	0
Belgium (95)	5.1	49.1	0	45.3	0.4	0.2	0
Denmark (95)	0	95.2	0	0	2.7	0	2.1
Finland (95)	0.01	88.6	0	0	11.4	0	0
Germany (95)	0.3	13.2	0	86.5	0	0	0
Iceland (95)	8.0	92.0	0	0	0	0	0
Japan (95)	0.1	89.8	0	0	0	0	10.1
Mexico (95)	0	0	0	74.6	18.8	0	6.6
Netherlands (95)	0	100.0	0	0	0	0	0
New Zealand (95)	98.0	0	0	0	0	0	2.0
Norway (95)	0	3.7	0	0	0.6	95.7	0
Portugal (95)	30.1	8.6	0	0	0	0	61.3
Spain (95)	26.7	35.4	0	37.9	0	0	0
Sweden (95)	0.3	99.7	0	0	0	0	0
Switzerland (95)	51.8	40.8	0	3.2	4.2	0	0
U.K. (95)	0	100.0	0	0	0	0	0

Source: OECD, 1999; 2001; 2002.

sub-national tax-sharing variable is not statistically significant at conventional levels.

### *Economic Growth*

Previously, the debate over the merits of fiscal decentralization was on theoretical grounds of efficiency gains. In a recent study, Davoodi and Zou (1998) analyzed empirically the impact of fiscal decentralization on economic growth and reported a negative relationship across 46 developing and developed countries. There are,

however, serious methodological issues in their analysis (Martinez-Vazquez and McNab, 1997).

One problem in the study is the misspecification of the fiscal decentralization variable. They measure fiscal decentralization as sub-national share of total government expenditure reported in GFS. Sub-national share of total government expenditure does not represent the multidimensionality of the fiscal decentralization process. Without controlling for autonomy over expenditure and revenue decisions and whether officials

Table 5. Replication of the DeMello Model: Decentralization and Fiscal Positions (1997–1999)<sup>16</sup>

	Sub-national government balance			
Log sub-national tax autonomy	-0.000009* (0.0000001)			
Log sub-national fiscal dependency		0.002246* (0.000381)		
Log sub-national non-tax autonomy			0.000378* (0.00035)	
Log sub-national tax sharing				-0.001106 (0.001553)
Adj R <sup>2</sup>	0.91	0.69	0.83	0.61
Durbin Watson	2.1	2.1	2.1	2.0
Num. Obs.	31.0	31.0	31.0	31.0

Standard errors are in parenthesis.

\* Significant at the 1% level.

\*\* Significant at the 5% level.

\*\*\* Significant at the 10% level.

are democratically elected, the expenditure share of sub-national governments as a fiscal decentralization variable means very little in representing the level of decentralization. If fiscal decentralization is defined as revenue autonomy of sub-national governments, then estimation results might change.

To demonstrate this point, we specified a regression model similar to Davoodi and Zou in order to explore how the revenue structure of sub-national governments affects estimation results—whether the negative relationship between fiscal decentralization and economic growth holds, as they suggested. The dependent variable in this model is the growth rate of real per capita output and independent variable is fiscal decentralization. However, as we discussed above, we define fiscal decentralization as the revenue autonomy of sub-national governments (see Table 3).

Table 6 reports the estimation results. First, we use the conservative definition of revenue autonomy variable, then we include non-conditional and specific grants as own-source revenues into the analysis (See Table 3). The positive coefficients of both conservative

and liberal definitions of fiscal decentralization variables are statistically significant suggesting that more revenue autonomy of sub-national governments brings higher levels of growth. In the last column, we include a control variable: population growth rate (Levine and Renelt, 1992). As presented in the table, the magnitude and direction of the fiscal decentralization variable remain the same in this model as well.

#### Public Sector Size

On the relationship between fiscal decentralization and public sector size, Oates (1985) tested the Brennan and Buchanan “Leviathan” model<sup>17</sup> for a group of 35 countries and argued that the hypothesis does not hold—fiscal decentralization does not limit public sector size. Like previous studies, Oates did not take into consideration the revenue structure of sub-national governments, but instead he measured fiscal decentralization as sub-national share of total government expenditure.

We replicate Oates’ model to observe how the revenue structure of sub-national governments affects the analysis. Table 7 reports the estimation results. As seen in the first column, sub-national tax autonomy has a negative significant impact on public sector size, suggesting that the public sector’s expenditure share of GDP decreases with the increase in sub-national tax autonomy. In the second column, we include two control variables identified in Levine and Renelt (1992).

<sup>16</sup> To alleviate the specification error problems, we used state dummies to capture state-specific characteristics, e.g., location, climate, and initial endowments. Therefore, our econometric estimates are based on a fixed effect model. In addition, given the variations in the dependent variables across the observed units, with some states demonstrating much more variance than others, the potential heteroskedasticity problem is avoided by utilizing the Generalized Least Square (GLS) estimation procedure.

<sup>17</sup> About “Leviathan” hypothesis see footnote 13.

Table 6: Replication of the Davoodi and Zou Model: Decentralization and Economic Growth

	Per capita GDP growth		
Sub-national own tax + non-tax revenues	0,237*		
	(0,026)		
Sub-national own tax + non-tax revenues		0,114**	0,126*
+ General purpose grants (with objective criteria)		(0,044)	(0,038)
+ Specific grants (not conditional)			
Population growth			3,995**
			(1,732)
Adj R <sup>2</sup>	0,80	0,68	0,71
Durbin Watson	2,0	1,8	2,0
Num. Obs.	31,0	31,0	31,0

Standard errors are in parenthesis.

\* Significant at the 1% level.

\*\* Significant at the 5% level.

\*\*\* Significant at the 10% level.

Table 7. Replication of the Oates Model: Decentralization and Public Sector Size (1997–1999)

	Total government expenditure % of GDP	
Sub-national own tax + non-tax revenues	-0,011**	-0,012**
+ General purpose grants (with objective criteria)	(0,004)	(0,005)
+ Specific grants (not conditional)		
Population growth		1,767*
		(0,202)
Per capita GDP growth		-0,075*
		(0,019)
Adj R <sup>2</sup>	0,99	0,99
Durbin Watson	2,6	2,5
Num. Obs.	31,0	31,0

Standard errors are in parenthesis.

\* Significant at the 1% level.

\*\* Significant at the 5% level.

\*\*\* Significant at the 10% level.

The population growth variable has a positive sign and is significant at one percent level. The positive sign of the population growth variable suggests that the increase in population increases the level of government services. Per capita GDP growth controls the influence of Wagner's law — which argues that rising incomes are positively related to government growth. However, the negative sign of the per capita GDP growth variable suggests that public sector size is an income-inferior good in these countries.

### Concluding Comments

This exercise shows the importance of choosing the fiscal decentralization variable in an empirical study. Once the degree of fiscal decentralization has been represented

as the revenue autonomy, the estimation results change significantly. Two key conclusions can be drawn from this approach to the issues that are fundamental in analyzing the impact of fiscal decentralization across countries:

- While it can be demonstrated that there was a great deal of political decentralization in the 1990s, the next step toward fiscal decentralization has been a bit sketchy. This can be largely explained by the fact that it takes time for systems to change from a long-lasting centralization to decentralization. Nonetheless, the preconditions for political decentralization are being satisfied in many countries, and it seems likely that the actual restructuring of the government will be achieved in this decade, for good or ill.

## Annex 1. Summary Statistics of Data in the Baseline Regressions

Variable	Number of cross sections	Number of observations	Mean	Maximum	Minimum	Standard deviation	Data source
Sub-national tax autonomy	10	31	0.072	0.228	0.000	0.071	OECD
Sub-national non-tax autonomy	10	31	0.175	0.363	0.040	0.075	OECD
Sub-national fiscal dependency (1)	10	31	0.278	0.537	0.041	0.123	OECD
Sub-national fiscal dependency (2)	10	31	0.156	0.522	0.000	0.137	OECD
Sub-national tax sharing	10	31	0.475	0.910	0.144	0.183	OECD
Sub-national government balance	10	31	-0.001	0.010	-0.005	0.003	World Bank Economic and Social Database
Per capita GDP growth	10	31	0.030	0.124	-0.065	0.043	World Bank Economic and Social Database
Population growth	10	31	-0.004	0.001	-0.016	0.005	World Bank Economic and Social Database
Total government expenditure % of GDP	10	31	0.394	0.463	0.034	0.082	World Bank Economic and Social Database

- It is important to choose the correct fiscal decentralization variable in an empirical study. Empirical estimations are sensitive to variable selection, and a wrong choice may have far-reaching consequences for policymaking. The fiscal decentralization variable estimated in a different way leads to a significant change in the results, which shows how fragile the estimation results are. Therefore, the analysis of the impact of fiscal decentralization on macro indicators requires qualitative as well as quantitative techniques that take into account the countries' institutional structures.

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# Fiscal Decentralization of the Public Sector in the Republic of Croatia—Process and Effects

Maja Lukeš-Petrović

Ministry of Finance

## Summary

*This material gives a short description of the basic features and problems in the process of implementation of public sector decentralization in the RC during two periods—from July to December 2001 and from January to September 2002. Part one gives a survey of the legal bases with the statutory and bylaw regulations that were the foundation for the beginning of the implementation, and the actual carrying out of the process of decentralization. In the second part, the legal assumptions for the provision of resources for the devolved functions provided for in the amendments to the Financing of Local and Regional Self Government Law are described. At the same time, a quantitative analysis is given of the realization of resources from the extra share in the income tax and from the equalization grants, for the two periods under observation, for each county and city according to each decentralized function.*

*Part three gives a survey of the changes and the progress being made in responsibility, decision-making and the allocation of resources according to functional and economic classifications and control of the lawfulness of the way the functions are carried out. There is discussion of the relation between the central government, units of local and regional self-government and establishments, all for the two periods under observation.*

*At the end the results achieved are stated, problems are detected and concrete proposals for procedures that ought to be adopted in the next phases of the process of decentralization are given.*

**Key words:** fiscal decentralization, public sector

## Assumptions and Conditions of the Public Sector Decentralization Process

*Basis and assumptions of decentralization: the Program of the Government of the Republic of Croatia, statutory and bylaw regulations; evolutionary processes of the drawing up of the strategy as the result of its implementation in the systems of local government*

Although the process of public sector decentralization in the Republic of Croatia officially started on July 1, 2001, decentralization did in fact exist in the debates even before its real manifestation in statute, when the Croatian Parliament passed the laws through which the financing of certain functions and costs of elementary and secondary education, as well as of health care and welfare, were transferred from the national budget to the budgets of cities and counties, also providing the resources for their implementation.

The Program of the Government of the Republic of Croatia sets out the necessity for the implementation of decentralization; this is not envisaged as a mere transfer of resources for given functions and expenditures provided in the national budget of the Republic of Croatia to the local and regional units of self-government. Rather, what is thought of primarily is the transfer of responsibility and decision-making about the resources for the decentralized functions from the state level to local and regional self-government, as well as the obligation of the optimum performance of the functions for which the resources are being transferred.

Although no formal paper has been adopted in the sense of a strategy to define the objectives, principles, effects and procedure of decentralization, all these elements are to some extent contained in the said program, in the separate laws through which the decentralized functions are transferred and the sources

of revenue are provided, and in the bylaw regulations through which their implementation is ensured.

It was concluded that the whole of the process of the decentralization of the public functions of the state should be carried out gradually, in several phases, depending on the macroeconomic evaluations of the economic development of the country in the coming phase.

In the process of the preparation of the statutory material, it was necessary to:

1. define the functions and the operators to which the functions and resources were to be transferred;
2. define the functions of the operators who decide about priority expenditures, levels of service in line with local needs;
3. ensure the lawful, regular and effective execution of the decentralized functions in the institutions that carry them out (personnel and other resources—buildings, equipment and information infrastructure);
4. define the responsibilities of operators for the performance of the functions;
5. define the degree of independence of operators in the performance of functions, tasks and services and in the realization of the income for the transferred functions;
6. define and make sure of regular revenue and equalization grants from the national budget;
7. ensure lawful, rational and effective management of revenue at local levels;
8. define the authorities of the state and the line ministries with respect to the local and regional units of self-government, particularly with respect to the passing of bylaws and instructions that prescribe the standards that will have a direct effect on the expenditure of local and regional self-government from the point of view of the decentralized functions.

In the initial phase of decentralization, a foundation was built from the existing territorial organization of the municipalities, cities and counties, the limited resources and fiscal restrictions of local government, and from the obligation to execute the achieved level of decentralized functions. Here the basic aim was, by using the limited resources in an efficient way, to encourage the democratization of the decision-making process and the

realization of public needs, as well as to make possible more effective and rational public sector and economic development, not only of the less developed areas but for the collective progress of the regions.

From an analysis of the network of establishments (schools, homes, centers, hospitals and so on), of personnel resources for the implementation of the activities and the fiscal capacities of the municipalities, cities and counties, it was concluded that because of the uneven relations among them, the decentralized functions should be devolved to the counties or to 32 cities that had achieved a given fiscal capacity and that would be able to carry out the tasks transferred to them. It was concluded that all the functions, apart from elementary education, should be transferred, with respect to their fiscal capacity, to the counties. According to estimates of the network of schools and their capacities, only elementary education could be decentralized down to the level of the cities.

An Amendments Law to the Elementary Education Law was passed, prescribing that funds be ensured in the budgets of local and regional self-government units for the material costs of elementary schools, investment maintenance of the premises, equipment and teaching resources and aids, and the capital construction of the school premises and equipment according to standards laid down by the minister. A provision of this Law states that the Government of the Republic of Croatia is obliged to determine each year, in addition to the national budget, the criteria and yardsticks for the provision of the minimum financial standard needed for the realization of public needs. In the financial documentation provided along with the law mentioned, it was stated which cities, apart from the counties and the city of Zagreb, were to take on the financing of the decentralized expenditures for elementary education. These are cities with populations exceeding 10,000 and county towns that in 1999 had 400 kuna per capita revenue from income tax. The financing of the decentralized expenditures of elementary schools that are not in the area of these cities was taken over by the counties.

An Amendments Law to the Health Insurance Law stipulated that in the budgets of the regional self-government units, resources should be provided for the investment maintenance of premises and equipment of healthcare establishments owned by the counties and the city of Zagreb. Given that the calculation of the depreciation of long-life assets in healthcare establishments was done away with in 1994, LGUs were prevented from providing the necessary resources for the



investment maintenance of premises and equipment. In the meantime, the costs of investment maintenance were sporadically met from the national budget from resources of the Croatian Health Insurance Institute, but not with the money of the actual healthcare establishments or their owners (except in few cases). The counties own the health centers, health care at home centers, polyclinics, general hospitals, special hospitals, sanatoria and emergency medical services.

An Amendments Law to the Welfare Law stipulated that funds be provided in the budgets of regional self-government units for the financing of welfare centers, for expenditures on material, energy, utilities and other services, current maintenance, and financial expenditure, for other miscellaneous expenditures, and for meeting the costs of fuel.

Additionally, the counties to which the ownership of the homes for the elderly and infirm was transferred had to provide in their budget funds for the continuation of the work of the homes by providing them with the difference between the total expenditure and the home's own revenues (charges for the care of persons outside their own families and for other services).

The time and the conditions of decentralization: local elections on May 20, 2001, implementation of decentralization from July 1, 2001, amendments to local budgets, operations organization

The National Budget of the Republic of Croatia Execution Law for 2001 set the deadline for the decentralization of functions. That is, up until June 30, 2001 funds for the functions that were being decentralized in elementary and secondary education, health care and welfare were planned in the Croatian national budget, but from July 1, 2001 had to be ensured and executed in the budgets of the counties and cities.

The operators to whom the functions were transferred were in a particularly difficult situation because of the elections that had been called and the discontinuity in the local government—the city councils or county assemblies that were supposed to adopt amendments to their budgets and plan in them the revenues and expenditure for the devolved functions.

At the level of local and regional self-government, numerous questions were raised about whether all the activities were being literally carried out at the local levels; activities in connection with the organization of departments that were to take over the functions and the employees, which later turned out to be one of the questions that was not unambiguously settled at all levels, neither by the amendments to the law implementing the

decentralization of the functions, nor by the activities carried through by changes in the organization of the county offices.

The Amendments to the Units of Local and Regional Self-Government Financing Law said that operators who were taking over the financing of the decentralized functions were obliged, according to Article 5 of the Budget Law (Official Gazette 92/94), to harmonize their budgets for 2001 by September 30, 2001 at the latest, and that until these amendments to the budgets for 2001 were adopted, for the execution of the devolved decentralized functions, they could carry out the reallocation of the set budgetary funds over the percentage allowed for in Article 25 of the Budget Law.

This law prescribed that the cities and counties could seek equalization grants from the national Budget only after they had adopted the amendments to their budgets, with the proviso that the final deadline was prescribed. In some areas, however, there was no constituted representative body (a commissioner of the Government of the Republic of Croatia being in position), a criterion which would normally render rebalancing the budget impossible. Despite this fact, the Ministry of Finance ensured the implementation of decentralization and thus created the premises for regular performance of the decentralized functions. Since this was related to a legal obligation and necessary expenses for the financing of the activities that were transferred from the national Budget to a lower level, the funds were provided and transferred to the spending agencies (the establishments) according to the amounts of the obligation determined from the Decree concerning the Manner of Calculating Equalization Grants for the Decentralized Functions of Local and Regional Self-Government Units for 2001 and from the Minimum Standards Decision.

### **Fiscal Relations in the Decentralization Process**

In the proposition of a model for the law concerning the provision of resources for the financing of decentralized functions at a local and regional level, it was necessary to make sure that the following principles were included:

1. revenues should be adequate to the functions and tasks to be carried out;
2. regularity and stability of collection of revenue—without any major temporal discrepancies;
3. recognition and predictability of tax revenue for planning in the budget;
4. equality and fairness in the taxation of all taxpayers;

5. effectiveness in tax brackets and collection of taxes;
6. neutrality with respect to the position of the economy and other social and economic indicators;
7. clear responsibility and definition of the sphere of competence of decision-making about the kinds of tax revenue.

These principles were put into practice by choosing the part of the income tax that belonged to the national budget as a kind of joint or shared tax for the financing of the transferred functions.

The legal bases for the provision of the resources for the transferred functions were provided for in the Amendments to the Local and Regional Self-Government Units Financing Law, which prescribed:

- a) a new allocation of income tax and the operators involved in decentralization,
- b) vertical and horizontal equalization—from functional grants from the national Budget and bases of the obligation—minimum standards and the manner of defining the grants.

Amendments to the Local Government Financing Law (OG 117/1993, 69/1997, 33/2000, 127/2000, 59/2001, 107/2001 and 117/2001) stated the manner and sources of the funds to meet the decentralized costs in the domain of elementary and secondary education and health care and welfare that had until July 1, 2001 been financed from the national Budget, all according to the previously stated amendments of separate laws.

Additional shares in income tax allocated to local government units were defined separately for each particular function—education, health and welfare. The cities (32 of them) and counties that took over the financing of the costs acquired the funds by being ceded additional shares in income tax according to fixed shares, for:

elementary education	2.9%,
secondary education	2.0%,
welfare	
welfare centers	0.4%,
homes for the elderly and infirm	
(from January 1, 2002)	1.6%,
health care	
investment maintenance of county-owned establishments	2.5%.

According to the Government's Degree on the Manner of Calculating the Amounts of Equalization Grants from the national budget for a given year, the difference in resources for the covering of obligations laid down for each year is to be provided from equalization grants in the national Budget. This is to be done according to the minimum financial standard in given domains. Thus, decentralized functions are then stipulated by separate laws, and the decisions of the Government prescribe the criteria and yardsticks for the provision of the minimum financial standards in a given year, from which come the bases for the determination of the obligations transferred to the counties and cities used for the calculation of the amounts of the equalization grants for the decentralized functions of local and regional self-government units from the national Budget for a given year.

According to the Law, the right to resources from the position of equalization grants for decentralized functions from the national Budget belongs to counties and cities if from the said special extra shares in income tax they do not realize resources up to the amounts of the transferred obligations for the decentralized functions determined by the Decree of the Government of the Republic of Croatia.

The cession of income tax and making equalization grants from the national Budget relates also to other municipalities and cities that, in line with Article 45 of the Local Government Financing Law, have undertaken the financing of the decentralized function of elementary education (to a municipality or city with more than 8,000 inhabitants or to several municipalities or cities that together have at least 8,000 inhabitants, the representative bodies of which have decided to carry out the functions of elementary education together, with the conditions and in line with the said decree).

Regular revenue and effective performance of functions are prescribed by the laws and decisions about minimum standards and the Decree on the Manner of Calculating the Amount of Equalization Grants for Decentralized Functions, pursuant to financial relations and transferred obligations for elementary and secondary education, welfare and health care laid down for counties, the city of Zagreb and 32 cities for a given year.

The basis for the determination of the transferred obligation of a county, the city of Zagreb and the 32 cities for 2001 and 2002 for elementary education, secondary education, welfare and health care derives from the decisions of the Government of the Republic of Croatia about the criteria and yardsticks for the ensuring of the minimum financial standards of these public needs in 2001 and 2002.

For the period from July 1 to December 31, 2001, the Decree prescribed the manner of planning revenue and expenditure for the decentralized functions in the budgets of cities and counties. Cities and counties were to plan expenditure for the decentralized functions according to the economic and functional classification of the account plan of the budget up to the total amount determined in the review of the obligations; they had to plan revenue for the decentralized functions starting off from an estimate of the realization of income tax (for the period from July 1 to December 31, 2001) according to each additional individual share in income tax, while they were to plan the difference of revenue up to the amount of the obligations from a review of the obligations from the funds of the equalization grants of the national Budget for 2001 from position 131652—Expenditure for equalization grants for the decentralized functions.

The manner of planning revenue and expenditure for the decentralized functions in the budgets of the counties and cities for 2002 was prescribed by a governmental Decree in the same way as for 2001, with the proviso that the counties and cities were to plan the difference in revenue up to the amount of the obligation from the review of the obligations of the counties from equalization grants from the national Budget for 2002—36311—Expenditure for equalization grants for the decentralized functions.

Resources come regularly into the accounts of the budgets of cities or counties, from the shared part of the income tax and pursuant to applications for the payment of funds for monthly equalization grants from the position from the national Budget of the Republic of Croatia, an application that the recipient of the grant submits to the Finance Ministry on the regulation form OPI.

According to this law, in 2001 the counties and cities had the right to equalization grants from the national Budget only when they had passed the amendments to their budgets for 2001, in which they had planned the revenue and expenditure for the transferred decentralized functions.

According to the decree, an application for the payout of funds for monthly equalization grants from the Budget were submitted by county and city recipients of equalization grants to the Ministry of Finance on the regulation form OPI.

Along with the first application for the payment of an equalization grant on form OPI in 2001, a county or city had to append the amendments to their budgets for 2001, with the position of the plan of the revenue (from the additional share of income tax and equalization grant)

and the expenditure plan (according to both functional and economic classifications).

Along with the monthly equalization grant application, the counties and cities had to enclose a report about the amount of obligations due for the decentralized functions for the preceding month, as well as about the monthly resources for those functions transferred to the end users (the establishments) on aggregate, per establishment, and various costs for the preceding month. The Finance Ministry calculated the amount of equalization grants for the decentralized functions in 2001 in collaboration with the line ministries relevant to the recipients of the grants, and according to the criteria and yardsticks from the decisions and up to the amount of the obligation determined according to the survey of the obligations for 2001.

The city or county divided the amount of the obligation determined (according to functions) for 2001 into six equal parts. From the monthly amount of the obligation, the amount of the realized income tax from the additional share for the decentralized function for the preceding month was deducted, and the difference in these resources up to the amount of the monthly obligation was met from the funds provided in the national Budget for 2001 in the previously mentioned position 131652—Expenditure for equalization grants for decentralized functions.

After FINA processed the data about the payment of income taxes for the preceding month, the grant was transferred to the recipients of the equalization grant for the difference in resources.

In 2001, grants were sent to counties and cities by the twentieth day in each month for the month before, and for December 2001 funds were paid in advance according to data about revenue realized for the preceding months and the determined monthly obligation.

Some counties and cities did not completely adhere to the obligatory method of planning as defined in the Decree for 2001, which was then accepted, since it was considered that this was the early phase of the application of the Decree. Planning of the decentralized obligations was accepted if the total amount of the obligation could be seen on the revenue side (from tax and grants) and on the expenditure side, the individual obligations according to the four functions, with the proviso that it was necessary to carry out the adjustment of the sums, because the budgets were adopted before the adoption of the Decree for 2001.

In line with the Decree for 2002, at the beginning of the year counties and cities receiving equalization grants

had to append, along with an application for equalization grants, their budget for the current year. The budget had to be followed up by a revenue plan (from the additional share of income tax and from the equalization grant), and an expenditure plan (according to functional and economic classifications), in aggregate amounts.

In 2002 counties and cities were obliged to report quarterly to the line ministry about the amount of obligations due according to the decentralized functions and about resources transferred for these functions to the end users (the establishments), in aggregate sums, per establishment, and according to types of costs.

As in 2001, the calculation of the amounts of equalization grants for the decentralized functions was carried out in 2002 by the Finance Ministry for all recipients of grants, according to the criteria and yardsticks from the decisions and up to the amounts of the obligations laid down according to the review of the obligations for 2002.

In 2002, the Decree on the Manner of Calculation of the Amounts of Equalization Grants for Decentralized Functions was changed, and upon the application of the counties and the cities, equalization grants were transferred in advance for the current month, and the difference in the monthly calculation was adjusted with the payments for the following month.

Quantitative indicators of the relations between resources realized from shares in income tax and shares realized from equalization grants and tendencies in 2001 and 2002 are a reflection of the fiscal capacity of each individual operator and the transferred decentralized obligations.

According to the Decree, in the second half of 2001, the amount of the decentralized obligations was determined to be 555.2 million kuna.

From the additional share in income tax made available, 48% of the obligations were covered, and 52% from equalization grants from the national Budget.

In the overall obligations for the decentralized functions for the second half of 2001, the cities accounted for 10.7% (only for elementary education), the counties for 89.3%. In this, the cities obtained 62.7% of the total liabilities for 2001 from taxes, and 37.3% from equalization grants, while the counties obtained 46.7% from the share in income tax, and 53.3% from equalization grants.

The obligations of the counties and cities in terms of individual functions came to: 39.6% for elementary education, 19.3% for secondary education, 6.5% for welfare, 34.6% of the total amount for decentralized functions for 2001 for health care .

In 2001, some operators who had taken over the financing of the functions were not paid equalization grants, because they had obtained resources from the ceded additional share in income tax that outweighed the sum of the transferred obligations.

The greatest share of revenue obtained from the additional share in income tax in the decentralized expenditures was obtained in the counties in the following percentages:

Primorsko-goranska 70%, Zagreb 61%, Split-Dalmatia 55%, and Istria 54%, while in all the other counties this part came to less than 50%.

From equalization grants from the national Budget, of the total grants transferred to the counties, the most resources were paid out to:

Osijek, Krapina, Varaždin, Sisak and Dubrovnik counties.

The greatest share of revenue obtained from the additional share in income tax in the decentralized costs in 2001 in the cities was made in the following percentages:

Varaždin 97%, Crikvenica 92%, Zaprrešić and Zadar 76%, Pula 75%, Makarska 71%, Osijek 67% and Čakovec 65%, while in all other cities this share was less than 60% of the obligation for the second half of 2001.

Of the total amount of equalization grants paid from the national Budget in 2001, the most resources were paid out to these cities:

Velika Gorica, Slavonski Brod, Šibenik and Pazin.

Of the 32 cities that assumed the financing of the functions of elementary education, three cities (Rijeka, Opatija and Rovinj) did not have equalization grant funds paid to them, because they made more money from the additional amount of income tax ceded to them than the transferred obligations for elementary education for the second half of 2001 came to.

An analysis of the realization of revenue from the additional share in income tax in the real cost according to counties and functions in the second half of 2001 provided the following results:

For elementary education—the greatest share, amounting to 48%, was realized by the Primorsko-goranska County with 48%, followed by Istria County



with 38%, Zagreb County with 27%, Krapina County and Split County with 25% each.

With respect to secondary education, the highest share, 130%, was realized in Zagreb County, 81% in Istria County, 78% in Primorsko-goranska and 60% in Split County.

For welfare—the highest share, amounting to 90%, was achieved by Istria County, followed by Primorsko-goranska 64%, Zagreb County 60% and Split County 40%.

For health care—the highest share was realized by Split County, 117%, Primorsko-goranska 81%, Zagreb County 79%, Istria County 45%, and Koprivnica County with 44%.

From this it follows that the Zagreb, Primorsko-goranska, Split and Istria counties were in 2001 the counties with the highest realization of funds from the additional share in income tax (in aggregate terms for the overall decentralized functions, and looking at each function separately), which corresponds to their real fiscal capacities as compared to those of the other counties.

According to the said Decree, if more resources accrue from the additional portion of the income tax than are required by the operator, the Finance Ministry can use the surplus for reduction of grants, in line with other functions in the year for which the funds were assigned, or for the following year. This provision was applied in 2001.

In 2001 the city of Zagreb had obligations for all decentralized functions amounting to 87.7 million kuna. The city met all these obligations from the additional share in income tax, and had a surplus of 8.2 million kuna. The shortfall in the funds in the share for financing obligations for welfare establishments and welfare was met by this surplus from the educational share of the income tax, with permission from the Finance Ministry and in line with the amendments to the Local Government Financing Law.

It follows that funds for the first phase of decentralization were obtained in line with the statute and various bylaws. Grants were transferred within the time limits, with an advance for December sent according to an estimate of the income tax. The surplus was not returned to the national Budget, but stayed in the accounts of the beneficiaries, with the advance for January 2002 reduced in line with the Decree on Regulation Obligatory Amounts.

In line with the Decree on the Calculation of the Amounts of Equalization Grants for 2002, total liabilities

of 1,511.8 million kuna for the minimum standards of all decentralized functions were planned. The annual liability of the counties for 2002 was determined to be 1,358.7 million kuna, or 89.9% of that, and the cities' obligations came to 153 million kuna, or 10.1% of the total obligations for 2002 (Table 4 Review of Resources for Decentralized Functions for 2002 According to 21 Counties and 32 Cities).

The obligations of the counties and cities in terms of individual functions came to: 37.4% for elementary education; 20.9% for secondary education; 16.2% for welfare, and 25.55% of all the decentralized functions for 2002 for health care (Table 5 Review of Structure in terms of Decentralized Functions).

During the first nine months of 2002, the decentralized liabilities of the operators came to 1,133.8 million kuna, in which the cities' share was 114.8 million kuna, and that of the counties 1,019 million kuna (Table 6 Realization of Revenue for Decentralized Functions, January –September 2002).

Some of the obligations were paid for from the additional share of the income tax, amounting to 483.4 million kuna, or 43% of total liabilities for this period. The remainder of these were met with funds from equalization grants from the national Budget, coming to 650.4 million kuna, or 57% of total liabilities for the first nine months of 2002.

In the total liabilities for the decentralized functions for nine months of 2002, the cities' share came to 10.1% (only for elementary education), and that of the counties to 89.9%. In this, the cities obtained 47.9% from tax, and 52.1% from equalization grants; the counties, on the other hand, had 42% of their revenue from income tax, and 58% of it from equalization grants, for the first nine months in 2002.

The realization of revenue from the share in income taxes in the counties and cities as compared with their liabilities in 2002 differs.

The share of the realization of income tax for the first nine months of 2002, as compared with the total liabilities for the period, range from the smallest 12% in Vukovar County to 90% in the city of Zagreb. This figure vaulted over 50% in the Primorsko-goranska County, reaching 55%, and in Zagreb and Istria counties, 54% each of the total liabilities for the first nine months of 2002.

The share of equalization grants realized in the first nine months of 2002, as compared with total liabilities for the period, ranges from the lowest amount, 10%, for the city of Zagreb, to 88% for Vukovar County. Apart

from the city of Zagreb, there are three other counties (Zagreb County, Primorsko-goranska and Istria) that obtained revenue from equalization grants of less than 50% of total liabilities, while the other counties exceeded this figure.

Liabilities for elementary schools for the 32 cities during the first nine months of 2002 came to 114.8 million kuna, approximately 55 million kuna of which (47.9%) came from the additional share of income tax (the 2.9% share), while 59.8 million kuna (52.1%) of all revenue for the covering of all liabilities came from equalization grants from the national Budget.

The lowest share of revenue obtained from the additional share in income tax, totalling 15%, was made by the city of Pazin, and the maximum share, totalling 97%, by Opatija, while Split has a 72%, and Rijeka a 70% share.

In the first nine months of 2002, the city of Opatija had the lowest share from equalization grants in the liabilities for the period, and the highest share was in the city of Pazin, totalling 85%. Four cities received equalization grants amounting to more than 70% of total liabilities for the period. The cities of Pazin (85%) and Vrbovec (84%) are particularly prominent in this respect.

From all that has been said, we can conclude that, in 2001 as well as in 2002, alongside the city of Zagreb, the counties with the highest realization of funds from the extra share in income tax (in aggregate terms for the total of decentralized functions, but for each individual function separately) were the Zagrebačka and Primorsko-goranska counties.

The city of Zagreb, which has the dual status of city and county, finances all its decentralized functions, with the annual liabilities in 2002 coming to 280.8 million kuna; of this, 82.9 million kuna were earmarked for elementary education; 59.0 million kuna for secondary education; 11.9 million kuna for welfare centres; 58.2 million for homes for the elderly, and 68.8 million kuna for health care establishments.

In the first nine months of 2002, the city realized 210 million kuna, 90% from income tax, and 10% from total obligations for the period from equalization grants.

In overview, a further acceleration of the dynamics of the realization of funds from the share in income tax is expected at all levels (cities and counties) in the next two months, and if the current dynamics are maintained, from this source at least 43% of all funds for decentralized functions will be obtained in 2002, and 57% of funds will come from equalization grants.

## **The Decision-making Process and the Democratization of Decentralization**

### *Phase-related Changes and Gradual Advances in Responsibility, Decision-making and Allocation of Funds According to Functions and Economic Classification in 2001 and 2002 and the Following Years*

From the beginning of the implementation of decentralization, in line with the Law, decentralized local self-government decision-making has gradually been introduced with respect to the allocation of funds to establishments in the decentralized activities.

In 2001, the allocation of resources to establishments, and applications for the transfer of equalization grant resources from the national Budget were prescribed in detail by the Decree and the Minimum Standards Decision in such a way that local areas could have no influence on the further reallocation of them to operators or institutions. In 2002, this was essentially modified on the basis of authorization to make independent decisions about minimum standards and the advance transfer of resources of equalization grants, and the further reallocation of them within globally determined resources.

The calculation of the amounts of equalization grants for decentralized functions in 2001 was made only after the delivery of the application form and the monthly reports about liabilities due; in 2002 this was done automatically in advance, according to the criteria from the Decisions and up to the amount of the obligations established in the Review of liabilities.

### *Relations Amongst the State and Units of Local and Regional Self-government and Establishments Whose Functions are Decentralized*

The effects of decentralization and the reconsideration of the Decree and the Minimum Standards Decisions in the context of the special laws and the development achieved show that the local areas, in spite of initial difficulties did on the whole meet their liabilities regularly.

The process of the transformation of the budgetary classification, budgetary accountancy and the system of financial reporting as well as computerization during 2002 involved certain difficulties for employees in the counties and cities, as well as the establishments that had been decentralized, with respect to the short deadlines given for the changes to take place in.

According to the Law and the Decree, the counties and cities receiving equalization grants are bound to transfer the resources regularly to the end users (institutions) whose financing they have taken over, with the proviso that these establishments (in line with the regulations) adopt financial plans and make reports to the counties and cities that finance them about the funds spent.

Depending on the year in which the law is applied, the unit of local or regional government is allowed to settle on resources and allocate them to the establishments within the activity, depending on priorities that have been laid down.

The counties and cities, spending agents of the equalization grants, are bound to use funds for decentralized functions obtained from extra shares in income tax and from equalization grants according to the decentralized purposes, as determined in the set framework, and according to the planned priorities in the activities that are prescribed by the units themselves according to the state of affairs in the activity as noted, and in line with the said law, the Decree and the decisions.

In education, funds can be used only for the financing of the regular curriculum of elementary or secondary schooling, because it is the minimum financial standard according to which the funds are provided. A municipality, city or county can, as heretofore, supply funds from its own budgetary resources for additional needs and curricular activities in elementary activity.

Counties and cities transfer means to establishments according to the dynamics and priority plans laid down in the plan of the budget. For the sake of providing continuity of financing the regular performance of the syllabus and curriculum in primary and secondary education, according to the Decree of the Government of the Republic of Croatia for 2002, the priorities are elementary school pupil transport, transport of employees to and from work in secondary education, and energy for heating and lighting in elementary and secondary education.

In accordance with Article 45a of the Local Government Financing Law, a unit of local or regional self-government is responsible for the functions that have been transferred.

In 2001, according to the Law, a given unit was bound to transfer funds obtained from the special share in income tax and from equalization grants to each establishment in proportion to the preceding year, in line with the Minimum Standards Decision and according to information about execution received.

For 2002, however, the Law said that the municipality, city or county could allocate the funds realized from these revenues around the establishments within the groups of the individual activity, but that the reallocation had to be founded on a plan published at least two months before its adoption, with the proviso that in the reallocation no individual establishment could have its funds reduced by more than 20% of the amount of the funds determined by the Minimum Standards Decision for 2001.

During 2001 and 2002 there were several demands for reallocation in the activities of education and health care, which resulted in amendments to the Minimum Standards Decision for both years and the Decree on the Manner for 2001 and 2002. Reallocation mostly referred to technical adjustments between establishments, to reallocation within the fixed amount for a given activity, and between investment maintenance and other current expenditure.

From 2004, according to the Law, reallocation will be able to be carried out without any restrictions, except that the plan has to be announced two months before adoption. Bearing this in mind, the question arises of the possibility of change of purpose among elements of the same function, up to the total amount of the function.

Article 45b of the Law says that it is possible for a municipality or city with more than 8,000 inhabitants, or several municipalities or cities that jointly have a population of at least 8,000, to combine and, according to the Law and the Decree, to finance elementary education.

In line with this article, a council, or a municipality or city of appropriate size, can make the decision that it will finance the expenditure of elementary education laid down according to the Decree of the Government of the Republic of Croatia, and that it will enable pupils of other municipalities or cities to attend such schools, on condition that these units take part in the financing of the expenditure. In addition, according to this law, several municipalities or cities that have together at least 8,000 inhabitants can decide to carry out the functions for elementary schools in their area together, on condition that the representative bodies of these units determine that they can perform the function of elementary education with funds determined pursuant to the Decree of the Government of the Republic of Croatia, that they make a decision about the rights of pupils who do not live in these units to attend elementary school, on the condition that the unit in which these pupils do live takes part in the financing of the expenditure, and that they make a

decision about founding a common body with the purpose to carry out procurement operations, accountancy and financial reporting about the function.

In 2001 there were a number of indications that some of the cities (that had certain financial problems) would not want to take on the financing of the decentralized functions, and in 2002 there are indications that some other cities are willing to do this. According to the Law, municipalities and cities that make these decisions deliver them to the county in which they are located. After the adoption of a decision by the local assemblies about taking over the financing of the function of elementary education, the county stops earmarking funds from the county budget's share in the income tax, and the funds are put into the account of the given city or municipality, and the spending agent for equalization grants from the national Budget is also the city or municipality. The procedure should be prescribed via bylaw—Decree of the Government of the Republic of Croatia or Regulations of the minister according to the authorization determined in Article 97 of the Law.

#### *Supervision of the Lawful Performance of Functions and the Proper Use of Resources*

Since according to special laws and decisions about minimum standards the resources for the decentralized functions are strictly purpose-related, the counties and cities that are recipients of equalization grants must use the decentralized function resources for the purposes as laid down.

According to the Decree of the Government of the Republic of Croatia, counties and cities must supervise the lawful operating of the administrative bodies that carry out operations of the decentralized functions and the work of the beneficiaries of the budgetary resources (establishments) that are financed from these resources. Control from the point of view of the lawfulness of procedures and the proper use of resources is carried out on special request by the line ministries.

The counties, the city of Zagreb and the cities are obliged to report quarterly to the line ministry about the amount of liabilities due according to the decentralized functions, as well as about resources transferred for those functions to the end users, in aggregate terms, per establishment, and kind of costs. In the first year of the application (second half of 2001) the reporting had to be done monthly.

We should, however, point out that a certain number of cities and counties did not adhere to this Decree, which resulted in a lack of quality analyses. Because of this,

for 2003, concrete measures will have to be included for the obligatory implementation of regulations, along with the appropriate sanctions.

A county, the city of Zagreb, and a city are bound to control the legal aspects of the work of the administrative bodies that carry out the operations of the decentralized functions and of the beneficiaries of the budgetary resources (establishments) that are financed from these resources.

At the request of the ministry charged with a given activity whose function is decentralized, and at the request of the Finance Ministry, where necessary, supervision of the lawfulness of procedures and the proper use of the funds is carried out.

In certain milieus, a certain fear, concern and inability to accept the new can be discerned, particularly because of the responsibility given to local governments in the application of decentralization, and the control of this responsibility. In some places decentralization is still experienced as being the old centralization together with a mere transfer of funds, while in others it is used outside or above the statutorily defined purposes and costs, with an expectation that what has once been done will later be sanctioned.

Insight into the revenues of counties and cities for 2001 has defined certain surpluses of funds in the accounts of the budgets of counties and cities, related to unspent funds for the decentralized functions. These are most often unspent resources for the investment maintenance of healthcare establishments owned by the county, because of the obligatory implementation of the Public Procurement Law and/or inadequate schedules and programs adopted by the county authorities together with the consent of the heads of the healthcare establishments that could not be implemented. According to information obtained from some counties, the reason the funds remain not spent is that the programs were late in being passed at the county level.

Some resources have been used not only for the investment maintenance of healthcare establishments owned by the authority, but for capital investment and for the computerization of the healthcare activity as well.

Changes have been requested in the decisions concerning the minimum standards in education for 2002—a reallocation within the limits set, but within the means for investment maintenance, current expenditure and capital investment.

From the financial reports about revenues obtained and expenditures made by counties and cities for the January–September 2002 period, it is clear that



considerable surpluses have been made from resources that have not been used. A look at the notes to the reports shows that the lateness is due to public bids being annulled or not completed.

In the second half of 2001, and particularly from the beginning of 2002, problems arising as a result of the change in the organization of county offices as bodies of state administration and in their rationalization appeared, the counties—the self-governing part of them—which is supposed to take over the surplus of employees who, apart from other assignments, should have been carrying out some of the decentralized functions.

But since the counties have been given some of the revenue only for the pure functions of the costs of the minimum standard, the costs for pay and material costs of the employees taken on have not been covered, funds for their work being provided and planned for in the national Budget.

Since in the accounts of the counties or establishments surpluses are created that are not being used and are carried over from year to year, the question arises of the necessity in 2003 of setting some restrictions on the transfer of funds for the functions of costs that have the character of capital expenditures, and increasing control of all counties and cities to do with the proper use of funds in line with the minimum standards decisions.

We are of the opinion that it will be necessary to step up the responsibility of the line ministries and the counties, as well as the cities, and once again to bring in transfer of equalization grant funds along with prior measures of control, and after proof that liabilities are due, particularly with respect to capital expenditure.

#### *Illusion and Reality of Decentralization and Relieving the National Budget in Consolidated General Government*

Among the public the view is put forward that the transfer of the financing of part of the public sector from the national to the local budgets to the tune of 1.5 billion kuna means a lower burden on the national budget and its proportion to GDP. Although at the level of local and regional self-government the share of the funds is increased by the same amount, the total burden of general government, in which local and regional self-government are consolidated, does not ultimately reduce the share of general government in GDP, only shifts the way it is shown from the national to the local and regional level.

The first phase of decentralization in the second half of 2001 and in 2002 resulted in an increase in the

share of local and regional self-government in the total consolidated revenue of general government and in GDP too as against 2000. This share is still gradually increasing, depending on the increase in the sums for the decentralized functions in 2003, which are expected to reach about 1.6 billion kuna.

Wishes and financial possibilities are not harmonized—the minimum standards and the growth of taxes and equalization grants are limited by economic trends and the given restrictions. This can be particularly seen in the areas of special national concern, in which due to tax exemptions to the local population the revenue from the ceded income tax and corporate income tax does not realistically enable the previous level of expenditure, apart from the decentralized functions, where the shortfall in tax revenue is made up from the equalization grants, up to the level of the obligatory standard laid down in the Decree and the Minimum Standards Decision for 2002. For this reason, additional measures of assistance are planned in 2002 for the sake of the improvement of the financial situation of the municipalities and cities that, because of the amendments to the Areas of Special National Concern Law, found their finances much deteriorated after August 1. It is expected that with new amendments in the system of taxation the negative effects of the precious solutions on the budgets of these units of local self-government will be corrected.

#### **A Year On—The Effects of Decentralization—Conclusions and Recommendations**

Decentralization is a gradual process. Like every new situation, it requires a change in the mentality and behavior of all those engaged—the cities, counties and government bodies.

Some find it very hard to accept the responsibility and ensure regular transfer of funds to the beneficiary establishments, with a consistent check on the spending of the funds.

Others find it difficult to accept that now decisions are made at a lower level, at the same level where the spending of resources is controlled.

In spite of certain difficulties in the inadequately defined relations between establishments and beneficiaries that are responsible to both county and city as well as to the state, decentralization is at the same time a democratization of relationships.

Asymmetrical decentralization, the administration of state administration (obligatory reporting) and dependence on equalization grants are less important than democratisation in decision making being carried

out, which means the reduction of the dominant influence of central authority.

The unequal fiscal capacity of local and regional self-government, and vice versa the proportional distribution of the networks and obligations for the decentralized functions, are the reasons that all the counties, the city of Zagreb and each of the 32 cities are the recipients of equalization grants for the decentralized functions from the national Budget for 2001 and 2002, and in the plan for 2003.

It is extremely important to point out that the decentralized functions of counties and cities are financed from the extra share in income tax and from the resources of equalization grants from the national Budget, and that there is coverage of 100% of the decentralized functions at the level of the standards, provided from the national Budget in 2001 (with the investment maintenance of healthcare establishments, however, not being financed from the national Budget), while for 2002 and 2003 they are considerably over the growth of expenditure in the national Budget and in the planned rate of inflation.

The share of the central government in income tax has been reduced and regular advance payment of equalization grants from the national Budget has been ensured.

Although at the moment more funds are earmarked for equalization grants than from the extra share of income tax, local and regional self-government are nevertheless ensured regular resources from sources that can be realistically planned, with self-government obtaining more room for independent decision-making with respect to the reallocation of funds for the functions that are decentralized.

The decentralized funds can be used only for the purposes of the decentralized functions from these activities, but in the first years a certain state control mechanism of the use of these funds has been built in.

Given the restricted material and time conditions, the first phase of decentralization has shown certain weaknesses, but also some positive movements in the better discernment of requirements, the additional provision of funds, and in the first signs of the rationalization of funds in some local settings.

In the future it will be necessary to:

1. carry out fiscal financial equalization from the national Budget in the form of various kinds of aids to local and regional self-government, along with the prescribed objective criteria and formulae for the level of minimum standards;
  2. ensure additional mechanisms of responsibility among local authorities for the performance of the transferred tasks, with external control of lawfulness;
  3. make possible greater intervention of local authorities in the allocation of funds for the decentralized functions, with their clear accountability for providing not only standard levels but also rationality and effectiveness in the performance of functions and tasks;
  4. set up departments—local self-governing bodies for the transferred functions inside the units of local and regional self-government for a professional performance of the transferred functions, since we are of the opinion that the current internal organization of the bodies of local and regional self-government does not permit this at a satisfactory level.
- Within all this the following are imperatives:
1. do away with relationships of subordination and coordination with the county office as a central government body and set up relationships with the administrative department for the budget and finances that has since July 1, 2001 carried out most of the jobs in the implementation of decentralization, as well as provide resources for the salaries of the new employees—the employees taken on from the county offices;
  2. draw up a computerization project for the sake of horizontal and vertical linking of administrative and self-governing bodies and establishments;
  3. work out a project for the introduction of local and regional treasuries as a possible subsystem connecting up with the national treasury;
  4. encourage further territorial and functional-financial linking of local and regional units in the execution of certain public services and operations that they cannot carry out with their own revenue or for which they do not have the appropriate establishment infrastructure;
  5. build up a more even model for revenue distribution (particularly tax revenue) to counties, municipalities and cities;
  6. consider the implementation of privatization of certain public services belonging to the private sector, one of the objectives of long-term development of public sector financing.

A working group composed of ministries, counties and cities' representatives as well as foreign consultants who worked on the first phase of decentralization have drawn up the working material Future directions for the decentralization of the public sector in the Republic of Croatia.

Since this document has not been considered by the working documents of the Government of the Republic

of Croatia, although there have been reports in the press, we cannot give even the basic adumbrations of the future trends in decentralization at the moment. We can confirm only that according to the available data, in line with world experience, an analysis is being carried out of the possible transformation of the communal charges into a poll, assets or council tax.

*Table 1. Realization of Revenue for the Decentralized Functions (July–June 2001) [million kuna]*

	Cities	Counties	Total	Percentage realization
Liabilities for decentralized functions, Jan.–Sept. 2002	59.3	495.9	555.2	100
Realized from extra share in income tax, Jan.–Sept. 2002	37.2	231.6	268.7	48
Difference for transfer from equalization grants resources	22.1	264.4	286.5	52

Table 2. Review of Funds for Decentralized Functions from July 1 to December 31, 2001 According to Counties (21) and Cities (32) [thousand kuna]

County/City	EDUCATION						WELFARE			HEALTH CARE		Total liabilities for decentralized functions
	Elementary			Secondary			Social welfare centers			Health care establishments	County investment maintenance liabilities	
	Current expenditure	Capital expenditure	Total liabilities of counties and cities	Current expenditure	Capital expenditure	County liabilities	Current expenditure	Fuel	County liabilities	County investment maintenance liabilities		
1.	2.	3.	4	5.	6.	7	8.	9.	10	11.	12.	
			(2+3)			(5+6)			(8+9)		(4+7+10+11)	
Zagrebačka	18.140	0.333	18.472	3.278	0.259	3.537	0.892	0.642	1.534	7.295	30.838	
Krapinsko – zagorska	8.162	0.269	8.430	3.664	0.209	3.873	0.555	0.415	0.971	14.552	27.826	
Sisačko – moslavačka	10.923	0.353	11.277	4.606	0.275	4.881	0.957	1.522	2.479	8.781	27.417	
Karlovačka	7.972	0.312	8.284	3.748	0.243	3.991	0.538	1.229	1.766	8.380	22.421	
Varaždinska	8.440	0.384	8.825	4.582	0.299	4.881	0.646	0.596	1.242	13.042	27.989	
Koprivničko – križevačka	6.847	0.244	7.091	2.881	0.190	3.071	0.332	0.486	0.819	4.180	15.160	
Bjelovarsko – bilogorska	7.655	0.328	7.982	3.071	0.255	3.326	0.659	0.617	1.276	6.425	19.009	
Primorsko – goranska	12.089	0.752	12.841	7.385	0.585	7.970	1.158	0.800	1.958	9.620	32.389	
Ličko – senjska	3.661	0.103	3.764	1.338	0.080	1.418	0.334	0.301	0.636	5.871	11.689	
Virovitičko – podravska	5.687	0.185	5.872	2.164	0.144	2.309	0.314	0.715	1.028	5.293	14.503	
Požeško – slavonska	5.018	0.190	5.208	2.120	0.148	2.268	0.254	0.484	0.738	5.484	13.698	
Brodsko – posavska	7.985	0.333	8.318	3.710	0.259	3.969	0.537	1.327	1.863	7.343	21.494	
Zadarska	7.425	0.440	7.865	3.832	0.342	4.174	0.407	0.997	1.404	7.915	21.358	
Osječko – baranjska	14.561	0.797	15.359	6.996	0.620	7.616	1.116	2.129	3.245	9.782	36.002	
Šibensko – kninska	5.947	0.262	6.209	2.088	0.204	2.292	0.509	2.043	2.552	6.124	17.177	
Vukovarsko – srijemska	8.640	0.433	9.073	4.056	0.337	4.393	0.521	0.898	1.418	4.001	18.885	
Splitsko – dalmatinska	19.212	1.153	20.364	9.683	0.897	10.580	1.534	1.698	3.232	6.825	41.002	
Istarska	12.974	0.529	13.503	5.189	0.412	5.601	0.697	0.308	1.005	12.472	32.581	
Dubrovačko – neretvanska	6.792	0.332	7.124	3.196	0.258	3.454	0.346	0.432	0.777	11.909	23.264	
Međimurska	4.804	0.220	5.024	2.604	0.171	2.775	0.256	0.660	0.916	4.131	12.847	
City of Zagreb	26.586	2.048	28.634	19.404	1.594	20.998	2.773	2.420	5.193	32.877	87.701	
TOTAL	209.521	10.000	219.521	99.595	7.781	107.376	15.335	20.719	36.054	192.299	555.250	

*Table 3. Structure of Liabilities for Decentralized Functions for July–December 2001  
According to Counties (21) and Cities (32) [%]*

	Elementary education	Secondary education	Welfare	Health care	TOTAL
Zagrebačka	59.9	11.5	5.0	23.7	100
Krapinsko – zagorska	30.3	13.9	3.5	52.3	100
Sisačko – moslavačka	41.1	17.8	9.0	32.0	100
Karlovačka	36.9	17.8	7.9	37.4	100
Varaždinska	31.5	17.4	4.4	46.6	100
Koprivničko – križevačka	46.8	20.3	5.4	27.6	100
Bjelovarsko – bilogorska	42.0	17.5	6.7	33.8	100
Primorsko – goranska	39.6	24.6	6.0	29.7	100
Ličko – senjska	32.2	12.1	5.4	50.2	100
Virovitičko – podravska	40.5	15.9	7.1	36.5	100
Požeško – slavonska	38.0	16.6	5.4	40.0	100
Brodsko – posavska	38.7	18.5	8.7	34.2	100
Zadarska	36.8	19.5	6.6	37.1	100
Osječko – baranjska	42.7	21.2	9.0	27.2	100
Šibensko – kninska	36.1	13.3	14.9	35.7	100
Vukovarsko – srijemska	48.0	23.3	7.5	21.2	100
Splitsko – dalmatinska	49.7	25.8	7.9	16.6	100
Istarska	41.4	17.2	3.1	38.3	100
Dubrovačko – neretvanska	30.6	14.8	3.3	51.2	100
Međimurska	39.1	21.6	7.1	32.2	100
City of Zagreb	32.6	23.9	5.9	37.5	100
TOTAL	39.5	19.3	6.5	34.6	100

Table 4. Review of Resources for the Decentralized Functions for 2002 Scording to Counties (21) and Cities (32)  
[million kuna]

County	Education		Welfare		Total welfare (4+5)	Health Care	Total liabilities for decent- ralized functions (2+3+4+5+6)
	Elementary schools (liability of cities and counties)	Secondary education	Welfare centres	Homes for elderly and infirm		Health care establishment	
1.	2.	3.	4.	5.	(4+5)	6.	(2+3+4+5+6)
Zagrebačka	42.0	10.2	3.7	0.0	3.7	18.5	74.3
Krapinsko – zagorska	19.8	11.4	2.3	0.0	2.3	14.0	47.4
Sisačko – moslavačka	25.3	14.0	5.5	5.6	11.2	18.3	68.7
Karlovačka	19.2	10.4	4.2	3.2	7.5	13.0	50.1
Varaždinska	24.4	12.8	2.9	2.4	5.3	17.0	59.5
Koprivničko – križevačka	17.1	8.0	1.9	4.6	6.4	10.7	42.3
Bjelovarsko – bilogorska	18.8	10.9	2.9	1.9	4.9	12.0	46.6
Primorsko – goranska	32.9	23.5	3.9	14.0	17.9	27.9	102.1
Ličko – senjska	8.6	4.7	1.3	4.8	6.1	6.4	25.9
Virovitičko – podravska	13.7	6.0	2.2	0.0	2.2	8.5	30.4
Požeško – slavonska	12.4	6.3	1.7	4.2	5.9	7.2	31.7
Brodsko – posavska	24.6	12.3	4.3	3.1	7.4	14.9	59.2
Zadarska	20.3	13.0	2.9	7.0	9.9	15.5	58.6
Osječko – baranjska	43.6	24.0	7.6	7.5	15.1	25.2	108.0
Šibensko – kninska	13.9	7.2	5.6	4.5	10.1	13.2	44.4
Vukovarsko – srijemska	26.8	12.5	3.5	5.0	8.5	16.0	63.9
Splitsko – dalmatinska	56.0	35.1	6.9	14.0	21.0	34.5	146.5
Istarska	30.7	16.7	2.2	11.8	14.0	18.5	79.9
Dubrovačko – neretvanska	17.7	10.7	1.9	9.5	11.4	14.8	54.6
Međimurska	15.1	7.1	1.9	2.7	4.6	9.9	36.7
City of Zagreb	82.9	59.0	11.9	58.1	70.1	68.8	280.8
TOTAL	565.8	316.0	81.1	164.3	245.4	384.6	1,511.8



*Table 5. Structure of Liabilities for Decentralized Functions for 2002  
According to Counties (21) and Cities (32) [%]*

County	Elementary schools	Secondary education	Welfare	Health care	TOTAL
Zagrebačka	56.4	13.8	5.0	24.8	100
Krapinsko – zagorska	41.7	24.0	4.8	29.5	100
Sisačko – moslavačka	36.8	20.4	16.3	26.6	100
Karlovačka	38.4	20.8	14.9	26.0	100
Varaždinska	41.0	21.5	8.9	28.6	100
Koprivničko – križevačka	40.5	18.9	15.2	25.3	100
Bjelovarsko – bilogorska	40.3	23.5	10.5	25.8	100
Primorsko – goranska	32.2	23.0	17.5	27.3	100
Ličko – senjska	33.3	18.3	23.6	24.8	100
Virovitičko – podravska	45.0	19.9	7.1	28.0	100
Požeško – slavonska	39.0	19.8	18.7	22.5	100
Brodsko – posavska	41.6	20.7	12.5	25.2	100
Zadarska	34.5	22.1	16.9	26.4	100
Osječko – baranjska	40.4	22.2	14.0	23.3	100
Šibensko – kninska	31.3	16.3	22.7	29.7	100
Vukovarsko – srijemska	42.0	19.6	13.4	25.1	100
Splitsko – dalmatinska	38.2	24.0	14.3	23.5	100
Istarska	38.4	20.9	17.5	23.2	100
Dubrovačko – neretvanska	32.5	19.5	20.9	27.1	100
Međimurska	41.3	19.3	12.5	27.0	100
City of Zagreb	29.5	21.0	25.0	24.5	100
TOTAL	37.4	20.9	16.2	25.4	100

*Table 6. Realization of Revenue for the Decentralized Functions (January–September 2002)  
[million kuna]*

	Cities	Counties	Total	Percentage realization
Liabilities for decentralized functions January–September 2002	114.8	1 019.1	1 133.8	100
Realization according to extra share in income tax January–September 2002	55.0	428.5	483.4	43
Difference for transfer from the equalization grant funds	59.8	590.6	650.4	57

*Table 7. Aggregate Review of Resources for the Decentralized Functions  
(January–September 2002) According to Counties (21) and Cities (32) [million kuna]*

COUNTY	EDUCATION					
	Elementary (county and city)			Secondary		
	Liability	Realized from tax share	Difference for transfer from budget	Liability	Realized from tax share	Difference for transfer from budget
Zagrebačka	31.5	10.3	21.2	7.7	7.1	0.6
Krapinsko – zagorska	14.9	3.4	11.5	8.5	2.3	6.2
Sisačko – moslavačka	19.0	3.6	15.3	10.5	2.5	8.0
Karlovačka	14.4	3.5	10.9	7.8	2.4	5.4
Varaždinska	18.3	5.0	13.3	9.6	3.5	6.1
Koprivničko – križevačka	12.9	2.9	9.9	6.0	2.0	4.0
Bjelovarsko – bilogorska	14.1	2.5	11.5	8.2	1.7	6.4
Primorsko – goranska	24.7	13.5	11.2	17.6	9.3	8.3
Ličko – senjska	6.5	0.9	5.5	3.6	0.7	2.9
Virovitičko – podravska	10.2	1.4	8.8	4.5	1.0	3.5
Požeško – slavonska	9.3	1.3	7.9	4.7	0.9	3.8
Brodsko – posavska	18.5	2.6	15.9	9.2	1.8	7.4
Zadarska	15.2	3.8	11.4	9.7	2.6	7.1
Osječko – baranjska	32.7	6.5	26.2	18.0	4.5	13.5
Šibensko – kninska	10.4	2.1	8.4	5.4	1.4	4.0
Vukovarsko – srijemska	20.1	1.9	18.2	9.4	1.3	8.0
Splitsko – dalmatinska	42.0	13.1	28.9	26.3	9.0	17.3
Istarska	23.0	9.6	13.5	12.5	6.6	5.9
Dubrovačko – neretvanska	13.3	2.7	10.6	8.0	1.8	6.2
Međimurska	11.4	2.4	9.0	5.3	1.6	3.7
City of Zagreb	62.2	58.3	3.8	44.3	40.2	4.0
TOTAL	424.3	151.3	273.0	237.0	104.4	132.6

Table 7. (continued) Aggregate Review of Resources for the Decentralized Functions  
(January–September 2002) According to Counties (21) and Cities (32) [million kuna]

County	Welfare				
	Welfare centres	Homes for elderly and infirm		Total welfare	
				Liability	Realized from tax share
Zagrebačka	2.8	0.0	2.8	2.5	0.3
Krapinsko – zagorska	1.7	0.0	1.7	0.8	0.9
Sisačko – moslavačka	4.2	4.2	8.4	2.5	5.9
Karlovačka	3.2	2.4	5.6	2.4	3.2
Varaždinska	2.2	1.8	4.0	3.5	0.5
Koprivničko – križevačka	1.4	3.4	4.8	2.0	2.8
Bjelovarsko – bilogorska	2.2	1.5	3.7	1.4	2.2
Primorsko – goranska	2.9	10.5	13.4	9.3	4.1
Ličko – senjska	0.9	3.6	4.6	0.7	3.9
Virovitičko – podravska	1.6	0.0	1.6	0.4	1.3
Požeško – slavonska	1.3	3.2	4.4	0.9	3.5
Brodsko – posavska	3.2	2.4	5.6	1.8	3.8
Zadarska	2.2	5.2	7.4	2.6	4.8
Osječko – baranjska	5.7	5.7	11.3	4.5	6.9
Šibensko – kninska	4.2	3.4	7.6	1.4	6.2
Vukovarsko – srijemska	2.6	3.8	6.4	1.3	5.1
Splitsko – dalmatinska	5.2	10.5	15.7	9.0	6.7
Istarska	1.7	8.8	10.5	6.6	3.9
Dubrovačko – neretvanska	1.4	7.2	8.6	1.8	6.7
Međimurska	1.4	2.0	3.4	1.6	1.8
City of Zagreb	8.9	43.6	52.6	40.2	12.3
TOTAL	60.8	123.2	184.1	97.3	86.8

Table 7. (continued) Aggregate review of resources for the decentralized functions  
(January–September 2002) according to counties (21) and cities (32) [in million kuna]

County	Health care			Total liabilities for the decentralized functions			Percentage	
	Healthcare establishments			Liability	Realized from tax share	Difference for transfer from budget	Share	Support from budget
	Liability	Realized from tax share	Difference for transfer from budget					
Zagrebačka	13.8	8.9	5.0	55.8	28.7	27.0	52	48
Krapinsko – zagorska	10.5	2.9	7.6	35.6	9.4	26.2	26	74
Sisačko – moslavačka	13.7	3.1	10.6	51.6	11.8	39.8	23	77
Karlovačka	9.8	3.0	6.7	37.6	11.3	26.3	30	70
Varaždinska	12.8	4.4	8.4	44.7	16.4	28.3	37	63
Koprivničko – križevačka	8.0	2.5	5.5	31.7	9.5	22.2	30	70
Bjelovarsko – bilogorska	9.0	2.2	6.8	34.9	7.9	27.0	23	77
Primorsko – goranska	20.9	11.6	9.3	76.6	43.8	32.9	57	43
Ličko – senjska	4.8	0.8	4.0	19.4	3.1	16.4	16	84
Virovitičko – podravska	6.4	1.2	5.1	22.8	4.0	18.7	18	82
Požeško – slavonska	5.4	1.1	4.2	23.8	4.3	19.5	18	82
Brodsko – posavska	11.2	2.2	8.9	44.4	8.4	36.0	19	81
Zadarska	11.6	3.2	8.4	44.0	12.2	31.8	28	72
Osječko – baranjska	18.9	5.6	13.3	81.0	21.0	60.0	26	74
Šibensko – kninska	9.9	1.8	8.1	33.3	6.7	26.7	20	80
Vukovarsko – srijemska	12.0	1.7	10.3	47.9	6.3	41.6	13	87
Splitsko – dalmatinska	25.8	11.3	14.6	109.9	42.3	67.6	39	61
Istarska	13.9	8.3	5.6	59.9	31.0	28.9	52	48
Dubrovačko – neretvanska	11.1	2.3	8.8	41.0	8.7	32.3	21	79
Međimurska	7.4	2.0	5.4	27.5	7.7	19.8	28	72
City of Zagreb	51.6	50.3	1.3	210.6	189.1	21.5	90	10
TOTAL	288.4	130.4	158.0	1 133.8	483.4	650.4	43	57

# Central Government and Local Self-government in Croatia: Decentralization and Democratization

Teodor Antić

Ministry of Justice, Administration and Local Self-Government

## Summary

*During 2001, new regulations were introduced in Croatia, bringing certain changes into the system of central government and local self-government. Through these regulations, some operations of central government were decentralized and devolved to the jurisdiction of local and regional self-government. The jurisdiction of local self-government is defined in a manner very close to the so-called general clause, and at the regional level, the affairs handled by the central government and the local self-government are separated. As a result of these changes in the law, local and regional units obtained new tasks in the area of basic and secondary education, health care, welfare and culture. During the implementation of decentralization, a series of questions were opened, to which answers are still being sought, and that slow down further implementation.*

**Key words:** decentralization—Croatia, local self-government, jurisdiction

## Introduction

After the multi-party elections in 1990, the Constitution of the Republic of Croatia was adopted on December 22, 1990 and independence was proclaimed on June 25, 1991. It was then that the public administration of Croatia was for the first time determined by the regulations of the Croatian Parliament.

Beside the universal problems that exist in all systems of government, the administration of Croatia was from the very beginning faced with the special circumstances of the historical moment: the fight for the independence of the state of Croatia, the transition to a multi-party political system and a market economy with a primarily private-ownership structure, as well as a war in which part of the country was occupied and destroyed or damaged. All this entailed the need to set up and strengthen all the components of a proper system of government for an independent state.

In such conditions, in 1991, the Local Self-Government and Administration Law defined the system of local self-government (NN 90/92). In 1993, the first local elections according to the new organization were held.

For the reasons given, the system of local self-government set up was conceived in such a way as to allow for and ensure central administration of all public affairs.

Even when the emergency conditions ceased, the emphasis still remained upon unity and centralization, and the interests that derive from regional and local diversity were played down. This led to rapid expansion and great concentration of the Croatian central government.

Soon after the end of the war and the reintegration of the occupied regions into the legal system of the Republic of Croatia, the need appeared for a thorough reform of the system of government and local self-government. This reform was supposed to be oriented towards:

- the opening, differentiation and strengthening of the operational independence of the administration, the de-concentration of government and decentralization in the political and administrative system,
- the strengthening of local and regional self-government, which would gradually become a partial takeover of some of the central government operations and become a counterweight to centralized government.

### De-concentration and Decentralization

When we speak of the organization of the government, it is necessary to differentiate certain concepts that some authors use differently in theoretical works, while in everyday speech they are often equated, although they have different meanings. These are the concepts of de-concentration and decentralization, and the removal of elements of etatism and hierarchialism [“de-etatism and de-hierarchialization”].<sup>1</sup>

De-concentration is a concept that implies all forms of government division (functional or territorial) from one center to several different operators or places, and is thus the widest concept. As a process it can consist of several different procedures that we shall cite.

1. Transfer of operations from central government bodies to operators of public law that are still formally not part of the governmental administrative system. These operators are thus under its control, but are financially independent. This is what is often termed function separation, and from this point of view, can also be referred to as horizontal decentralization.
2. The transfer of operations from central bodies of the administration to distant bodies of state administration, or bodies of local self-government. In this sense, we mean vertical decentralization.

Certain operations from the jurisdiction of the state administration bodies that are carried out by officials in the headquarters of that body can be confided to officials in remote units—offices, stations and the like that are outside the headquarters. In this case the same jobs, for different areas of the state, are carried out in several different places. Thus in the Republic of Croatia, operations of state administration in the area of counties are carried out by state administration offices, and in some units of local self-government these are done by their local offices.

In the later phase, the performance of these operations is resigned to the bodies of local self-government. Local bodies can be entrusted with the performance of certain operations of state administration.<sup>2</sup> Thus the adoption of decisions about certain concessions on maritime property, a matter from the jurisdiction of state administration, is confided to the county assemblies.

<sup>1</sup> The interpretation of these concepts in this text is based on Pusić’s conception (Pusić, 1997: 243–245).

Some operations of state administration may be developed in local units. They then cease to be operations of the jurisdiction of state administration, and become operations within the self-government sphere of competence. The state, or central government, only controls whether they are lawfully carried out. For example, firefighting operations are transferred to units of local self-government.<sup>3</sup>

3. The transfer of operations from a body of state administration to organizations outside the system of state administration. State bodies can found various consultative bodies that have the role of involving interested operators from outside the system of state administration and strengthening the democratic manner of decision-making or of providing cooperation from people with special expertise. These bodies can carry out various decision-making tasks, management, control, settlement of disputes and so on. This is therefore a question of “de-hierarchicalization”.

For example, in the area of culture, cultural councils for individual areas of artistic and cultural creativity have been set up within the line ministry. The members of these councils are people from arts organizations as well as artists. They have a number of tasks: from proposing individual decisions and measures to co-decision-making concerning certain operations.

4. The privatization of public corporations, or the transfer from public authorities to private operators (non-state-owned organizations). In this case we are speaking of the de-etatisation [denationalization] procedure. An example of this procedure is the privatization of part of the telecommunications system.

As can be seen from these examples, the process of reform of public administration in Croatia has all the components of de-concentration.

The basic topic of these considerations is the process of decentralization that is mainly planned and carried out as a process of vertical decentralization.

<sup>2</sup> These jobs are still jobs of the state administration, but physically they are carried out by local civil servants; the state retains full control of the way they are carried out, with respect to lawfulness, professionalism and effectiveness.

<sup>3</sup> Our laws mention only the concept of transferred jobs, in the sense of confided jobs. For the sake of the clarity of the provisions and the unambiguousness of their implementation, this error in the laws should be corrected as soon as possible.

The long-term goals of the process of vertical decentralization depend on the conception accepted for the role of the local units in the state. With respect to this particular role, the local institutions can become:

- an instrument of state government, that is, a part of the state apparatus (the conception of administrative decentralization);
- a counterweight to the state administration (the conception of political decentralization);
- a substitute for the working of the state authority (Ivanisevic, 1998).<sup>4</sup>

The short-term, but at the same time long-lasting objectives of decentralization are the improvement of the situation in a given area of administration and in the administration as a whole, bringing the decision-making process closer to the citizens, and reducing the costs of the state apparatus.

Below we shall draw attention to how much each of these conceptions is accepted in the process of the decentralization of public administration in Croatia and to what level the short-term objectives have been achieved.

### **The Initial State of Affairs and the Guidelines for Decentralization**

Considerations concerning the need to decentralize public administration in Croatia began soon after its organization, but the first steps in this direction were taken only at the end of 1999.

At the beginning of the implementation of the new Firefighting Law (NN 106/99),<sup>5</sup> the firefighting units (stations and sub-stations) of the Ministry of Internal Affairs (MUP) became public firefighting units of the municipalities and cities according to the location of their headquarters. Cities and municipalities took over the buildings, land, equipment and resources as well as their employees and also the obligation to finance their regular activities (with the exception of the obligation to provide financial resources for the employees' wages, which is not transferred at once in its entirety, rather gradually over five years, that is, until the end of 2004).

However, the local units of self-government did not have transferred to them at the same time the

financial resources needed for the performance of these assignments from the national budget, despite the fact that it would have been most logical to have done this by increasing their shares in the shared taxes. Still, the law did allow the local units to finance the fire service by increasing the communal economy charge.

The new State Survey and Cadastre of Real Estate Law (NN 128/99) determined the obligation of units of local self-government to set up administrative bodies competent for surveying, and in their budgets to provide the financial resources for their work, that is, for them to carry out certain operations. Alongside other operations, these bodies were supposed to set up and run a cadastre of overhead lines that were in the jurisdiction of the body of state administration. And yet in this case too, the financial resources needed to carry out these jobs were not transferred to the units of local self-government.

At the end of 1999, through amendments to the Local Self-Government and Administration Law (NN 128/99), the role of the *zupan* or county prefect as head of the state administration in the county was separated from the position of the chief official of the county self-government. Since that time the prefect, after election by the county assembly, is no longer confirmed by the president of the state.

Still, more serious commitments to reform and decentralization of state administration business were visible only after the elections of 2000. The first major steps were taken in 2001.

### *The State of Affairs in the State Administration System and Local Self-Government at the Beginning of 2000*

The central state administration is governed by laws concerning the state administration system, the Government of the Republic of Croatia, the organization and jurisdiction of the ministries and state administrative organizations, senior and junior civil servants [state officials and other state employees] and the salaries of those charged with judicial duties, as well as a series of special laws and bylaws governing given areas of work of the bodies of state administration.<sup>6</sup>

<sup>4</sup> We find a similar division in Pusić (1985: 309-313) and Koprić (2001: 420-427).

<sup>5</sup> Application from Jan 1, 2000; later amended NN 117/01 and 36/02 (decision of the Constitutional Court of Republic of Croatia).

<sup>6</sup> The State Administration System Law, NN 75/93, 92/96 (Article 31 of the Law on Amendments to the Organisation and Jurisdiction of Ministries and State Administrative Organisations Law) and 48/99; The Government of the Republic of Croatia Law, NN 101/98; The Organisation and Jurisdiction of the Ministries and State Administrative Organisations Law, NN 48/99; The State Officials and Other Employees and Salaries of Officers of the Court, NN 74/94, 86/94 and 75/95.



The system of state administration includes the administrative bodies and organizations that are directly guided by and linked with the Government of the Republic of Croatia, the highest state political and administrative body. Through this they are linked indirectly with the highest political authorities in the state—the Parliament and the President.

The bodies of state administration are the ministries (17), state administrative organizations (10) and the county offices (9–11 in each county), as well as the city offices of the City of Zagreb.

The business handled by the state administration is the immediate implementation of laws (settling administrative operations, running the prescribed registers, issuing certificates and other official documents for the performance of other administrative and expert affairs), adopting regulations for their implementation, carrying out administrative control, and other administrative and expert affairs.

Looking at the state administration from the level of the various administrative areas (line ministries), its business can be classified into:

- a) the classic line ministries of state authority (defense, internal affairs, foreign affairs, justice and finance)
- b) economic line ministries (economics, agriculture and forestry, development, immigration and reconstruction, tourism)
- c) technical departments (maritime affairs, transportation and communications, science and technology)
- d) communal economy departments (zoning, construction and housing)
- e) social departments (culture, education and sports, labor and welfare and health care) and
- f) particular line ministries (concern for veterans of the Homeland War).

The system of local self-government covers altogether 564 units, that is, 421 municipalities, 122 cities, 20 counties (which are also the local units of the central administration) and the City of Zagreb (a special and unique territorial unit whose status is that of both a city and a county).

Local self-government is determined by four laws: that concerning local self-government and administration, the areas of the counties, cities and municipalities in the Republic of Croatia, the financing of units of local self-government and administration, and the determination of

operations from the self-governing sphere of interest of units of local self-government and administration<sup>7</sup>.

Local self-government operations cover areas of zoning and the planning of settlements, communal economy activities, protection of the environment, preschool education, culture, sports and welfare.

The task of the county is to coordinate the interests and views of the municipalities and cities in their area, and the even development of these units.

#### *A General Evaluation of the State of Public Administration in the Republic of Croatia at the Beginning of 2000*

In the system of state administration there is still an emphasis on unity and the tendency towards centralization, while the process of expansion and concentration is continuing. The state administration is a powerfully centralized and massive apparatus that cannot be flexible and that adapts with difficulty to its new roles and assignments.

The irrationally large number of units of local self-government and employees in its various administrative bodies affects the size of public spending. In addition, centralization of the many administrative activities prevents any effective performance of the work of local self-government. At the same time, the existing system of financing the units of local self-government is not capable of providing for the development of the communal infrastructure, nor of responding to the basic needs of citizens in the areas of health care, welfare, employment, education, culture and environmental protection.

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<sup>7</sup> The Local Self-Government and Administration Law, NN 90/92, 94/93, 117/93, 5/97 (Decision of the Constitutional Court), 17/99 (Constitutional Court Decision) and 128/99; later amended one more time, Official Gazette 51/00 (Article 16 of the Constitutional Law concerning amendments to the Constitutional Law on human rights and liberties and the rights of ethnic and national communities or minorities in the Republic of Croatia); the Law on the Areas of the Counties, Cities and Municipalities in the Republic of Croatia, NN 10/97, 124/97, 50/98 (decision of the Constitutional Court) 68/98, 22/99, 42/99 (decision of the Constitutional Court), 117/99 and 128/99; the Financing of Units of Local Self Government and Administration Law, NN 117/93 and 69/97 (Article 28, Paragraph 3 of the Tax on the Sale of Real Estate Law); the Determination of Operations from the Self-Governing Jurisdiction of Units of Local Self-Government and Administration, Official Gazette 75/93, later many times amended with separate laws governing individual administrative areas. Local self-government is also governed by additional laws, which are not relevant to the topic of this paper.

Such a situation can prevail only if the state administration is gradually transformed in the performance of operations from its jurisdiction into an instrument for the solution of current problems in society, becoming the administration of the public sector instead of the traditional administration of the state.

For this reason the necessity arises to begin the process of transferring administrative operations and redeploying personnel from the state administration into broader subsystems, particularly to bodies of local self-government that are closest to the citizens.

## Reform—Guidelines, Activities, Results

### *Guidelines and Initial Activities*

The Government of the Republic of Croatia elected after parliamentary elections held on January 3, 2000, announced in its Work Program for its period of office (below: Government Program) the reform of the public administration in the area of internal politics in the direction of decentralization.

Among other things, the Government Program provides for:

1. the halting of the expansion of state administration (avoidance of the founding of new administrative organizations or the hiring of new officials and other employees);
2. horizontal decentralization (transfer of certain state administration operations to autonomous organizations outside the system of state administration);
3. a critical analysis, evaluation of the rationality and economy of the state administrative machinery, the implementation of a cost-reduction and savings program;
4. initiating a process of broad decentralization, and a strengthening of the role of local and regional self-government (determination of the jurisdiction of local self-government by a general clause, the introduction of the principle of subsidiarity, the augmentation of fiscal capacity of local and regional units);
5. the gradual transformation of the territorial organization (establishment of a smaller number of regional units, consolidation of local self-governing units in order to increase their capacity and the degree of the rationality of local structures (Government, 2000b: 31–31).

The objective of the reforms is to bring the citizens closer to the decision-making process, to have greater citizen participation, and a more comprehensive meeting of needs with the ultimate result being the reduction of the concentration of political power in the central government of the state.

In July 2000, the Government of the Republic of Croatia set up its Office for the Development Strategy of the Republic of Croatia, a professional department with the task of coordinating the preparation, drawing up and implementing strategic guidelines from the Government Program, making proposals for strategic development documents, and ensuring the bases for the elaboration and implementation of the project for the strategic development of Croatia in the 21<sup>st</sup> century.<sup>8</sup>

The Project “Strategy for the Development of Croatia in the 21<sup>st</sup> century” (below: Strategy Project) covers 19 different areas relating to economic and social life. For each area, a team of experts was set up whose task was to draw up documents about the strategy for the development of this particular area. The Strategy Project has a Central Council headed by the Deputy Prime Minister (as coordinator for the elaboration of the strategy), and the members are the leaders of the individual areas.

After their elaboration, the proposal of the separate strategy for each individual area is published on the Internet. In this manner the information of interested institutions and citizens is provided for<sup>9</sup>.

Public discussions are held about the texts of the separate reports, the line ministries, interested ministries and individuals from a given area that is involved.

It was provided for that the Government should unite all the separate reports in a single document concerning the overall strategy of the development of the Republic of Croatia. This document was to be sent to the Parliament for adoption by the end of 2001. However, because of delays in the drawing up of the individual separate reports, after each was produced, it was then accepted individually and sent separately to the Parliament for adoption.

Some of the separate sections contain texts that indicate the need for decentralization and the denationalization of certain operations of state admin-

<sup>8</sup> Decree concerning the Office for the Development Strategy of the Republic of Croatia, NN 77/00.

<sup>9</sup> All information about the Project, as well as integral texts of the strategic documents for given areas are available on [www.hrvatska21.hr]

istration, particularly in the area of public administration, welfare, education and health care.

In November 2000, the Government of the Republic of Croatia and the Open Society Institute of Croatia (OSI) entered into a Cooperation Agreement. A considerable part of this agreement relates to the area of the decentralization of public administration.

Pursuant to this agreement, a contract concerning the execution of the Decentralization of the Public Administration (DPA) was signed between the OSI and the Croatian Law Center (CLC).

The DPA project deals with the determination of directions for the decentralization of public administration and with necessary concrete actions, so that as early as the phase of the elaboration of the model a dialogue could be started up with the local self-government units, and with citizens affected by the work of the public administration and who are recipients of its services.

The DPA Project covers a number of separate areas:

- the local government electoral system;
- territorial organization of local and regional self-government;
- the legal position and sphere of competence of local self-government;
- status of local officials;
- decentralization of elementary and secondary education;
- decentralization of health care;
- decentralization of social services;
- decentralization in culture;
- financing of local and regional self-government.

For each area, a separate team of experts was set up. Members of these teams were lawyers, political scientists, economists, experts in public finance, sociologists, historians, geographers, statisticians and experts in the area of public services. The work of the expert teams was coordinated and directed by the Expert Council. Some fifty experts were engaged in this work, and representatives of government and non-governmental institutions, as well as representatives of local and regional self-government were included in the implementation of the projects.

Supervision of the execution of the CLC is carried out by the Project's Supervisory Board, made up of

representatives of the OSI, the Government of the RC and the CLC.

In its material for each of the areas, the Project covers an analysis of the state of affairs and an identification of the problems, an elaboration of the proposals for the appropriate policy and alternative models, the legitimization of the proposal (via different forms of discussion with numerous persons concerned), the adoption of the proposals and their implementation, and an evaluation of the results and degree of success.

Furthermore, since 2000 a number of partial programs and projects have been carried out to cover individual areas that need to have the decentralization procedure implemented. They are being carried out by domestic and foreign institutions with more or less full support and cooperation from state bodies, or even independently of them.

The projects are as follows:

1. Reform of Welfare (Ministry of Labor and Welfare of the RC, the World Bank and the Department for International Development of the UK—DFID).<sup>10</sup>
2. Fiscal Decentralization (Ministry of Finance of the RC, US AID and the Barents Group (USA).
3. As part of the OBNOVA [RECONSTRUCTION] program: technical assistance in the formulation of the framework for the conceptualization of regional policy of the RC (Ministry for Public Works, Reconstruction and Construction of the RC and the EU).
4. Analysis of Public Expenditure (Ministry of Finance, RC, and World Bank).
5. Local Finances and Local Budgets in the RC (Institute for Public Finance).
6. Reform of Local Self-Government and Administration (Urban Institute, USA).

### *Activities Completed and Results Achieved*

#### *Projects*

In autumn 2000, activities directed towards decentralization were stepped up. The implementation of individual projects was started and certain bodies of the central state administration were headed towards the execution of

<sup>10</sup> Information on the project are available on [www.mrss.hr/projekti/soc-zasita.htm](http://www.mrss.hr/projekti/soc-zasita.htm).

this assignment. During 2001, the first results of the activities through which the process of decentralization was started appeared.

In the implementation of the Strategy Project, the Government's Office for the Development Strategy of the RC appointed the leaders of individual areas. They set up expert teams that by the summer of 2002 had drawn up drafts of separate reports for all areas.

By the end of September 2002, the Parliament had adopted strategy documents for seven areas (information and communication technology, environmental protection, the arts [culture], macroeconomics, national security, energy and food). Strategic documents for three areas are in the process of being accepted in the Government of the RC (pensions system and welfare, science, and education). For nine of the areas, the strategic documents are still in the process of being drawn up, or of public debate, or being agreed on (public administration, tourism, SMEs, housing, health care, maritime affairs, transports, international integration and shipbuilding).<sup>11</sup>

At the same time, the implementation of the DPA Project started as well.

By spring 2002, an analysis of the state of affairs and expert backgrounds for decentralization in the areas of education, social services, health care, the arts, the legal position and jurisdiction of local self-government, its territorial organization and financing had been drawn up. During the summer 2002, all the expert analyses had been reviewed by independent international experts (associates of the Local Government and Public Reform Initiative [LGI]-Budapest).

At the beginning of October 2002 an expert debate was organized, where the results of the DPA Project were presented, as well as the drafts of the expert backgrounds, and the reviews of the international experts. After the expert discussion, the final versions of proposals for models in all the separate components of the DPA Project are expected.

The other projects mentioned were also started, some of them having been completed in 2001 and 2002. Some of the projects are still in various phases of implementation.

### *Regulations*

In 2001, the process of decentralization started with respect to laws and standards.

Through changes in the Constitution of November 2000, the conditions were created for the expansion of the jurisdiction of local self-government, and the concept of regional self-government was introduced.<sup>12</sup>

At the beginning of March 2001, the Government drew up, and by summer the Parliament had accepted a package of statutory proposals starting the process of decentralization of individual operations of state administration.

Through the passing of the new Local and Regional Self-Government Law (ZOLPS in Croatian) (Official Gazette, 33/01; later supplemented with authentic interpretation, Official Gazette, 60/01) decentralization was carried out in the area of the organization of the administration (provisions concerning organizational structure), and the decentralization of operations in some other administrative areas was made possible (jurisdiction provisions).

After this, the Parliament passed amendments to the law through which the areas of elementary and secondary education, health insurance and welfare were determined; amendments that partially led to the decentralization of the management and financing of certain establishments in the areas stated.

Through amendments to the Elementary and Secondary School Law, ownership rights to the elementary and secondary schools and student dormitories were transferred to units of local and regional self-government, the question of school governance was settled, and the obligations to meet the costs of schools were demarcated.

Amendments to the Health Insurance Law led to the devolvement of some of the obligations for providing for the work of some health care institutions being passed down to the counties.

Through amendments to the Welfare Law, some of the welfare operations were transferred to the counties, the question of the management of welfare centers was settled, and the obligations for the meeting of costs were demarcated. These amendments also meant that the foundation rights to some of the welfare homes were transferred to the counties.

The application of these laws started on July 1, 2001.<sup>13</sup>

In the area of culture, a series of laws were passed, implementing de-etatisation in the area of founders' rights. Municipalities, cities and counties, as the founders

<sup>11</sup> Data from the Office for Strategy of the Government of the Republic of Croatia, October 2002.

<sup>12</sup> Change of the Constitution, NN 113/00, Articles 66–71.

<sup>13</sup> All these laws are printed in NN 59/01.



or owners of museums, libraries, public theaters and other public establishments in culture and the arts, no longer need the confirmation of the Minister of Culture when they appoint and discharge directors.<sup>14</sup>

The passing of the Culture Councils Law (NN 53/01) meant the end of hierarchy in decision-making and financing in arts activities. The arts councils were set up in the Ministry of Culture for the individual activities. The influence of people in arts administrations and actual artists is thus ensured in the making of decisions that are important for culture and the arts (proposing the objectives of cultural policy and measures by which to achieve them, joint decision-making in the determination of arts policy, giving expert proposals and opinions, providing opinions about the annual programs for public requirements in culture).

Furthermore, the Amendments to the Financing of Units Local Self-Government and Administration Law were passed (NN 59/01); these governs in particular the question of the financing of decentralized operations.

Pursuant to this law, the Government passed a Decree determining the manner of calculating the amount of equalization grants to be given to cities and counties for decentralized functions during the period from July 1 to December 31, 2001.

For the sake of implementing this decree the Government passed in 2001 special decisions about the criteria and yardsticks for the provision of minimum financial standards for public requirements in elementary and secondary education, the minimum financial standards for investment maintenance of health care institutions, as well as for current expenditures of welfare centers and expenditures in heating grants.<sup>15</sup>

<sup>14</sup> Amendments to the Libraries Law, NN 104/00; Amendments to the Theaters Law, NN 127/00; Governance of Public Establishments in the Culture Law, NN 96/01.

<sup>15</sup> The Decree concerning the Manner of Calculating Equalization Grants for the Decentralized Functions of Local And Regional Self-Governing Units for the period from July 1 to December 31, 2001; the Decision on the Criteria and Yardsticks for the Provision of the Minimum Financial Standard for the Public Needs of Elementary Education in 2001; the Decision concerning the Criteria and Yardsticks for the provision of the Minimum Financial Standard for the public needs of Secondary Education in 2001; the Decision on the Minimum Financial Standards for the Investment Maintenance of Health care Establishments in 2001 for the decentralized functions from July 1 to December 31, 2001; the Decision on the Minimum Financial Standards for current expenditures of the welfare centers and expenditures for assistance for fuel in 2001. The Decree and all the decisions are published in Official Gazette 75/01.

When the Amendments to the System of State Administration (NN 59/01) came into force, the role of the prefect as head of the county self-government and his simultaneous role as head of the office of state administration in the county were at last divided.

### *Current Situation*

In consideration of the current state of affairs in areas in which the procedure of decentralization was carried out, it is more appropriate to talk of the consequences and effects than of the results of what has been done, for two reasons.

Firstly, the activities completed are only the very first steps on the road to decentralization and no results, in the sense of the achievement of the objectives set up, can yet be demonstrated.

Secondly, the regulations passed which began the process of decentralization did not derive from the projects mentioned, rather the process of drawing them up and adopting them was carried out in a way that bypassed the execution of the projects.

In the sequel to this chapter, we shall give a review of the current state of affairs in the system of state administration and local and regional self-government, as well as in the individual areas in which the procedure of decentralization has been carried out to a greater or lesser extent. Attention will be drawn in so doing to the differences that have arisen as compared with the initial state of affairs. Similarly, in given areas an account is given of the demarcation of the jurisdictions or spheres of competence of the different levels of administration.

### *The State Administration*

The central state administration is governed by laws concerning the system of state administration, the Government of the Republic of Croatia, the organization and sphere of competence of the ministries and state administrative organizations, state officials and other employees, and an array of separate laws and bylaws governing individual areas of work of the state administration bodies.<sup>16</sup>

<sup>16</sup> System of State Administration Law, NN 75/93, 92/96 (art. 31 of the Amendments to the Organization and Jurisdiction of the Ministries and State Administrative Organizations Law), 48/99, 15/00, 127/00 (authentic interpretation) and 59/01; the Government of the Republic of Croatia Law, NN 101/98 i 15/00; the Organization and Jurisdiction of the Ministries and State Administrative Organizations Law, NN 48/99, 15/00 and 20/00 (corr.); the State Officials and Other Employees Law, NN 27/01; Decree concerning the Organization of the State Administration Office in the Counties. NN 21/02.

State administration bodies include the ministries (19, or two more than at the beginning of 2000), state administrative organizations (8, or two less than at the beginning of 2000), state administration offices in the counties (one office per country) and the city offices of the city of Zagreb.

The process of decentralization has not affected changes in the organization of state administration or the reduction of the number of officials and other employees in the central bodies of state administration.

Changes in the organization of the bodies of state administration in the counties and in the number of officials and other employees are also not the direct result of the decentralization process, although this process has had somewhat of an indirect effect on them.

Thus in each county there is an office of the state administration that consists of the departments that are set up for the individual administrative domains. At the top of the office is a Head appointed by the Government of the Republic of Croatia.

The number of people employed in the county offices was reduced after December 31, 2001 by 975 people (749 officials and 226 other employees); of this number, local self-government took over 165 persons, and 562 officials are still “available” and receive emoluments from the national Budget.<sup>17</sup>

#### *Local and Regional Self-Government*

Local and regional self-government are governed by laws concerning local and regional self government, the election of members of representative bodies of local and regional self-government, of the county areas, cities and municipalities in the Republic of Croatia, the city of Zagreb, and the financing of units of local and regional self-government laws.<sup>18</sup>

<sup>17</sup> Information from the Ministry of Justice, Administration and Local Self-Government, September 2002.

<sup>18</sup> Law concerning local and regional self government, NN 33/01 i 60/01 (authentic interpretation); Election of members of Representative Bodies of Units of Local and Regional Self-Government Law, NN 33/01 and 10/02 (Constitutional Court decision); Areas of the Counties, Cities and Municipalities in the Republic of Croatia Law NN 10/97, 124/97, 50/98 (Constitutional Court decision), 68/98, 22/99, 42/99 (Constitutional Court decision), 117/99, 128/99, 44/00, 129/00 and 92/01; City of Zagreb Law, NN 62/01; Financing Units of Local and Regional Self Government Law, NN 117/93, 69/97 (Article 28 Para 3 of the Tax on Sale of Real Estate Law), 33/00, 73/00, 127/00 (Art. 172, subpara. 11 General Tax Law), 59/01, 107/01 and 117/01 (corr.).

The system of local self-government in a broader sense covers 425 municipalities (four more than at the beginning of 2000), 122 cities, 20 counties (to the extent that they are regional self-government units), and the city of Zagreb (which is both city and county).<sup>19</sup>

Cities and municipalities within the sphere of competence of their self-government carry out operations of local importance that directly realize the needs of the citizens, and that have not been assigned by constitution or law to the state bodies. This kind of determination of their sphere of influence is very close to the spirit of the general clause and corresponds to the principle of subsidiarity. The following operations are determined as obligatory:

- housing and the arrangement of settlements;
- zoning and town planning;
- utilities or the communal economy;
- concern for children;
- welfare;
- primary health care;
- pre- and elementary schooling;
- culture, physical education and sports;
- consumer protection;
- protection and improvement of the natural environment;
- firefighting and civilian protection.

In their self-governmental sphere of influence, the counties carry out operations of regional importance, particularly in the domains of:

- education;
- health care;
- zoning and town planning;
- economic development;
- transports and transportation infrastructure;
- planning and development of the network of educational, health care, social and cultural establishments.

<sup>19</sup> Data from the Ministry of Justice, Administration and Local Self-Government, October 2002.



If they provide the financial resources for them, units of local self-government can also carry out operations that are in the jurisdiction of the county.

With respect to organizational structure, the provisions of ZOLPS allow local units greater freedom of internal organization. Thus local units decide independently on their internal organization (certain categories of units even decide on whether they will have an Authority), or about setting up joint administrative bodies for several units.

### *The Area of Education and Preschool Education*

Preschool education and care for children of preschool age have from the beginning of the organization of local self-government belonged within the jurisdiction of local units.<sup>20</sup>

Unlike the system of preschool education the school system was in its entirety within the jurisdiction of the bodies of central state administration until July 1, 2001.<sup>21</sup>

Within the school system there are 828 main and 1,270 area elementary schools, 365 secondary schools, 72 music and ballet/dance schools, 13 secondary art schools and 53 student dormitories.<sup>22</sup>

The 2001 Amendments to the Elementary Education and the Secondary Education Law transferred founders' rights to elementary and secondary schools and student dormitories to local and regional self-government units. These amendments settled the administration of the schools and the demarcation of the obligation of meeting the costs of schools and dorms. A new provision was that the minister no longer appoints the principals of secondary schools, and no longer has to give consent to the appointment of head teachers of elementary schools, rather the principals are in both cases appointed by the school committee [board of governors] subsequent to a public tender.

<sup>20</sup> This system is specifically governed by the Preschool Education Law, NN 10/97.

<sup>21</sup> The system is separately governed by the Elementary Education Law, NN 59/90, 26/93 (Article 129 of the Amendments to the Law defining fines for economic offences and misdemeanors), 27/93, 7/96, 59/01, 114/01 and the Secondary Education Law, NN 19/92, 26/93 (Article 128 of the Amendments to the Law defining fines for economic offences and misdemeanors), 27/93, 50/95, 59/01 and 114/01.

<sup>22</sup> Data from the Ministry for Education and Sports, 2002.

According to the new division of jobs and authorities in the area of preschool education and education, we present the jurisdictions of the state, the counties, the cities and the municipalities.

1. The state, or central government, carries out the following operations:

- a) elementary schools
  - provides financial resources for salaries, transports and other remunerations of employees, the further training of teachers, education in minority languages, meeting the increased costs of children with learning difficulties, financing programs for work with gifted pupils, pays for the costs of IT and the equipment of libraries, jointly finances programs of private education, capital development to the minimum financial standard and programs of interest to the education industry as a whole (national Budget);
  - gives a ruling stating that the conditions for carrying out the work have been met (minister of the Education and Sports Ministry), without which a school cannot start working;
  - gives previous consent to a network of elementary schools (minister of the Education and Sports Ministry);
  - adopts the teaching standard (Parliament);
  - determines the criteria and yardsticks for the provision of the minimum financial standard for the sake of satisfying public needs in the area (Government of the Republic of Croatia);
  - can discharge a head teacher if the school committee does not do so, although the conditions for this have been met (minister of the Education and Sports Ministry);
- b) secondary schools:
  - provides financial resources for the salaries and remunerations of the employees, further training of teachers, education in minority languages, covers increased costs of children with learning problems, finances programs for work with gifted pupils, pays for the costs of IT and equipment of libraries, co-finances private education programs, capital construction up to the minimum financial standard and programs

- of common interest to the education industry (national Budget);
- adopts a ruling consenting to the beginning of work of a school (minister of the Education and Sports Ministry);
  - draws up the project of a secondary schools network;
  - adopts the teaching standard (Parliament);
  - determines the criteria and yardsticks for the provision of the minimum financial standard in order to satisfy public needs in the area (Government of the Republic of Croatia);
  - supervises the way the work is carried out (Education and Sports Ministry);
  - can dismiss the principal when the school committee does not do so, although the conditions for this have been attained (minister of the Education and Sports Ministry).
2. The counties carry out the following operations:
- a) elementary schools
- are the founders of schools in their areas (except in 32 cities);
  - provide financial resources for costs of materials, investment maintenance, procurement of school equipment, teaching resources and aids, transports of pupils and capital construction of premises and equipment (up to standards laid down by the minister of the Education and Sports Ministry);
  - determine general public needs in the education industry in its area (at choice, e.g., joint financing of school meals, longer school hours and so on) and provides the financial resources to secure them;
  - determine the network of elementary schools in their area (with the prior consent of the minister of the Education and Sports Ministry);
  - can dissolve the school committee of a school they own if it does not carry out the operations within its sphere of competence in line with the law, or carries them out in a way that makes the regular work and activity of the school impossible.
- b) secondary schools
- are the founders of schools in their area;
  - provide financial resources for costs of materials, investment maintenance, procurement of school equipment, teaching resources and aids, transports of pupils and capital construction of premises and equipment (up to standards laid down by the minister of the Education and Sports Ministry);
  - determine general public needs in the education industry in its area (at choice);
  - determine the network of elementary schools in their area (with the prior consent of the minister of the Education and Sports Ministry);
  - choose three members of the school committee (county assembly) at the recommendation of the administrative body of the unit of local self-government in which the school lies;
  - can dissolve the school committee of a school they own if it does not carry out the operations within its sphere of competence in line with the law, or carries them out in a way that makes the regular work and activity of the school impossible.
- c) student dormitories:
- are owners of dorms in their area and from this point of view they have all the same rights and duties as they do with respect to secondary schools.
3. Cities and municipalities carry out the following operations:
- a) elementary schools
- 32 cities<sup>23</sup> are the founders of schools in their area and have the same rights and authorities toward them as the counties do with respect to the schools which they founded;

<sup>23</sup> These are: Samobor, Velika Gorica, Vrbovec, Zaprešić, Krapina, Kutina, Sisak, Karlovac, Varaždin, Koprivnica, Bjelovar, Crikvenica, Opatija, Rijeka, Gospić, Virovitica, Požega, Slavonski Brod, Zadar, Osijek, Šibenik, Vinkovci, Makarska, Split, Labin, Pazin, Poreč, Pula, Rovinj, Umag, Dubrovnik and Čakovec. This list is composed in Article 3 of the Decree concerning the Manner of Calculating the Amount of Equalization Grants for the decentralized functions of units of local and regional self-government for 2002, Official Gazette, 118/01. The criteria for determining these cities were: county towns and cities with populations of over 10,000, and income tax revenue in 1999 greater than 400 kuna per capita. Unfortunately, these criteria were not previously published, and are still not a component part of any regulation.

- choose three members of the school committee of the schools in their area (city or municipal council).
- b) secondary schools
- propose three members of the school committee for any school in their area.

### *The Area of Health Care*

The area of health care is governed by the Health Care Law and the Health Insurance Law.<sup>24</sup>

In the health care system operate health care institutes owned by the state and those owned by the counties.<sup>25</sup>

The state owns the clinics and clinical hospitals (12 of them), the clinical hospital centers (2) and the state health care institutes (6).

The counties own health centers (120), home-nursing establishments (106), polyclinics (169), general hospitals (23), special hospitals (30), apothecary establishments (130), sanatoria (5), emergency medical service establishments (4) and public health and transfusion medicine institutes (21) (Government, 2002: 6).

The operations and the financing in this area are not arranged exclusively according to the rights and duties of ownership.

The health care industry is financed pursuant to a contract between each individual establishment and the Croatian Institute for Health Insurance (HZZO).

Apart from that, resources for the financing of other operations and obligations are provided by:

1. The central government
  - entirely, for all institutes it founded;
  - for capital investments in establishments founded by the counties;
  - for numerous remunerations and compensations (in lieu of pay, for maternity benefits and so on) and grants (for layettes and so on);
  - for health care of uninsured persons;
  - for health care of members of rural households older than 65;
  - for certain other operations provided for by the law in connection with health care.

2. The counties
  - for the investment maintenance of premises and equipment of establishments they founded;
  - for health care measures for the protection of human environment;
  - for epidemiological, health care statistics and social medicine activities (not provided by the Republic of Croatia);
  - for health care of persons who take part in public works, civilian protection, volunteer firefighting, pupils in practical work and so on (not provided by the Republic of Croatia).<sup>26</sup>

Health care establishments (state and county) are governed by an administrative council in which the owner appoints the majority of members.

The operations of an establishment are run by a director who is appointed after a public tender held by the governing council, with the consent of the minister of the Health Ministry.

### *The Area of Welfare*

Welfare is governed by the Welfare Law (NN 73/97, 27/01, 59/01 and 82/01).

There are three types of establishment in the welfare system:

1. welfare centers (78 main and 26 area).
2. welfare homes: for the elderly and infirm (48), for mentally ill adults (15), for physically or mentally handicapped persons (24), homes for children without appropriate parental care (14), homes for children and young people with behavior disturbances (11), and homes for children and adults who are victims of family violence (not one has actually been set up yet).
3. centers for assistance and nursing (Government, 2002: 82).

<sup>24</sup> Health Care Law NN 1/97 (revised text), 111/97 (Art 69. Protection of Persons with Mental Disturbances Law), 95/00 (Constitutional Court decision) and 129/00; Health Insurance Law, NN 94/01.

<sup>25</sup> Some health care establishments may be privately owned, but they are not crucial for this paper's topic.

<sup>26</sup> As for the financing of capital investment and investment maintenance of health care establishments, the new Health Insurance Law that came into force on January 1, 2002 does not contain any provisions about this, as was expressly stated in the Amendments to the Health Insurance Law (Official Gazette 59/01). It was expected that these provisions would be contained in the new Health Care Law. However, since this law has not yet been passed, at the moment, this question is not settled, but in practice one proceeds according to the provisions of the previous Law on Health Insurance, although strictly speaking they have ceased to be valid.

The June 2001 Amendments to the Welfare Law led to a new form of governance of welfare establishments. An establishment is run by the governing council in which the owner appoints the majority of members. The director of a welfare center is appointed by the governing council after a public tender (no longer the minister). From January 1, 2002, ownership rights to homes for the elderly and infirm have been transferred to the counties.

The division of jobs and authorities in the area of welfare between individual levels of the administration now look different:

1. The central government takes care of the following operations:
  - a) welfare centers
    - is their owner/founder;
    - provides financial resources for expenditure for employees, training and further training, and procurement of capital resources;
    - appoints the majority of members of the governing council (three).
  - b) welfare homes
    - is the founder of existing homes (except for homes for elderly and infirm);
    - issues permission for the founding of certain types of welfare homes;
    - determines the needs for the foundation of certain types of welfare homes;
    - in the foundation procedure, determines whether the conditions with respect to space, equipment, professional and other employees have been met, the health care and ecological conditions, and determines the harmonization between the institution's regulations and the law;
    - makes a decision about the minimum standards for the performance of welfare work for decentralized functions as a basis for the planning of grants from the national Budget at an annual level;
    - provides financial resources for the completion of capital works already started in homes whose ownership (homes for the elderly and infirm) has already been transferred.
  - c) centers for assistance and nursing
    - issues a ruling concerning the satisfaction of conditions with respect to space, equipment, professional and other employees as well as other conditions for the performance of
2. Counties carry out the following operations:
  - a) welfare centers
    - provide financial resources for expenditure for materials, energy, utility and other services, current maintenance, financial expenditure and some other expenditure
    - appoint one member of the governing council.
  - b) welfare homes
    - own the homes for the elderly and infirm in their area
    - can found new homes of a certain type
    - issue permits for the foundation of new homes for the elderly and infirm in their area
    - in the procedure of founding new homes for the elderly and infirm, determine whether the conditions relating to space, equipment, professional and other employees, health care and ecological conditions are met, and determines the harmonization of the internal regulations with the law;
  - c) provide financial resources to meet the costs of heating, with the conditions and in the manner prescribed by the Law
  - d) submit reports about the degree to which welfare rights have been fulfilled to the Ministry of Labor and Welfare in its area and adopt Regulations (with the prior consent of the Ministry) concerning the contents of and the way of running records and documents, as well as about the manner of and deadlines for submitting reports of units of local self-government and welfare centers about the fulfillment of single rights.
3. Cities and municipalities carry out these operations:
  - a) welfare homes
    - can found new homes of a certain type
  - b) centers for assistance and nursing
    - founding, appointment of directors
  - c) provide financial resources for meeting the costs of residence with conditions and in the manner prescribed by the Law
  - d) submit a report about the satisfaction of welfare rights.

the activity (the competent county office of the state administration, i.e., central government)



### *The Area of Culture*

The area of culture is arranged by an array of laws governing the work and operations of culture establishments (theaters, libraries, archives, museums and other establishments). Special laws govern separate operations (protection and preservation of cultural assets, the foundation and work of culture councils, the management of public establishments in culture and so on). There are also other laws governing specific activities in the field (cinema, publishing, the music industry and so on).<sup>27</sup>

The foundation of arts councils has led to the enhancement of the influence of people and artists working in culture on the decision-making process that is important for culture, and in this manner a procedure to limit the hierarchy has been started.

The activity of setting up archives and the protection of cultural assets is mainly in the jurisdiction of state bodies, while the work of theaters, museums and libraries is mainly in the jurisdiction of local and regional self-government.

Public establishments in culture are by right governed by a governing council (establishments that have up to five employees, and theaters administered by their director are exceptions to this). Most of the members of the governing council are appointed by the owner of the establishment.

The director of the institution is appointed by the representative body of the owner, at the recommendation of the governing council, with the opinion of the expert or artistic council, there being no longer any subsequent confirmation or agreement from the minister of culture, except in the case of the directors of the national theaters.

A decision about status changes and the cessation of the activity of a certain cultural establishment can be taken by the owner only with the prior consent of the competent minister (museums, libraries) or the Government of the Republic of Croatia (national theaters).

### *The Financing of Local Self-Government*

The 2001 Amendments to the Local Self-Government and Administration Financing Law led to the size of local units' shares in income tax being determined according

<sup>27</sup> Theaters Law, NN 61/91, 13/97 and 127/00; Libraries Law, NN 105/97, 5/98 (corr.) and 104/00; Archives and Archival Material Law, NN 105/97 and 64/00; Museums Law, NN 142/98; Protection and Conservation of Cultural Assets Law, NN 69/99; Arts Councils Law, NN 53/01; Administration of Public Establishments in the Arts Law, NN 96/01.

to the extent of operations that given units undertake, that is, according to which jobs they have taken on in the process of decentralization. Bylaws determine the manner of calculating equalization grants for decentralized functions and the yardsticks for ensuring the minimum financial standards of public needs in activities of primary and secondary education, welfare and health care.

The financing of local and regional units is governed by an array of regulations:

1. laws concerning the financing of units of local and regional self-government and the budget.
2. the decree on the manner of calculating the amount of equalization grants for decentralized functions in 2002.
3. decisions valid for 2002 concerning the criteria and yardsticks for providing the minimum financial standard of public needs for primary and secondary education, for the decentralized functions for health care establishments, the minimum financial standards of the material expenditure of welfare centers and heating grants, and for the decentralized financing of homes for the elderly and infirm<sup>28</sup>.

Units that carry out certain decentralized functions have the right to an additional share of income tax, as follows:

elementary education	2.9%
secondary education	2.0%
welfare	
welfare centers	0.4%
homes for the elderly and infirm	1.6%
health care	
establishments owned by the county	2.5%
firefighting	2.0% (in 2002)
	up to 8.0% (from 2005).

<sup>28</sup> The Financing of Units of Local and Regional Self-Government Law, NN 117/93, 69/97 (Article 28, para. 3 of the Tax on the Sale of Real Estate Law), 33/00, 73/00, 127/00 (Article 172 subpara. 11 of the General Tax Law), 59/01, 107/01, 117/01 (corr.); Budget Law, NN 92/94; Decree on the Manner of Calculating... 2002, NN 118/01 and 97/02; Decision on Criteria and Yardsticks for Ensuring the Minimum Financial Standards of Public Needs in Secondary Education in 2002, NN 110/01; Decision Concerning the Minimum Financial Standards for the Decentralized Functions for Health care Establishments in 2002, NN 110/01 and 115/01; Decision Concerning Minimum Financial Standards for Material Expenditure of Welfare Centers and Assistance for Fuel in 2002, NN 110/01; Decision Concerning Minimum Financial Standards for the Decentralized Financing of Homes for the Elderly and Infir in 2002, NN 110/01.

Units of local and regional self-government that still do not obtain from their additional share of income tax revenue to cover the obligations transferred for a given decentralized function have the right to resources from the national Budget as beneficiaries of equalization grants.<sup>29</sup>

A unit of local and regional self-government was obliged in 2002 to transfer the resources obtained from the increased share in income tax and from equalization grants to each individual establishment in proportion to the sums of the previous year, according also to the minimum standards decision. These sums can be redistributed within the group of individual activities. The redistribution has to be founded on a plan that should be made public at least two months before it is adopted. Through redistribution, no given establishment can have its funds reduced by more than 20% of the previous year's amount determined by the minimum standard.

In 2003, a unit of local and regional self-government can freely dispose of these funds within the groups of individual activities. The redistribution of resources is based on a plan that has to be published two months before adoption.

The minimum financial standards for the financing of individual decentralized functions are laid down by the said decisions of the Government of the Republic of Croatia for each function. From these decisions any possible right to equalization grants from the national Budget and the amount of them are also derived.

### **Problems in the Implementation of Decentralization**

In spite of previous warnings of disaster, the measures of decentralization carried out did not lead to major disruptions or blockages in the functioning of the activity in which they were applied.

However, it should be admitted that some of the measures are carried out with difficulties, problems and doubts, for which there is not always a rapid or appropriate solution. For this reason the further process of decentralization is going on slowly, and tends to be ineffective.

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<sup>29</sup> The amount of the liability transferred is laid down in the Aggregate Review of Resources for Decentralized Functions per County and City, the Review of Resources for Decentralized Functions for Elementary Schools per County and the Review of Resources for Decentralized Functions for Elementary Schools per City, which are a component part of the Decree on the Manner of Calculating the Amount of Equalization Grants for the Decentralized Functions of Local and Regional Self-Government for 2002.

According to results achieved so far, the first phase of decentralization can be given the mark of borderline successful. This is the result of a number of objective and also of human-element factors for which the state and the local bodies are responsible.

Below, the limitations that slow down the further course of decentralization are put forward and analyzed.

#### *Limitations at the Central Government Level*

A number of operators are involved in the process of decentralization at the level of the central government: the Government of the Republic of Croatia (as political body), individual ministers (as heads of ministries), ministries (state administration bodies), officials [i.e., civil servants] of individual ministries (as individuals), each of them having a particular role in the process.

But in the implementation of the process, with each of these operators, a number of objective and human-element circumstances arise that slow down, limit and frustrate the desirable course of events and achievement of results.

1. The Government of the Republic of Croatia correctly started off the whole process with the adoption of its Program determining decentralization as the principle of its future work in many areas. In the Program itself and in later procedures, the Government has continued to express its undoubted political will for decentralization.

However, after the governmental Program was passed, no documents of a detailed, implementation-level nature were adopted to determine the objectives, work out the methods, impose concrete tasks, determine those in charge, the deadlines and the yardsticks for performance measurement, i.e., for the achievement of the aims of decentralization.

Decentralization is not an end in itself, only a means to an end. For this reason the absence of this general document or of several separate documents (depending on the given line ministries) creates a lack of clarity and doubts concerning concrete operations of the implementation of decentralization: the where, when, how and why of decentralization.

All are involved in the implementation of decentralization, but not a single operator is charged with the whole of the process.

2. In consequence of the absence of an appropriate document at all levels of decision-making and implementation, decentralization is often understood



as just one of a string of usual and regular tasks, and that is how it is approached. Activities in the process of decentralization are often worked off as a purely routine matter, not as a strategic activity. Still more frequently, under pressure of the need to settle day-to-day problems, tasks related to decentralization are forced to take second place because, being long-term operations, they can afford to wait.

3. The pressure to satisfy the expectations of the public as fast as possible has resulted in the process of decentralization being started even before the adoption of the development strategy, and also before the first results of the decentralization projects started. For this reason the first phase of decentralization was prepared in a very short time, which made a full analysis of the existing situation impossible, particularly not the creation of alternatives, with simulations of the consequences and projection of the effects. Unfortunately, the basic method chosen was that of trial and error.
4. The decentralization process requires special research and administrative skills and abilities in the management of processes, for which most civil servants have not been trained. Most of them have been trained to carry out routine tasks, but for the performance of such an untypical job, they are not prepared. For this reason, the assistance and advice of foreign experts are often sought. However, problems often crop up on both sides in this cooperative process between local officials and foreign experts, the lack of knowledge of the language being the most banal, but also sometimes an enormous obstacle.
5. The consequence of the fact that a relatively small number of administrative personnel possess the special skills and knowledge (from foreign language skills to the ability to run given processes) is that the few individuals who do possess them are vastly overloaded. These individuals, along with their ordinary work obligations, are also included in all the numerous projects, seminars, working groups, coordination bodies and similar forms of organization. The one advantage of this situation is in that in this way, in the work of these bodies, these individuals can make a great contribution, because of the sheer amount of information coming into them. Some of these activities overlap. Since on the whole, though, they are not coordinated, there is an unnecessary dispersal of time and energy. This

kind of engagement has its own objective limits, which are often not considered, which again has an impact on the quality of work and the performance of the tasks.

6. Decentralization meets with the resistance of some of the civil servants and officials. The causes for this resistance are various. The most mild reason for resistance is fear of the new. Decentralization brings in new relationships that change the existing, run-in, work procedure, and the fear of possible difficulties in getting used to new conditions and circumstances arises. But behind the resistance there can also be fear of reduction or loss of importance and position, sometimes fear of getting laid off. Indeed, when some affairs are transferred from the state administration to the local units, some of the civil servants will lose more or fewer of the operations confided to them previously. This will certainly affect their positions and everything that appertains to them.

#### *Limitations of local self-government*

From the very beginning of the organization of local self-government in the Republic of Croatia, local units resented the highest government bodies for assigning them a very inadequate and narrow area of competence, often symbolically described as “grass clipping”.

But when the first phase of decentralization started, many of the local units resisted this process. This resistance was carried out even after the implementation of the first measures of decentralization.

The reasons for the resistance are sometimes objective, and sometimes related to the individual. The most marked are as follows:

1. Many municipalities and cities in the Republic of Croatia are small. The average municipality has only 3,228 inhabitants and is only 86 square kilometers in area; the average city has a population of a mere 18,741, and an area of 167 square kilometers, and these in European terms must be placed in the category of small local units. Hence, many local units simply do not have the capacity to carry out all the operations that local self-government ought to attend to. This is not only an issue of financial capacity, but also of staff potentials.
2. Negative experience with the devolvement of administrative operations to date from the state to the local level, when this devolvement was not

accompanied by the transfer of the appropriate financial resources (for instance, firefighting and the cadastre of overhead lines), enhances fears that it will not be possible to carry out the tasks confided to the local units.

3. The situation in areas in which the operations are being devolved is fairly difficult, and there is some fear that with decentralization, it is not only the work that will be transferred, but also the responsibility for the bad state of affairs as found, for which the local units are not in fact to be blamed.
4. The officials in many local (in particular, small) units do not have the knowledge, skills and experience to take on new and very complex operations. Most of them are equipped to handle routine operations, but not up to taking on new and responsible tasks.
5. Some of the local officials do not want to take greater responsibility. Decentralization is forcing them to acquire a different kind of management and the spending of budgetary resources on new priorities. These priorities are not always publicity-friendly, do not contribute to their popularity. Apart from that, through the decentralization of given functions, local officials become directly responsible to the citizens for the financing and the performance of these functions, and there is no longer any ability to transfer the responsibility on the regular whipping-boy—the central government.

### **Recommendations for the Continuation of the Decentralization Process**

The process of decentralization in Croatia encompasses the central state administration and the local self-government, in the broadest sense. This initial range is not adequate, however, for the system of administration to be called decentralized.

From experience acquired from preparing and implementing the first phase, it is possible to draw certain conclusions for further, more successful and effective implementation of the process.

Firstly, individual ministries within whose activities it is planned to carry out decentralization (whether it is the transfer of activities from the ministry to the regional administration units, or the devolvement of activities from the administration to the local self-government) should draw up a document in which the basic elements of decentralization must be defined (objectives, methods and manner of implementation, concrete tasks with those responsible and the deadlines, and criteria for

performance measurement, that is, the attainment of the objectives of decentralization). These documents (as proposed by the line ministries) should be adopted by the Government of the Republic of Croatia, after which they will become an accompanying implementation act going alongside the development strategy of the Republic of Croatia.

Secondly, monitoring of the decentralization process and coordination of the activities of the line ministries should be confided to a special coordinator. This should be a person with a broad field of knowledge and experience, on the basis of which this person would take part actively in the implementation of decentralization in individual administrative fields and would at the same time unite and coordinate the activities of different operators in the process, including all the projects that are carried out in association with the bodies of state administration, or even independently of them.

It is not necessary to set up any new organizational unit for these operations; rather, the coordinator should be brought into the Strategy office or should have a direct link to the member of the inner cabinet of the Government charged with handling decentralization.

Thirdly, additional training of civil servants should be an on-going activity and an obligation upon state bodies (that they are obliged to make possible) as well as upon the actual civil servants (who should be obliged to undertake it as a condition for the performance of certain activities).

Fourthly, the implementation of each individual decentralizing measure should be well prepared in every manner possible: holding seminars, issuing brochures, providing access to information and instructions and so on. This will achieve several aims: settled solutions suit the needs of practice better, the operators are trained in advance to be qualified to carry out the tasks, political support is provided by the measures passed.

Fifthly, in order to make local structures qualified to carry out an increasing number of ever more complex operations, it is necessary to step up collaboration with NGOs that can carry out this perhaps crucial assignment. These organizations should be advised to draw up independent analyses of the impact of the measures of decentralization carried out in order to spot and remove difficulties and obstacles, and allow for any possible adjustments in the implementation of it.

Sixthly, special attention must be devoted to the areas of the Republic of Croatia that are, objectively speaking, incapable of carrying out their tasks (areas of special national interest, the islands and so on). It is

necessary to plan special measures for units in these areas to enable them to function independently for a certain period and, as far as possible, to fulfill the obligations that derive from their sphere of competence as independently as they can. If the objectives are not achieved by these measures in the planned period, this will be an unerring indicator of the need to undertake organizational changes in the territorial system.

These indicators are surely not the only that could be given and through which it is possible to ensure the successful implementation of the decentralization process and the achievement of the results that are expected from it.

For this reason it is necessary to go on involving as many operators as possible (organizations and individuals) in the process, who will be able to make this process easier and faster with their knowledge and experience, both from the administration (in the broadest sense) and from civil society.

Reform of the system towards decentralization is a politically very sensitive process, of a very complex nature. For this reason the capacity of the operators who are required to put it through is very important.

The Croatian administration is capable of carrying out this reform, but in order to be able to go through the task with complete success, it has to be able to recognize and identify the limitations and obstacles that will meet it on the way, and find adequate ways of surmounting them. Only in this way will all the objectives put forward by decentralization be achieved.

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# Economic Arguments for Fiscal Decentralization —The Experience of Other Countries and Options for Slovenia

Stanka Setnikar-Cankar

University of Ljubljana, School of Public Administration

## Summary

*An important dimension of the public sector reform is the distribution of authority and financial resources for public services among different levels of government. Taking into account the theory of public choice and the data from six West-European countries, we attempted to discover whether population density and revenue in a country affect its degree of centralization. Unfortunately, the experience of developed countries in Europe cannot serve as a reference and a ground for comparison in seeking an optimum level of centralization of the provision and financing of public services in Slovenia. On the other hand, the development of “excessive centralization” requires redress in favor of decentralization for a number of reasons.*

**Keywords:** Public sector reform, fiscal and financial decentralization, indicators of centralization, correlation between indicators of centralization and economic indicators, experiences of developed countries

## Introduction

The extensiveness of public finance, unfavorable economic indicators and especially compliance with criteria set by the European Union are pressing demand for a reform of the public sector in Slovenia. The changes in organization and the number of organizational units, their ownership, methods of management, numbers of employees, etc. all affect expenditure for this purpose. The coming years will be of key importance for Slovenia for defining how to complete economic reforms, for investment promotion and creation of new jobs and rationalization of the social state through fiscal spending.

An important dimension of the reform that attracts special attention in most countries has been public finance and the introduction of economic criteria to public sector operations.

The starting point for the economic dimension of the public sector reform is the assumption that

the performance and competitiveness of the national economy is being eroded by the bureaucratic nature of the public sector. On the one hand, the growing competitiveness requires closer supervision over public sector operations to reduce the load on the economy and encourage rational use of budget resources, and on the other hand greater public sector autonomy in order to increase its performance and quality.

Until recently it was still possible to defer fundamental reform in favor of economic priorities, but this is no longer the case as the underdevelopment of the state and its institutions is hindering further development (Setnikar-Cankar, Berlogar, 2001). Today, the state is Slovenia’s largest entrepreneur and, as with any enterprise, it cannot function without a good administrative apparatus. There is a widespread belief that Slovenian public administration is not up to scratch, as it is still insufficiently creative, and takes orders without thinking for itself. As in a democracy people are usually not forced into changes, leaders must be capable, enterprising, charismatic and mature persons. It is a fallacy to believe all can be achieved through acts and regulations (Bučar, 1998: 4–9).

Therefore, an important dimension of public sector reform is the distribution of authority and financial resources for public service provision between different levels of government.

The experience of certain developed countries that launched similar reforms ten years ago is interesting (Public Management Reforms, 1997).

Characteristic of changes to public sector *modus operandi* are increasing decentralization and operational autonomy coupled with the centralized setting of strategic goals and operational standards. The new rules in public sector operations require a definition of working standards determining the extent, quality and accessibility of services, methods for measuring results and setting up mechanisms for influencing service beneficiaries.



Evaluations (Public Services Go to the Market, 1995) in Finland show a growing demand for services and an increase in the number of beneficiaries, increased financial independence, higher level of competitiveness, a more flexible employment policy, greater variety in services, looser state supervision and management, improved quality of services and greater beneficiary satisfaction.

The Ministry of Finance was the central institution responsible for the reform of public management that started in 1987, although the Ministry of the Interior, through its responsibility for the local government, was also involved.

The basic elements of financial-managerial reform in Finland have been based on fiscal financing that takes into account the results, the “corporatization” of public companies (in 1996, 24 organizations were changed into state companies that are very successful—the post office, state publishing center), evaluation as an important management tool in the state sector, changing employment policies with the decentralization of responsibilities, and pay linked to productivity.

In the Netherlands there was a general consensus on decentralization and changes of government organizations into smaller ministries along with greater budget transparency, and there were no great debates in the parliament or media. Instead, there was a vigorous professional debate on the reforms in academic circles.

The question is what would be the optimum level of centralization or decentralization, given the size of economy, growing inequalities due to economic development, effective use of relatively rare resources, accessibility of services and their volume and quality.

One of the advantages of development in Slovenia in the seventies and eighties was that it was relatively evenly spread. Although certain areas had the status of less developed regions, this opened up possibilities of additional resources for stimulating investment in the economy and infrastructure. Developed urban centers and the countryside were almost equal and any deviation was kept within acceptable limits. Today’s development favors certain centers and certain urban areas. The centralization of economic development goes hand in hand with the centralization of economic and political power. The concentration of capital, jobs and economic and political power results in great upheavals within society, between social groups and between the center and other parts of the country. Dissatisfaction and negative attitude to everything that is connected with decisions adopted by the center produce unwanted

effects. Poor mutual relations and mistrust have prevented constructive dialogue, and decisions that should be made professionally are immediately proclaimed central or political. Fear of centralization exists in areas far from the center and is partly justified.

The question is why there is such a widespread belief that the state or central authority is a worse manager than lower-level organizational units. This conviction is not just characteristic of Slovenia but is present to a certain degree in most countries determined to reduce centralization.

The question remains whether the differences depend on objective indicators such as the size of a country, its population, level of development and per capita income. If there is a link between the level of centralization and the stated indicators, we can use these findings to establish an optimum financial policy and service provision for a particular country. Taking into account the theory of public choice and data from six West-European countries, we attempted to find out whether population density and revenue in a country affect its degree of centralization.

In such a way we could look for an appropriate level of centralization or decentralization for Slovenia based on its size, relative population density, level of development and per capita income.

### **Fiscal and Financial Decentralization**

An important dimension of public sector reform is therefore the distribution of authority and financial resources for public service provision between different levels. In the seventies and eighties the state became predominant in most countries in Western Europe as it retained most of the revenue and provided most of the services. Limitation of the financial autonomy of local communities resulted in their heavier dependence on funding from the state budget and a stronger political dependence on the state. The development of “excessive centralism” must be redressed by decentralization for a number of reasons (Oates, 1972: 11–12):

1. Fiscal decentralization should lead to a more effective utilization of resources in the society. Where groups of voters wish different levels and quality of public services at the local level, centralized allocation of funds for specific purposes causes inefficiencies.
2. Decentralization can increase the legitimacy of local authority that can better take into account voters’ wishes.



3. Organizational theory defines the optimum levels of management and control. Centralization can increase the costs of administrative supervision and reduce the effectiveness of central government policies.
4. Decentralization can reduce the state budget deficit where local communities acquire the competence for certain services but not financial resources.

Whilst excessive centralization sooner or later leads to demands for change towards decentralization, effective economic policies require an opposite tendency, to transfer competence to a higher level. Central government wishes to have a dominant role in the economic field due to external pressures caused by global competition. The internal mobility of goods, services, manufacturing and population can force the government into reducing internal decentralization.

The reform of public administration as a change in the distribution of authority among various levels exists due to opposite tendencies that differ between countries. The question is what would be the optimum level of centralization or decentralization, given the size of the economy, growing inequalities due to economic development, effective use of relatively limited resources, accessibility of services and their volume and quality.

Resistance to centralism is one of the many arguments used to account for the establishment of new municipalities in Slovenia. The existing 192 municipalities and many lower-level communities wishing to be municipalities reflect the negative experience with centralism. Although there are certainly other reasons, one cannot ignore the population's allergy to all that brings economic or political centralization. It is not right to criticize people's wishes to have their own municipalities, even if this incurs additional expense for its management. Expected advantages greatly outweigh the negative effects. People expect the new municipalities to better satisfy their needs with funding from various sources. It is difficult to say whether these expectations are justified or not. Analyses of expenditure for specific needs per person in certain new municipalities have shown that expectations are being realized (Devjak, 2001).

The question is whether the experience of developed European countries can serve for reference and comparison purposes in seeking an optimum level of centralization in providing and financing public services in Slovenia and other transition countries.

### Levels of Centralization

Wallis and Oates (1988, 6–7) used two indicators of public sector centralization:

1. the share of state spending in the total state and local government spending, and
2. the share of state revenue in the total state and local government revenue.

These indicators can be used by countries at two levels: a) the federal or central government level and b) the local government level. Federal countries have three levels of government: federal or central, state or Länder and local. When countries are compared with respect to the centralization or decentralization criteria, the first level (federal or central government) is considered and combined with the second and third levels (state and local government). The term local government takes into account all levels below the central government level (OECD, 1999).

As we are interested in the long-term orientation of developed Western European countries in financing national and local consumption, we looked at data over a lengthy period of time. We considered data from six countries over 40 years from 1950 to 1990 (Steunenberg and Mol, 1997). Further studies took into account data for a larger number of countries over the period from 1980 to 1996 (OECD, 1999).

The study was concerned with the development of relationships between the state and local communities in six countries of Western Europe during the period from 1950 to 1990.

The indicators show a dependence of local communities on the state in providing public services and their funding (Table 1).

The data show West Germany to have the lowest share in state expenditure over the last 40 years that decreased from 49% to 43%. Closest to this are the Netherlands with an average percentage of state expenditure of 64%. Great Britain, Ireland and France had shares from 72% to 77%. The highest percentage in the 1950-1990 period was that of Belgium, standing at almost 82%.

These differences between countries need to be approached with some care, as they also depend on the extent to which data are comparable between countries.

Comparing the data over a 40 year-period provides an insight into some particularly interesting dynamics in two countries—West Germany and Belgium. Among all the

*Table 1. State Expenditure as the Average Percentage of the Total Expenditure of the State and Local Governments in the Selected Countries, 1950–1990*

Country	1950–1959	1960–1969	1970–1979	1980–1989	1950–1990
West Germany	49.0	46.0	42.9	43.8	45.4
Netherlands	63.0	63.3	66.4	64.2	64.3
Great Britain	76.1	70.4	67.5	73.0	71.8
Ireland	71.6	71.4	71.4	74.1	72.3
France	—	79.1	76.4	76.0	77.0
Belgium	79.9	80.2	82.4	84.1	81.7

Source: Steunenberg and Mol, 1997: 238.

*Table 2. State Tax as the Average Percentage of the Total State and Local Government Tax in the Selected Countries, 1950–1990*

Country	1950–1959	1960–1969	1970–1979	1980–1989	1950–1990
West Germany	58.9	55.9	52.7	51.5	54.7
France	84.9	90.5	88.4	85.6	87.7
Great Britain	90.0	87.0	87.3	86.9	87.8
Ireland	83.1	86.4	91.3	97.1	91.1
Belgium	95.3	93.8	93.4	93.0	93.9
Netherlands	95.4	97.1	97.2	96.0	96.4

Source: Steunenberg and Mol, 1997: 238.

countries considered West Germany had the lowest level of centralization at the start of the observed period (49% from 1950 to 1959), which further decreased (to 43.8% from 1980 to 1989). At the same time, Belgium was the country showing the highest level of centralization in the observed period, which further increased from 79.9% to 84.1%. This is a very significant finding that can affect the explanation of the correlation established. The selected countries did not change their direction of development within the selected area irrespective of the movement of other economic indicators.

The second indicator of centralization was of the state tax as a percentage of the total state and local authority taxes over the same period. Tax revenues are based on the revenues from direct and indirect taxation (Table 2).

The indicator of tax centralism ranked the countries differently than the indicator of public service centralism. The exception was West Germany, with an approximate state tax rate of 55%, which was also the lowest rate. The Netherlands had the highest state tax rate of 96%,

then followed Belgium and Ireland (over 90%) and Great Britain and France with around 87%.

The difference in ranking was accounted for by the relatively high local government expenditure (46% on average) that was not financed from locally levied taxes but by state transfers.

The other important finding in comparing the tables was the different direction towards or away from centralization. In Ireland, for example, both the share of state expenditure and that of state taxes rose. This led to increased centralization. Belgium is an example of a country whose percentage of state expenditure increased and where there was greater independence in tax collection at local level.

We are aware that there are deficiencies in comparing Tables 1 and 2. The first table shows the expenditure and the second tax revenues. Non-tax revenues represent a more important source of income for local communities than for the state. Considering only tax revenues can affect the level of centralization, so in Table 3 we show countries with respect to total revenues for 1980 and

Table 3. Revenues Received by General Government as % of Total Revenues

	Tax revenue [%]		Non-tax revenue [%]	
	1980	1996	1980	1996
<b>FEDERAL COUNTRIES</b>				
Belgium	94.7	96.2	5.3	3.8
Germany	86.7	83.8	13.3	16.2
<b>UNITARY COUNTRIES</b>				
France	90.7	90.8	9.3	9.2
Ireland	83.7	78.5	16.3	21.5
Great Britain	82.0	88.0	18.0	12.0
Netherlands	85.8	86.4	14.2	13.6
<b>UNITARY COUNTRIES IN TRANSITION</b>				
Czech Republic	—	91.4	—	8.8
Hungary	—	81.8	—	18.2
Poland	—	86.4	—	13.6
Slovenia	—	95.4	—	4.6

Source: OECD, 1999: 275; Ministry of Finance, 2002.

1996 (OECD, 1999). In addition to data from the selected countries in tables 1 and 2, we have added data from four EU applicant countries—the Czech Republic, Hungary, Poland and Slovenia. We broke the countries into three groups—federal, unitary countries and unitary countries in transition (Table 3).

All the three groups of countries indicate exceptional shares in tax revenues (maximum 96,2%, minimum 78,5%) as compared to non-tax revenues. We believe this has only a limited impact on centralization and cannot change conclusions reached on the basis of tax revenues only. Data from 1980 and 1996 show only these to have changed direction in the selected countries.

We could say that there are significant differences between the countries compared and that there is no uniform behavior. The question still remains whether these differences are objective, such as the size of a country, its population, level of development and per capita income. If there is a link between the level of centralization and the stated indicators, we can use these findings to establish an optimum financial policy and service provision for a particular country.

A correlation for the selected six typical countries over the period from 1950 to 1990 was established by Steunenberg and Mol. We assume that their findings can be used to answer the question which direction Western European countries in transition should take. In such a way we could try to establish a suitable level of

centralization or decentralization for Slovenia based on its size, relative population density, level of development and per capita income.

### Size and Population

There was an expectation that larger countries (by area and population) were less centralized in the public sector. In larger countries with heterogeneous populations, differences in levels of development, natural conditions, etc., there was a transfer of competence to local levels for the purpose of adaptation to specific conditions and thus for better satisfaction of citizens' needs. Steunenberg and Mol took the size and population in one indicator as the population per square kilometer and found its connection to the level of centralization. It is expected that a higher population density will be associated with a less centralized public sector.

The data showed that the increase in population from 1950 to 1990 had a positive effect on decentralization of funding and public service provision *only in West Germany and France*, whereas in other countries there was a growth in centralization (Steunenberg and Mol, 1997: 245). The population density hypothesis appears to be inadequate in explaining the different developments in relations between central and local governments.

Looking at the data for the six countries, it was impossible to establish a rule that for a small country, such as Slovenia, we take into account its absolute and relative size for a more favorable level of centralization.

### Income and Welfare

The second possible explanation for the level of centralization is based on the level of income as an indicator of development and welfare. Steunenberg and Mol assumed that a growth in income would lead to a higher level of centralization. A primary distribution of income causes greater differences between social groups, so the state must redistribute income and transfer assistance to lower-income group. An additional reason for a higher level of centralization would be the uneven economic development in various regions and sectors causing an increase in differences that should as a rule increase state intervention. The assumption was that the effect of higher per capita incomes would also raise the level of centralization in the public sector. Income is measured in terms of gross domestic product (GDP).

We are aware of the problems associated with the hypothesis, as various empirical studies emphasize the positive correlation between fiscal decentralization and economic growth measured with the selected indicators. It would be more reasonable to expect a positive correlation between the level of development and decentralization, although this is also questionable. The question is posed as to whether the causes and effects of changes in levels of economic development are reflected in the levels of decentralization. We assume that there will be a relative progress in decentralization.

In spite of this open question, we can agree with the hypothesis of the authors that the correlation is negative. Income redistribution is primarily regarded as a task of the central government.

The results of comparing the selected countries over the period from 1950 to 1990 show that a rise in per capita GDP does not statistically affect the level of centralization. In other words, the function of redistribution of income cannot explain differences in levels of centralization in the selected countries. The expected positive effect was only found to exist in

Belgium, whereas a growth in income in other countries only led to greater decentralization, making the effect statistically unreliable. For France and Germany, which experienced a decline in the degree of centralization, negative coefficients have been observed (Steunenberg and Mol, 1997). The redistribution hypothesis is not able to explain the differences between countries.

On the basis of this we cannot say that a higher level of centralization could be expected in Slovenia with a growth in per capita income.

### Recent Situation in Slovenia

The level of centralization of public service provision in Slovenia is shown by data in table 4 collected from 1995 to 2001.

A comparison with the data in Table 1 for selected European countries shows that during the period from 1995 to 2001 Slovenia had a higher level of centralization than any of the countries during the period from 1950 to 1990.

Public service provision at the local level in Slovenia is primarily the result of the local government reform (Setnikar-Cankar, Vljaj and Klun, 2000).

### Reform of Local Self-government in Slovenia

The reform of local self-government has fundamentally changed the image of public administration in Slovenia. The reforms were divided into four categories:

- financial: a new definition of financial sources;
- organizational: the establishment of a representative body and the office of mayor;
- functional: definition of a newly established municipality's duties;
- territorial: the reduction in the size of regions to reach the optimum conditions for efficient administration of local public matters.

Table 4. Local and State Expenditure as a Percentage of Total State and Local Expenditure, 1995–2001

	1995	1996	1997	1998	1999	2000	2001 (temp.data)
Local expenditure as % of GDP	4.7	4.9	4.8	5.0	5.1	5.3	5.3
Local expenditure as % of total state and local expenditure	17.3	17.3	16.0	16.1	16.3	17.3	15.2
State expenditure as % of total state and local expenditure	82.7	82.7	84.0	83.9	83.7	82.8	84.8

Source: Ministry of Finance, 2002.

## Structure of Local Authorities

Table 5. Municipalities in Slovenia in 2002

Inhabitants	Municipalities
less than 1,000	6
1,001–5,000	90
5,001–10,000	42
10,001–50,000	51
50,001–100,000	1
100,001–500,000	2
Over 500,000	0
Total	192*

Source: Horvath, 2000.

\* 11 of which are urban municipalities

The scope of duties and functions performed by a municipality includes local matters that affect only the people in that municipality, as determined by the municipality itself. The State may delegate by statute such duties and functions as fall within its authority, to municipalities or wider self-governing local-government bodies, subject to their prior consent, and to the provision of the necessary means for the performance of such duties and functions.

### Finance

The Constitution provides that the municipality shall raise its own revenue. Those municipalities, which, due to a lower level of economic development, are unable to cover all expenditures arising from the performance of their duties, shall be entitled to additional financial assistance from the State.

### Taxes

The types of taxes local communities have at their disposal are defined in the Law on the Financing of Local Government. Taxes listed at the communities' disposal are: gift and inheritance tax, gambling tax, tax on the use of goods, and property tax.

### Grants from Higher Administrations

The Ministry of Finance transfers current monthly installments of the funds allocated to local governments on the basis of projections of guaranteed spending. These current transfers are intended for the financing of current expenditures and investments.

Special grants are transferred by individual ministries for a wide range of specific investment projects such as demographically endangered regions, municipal

services, gasworks, heating plants, the construction of waste water, purification plants and other similar services, the construction of waterworks, municipal waste sites and so on. Each year applications for any such funding must be filed before set deadlines.

The Ministry of Finance is working on a new law regulating taxation of property; significant financial effects will not be seen until this law has been passed.

The state does not exercise any control over the local level units in the field of finances. The state has set up auditing services, which may be used to control the use of budgeted funds by the local communities.

### Open Questions

There are still some open questions regarding the necessary functional and structural changes of local administrative systems:

- a) Additional Development of the Local Self-Government System:
  - development of its structure;
  - defining the functions and mode of operation;
  - establishing the regions as a second tier of local self-government;
  - financing local self-government;
- b) Relations between the Central Government and Local Self-Governments:
  - clear division of competencies, tasks and responsibilities between the central government and local self-governments;
  - delegation of state tasks to the local self-governments (so-called "transmitted tasks");
  - development of control mechanisms at the state level to measure the performance of local self-governments;
  - design of legal and institutional frameworks, to clearly define the influence of the central government on local self-governments and protect them against unfair state intervention.

### Applicability of the Experience of Other Countries to Slovenia

A comparison of percentages of expenditure and tax revenue in the selected countries during the period from 1950 to 1990 shows that all countries had a higher percentage of state tax than of state expenditure. This leads us to the conclusion that local units were dependent on transfers from the state for funding local services. In other words, as local expenditure grew faster than tax



collection at the local level, the deficits in local budgets were financed by a faster growth in state transfers for local needs.

We may conclude that changes in public expenditure and taxation are linked to the level of centralization. Public expenditure at the local level is financed through changes in tax revenue and state transfers. Local communities primarily rely on property tax revenues, whereas the state has a monopoly over income tax. Consequently, the growth of state revenue is positively linked to the growth of GDP and income. However, the percentage of revenue used at the state or local level does not depend on economic criteria as shown, but apparently on political choice. Governments giving priority to social criteria and equality will intercede in favor of a higher level of centralism and vice versa.

### Final Conclusions

How does the described experience and findings from developed countries benefit Slovenia in its project of public administration reform?

Slovenia is confronted with a paradox in budgetary expenditure, i.e. the share of the public sector in GDP. On the one hand, there is a deficit in budget resources, i.e. the revenue, owing to a decline in certain revenues linked to the process of accession to the European Union. On the other hand, there are factors linked to the process of ownership transformation in the economy, economic restructuring, denationalization, introducing market criteria into practically every area of society, new obligations due to adapting to the European Union (e.g. additional employment) that make new demands on budgetary resources. A high level of unemployment, a disproportionate number of pensioners compared to the actively employed, inequality in the access to certain public sector services, a growing inequality of development among local communities, etc. make increased demands on the budget in the form of financial assistance, compensation and investment. At the same time, there are measures that are the result of political decisions requiring a higher level of centralization in the area of public services.

Introducing market criteria in the economy, opening of markets, confrontation with foreign competition on the world market and the urgency of reducing production costs all require a reduction in public expenditure, stimulation of the growth of gross domestic product, a reduction in the budget deficit and maximizing rationality in spending budgetary funds.

Experience to date shows that it is very difficult to reduce the existing power and influence of central authorities. Typical examples are the debates on the introduction of regions in Slovenia that are allowed under the act on local government but not required by it. Their establishment is only valid if the state will transfer a part of its authority to them.

Naturally, programs clearly distinguish between operative decentralization with simultaneous centralization of goals and criteria, and political power.

The implementation of the public administration reform project will show whether the power centers and lower organizational units are prepared for the reform in Slovenia. Experience shows that it is not possible to introduce new methods of management without an appropriate level of decentralization. Maintenance of the increase in centralization is a sign of an "administrative-bureaucratic culture". Decentralization requires a new management policy that includes evaluation of results, elements of a market system and user orientation.

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**Part II.**  
**The Financing of Local Government  
and Self-Government**

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# Local Self-Government Financing

Dubravka Jurlina Alibegović

*Institute of Economics, Zagreb*

## Summary

*This paper presents the main results of the Local Self-Government Financing Research that was conducted within the project called Decentralization of Public Administration. The project development was coordinated by the Croatian Law Center.*

*The main purpose of the project was a reform of the local self-government system in Croatia, in order to satisfy the needs of citizens at the local government level in a more efficient and cost-effective way, and to adjust the local self-government systems to European efficiency standards.*

*This paper aims to draft a model of local government financing by proposing a change in the current method of financing, and to make a proposal for a dynamic model of decentralized financing based on the results and conclusions of the analysis.*

*To achieve the main purpose, the current status of the local and regional self-governments is analyzed, a method of analyzing the model of local and regional self-government financing is determined and a comparison is made between the current local self-government system in Croatia and that in other countries.*

*Two main objectives and a number of sub-objectives are set and the measures for their realization are described.*

*This paper is an abbreviated version of a document that resulted from a two-year cooperation of a group of experts on the project called Decentralization of Public Administration<sup>1</sup>.*

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<sup>1</sup> The following team of experts worked on the project Local Self-Government Financing: Emira Bečić, M.A., Ministry of Science and Technology; Jelena Šišinački, M.A., Institute of Economics, Zagreb; Zdravko Petak, Ph.D., Faculty of Political Science, University of Zagreb; Marija Zuber, M.A., Računovodstvo i financije (magazine), Zagreb; Hrvoje Arbutina, Faculty of Law, University of Zagreb; and Prof. Olivera Lončarić Horvat, Ph.D., Faculty of Law, University of Zagreb. The head and coordinator of the local self-government financing team was Dubravka Jurlina Alibegović, M.Sc., Institute of Economics, Zagreb.

**Key Words:** local and regional self-governments, local budgets, model of financing, decentralization

## Introduction

This paper explores the issue of local self-government financing in Croatia. Although the process of decentralization of authority and financing has already started in the Republic of Croatia, this paper points out the fact that the system of financing is actually centralized. As such a system does not provide municipalities and cities with an appropriate level of authority to provide and finance public services to the local population, a higher level of decentralization in financing the local and regional self-government units is expected in the future.

Given the mainly different levels of development of local and regional self-government units, it is necessary to develop such models of financing that can satisfy the needs of the local population and help to harmonize their standards of living. In other words, it is necessary to reach the highest possible level of fiscal decentralization, which is only possible if local units have enough own sources of financing to provide all public services that come within their fields of activity.

The main goal of this paper is to develop a draft model of financing by proposing a change in the current method of financing local and regional self-government units, and to make a proposal for a dynamic model of decentralized financing based on the results and conclusions of the analysis.

A strong impediment to the research work has been the fact that the Ministry of Finance still has not processed data on the execution of the 2001 budgets of the local and regional self-government units, which is why the impacts of the started decentralization process cannot be analyzed. When the processed data for 2001 and, subsequently, for 2002 are available, it will be possible to draw the relevant conclusions about the progress of the planned decentralization process, its limitations, potential drawbacks and prospects.

The paper consists of several parts. The introduction is followed by a presentation of the concept of decentralization of local self-government financing, and its main advantages. The reasons for starting the decentralization process are explained along with a brief description of the local and regional self-government system in Croatia. In addition, an explanation and definition of the method of analyzing the model of the local and regional self-government financing is provided.

Part three contains the analysis of the current model of the local and regional self-government financing in Croatia. Part four provides a more detailed analysis of local budgets, including the analysis of local budget revenues and the structure of local budget expenditures, the analysis of the local units' fiscal capacities and a brief analysis of the system of grants.

A separate part of the paper gives an overview of the objectives and sub-objectives together with the measures for their realization. The last part presents the main conclusions and recommendations.

#### Decentralization of the Local Self-Government Financing

A strong trend towards government decentralization has been perceived all over the world, while decentralization can be simply defined as a transfer of political power and influence from a higher level of government (central government) to lower levels of government (local and regional governments). Despite the differences in the progress of decentralization among countries, what they all have in common is that the need for decentralization results from the need for a more efficient public sector. Various local interests and needs for public goods and services can be best satisfied through decentralized decision-making on the functions and public services provided by individual (especially local) levels of government.

A country may derive a lot of benefits from the decentralization of its government functions. One of the important benefits is improved efficiency in the provision of public services, since the local government has a better insight into the local population's needs for public services. A decentralized provision of public services satisfies the users of services who have benefited from the services and who, in the end, paid for them.

Decentralization can help in achieving a number of other goals, the most important among them being a reduced share of the public sector in the overall economy, mobilization of public revenue accompanied by a reduction in the cost of public services, linking the responsibilities for local public outlays with the

disposable financial resources, increasing the local government's own revenues and encouraging cooperation between different levels of fiscal government in the provision of public services.

Croatia can be ranked as a highly centralized country on the basis of two indicators: the share of revenue and expenditure of municipalities, cities and counties in the total revenue and grants of the consolidated central government (Table 1); and the share of revenue and expenditure of the local and regional self-government in GDP.

*Table 1. Revenues and Expenditures of Municipalities, Cities and Counties as a Share of Total Revenue and Grants of the Consolidated Central Government [%]*

	1995	1996	1997	1998	1999
Revenue	9.20	11.30	11.60	10.80	10.32
Expenditure	8.60	11.20	11.40	11.60	10.57

Source: Ministry of Finance of the Republic of Croatia, 2002..

The percentage of revenue and expenditure of the local and regional levels of fiscal government in the Republic of Croatia is relatively low, in that the revenue of the local self-government accounted for 9.20% of total revenue and grants of the consolidated central government in 1995, 11.30% in 1996, 11.60% in 1997, 10.80% in 1998 and 10.32% in 1999.

The share of the lower levels of fiscal government's spending in GDP, which is another indicator of the importance of local government in the overall economy, is also low. Thus, total expenditure of local self-government in the period from 1995 to 1999 ranged from 4.2% to 5.7% of GDP, which suggests that, by international standards, Croatia is a highly centralized country.

One of the main tasks of the government of the Republic of Croatia is to reduce and rationalize the central government budget expenditure as well as the expenditure of the consolidated central government. At the same time, Croatia has embarked on the program of decentralization of certain public functions, which is expected to result in the decentralization of certain administrative and professional operations, i.e. their devolution by the ministries to the local and regional self-government units.

This was the basis for developing a model of decentralization of a part of public services in the area of education, health care and social welfare. According to

the model, outlays for gross wages and contributions on wages in primary and high school education, as well as a part of health care services and social welfare are covered by the state budget; while material costs, investment maintenance costs and capital investment costs are devolved to local and regional self-government units.

The above described activities marked the beginning of the first stage of decentralization of administration and financing of a part of public needs in July 2001, accompanied by revenue sharing between the central government and local and regional levels of government, in order to cover the shortfall in funds to finance these needs. It is expected that a comprehensive reform aimed at decentralization of responsibilities and financing of public needs at the central government level and lower levels of fiscal government will continue in the following fiscal years. Within this framework, the activities, responsibilities and financing for a part of public functions (e.g. primary, high school and, partly, university education, health care and social welfare) will be gradually devolved by the central government to the local and regional self-government, parallel to the transfer of budget revenues.

#### *Local and Regional Self-Government in Croatia*

Local and regional self-government in the Republic of Croatia is regulated by a number of statutory provisions. Apart from the Constitution of the Republic of Croatia, these issues are regulated by 23 legal acts, four rulebooks, one decree, five decisions, two enactments and the European Charter of Local Self-Government. According to the stated regulations, as of December 2001, the Republic of Croatia included 424 municipalities, 122 cities, 20 counties and the City of Zagreb, which has the status of both a county and a city.

In order to understand the problems of the local and regional self-government it is worth mentioning that, according to the 2001 census, Croatia had 4,381,352 inhabitants. The City of Zagreb numbered 770,058 inhabitants, or 17.16% of the total Croatian population. This means that 3,611,294 inhabitants or 82.42% of the total population (excluding the inhabitants of Zagreb) live in the remaining Croatian territory. The total number of persons living in cities (including Zagreb) is 3,030,002 or 69.16%. The urban population (excluding Zagreb) accounts for 2,259,944 or 51.58% of the total population. Municipalities account for 1,351,350 or 30.84% of the total population. A considerable number of citizens, i.e. 871,390 or 19.89% of the total Croatian population, live in municipalities and cities in the areas of special government concern.

Given the above mentioned figures on the population in municipalities, cities, the City of Zagreb and the municipalities and cities in the areas of special government concern, it is worth noting that the main task of the local self-government units is to improve the standard of living for all their citizens and to look for necessary sources of financing to ensure regular performance of the functions of local and regional self-government units. Of course, this applies to all local and regional self-government units.

The scope of activity of cities and municipalities includes the following:

- urban development and housing;
- physical and urban planning;
- municipal services;
- child care services;
- social welfare;
- primary health care;
- education and primary education;
- culture and sports;
- consumer protection;
- environmental protection and development;
- firefighting and civil defense.

A county is responsible for performing the operations of regional significance and providing for a balanced development of municipalities and cities within its territory and the county as a whole, particularly operations related to:

- education;
- health care;
- physical and urban planning;
- economic development;
- transport and transport infrastructure;
- planning and development of the network of educational, health care, social and cultural institutions.

#### **Local and Regional Self-Government Financing**

*The Law on Financing Local and Regional Self-Government Units* (N.N., Nos. 117/93, 69/97, 33/00, 73/00, 127/00, 59/01, 107/01 and 117/01) regulates the sources of funds and methods of financing the functions

of municipalities, cities and counties, types of taxes, tax sharing among different levels of government, tax bases, taxpayers, tax rates and the calculation and manner of tax payment.

Units of local and regional self-government derive their revenues from:

- own sources (revenues from own assets, county, city and municipal taxes, fines, fees and charges);
- tax sharing (sharing of income tax, profit tax and real property transaction tax);
- grants from the state and county budgets;
- fiscal equalization grants to finance decentralized functions;
- revenue sharing (revenues from contracted annual charges for concessions to pump mineral and thermal water and to use water for public water supply).

#### *Changes in the System of Financing*

A series of decisions and decrees enacted in early July 2001 marked the beginning of the first stage of the decentralization process in Croatia aimed at devolving the management and financing a part of public services on municipalities and cities, parallel with the transfer of funds for the financing of these services. Table 2 gives a comparison between the old and the new method of revenue collection in municipalities, cities and counties, showing the effort to increase decentralization of responsibilities and sources of financing for decentralized functions devolved on lower levels of fiscal government.

The change in the sources of revenue of municipalities and cities is seen in the option to introduce new municipal and city taxes, as well as surtax on income tax payable at various rates, depending on the type of local unit (municipality, town, city or the City of Zagreb).

Tax sharing between the state and local government has also undergone changes. Individual levels of government (the central government, counties, municipalities and cities) are entitled to tax sharing in the percentages regulated by law, where tax sharing includes:

- income tax, shared among the government, municipality, city and county;
- profit tax, shared among the government, municipality, city and county;
- real property transaction tax, shared among the state, municipality and city.

The largest changes in the system of local and regional self-government financing were introduced in income tax sharing to the benefit of lower levels of fiscal government. The share of the state in income tax revenue decreased while the share of municipalities, cities and counties went up. A part of the income tax has been allocated for the financing of decentralized functions in primary and secondary education, social welfare and health care. Meanwhile, the local self-government units, which cannot provide enough funds to finance their decentralized functions, are entitled to a share in income tax in the form of equalization grants for decentralized functions.

The sharing of other revenues, i.e. profit tax and real property transaction tax revenues of local self-government units remained unchanged.

The revenues shared among the state, municipalities and cities are revenues from contracted annual charges for concessions to pump mineral and thermal water and to use water for public water supply.

Apart from the above mentioned tax revenues, local self-government units also have numerous other revenues derived pursuant to special laws and/or decisions made by representative bodies, i.e. charges and fees declared in their respective budgets as non-tax revenues.

The purpose of these changes in the system of local and regional self-government financing has been a devolution of authority, an increase in the level of responsibility and enhancing the scope of public services provided at the local level of government, parallel with the allocation of funds for their financing. As the Ministry of Finance currently has no processed data on the execution of local budgets for 2001 and 2002, it is difficult to weigh the impact of the first stage of decentralization in Croatia. This means that it is still unknown to what extent the goals of devolution of authority and decentralization of the financing of public services in education, health care and social welfare have been realized in municipalities, cities and counties together, as well as in each particular city or county that has assumed the decentralized functions in the area of education. Furthermore, it is impossible to establish whether the cities and counties have properly performed all decentralized functions devolved to them and whether the allocated funds for their financing have been sufficient (Table 2).

In light of this, it is necessary to address the question of fiscal equalization. Although each local self-government unit is aimed at providing a satisfactory level of public services to its citizens, one should bear in mind



Table 2. Comparison Between the Old and New Ways of Revenue Collection in Municipalities, Cities and Counties

Old sources of revenue (until July 1, 2001)	New sources of revenue (as of July 1, 2001)
<i>1. Municipal and city taxes</i>	
1.1 Consumption tax	1.1 Consumption tax
1.2 Country cottage tax	1.2 Country cottage tax
1.3 Advertisement tax	1.3 Public use area tax
1.4 Firm tax	1.4 Tax on uncultivated farmland
1.5 Public use area tax	1.5 Tax on unused business immovables
	1.6 Tax on unbuilt building site
	1.7 Firm tax
<i>2. Surtax on income tax</i>	
<ul style="list-style-type: none"> <li>– Cities with more than 40,000 inhabitants may impose a surtax on income tax up to 30% of their share in income tax (e.g. up to 7.5% of total tax)</li> <li>– The City of Zagreb may impose a surtax on income tax up to 60% of its share in income tax (e.g. 27.5% of total tax).</li> </ul>	<ul style="list-style-type: none"> <li>– Municipalities may impose a surtax up to the rate of 10%</li> <li>– Cities with less than 30,000 inhabitants may impose a surtax up to the rate of 12%</li> <li>– Cities with more than 30,000 inhabitants may impose a surtax up to the rate of 15%</li> <li>– The City of Zagreb may impose a surtax up to the rate of 30%</li> </ul>
<i>3. Tax sharing</i>	
3.1 Income tax (state 70%, city or municipality 25%, county 5%)	3.1 Income tax (state 29,2%, county 8%, city or municipality 32%)
3.2 Profit tax (state 70%, city or municipality 20%, county 10%)	
3.3 Games of chance tax (state 50%, city or municipality 50%)	3.1.1 Income tax allocation for decentralized functions (9,8%)
3.4 Real property transaction tax (state 40%, city or municipality 60%)	<ul style="list-style-type: none"> <li>– primary education 2,9%</li> <li>– secondary education 2,0%</li> <li>– social welfare 2,0%</li> <li>– social work centers 0,4%</li> <li>– retirement homes 1,6%</li> <li>– health care 2,9%</li> <li>– investment maintenance of institutions owned by counties—2,5%</li> <li>– health care for uninsured persons—0,3%</li> <li>– health care for farmers above the age of 65—0,1%</li> </ul>
	3.1.2 Share of income tax for equalization grants to finance decentralized functions (21%)
	3.2 Profit tax (state 70%, county 10%, city or municipality 20%)
	3.3 Real property transaction tax (state 40%, city or municipality 60%)
	3.4 Sharing of revenues from the concessions:
	<ul style="list-style-type: none"> <li>– to pump mineral or thermal water (state 50%, city or municipality 50%)</li> <li>– to use water for public water supply (state 70%, city or municipality 30%)</li> </ul>

Source: The author's classification.

that a large number of local units do not have enough own revenue to finance these services. The task of the state is to provide for an appropriate fiscal equalization system to cover the shortfall in funds for public services at the local level.

The problem of fiscal equalization within the system is solved by the allocation of a part of income tax for financing the decentralized functions in primary and secondary education, social welfare and health care, while the local self-government units with insufficient funds for financing their assumed decentralized functions are allocated a part of income tax as equalization grants to finance these functions. The equalization grants for financing the decentralized functions are provided from the state budget for covering public outlays in the areas of primary and secondary education, social welfare and health care, devolved on the local and regional self-government units. The method of calculating the amount of equalization grants is regulated by a decree of the Government of the Republic of Croatia.

#### *The Analysis of the Local Self-Government Financing*

A more detailed analysis of the current model of financing local self-government units included a number of activities:

- assessment of the local units' fiscal capacity and determination of indicators on which the analysis would be based;
- assessment of the local units' tax burden (by analyzing their own sources of revenue and revenue per capita in order to determine the real possibilities, if any, that municipalities and cities set/introduce tax rates or new taxes as an additional source of revenue provided for by current national legislation);
- establishing and assessing the financial position of local self-government units (by analyzing the spending of their budgets and the structure of budget expenditures of local self-government units based on a separate analysis of the current status and the trends);
- establishing and assessing the financial position of local units in the areas of special national concern;
- establishing and assessing the financial position of local units on islands;
- analysis and assessment of the relationships in the distribution of revenue at the local government level pursuant to the provisions of the current law

on local self-government financing (special attention should be given to the system of and criteria for the allocation of grants, supports and subsidies to the local self-government units). In addition, the criteria for the relative amount of revenues, i.e. the deviation from the state and/or county average should be examined;

- analysis of the structure of local units' budget expenditures and the activities financed by them;
- analysis and assessment of the fiscal equalization system as a part of the state fiscal system. (From its introduction to the present, the fiscal equalization system has been reduced to mainly transferring funds to the areas of special national concern for the reconstruction of areas devastated by war);
- analysis and assessment of the decentralization system within the state fiscal system based on the solutions provided by the current legislation;
- exploring the possibilities of fiscal authority distribution provided by the current law, according to the fiscal government level and the appropriate distribution of funds;
- empirical analysis and assessment of the impact of financing instruments by comparing the solutions provided by law and the situation in local self-government units.

The analysis of the system status and models of financing the local self-government units in Croatia, as well as the available fiscal statistics resulted in the definition of two groups of indicators:

- the basic indicators of financial position, and
- fiscal capacity indicators.

The basic indicators of financial position used for a current status analysis of the system of financing the local self-government units in the Republic of Croatia are the following:

- current revenue;
- current expenditure;
- current revenue/current expenditure;
- total revenue and grants;
- total revenue excluding grants;
- total expenditure;
- total revenue/total expenditure;

- capital expenditure;
  - population size;
  - current revenue per capita;
  - current expenditure per capita;
  - total revenue including grants, per capita;
  - total revenue excluding grants, per capita;
  - outlays for employees/current revenue.
- municipalities and cities whose revenue per capita is above the county average;
  - municipalities and cities whose revenue per capita is below 75% of the county average;
  - municipalities and cities whose revenue per capita is below 50% of the county average.

Alternatively, the following indicators have also been determined:

- indicators introducing the amounts of grants in the calculation, but excluding the City of Zagreb;
- indicators not including the amounts of grants in the calculation, but excluding the City of Zagreb and cities with more than 40,000 inhabitants.

The fiscal capacity indicators are the following:

- counties whose revenue per capita is above the national average in Croatia in 1999 and 2000;
- counties whose revenue per capita exceeds 75% of the national average in Croatia in 1999 and 2000;
- counties whose revenue per capita is below the national average in Croatia in 1999 and 2000;
- counties whose revenue per capita is below 75% of the national average in Croatia in 1999 and 2000;
- counties whose revenue per capita is below 50% of the national average in Croatia in 1999 and 2000;
- revenue outturns per capita by county at the national level in 1999 and 2000;
- revenue outturns for municipalities and cities by county;

Given the above mentioned basic functions of local self-government units, as well as the legally prescribed sources of financing and the different levels of development of local and regional self-government units, it is necessary to develop such models of financing that can satisfy the needs of the local population and help to harmonize their standards of living.

In other words, it is necessary to reach a maximum level of fiscal decentralization, which is considered as a measure of financial dependence of lower levels of government on the central government. A system is considered fiscally decentralized if a larger amount of fiscal revenues (measured by local units' revenues-to-GDP ratio) remains at the local government level. This can only be achieved if a local unit has sufficient own sources of financing. More specifically, although it is legally prescribed that a local unit's revenue must be proportional to its expenditure, this is not always possible, because local units are obliged by their by-laws (instructions and decrees) to perform functions which are not always sufficiently funded.

## Local Budget Analysis

### *Analysis of the Local Units' Budget Revenues*

The main indicator of the extent and importance of local and regional self-government is the share of the local self-government's revenue in GDP and in the total

*Table 3. Total Revenues and Grants of Local Government Budgets in Croatia, 1998—plan 2001 [%]*

Revenue	1998	1999	2000	Plan for 2001
I Total revenues and grants	100.0	100.0	100.0	100.0
I.A) Total revenue	90.3	92.3	93.8	93.9
I.A) I. Current revenues	85.2	85.7	87.2	85.4
– Tax revenues	55.9	55.2	55.7	51.1
– Non-tax revenues	29.3	30.5	31.5	34.2
I.A) II. Capital revenues	5.1	6.6	6.7	8.6
I.B) Grants	9.7	7.7	6.1	6.0

Source: Government Finance Statistics Yearbook 2001, Washington: IMF.

budget revenue of the state. The share of revenues of local budgets in the revenue of the consolidated general government budget is relatively small. In 1999, local budgets' revenues made up 10.32% in the consolidated general government budget revenue and with 5.42% in GDP. In 2000, the share of local budgets' revenues in the consolidated general government budget revenue and GDP was 11.07% and 5.25%, respectively.

Taken as a whole, current revenues (*tax and non-tax revenues*) have the largest share in the total revenue of municipalities, cities and counties. Thus, they amounted to 85% in the total structure of revenues in 1999, while in 2000 their share reached 87%. Tax revenues accounted for 55% of total revenue in 1999 and grew slightly in 2000 to reach 56%. The share of capital revenues was 7% in both 1999 and 2000. The share of grants declined from 8% in 1999 to 6% in 2000.

The following table shows the structure of total revenues and grants of local government budgets in accordance with the methodology of the International Monetary Fund (Table 3).

The largest share of local units' tax revenues stems from *tax sharing* (sharing of income tax and profit tax), which accounted for about 47% of total revenue in the two observed years (income tax accounted for 35% of the revenue from tax sharing in 1999 and 39% in 2000), while the share of profit tax dropped from 12% in 1999 to 8% in 2000.

The analysis of individual levels of local self-government shows that tax revenues account for the largest share in the structure of budget revenues of cities, representing 60% of their total budget revenues. As concerns county budgets, tax revenues accounted for 57% and 62% of total budget revenues in 1999 and 2000, respectively. However, the share of tax revenues in municipalities exceeded one third of their total budget

revenues, amounting to 31% in 1999 and 34% in 2000. Such an increase in the share of tax revenues can be partly accounted for by the impact of the Law on Areas of Special National Concern and the change in the share of municipalities and cities in income tax (this share rose from 25% in 1999 to 32% in 2000), as well as by the tightening of fiscal discipline.

The share of income tax and surtax on income tax in total revenue of municipalities ranged from 20% in 1999 to 23% in 2000. The share of these taxes in cities was 39% in 1999 and 43% in 2000, while in counties it was 29% in 1999 and 39% in 2000. In the City of Zagreb revenues from income tax and surtax on income tax account for about 50% of the total city revenue.

The share of grants in the total realized revenues of all municipalities, cities and counties was 8% in 1999 and 6% in 2000. They represented a significant source of the county budgets' revenues, accounting for 25% of the total budget revenue in 1999 and 20% in 2000. In municipalities they made up 19% in 1999 and 15% in 2000, while in cities they accounted for as little as 3% of their budget revenue (Table 4).

The studies on local financing use different terms for non-tax revenues. For the purpose of this analysis the term own revenues will be used to cover non-tax revenues and own tax revenues.

*Own tax revenues of local budgets.* According to international standards, tax on real estate comprises revenues from firm tax, country cottage tax and public use area tax. Domestic taxes on goods and services include advertisement tax, consumption tax, tax on motor vehicles, tax on boats, etc. They mainly represent the local budgets' own revenues.

Own tax revenues account for as little as 9% of total tax revenues of cities and municipalities and 14% of total tax revenues of counties. If own tax revenues are

Table 4. Structure of Budget Revenues in Municipalities, Cities and Counties in 1999 and 2000 [%]

Type of revenue	Total		Municipalities		Cities		Counties	
	1999	2000	1999	2000	1999	2000	1999	2000
Total revenues and grants	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total revenues	92.31	93.85	80.55	85.43	96.69	97.45	74.59	79.66
tax revenues	55.19	55.69	31.41	34.09	59.49	59.51	56.86	61.93
non-tax revenues	30.50	31.48	41.29	41.00	30.27	31.37	15.47	16.38
capital revenues	6.62	6.68	7.85	10.34	6.92	6.57	2.26	1.35
Grants	7.69	6.15	19.45	14.57	3.31	2.55	25.41	20.34

Source: Ministry of Finance of the RC, 2002.

added to *non-tax revenues*, mainly consisting of fees and charges for: municipal services, utilization of maritime resources, extraction of minerals, use of space by power plants, use of public land, lease of hunting ground, as well as local tourist tax, charges, stamp duties, revenues from contracted annual charges for concessions to pump mineral and thermal water, etc., and *capital revenues*, then their share is much larger—62% of the budget revenues of cities and municipalities, or 46% of budget revenues of municipalities. However, these revenues may only be used for their prescribed purposes. As concerns the municipal and city budget structures, the majority of the above mentioned revenue stems from fees for municipal services and contributions, which account for 16% of total budget revenue, while in some local units this share can even exceed 50%.

In the local units' financial reports that are prepared in accordance with international standards, non-tax revenues of municipalities, as opposed to other units, account for the largest share in the total budget revenue—41%. Non-tax revenues of cities account for 31% of their total revenue. As concerns counties, the share of non-tax revenues in the total revenue was as low as 15% in 1999 and 16% in 2000.

An analysis of the local units' budget revenues reveals a number of common characteristics.

Taken separately, the roles of certain tax revenues in the budgets of individual levels of local and regional self-government are different. This is primarily the result of tax sharing and different tax bases. However, it is obvious that the share of local taxes in the total revenue is insignificant at all levels of local and regional self-government.

Looking at the whole, the rate of collection of revenues from fees is not satisfactory, which is not only the result of inefficiency of local government units and the methods of collection, but also of the loopholes in legislation regulating the supervision of revenue collection.

#### *Analysis of the Structure of Local Units' Budget Expenditures*

When discussing the structure of local units' budget expenditures we should concentrate on their main characteristics. It is worth noting that the structure of total expenditure of local and regional self-government units indicates an upward trend in current expenditures. Current expenditures accounted for 68% of total expenditure in 1999, and 73% in 2000. The largest share in total expenditure was that of expenditures for the purchase

of goods and services, capital outlays and outlays for employees.

Outlays and contributions for employees account for an average of 22% of total expenditure at the national level. However, in municipalities and cities, that share ranges from 3% to 100% of current revenues, and sometimes it even exceeds 100% of current revenues.

The analysis of outlays for employees as a share of current budget revenues per municipality in 2000 shows interesting results. Of the total number of municipalities in Croatia, 279 municipalities, or 66%, spend from 3% to 50% of their current revenues on outlays for employees, while 17 municipalities spend more than 100% of their current revenues on outlays for employees.

The analysis of the share of outlays for employees in current revenues per municipality in 2000 shows that of the total number of 122 cities, excluding the City of Zagreb, 108 cities, or 89%, spend from 7% to 50% of their current revenues on outlays for employees.

The average outlays for employees per capita in local self-government units at the national level stood at 148,000.00 HRK. (According to the annual financial statements of local self-government units for 2000, the number of the employed was 25,518 in 2000 and 25,405 in 1999.)

#### *Analysis of the Local Budgets' Fiscal Capacity*

The fiscal capacity analysis of local self-government units in the period 1999–2000 was based on several indicators to provide relevant data on the actual status of the local self-government financing system. For this purpose, indicators of the level of development of local self-government units were established, and municipalities and cities were classified according to three main criteria: 1) current revenues per capita; 2) current expenditures per capita; and 3) current revenues/current expenditures.

Based on the Central Bureau of Statistics data (the census taken on March 31, 2001, first unofficial data) on the population size of the Republic of Croatia and the revenue of counties, cities (excluding the City of Zagreb) and municipalities raised in 1999 and 2000, a national average revenue per capita and 75% of the average revenue per capita were calculated on the basis of the total realized revenues in 1999 and 2000 (in accordance with the Financing Law).

The largest revenue per capita was recorded in Istria County, 2,685.00 HRK in 1999 and 3,167.00 HRK in 2000. This is double the national average, or 4.5 times the average of Vukovar-Srijem County, which had the



smallest revenue per capita of as little as 603.00 HRK in 1999 and 785 HRK in 2000.

The analysis of the local budgets' fiscal capacity can be summarized as follows:

- In 1999, 12 counties realized the average revenue per capita, while eight counties, out of a total of twenty, recorded below-average revenue per capita. In 2000, the average revenue per capita was recorded in 13 counties, while seven counties had below 75% of the national average revenue per capita.
- Inequality in economic power is an important factor of and/or reason for uneven growth of revenue per capita in counties, and a source of intensifying differences. In addition to inequality in economic power, there are other factors, such as unofficial economy, various legal benefits, exemptions granted to the areas of special national concern, etc.
- According to the index of current revenue/current expenditure in 2000, 33 cities (27%) were unable to cover their current expenditure by current revenue;
- 151 municipalities (35.8%) were unable to cover their current expenditure by current revenue;
- A total of 184 (33.8%) local self-government units were unable to cover their current expenditure by current revenue (Figure 1).

### Grants

According to the current legislation, the system of financing public needs is based on grants as an exclusive means to support the units of local self-government with lower fiscal capacities. However, owing to the consequences of the war, grants are mostly targeted at the areas of special national concern, and not at all local self-government units, to finance a certain level of their population's public needs. More specifically, the law stipulates the following method of fiscal equalization:

- A *county* whose own per capita revenue and the revenues of municipalities and cities in its territory are below the national average (excluding the city of Zagreb) is entitled to a grant from the state budget up to 75%. However, the grant may not be given to a county in whose territory the rate of surtax on income tax is below 1% and the tax rates and tax amounts are below the legally prescribed rates or amounts.

- A *city* or *municipality* whose revenues—assuming an average tax burden per capita are below the county average and excluding cities with more than 40,000 inhabitants—is entitled to a grant from the county budget to the amount of the difference between the raised revenue per capita and 75% of the average county revenue per capita. However, the grant cannot be given to a municipality of city with below-1% surtax on income tax and with local tax rates and tax amounts below the legally prescribed maximum rates and amounts.

In the previous years these regulations could not be applied to all counties, but were only given, within the means of the state budget, to counties (or directly to municipalities and cities) in the areas of special national concern. So, current grants amounted to around 372 million kuna in 1999 and around 270 million kuna in 2000.

In addition to the described system of grants, the new legislation also introduces equalization grants to finance public expenditures for decentralized functions in the areas of primary and secondary education, social welfare and health care that have been devolved on the units of local and regional self-government. The method of calculating the equalization grants for decentralized functions is regulated by a decree of the Government of the Republic of Croatia.

### Objectives and Measures to Improve the Local Self-Government Financing

Given the main objective of the system of local self-government reform in Croatia, which is to satisfy the local population's needs in a more efficient and cost-effective way and to bring it closer to European efficiency standards, a broad analysis was carried out in order to formulate the objectives and the necessary measures to reach them.

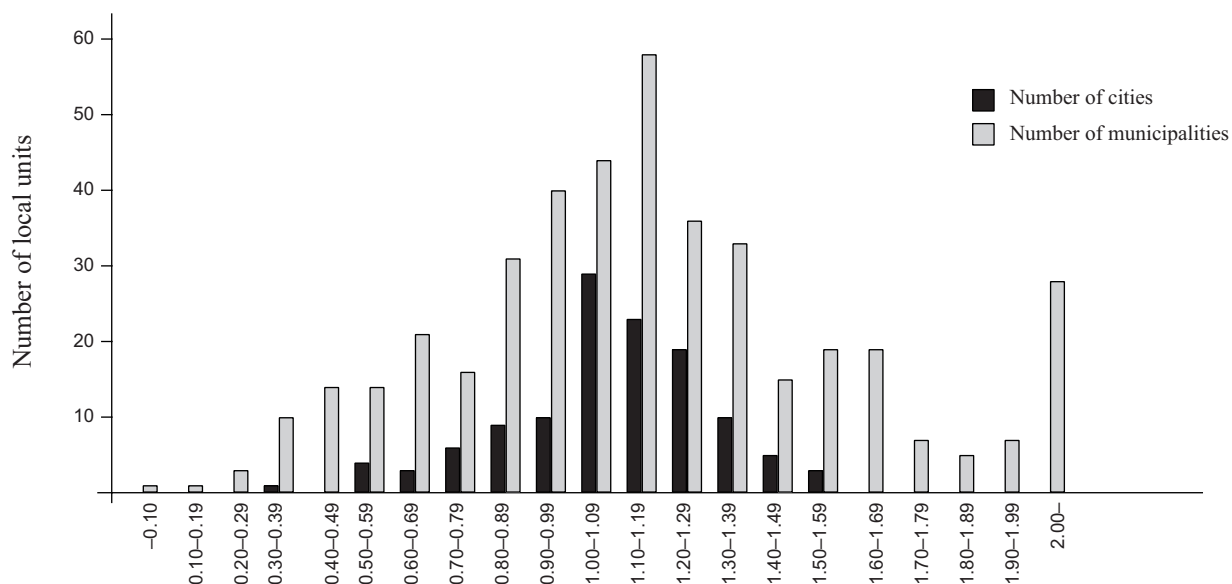
In the following text we will formulate two main objectives and a number of sub-objectives, and propose measures to improve and promote local self-government financing.

#### Objective 1 Changing the Method of Financing Local and Regional Self-Government Units

Sub-objective 1.1 To establish the capacity to finance the basic (obligatory) and additional (optional) expenditures, with a separate consideration of certain areas (e.g. the areas of special national concern and islands).



Figure 1. Municipalities and Cities According to the 2000 Current Revenue/Current Expenditure Index



Classes	Explanation	Number of cities	Number of municipalities
-0.10		0	1
0.10-0.19		0	1
0.20-0.29		0	3
0.30-0.39		1	10
0.40-0.49		0	14
0.50-0.59	A local self-government unit is unable to cover its current expenditure by current revenue	4	14
0.60-0.69		3	21
0.70-0.79		6	16
0.80-0.89		9	31
0.90-0.99		10	40
1.00-1.09	Coverage point 1.0	29	44
1.10-1.19		23	58
1.20-1.29		19	36
1.30-1.39		10	33
1.40-1.49		5	15
1.50-1.59		3	19
1.60-1.69		0	19
1.70-1.79		0	7
1.80-1.89		0	5
1.90-2.00		0	7
2.00-		0	28
TOTAL		122	422

M.\* 1.1.1 Compiling a list of basic (minimum) and additional (extended) activities related to the performance of self-government functions of municipalities and cities (cities up to 30,000 inhabitants and those over 30,000 inhabitants).

Once the list of basic (minimum) and additional (extended) activities related to the performance of self-government functions has been compiled, it is necessary to determine the sources of financing the basic (minimum) activities. This will provide for minimum standards of basic self-government functions in each local unit. At the same time, local self-government units are allowed to perform additional activities provided that they find the sources for their financing.

M. 1.1.2 Strengthening of the fiscal capacity of local and regional self-government units, especially by increasing their own revenues; proposing changes in the revenue structure of local and regional self-government units.

The 2000 indicators, obtained by an empirical analysis (the analysis of fiscal capacity) that is the ratio between current revenues (the analysis was based on current revenues as own revenues, where having such revenues is supposed to be the minimum condition for a unit to exist) and current expenditures for the basic functions to be performed by each local self-government unit, suggest that 184 municipalities and cities were unable to cover their current expenditures by current revenues. In addition, it is shown how many local self-government units, which have raised more funds, can use these funds for their own development, i.e. capital construction.

The results of the fiscal capacity analysis by county indicate that total revenues including grants per capita in most local self-government units are below the national average. An additional analysis was carried out excluding grants to provide a more realistic picture, i.e. to establish the actual amount of funds necessary to give grants to counties to the maximum amount of 75% of the national average.

In view of the above, we propose the following:

a) Larger own tax revenue

According to the generally accepted principle, which should be the basis for the financial autonomy of local self-government units, local units are supposed to raise as large revenues as possible from own taxes, with as low tax revenues-to-transfers ratios as possible.

b) The role of user fees (fees for services rendered to citizens and various occasional receipts) and other non-tax revenues.

The amount of revenues raised from user fees depends on the local authorities' initiative, so it is necessary to strengthen the role and efficiency of local authorities in collecting revenues from user fees.

The local self-government units should be allowed to use other non-tax revenues (utility charges, fees for the extraction of minerals, use of public land, contracted annual charges for concessions, etc.) primarily as special-purpose revenues, but also for the financing of other minimum activities related to the performance of self-government functions of municipalities and cities. That would imply a change in the role of a continuously growing share of non-tax revenues in the structure of revenue of local self-government units by changing the current regulations on the purpose of certain revenues.

c) The role of borrowing

The purpose of borrowing should not be to harmonize local budgets but to finance capital investment. The amount of borrowing should depend on the value of a local unit's assets.

d) Grants

The current criteria for giving grants (revenue below 75% of the average) should be changed, and grants should depend on the types of public services (minimum services) to be provided by a particular local unit in the areas of education, health care, social welfare, environmental protection, public utilities, physical planning, transport, public order, protection and improvement of the status of ethnic and national minorities, as well as culture.

Grants (for covering current expenditures) should be given in accordance with the following criteria:

- the size of population adjusted for fiscal capacity;
- age distribution of population;
- social and economic structure of population (the number of the unemployed, children, etc.);
- certain structural characteristics of a local self-government unit (area, total length of roads to be maintained, etc.).

The purpose of grants should not only be fiscal equalization or allocation of funds for financing the basic functions, i.e. provision of general public services, but certain public functions within the field of activity of the local self-government units.

With respect to the criteria for giving grants, the system of grants should include:

- special grants for the coverage of current expenditures;
- operational general-purpose grants;
- operational special-purpose grants;
- special grants for the coverage of capital expenditures;
- capital general-purpose grants;
- capital special-purpose grants.

The system of grants for the coverage of current expenditures should be based on own tax and non-tax revenues (an alternative to that could be a raising of current revenues per capita by the relevant local self-government unit) and on the needs for the basic functions within the field of activity of the local self-government unit.

M.1.1.3 Income tax sharing with the state to finance the functions transferred from the state to the local government level. As an alternative, the system of grants should include special-purpose grants to local self-government units to finance their performance of functions transferred from the higher levels of government (regional self-government or central government).

M.1.1.4 Different approaches to financing the cities and municipalities in the areas of special national concern, including islands and other local self-government units.

M.1.1.5 Regular monitoring of the databases of local and regional self-government units that are relevant for making decisions on the criteria for giving grants:

- a) Appointment of a coordinator responsible for making an up-to-date list of available data, collection of the missing data, and creation of a regional and local databases.
- b) Development of the methodology for the collection of the necessary regional and local data.
- c) Allocation of duties to each participant in the collection of data on regional and local levels.

M.1.1.6 Making a proposal that the structure of expenditures of local and regional self-government include the coverage of basic (minimum) and additional (extended) functions within the field of activity of municipalities and cities (cities up to 30,000 inhabitants and those with more than 30,000 inhabitants).

Sub-Objective 1.2 Definition of Fiscal Criteria for the Establishment of a New Local and/or Regional Self-Government Unit.

M.1.2.1 The minimum criteria for the amount of revenues of local and/or regional self-government units necessary for the coverage of the basic (minimum) functions within their fields of activity should be defined by the Ministry of Finance within the budgetary process for a new fiscal year, and the Government of the Republic of Croatia should submit them, as a part of the so-called “budgetary package,” to the Croatian Parliament for adoption.

Sub-Objective 1.3 Encouraging the interconnection between municipalities, cities and counties in order to achieve common goals and to increase the revenues necessary to finance the basic (obligatory) and additional (optional) functions, as well as to collect more funds for investment in joint capital projects, and through this, to increase their credit rating.

M.1.3.1 A system of grants should be established (like in M.1.1.2 d) as an incentive to form an interconnection of local self-government units in the cases when their individual current revenues (per capita) are insufficient to finance their minimum functions.

M.1.3.2 Greater Importance of Capital Revenues.

Capital revenues account for a relatively small share of total revenue of local self-government units. A large part of funds for capital project financing is provided from the state budget, and, in the case of capital projects at the municipality or city level, from the county budgets (in the form of supports and grants). For capital projects that are of common interest to several local self-government units and are financed by capital revenues of several such units, additional special-purpose capital grants should be provided at a several times higher amount than the amount of total capital revenues.

M.1.3.3 The mechanisms of stimulating the cooperation between municipalities, cities and counties in pursuing their common goals should be determined more clearly. In this connection, special emphasis should be placed on the development of international cooperation and integration, particularly cooperation at the regional level.

M. 1.3.4 An optimum number of local self-government units should be established in Croatia.

## *Objective 2*

### *Proposing a Dynamic Decentralization Model*

Sub-Objective 2.1 The financial effects of the regulations governing decentralization should be monitored, so that the initial process of decentralization within a dynamic model could be either adopted, modified or stopped.

M.2.1.1 The Drawing up of an annual ranking list of municipalities and cities, and determination of fiscal capacity indicators as the criteria for an evaluation of the economic power of each local self-government unit.

Such a ranking list would reflect the actual status of the revenue structure, capability to perform the self-government functions within the competence of municipalities and cities, as well as the decentralized functions devolved to them. Furthermore, it will show the possibilities of the local units' economic development, contribute to the growth of responsibility of public services for their own improvement, and encourage democracy.

M.2.1.2 The expenditures for the functions devolved by the state budget to local self-government units should be subject to stricter control, while greater emphasis should be laid on planning, preparation and the drawing up of the budgets of local self-government units as well as on analyzing the execution of the budget at the levels of local and regional self-government.

M.2.1.3 Gradual reduction in the state's participation in revenue sharing.

M.2.1.4 Permanent monitoring and analysis of the proposed solutions for the decentralization of public functions.

M.2.1.5 Permanent monitoring of the impact of new measures on the realization of revenues at the local and regional self-government levels.

## **Conclusions and Recommendations**

From the point of view of fiscal capacity, the current organization of local and regional self-government is inefficient. This is suggested by the results of the analyses of the local self-government units' budgets. Depriving the local self-government units of their autonomy or their annexation to the neighboring municipalities and cities, or any other change that affects the existing territorial organization, is hardly a solution that could attract public support at this point in time. Before such a radical change is made, the existing opportunity to interconnect municipalities, cities and counties should

be used in order to carry out the projects that they cannot finance individually. The financing of municipalities, cities and counties is a very complex problem that requires continuous monitoring and analysis, continuous adjustment, as well as proposing new/further research.

The decentralization process should be continued and applied in stages. As decentralization means transfer of authority, responsibility and funds from a higher level, i.e. the central government, to the local government levels, for the continuation of this process it is necessary to:

- ensure responsibility and transparency of operations at all government levels, i.e. assign duties according to the level of government;
- safeguard the independence of local self-government units in financing their expenditures and raising revenues, where it is most important "that all units are given relatively equal opportunities to provide services to their citizens". This can be achieved by a continuous adjustment of equalization grants within the proposed model of fiscal decentralization;
- abandon the current practice of prescribing standards of the local units' operations by the central government and encourage cooperation between the central government and the local self-government units in setting these standards. This would help to neutralize a direct influence of the central government on the responsibilities and obligations of local self-government units.

The proposed changes in the system of financing the local and regional self-government should only be taken as a provisional model, which requires continued modification based on the monitoring, analysis and evaluation of the fiscal capacity outturns of local self-government units over a minimum period of three fiscal years. During this process, care should be taken that the necessary conditions for the regional development and economic growth of the country are fulfilled.

# Local Government Budgeting in Croatia<sup>1</sup> —One Year Later—

Katarina Ott and Anto Bajo  
*Institute of Public Finance, Zagreb*

## Summary

*This paper aims to briefly describe the main problems of local government budgeting in Croatia a year ago and today. The problems are divided into those connected with the number and size of the local government units (LGUs), the budget itself and the budgetary process. For each problem, first the situation a year ago is analyzed, followed by the suggestions put forward at that time and, finally, the changes within one year are described. The basic conclusion is that it is less important where the budgeting functions are performed than how this is done. Therefore, we suggest further strengthening of the budget, budgetary techniques and budgetary process at all levels of government, a more powerful financial control mechanism at the central government level accompanied by an appropriate education of public officials and the general public.*

**Key words:** local government budgeting, Croatia

## Introduction

A lot of time and energy has been expended on fiscal decentralization issues. However, all our research has so far supported the approach that it is not important where but how the budgeting functions are performed.

This paper derives from a research project and a paper that we wrote in 2001. We then concentrated on some of the problems in the Croatian local government budgeting connected with the number and the size of the local government units (LGUs), the budget itself and the budgetary process. In this new version of the paper we

mainly repeat what we did a year ago—a description of the situation and suggestions for policymakers, but we also include the changes that occurred in the meantime. We think it would be interesting to see what these changes are and what conclusions we could draw from them.

## Problems Connected with the Number and Size of the LGUs

Croatia has three tiers of government: (1) central government, (2) counties, and (3) municipalities and cities. Counties are units of local administration and local self-government, while cities and municipalities are units of local self-government only. The counties, cities and municipalities regulate their own internal organization and structure and the way they operate by their statutes. An overabundance of LGUs has resulted in an accumulation of oversized administrative machinery at several tiers of government and an inadequate distribution of functions and responsibilities. The situation has been aggravated by the establishment of areas of special national concern in response to the damage caused by the war.

*The situation one year later.* Since 2001, the central government has been able to devolve some administrative affairs not only to counties but also to local units (municipalities and cities). The authorities of prefects, mayors and heads are the same. Where the national administration affairs have been transferred to the competence of the county, city or municipality, there the prefect, mayor or head of a local unit is equally responsible to the administrative bodies of the central government.

## Territorial Organization

Croatia is a small country (4.4 million people, 56.5 thousand square kilometers) with a large number of LGUs: 422 municipalities, 122 cities and 20 counties (plus the capital, Zagreb, which has the dual status of

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<sup>1</sup> This paper springs from the research project led by the authors and financed by the Institute of Public Finance, Zagreb, the Croatian Tax Administration, the Open Society Institute and the Local Government and Public Service Reform Initiative, Budapest. The full research report was published in Croatian in *Financijska teorija i praksa* 25 (3), 2001. pp. 311-449. The authors would like to thank Branka Kusic from the Ministry of Finance for her valuable comments and contributions to the new revised paper.



city and county). The large number of local units makes it impossible for the central government to get a realistic picture of their finances.

Every place that satisfies the formal criterion of a population of 10,000 can become a city. This means that there are cities that cannot justify the title either by their revenues or by the functions that are statutorily stipulated. The situation is similar with municipalities. The fashionable trend toward municipality establishment that took Croatia by storm in 1993, allowed any petty rural area to establish a municipality of its own. The main problem is illustrated by the amassing of administrative bodies and employees in these municipalities. Such LGUs are simply incapable of either financing their current expenditure or providing basic services in their areas. And so they depend on direct transfers from the government budget. In practice, this leads to a centralization of government, in spite of a theoretical territorial decentralization.

*Suggestion.* An optimum number of local units should be determined. A detailed analysis of the financial situation in local units and their ability to finance themselves and provide public services should be carried out. After that, a decision should be made as to a reduction in the number of existing municipalities and counties, which is unsustainable, and imposes a heavy burden upon the government budget.

*The situation one year later.* The trend towards the establishment of new local units has continued. Since 2001, three new municipalities have been established. It should be emphasized that the decisions on the establishment or the approval of the establishment of local units lies within the competence of the Ministry of Justice, Administration and Local Self-Government (hereafter: MPULS). It adopts its decision according to the opinions from the line ministries (e.g. the Ministry of Finance), counties, and other local units and competent institutions. There are cases in which decisions to establish new local units are taken in spite of a negative opinion of the competent body.

#### *Oversized Administration at Several Tiers of Government*

Administrative functions at the local level are performed by counties. The administrative functions performed by the administrative bodies of the counties are financed from the government budget, while the functions within the sphere of local self-government are financed from the county budgets. This duality is observable in the function of the prefect, who carries out the functions of

both the central government and local self-government. New laws envisage these functions being split between two officials. But before this is done, the National Administration System Law will have to be changed—something no one seems to have thought about.

The question has arisen about the accretion of administrative machinery at the county level. Given the widespread criticism aroused by cities and municipalities about the operation of counties and county bodies, it is essential to settle on the number of administrative bodies and the people employed within them. The existing administration at the county level is inefficient. Another problem is the level of salaries in the administrative services of local units, which exceeds that of the central government bodies. There are no evaluation criteria for the performance of the administrative services of local units; in most cases the system of rewarding good work and penalizing the bad is based on the internal regulations of the local units. The central government has practically no control over these regulations, or knowledge of their content.

*Suggestion.* In all local units (counties, municipalities and cities), the number of administrative units and their employees should be determined.

*The situation one year later.* Since 2001, all local units have been able to perform the operations related to self-government provided that they find the sources of financing. To make use of this possibility, it is still necessary to work out the transfer procedure. It is possible to establish a common administrative body for several local units<sup>2</sup>. The MPULS can give the local communities the authority to manage administrative affairs, but it can also take it away. The question is whether local units will manage their administrative affairs through common administrative bodies or whether each of them will set up their own departments. The increase or reduction in the size of the administrative apparatus depends on this option. The MPULS endeavors to carry out the recommendations of the government to reduce the number of employees in the administrative bodies of the local units.

<sup>2</sup> The Local and Regional Self-Government Law (NN 33/01 and 60/01).



Table 1. Distribution of Authority Among the Levels of Government

Title	Central gov.	Municipalities	Cities	Counties
1. General public (administrative) services	X	X	X	X
2. Defense	X			
3. Law and order	X			
4. Education	X	X	X	X
4.1. Preschool		X	X	
4.2. Elementary	X	X	X	X
4.3. Secondary (high)	X			X
4.4. Tertiary (university)	X			
5. Health Care	X			X
6. Social security and welfare	X	X	X	X
7. Housing and utilities		X	X	
8. Recreation, culture and religion		X	X	X
9. Agriculture, forestry, hunting and fishing	X			X
10. Mining, industry and construction	X	X	X	X
11. Transport and communications	X	X	X	X
11.1. Road transport	X	X	X	X
11.2. Rail transport	X			
11.3. Air transport	X			
12. Other economic affairs and services	X	X	X	X

### *Inadequate Distribution of Functions and Responsibilities*

Despite the many laws<sup>3</sup>, there is no clear delimitation of functions between the levels of government. As shown in Table 1, almost all functions are financed from both central and local government levels. Local governments do finance certain functions, such as welfare and secondary education, although they have no legal obligation to do so. Some healthcare functions have been devolved to the counties, although they are incapable of financing them (Table 1).

<sup>3</sup> The principal laws regulating local self-government and administration are: The Local Self-Government and Administration Law (1992), The Local Self-Government and Administration Units Financing Law (1993), The Areas of the Counties, Cities and Municipalities Law (1993, 1997), The Budget Law (1994) and The City of Zagreb Law (1997). In 1997 Croatia ratified the European Charter about local self-government, accepting the principles laid down in the Charter.

*Suggestions.* It is necessary to distinguish between the functions of the central and local governments. The authority and responsibilities for the financing of functions, and the provision of public services at the local level, should be regulated by a single law.

Also, a clear distinction should be made between the rights and obligations of local units and those of the central government. This will motivate the individual local units to meet their obligations, and should these obligations be neglected, it will be easy to establish individual responsibility for mistakes and oversights.

The efficiency of financing the public expenditure of local units from the central government budget should be reassessed, particularly as concerns the financing of elementary and secondary education, health care, welfare, fire protection, and road maintenance and construction. Along with the decentralization of expenditure, a gradual decentralization of the local units' revenue should also be provided for.

*The situation one year later:* Quite important changes have taken place since July 2001, when the right to found secondary and elementary schools was devolved on local units. The government provides for a part of funds for financing the elementary education (in 32 cities) and secondary education by giving grants. The same applies to healthcare and welfare establishments. Besides the grants from the government budget, local units are allocated a larger share in common taxes (income tax) and can realize their own receipts.

It should be emphasized that the local units have not been given full authority to carry out decentralized functions, because the central government is still there as the founder and financier of both welfare and healthcare institutions. Through the system of sharing taxes and equalization grants the central government still exercises the central control of financing these functions. Thus, only partial (formal) decentralization of responsibility and financing has been provided. The state has retained financial control through the mechanism of fiscal grants.

#### *Areas of Special National Concern*

The situation has been aggravated by the creation of areas of special national concern in response to the damage caused by the war. These areas were set up for the purpose of a more rapid development, and they have a privileged status in financing. Through many tax exemptions, the government is attempting to jump-start the economic development of these regions.<sup>4</sup> However, these development measures have never relied on any serious analysis, and there are no tested economic indicators of the development of the regions. Moreover, there are no accurate data on the number of employees in the administrative services, or employees in industry and business. The government currently provides grants from the central budget. However, the criteria are very questionable, as are the amounts of funds sent to these areas year after year.

<sup>4</sup> In 2000, new tax incentives in the areas of special national concern were introduced. When it comes to the revenue shared between the central government and the local units in the next five years, the local units in the areas of special national concern will have the right to 92% of all revenue from personal income tax and 90% of profit tax revenue (compare with Table 4). This redistribution, or cession, in favor of the areas that were occupied and directly damaged in the war will last until the end of 2005. Apart from these tax benefits, local units in the areas of special national concern also receive subsidies and grants from the government budget, and receive other types of revenue in accordance with special laws and decisions of the local government representative bodies.

*Suggestion.* Realistic conditions and indicators of development in the areas of special national concern should be determined, and the efficiency of the government incentives aimed at improving the functions of the public sector in these regions should be assessed.

*The situation one year later:* The number of units in the areas of special national concern (PPDS) has not changed (there are still 111 such areas). However, the population of the PPDS has increased. Up to 2001, not all settlements of the cities and municipalities within the PPDS were necessarily part of the PPDS. Since 2001, however, all the settlements that are in the territory of the PPDS are involved in the PPDS. As a result, the number of inhabitants in the PPDS has increased from 364 to 482,000, i.e., by 117,000.

A model for the calculation of grants to local units in the PPDS has been worked out. It involves several criteria, and was first used in drawing up the plan of the Government budget for 2002. Since the criteria have a lifespan of only one year, they should be included in the Local and Regional Self-Government Financing Law.

Local units can only use grants for financing the obligatory expenditures laid down by law. Although this is not expressly stated, these are special-purpose grants.

#### **Budget Related Problems**

Budget related problems include inadequate classification of budgets, lack of budgetary classification, lack of fiscal capacity indicators, the absence of consolidation of LGU budgets, complicated accounting, non-uniformity in budget plans, lack of estimates and methodology, and the lack of a developed national treasury system.

#### *A General View of the Budget Related Problems*

##### *Classification of Budgets*

Classification of budgets does not support the separation of functions according to the level of government. Planning of the budget is carried out according to the account plan, which cannot be applied at the LGU level, because of the particular types of revenue and expenditure.

It is impossible to present the data on current and capital expenditure, and the data on utility charges, according to the economic and functional classifications. Thus, for example, some local units include the salaries and material expenses of employees in grants and current and capital transfers, although they should be

expressed as employee expenditure. The problem lies in the account plan of the budget(s), which does not provide the information about overall expenditure by a purely functional or economic structure (since economic, functional and institutional classifications are all mixed up). In order to obtain data by functions and economic categories, the data from financial reports and other sources have to be constantly adjusted, and this does not give a very realistic picture of the situation.

*Suggestion.* The obligation should be prescribed to separately keep detailed functional, administrative and economic classifications of all budgets of all government units.

*The situation one year later.* A new accounts chart has been adopted that makes possible the planning of the budgets of local units (counties, cities and municipalities) according to an economic, functional and organizational classification. All revenue/receipts and expenditures/outlays of the budget (clearly structured) are planned, but this time including the budget beneficiaries (their own revenues and revenues pursuant to special regulations).

In 2002, the plans of the local units' budgets included individual expenditures of each spending agency, but only for the part financed from the local budget. In drawing up the budget plan for 2003, a further step was taken, i.e. the budget plan shall also include the revenues derived by budgetary beneficiaries on the market from performing their basic and other operations, according to the definition of their activities, revenues from donations, and the revenues pursuant to special regulations, as well as the expenditures that are financed by the budgetary beneficiary's own funds.

Previously, the budgetary plan consisted of a general and a specific section. The novelty inheres in the general part of the budget being planned according to the organizational, economic and functional classifications. The budgetary plans of local units also contain the plans of their budgetary beneficiaries. This provides for a consolidation of the budgets of local units.

### *Fiscal Capacity Indicators*

It is hard to measure the fiscal capacity<sup>5</sup> of local units because there are no exact figures on the population

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<sup>5</sup> By fiscal capacity we mean an indicator of a local unit's ability to collect revenue and finance expenditure. For a definition of fiscal capacity it is essential to determine the parameters on which the calculation will be based.

involved.<sup>6</sup> It is also hard to get a realistic account of the revenues and expenditures of the LGUs. An additional problem inheres in the tax bases and the rates of local taxes<sup>7</sup>, which are not systematically controlled at the central government level. In addition, there are no figures on the GDP in given areas (counties). The government has established, in general terms according to per capita revenue, the criteria for the allocation of grants used for fiscal equalization. However, the criteria and equalization of fiscal capacity on the basis of income are not applied, and the fiscal capacity of most counties is below the average.

*Suggestion.* On the basis of the 2001 Census data, regional statistics (the regional GDP figures) should be improved as soon as possible. The collection of data on local revenues should also be improved. The purpose of these measures is to calculate fiscal capacity indicators.

*The situation one year later.* In 2001, the results of a new Census were published. Thus the government obtained some of the input required for a more realistic calculation of grants. Unfortunately, there is still no calculation of regional GDP. Apart from that, the ground has been cleared for a comparison of local units, which are all obliged to inform the Tax Administration about the introduction of new tax rates and tax bases.

While making up a model for the calculation of grants to local units in the PPDS from the government budget, the Ministry of Finance makes use of an estimate of fiscal capacity. For 2002, counties were given grants according to the following criteria: the population size as per the 2001 Census, the average per capita revenue at the county level (state average) for the county budget for 2000 and the county budget revenue for 2000. Since 2001, criteria for the allocation of grants to the PPDS have been applied that are based on the calculation of revenue per capita as compared with the regional or state average. Categories of expenditure (for employees) based on the results for the previous year are included into the calculation of the grant.

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<sup>6</sup> The most recent data available derive from the 1991 Census. In the meantime, Croatia had a war and great migrations of inhabitants to and from the country. The data from the 2001 Census are not yet available.

<sup>7</sup> However, local taxes have little influence on the fiscal capacity of local units as they only account for 4% of total budgetary revenues.

### *Consolidation of LGU Budgets*

The local units' budgets are still not consolidated, just like there is no consolidation at the same level of government (county, municipality and city). In outline, a summary balance sheet is drawn up for all local units. One of the main problems is the classification of the budget(s), which makes a consolidation of budgets at the local unit level impossible, something which is only further aggravated by the absence of instructions about how to carry out consolidation.

*Suggestion.* A new account planning of the budget for the country as a whole and for local units should be introduced, and a review of public expenditure in terms of functions and economic categories should be provided for.

*The situation one year later.* The adoption of a new accounts chart, the decree concerning financial reporting, and the new decree concerning budgetary accounting have created the possibility for consolidation of the budgets of local units. The budget plans of local units for 2002 also contain the plans of their budgetary beneficiaries, which makes it possible to consolidate the budgets of local units (together with the budgetary beneficiaries' own revenues). The consolidated budget of the local units is to be drawn up quarterly and annually. There is still no official report or information on the first consolidations, because the regulations governing financial reporting were adopted only at the beginning of 2002. The first results concerning the consolidated budgets of local units are not expected until 2003, when the realization of the budget for the previous year (2002) will be announced.

It should be noted that the scope and quality of consolidation might be dubious because it has not been decided which budgetary beneficiaries will be included in the consolidation. This is caused by the absence of a clear definition of "budgetary beneficiary."

### *Complicated Accounting*

Budgetary accounting is complicated and governed by numerous regulations that overlap, while remaining unclear conceptually and in terms of content. For example, budget accounting underrates obligations, overrates assets and makes consolidation impossible.

There is no single model or methodology for showing revenue and expenditure for all budgets. The lack of a unified methodology makes it impossible to keep up with and consolidate local unit budgets.

*Suggestions.* The Ministry of Finance should clearly inform all local units about the prescribed form or model

of financial reporting.

A review of the entire budgetary accounting and reporting system is necessary, which should be regulated by a single law. Various regulations should be terminologically unified, because local units interpret and apply them in different ways.

The Ministry of Finance should impose the obligation to adopt annual accounts of the budgets of local units as financial reports. Changes should start from classifying revenue and expenditure into a certain number of modified categories. This would make the collected financial data analyzable in various ways and for various purposes.

*The situation one year later.* A series of new regulations has been enacted<sup>8</sup> which has fundamentally changed the system of accounting at the level of central and local government. A new Budget Law and an Accounting Law are currently being drafted, which should unite all the provisions contained in by-laws.

The new system of accounting has set up a new framework for financial reporting, uniform for the central government, local units and their budgetary beneficiaries. Instead of the accounting on a cash basis, the receipts and revenues, as well as expenditures and outlays, are registered according to the so-called modified accrual accounting basis.

The content of financial reports of the budget and of budgetary beneficiaries has been defined and prescribed in detail. All local units consolidate the financial reports of their budgetary beneficiaries and the financial report of the budget. The overall—consolidated financial report is submitted to the Ministry of Finance within 20 days from the expiry of the reporting period. Financial reports are drawn up quarterly and annually.

The legal obligation has been stipulated to adopt the annual execution of the budget. The annual execution of the budget is adopted by the representative body at the proposal of the relevant authorities, but only after the end of the year for which the budget was adopted. The local authority is obliged to submit the proposal for the annual calculation of the budget to the body competent for the control of the utilization of resources by April 15.

Along with the annual calculation of the budget, the following shall be submitted to the representative body for the adoption of the annual execution of the budget:

<sup>8</sup> The Decree on budget accounting, Regulations concerning financial reporting, Regulations concerning budgetary accounting and the accounts chart, Amendments to the Local and Regional Self-Government Financing Law.

the profit and loss accounts of public corporations, public institutions, and the permanent reserves of the local units, and the balance sheet. A part of the annual execution of the budget (the general part) is published in the same manner as the budget itself.

### *Planning and Estimation of the Budget*

The basic elements for planning and estimation of the budget are not always uniform or worked out in detail. They depend on the size of the budget, the structure of public expenditure and revenue, and the type of public functions financed from the budget. Methods and quality of estimating LGU budgetary revenue and expenditure do not depend on the size of a budgetary unit or its economic power, but on the interest of the executive bodies, and the expertise and personnel of the finance departments responsible for planning and preparing the budget.

*Suggestion.* Local units should base the planning of their budgets upon their own indicators. Local units that receive transfers from the government budget have to keep to the guidelines for salaries and expenditure movements. They also have to keep up with expenditure in terms of items.

*The situation one year later.* In planning and estimating their budgets, local units start from the guidelines (budget circular) of the Ministry of Finance for the preparation and drawing up of budgets for the following three-year period. The guidelines are based on the estimate of the macroeconomic indicators that the MF has to draw up and submit to the local units every year.

The MF submits its guidelines to the counties, which use them to draw up the guidelines for the county budget, as well as for the municipalities and cities in their respective areas. The MF also delivers its guidelines to all municipalities and cities, so that they can start preparing their budgets even before the county has drawn up its own guidelines. The problem here is that the counties do not stick to this schedule.

Guidelines for drawing up the budgets for the 2003–2005 period contain recommendations for the preparation and planning of the budget, separately for revenue/receipts and expenditure/outlays. The planned revenues of the budgets and budgetary beneficiaries of local units are based on an estimate of trends in economic indicators and the size and structure of public and local revenues.

Of course, planning of the local budget depends on the qualifications and knowledge of the local unit's

experts (the head and the finance department). The frequent rebalancing of local unit budgets during the year (two or three times) indicates that many local units have not yet mastered the principle of realistic budgetary planning.

### *Public Investment Planning*

So far, the government has not dealt in any serious way with the planning of public investment, nor has any overall approach to the financing of capital projects at the local unit level been set up. A list of capital investment per sector first appeared as late as the beginning of 2000, for the 1996–1999 period. The strange thing is that this list cannot even be found in the Ministry of Finance, whose decision-makers know nothing about its existence. It was compiled and signed by the Government. Owing to this news blackout, the competent institutions, above all the Ministry of Finance, find it difficult to control the degree to which the local government capital investments are financed and carried out. Besides, capital projects are not included in public investment programs.

*Suggestions.* A complete and detailed record of capital projects financed at the local level should be kept at the central government level, in order to control the transfer of capital grants to local units.

It is necessary that the procedure of capital investment planning should include feasibility studies giving consideration to the potential sources of financing. As this relates to projects that are of great importance to the society as a whole, the obligation to make a social justifiability study of each such investment should be imposed.

Local administration should be equipped and trained to use modern methods of capital project planning. This, of course, goes for the administration at the national level as well.

All local units should be obliged to measure the costs and benefits of capital projects, and to plan capital projects over a longer period of time.

*The situation one year later.* There have been no significant changes. A novelty is that local units must work out in detail the capital part of their budget for 2003, in order to plan capital programs and borrowing for a number of years. The capital part of the budget encompasses all expenditure for the procurement of non-financial assets, with the exception of current non-financial assets. During the planning of capital programs, projects under way and reconstruction projects are given priority. This is a recommendation of the MF to local units contained in the guidelines for the preparation and



drawing up of the budgets of local units in the period from 2003 to 2005.

### *National Treasury System*

The treasury system does not operate at the national level, and there is no national financial information system. There are no long-term plans for the structuring of treasuries at the level of LGUs. At the central government level, the function of cash management is not separated from debt management. Both functions are organizationally linked in a single administration or agency of the Ministry of Finance. The basic problem is that there is no developed national treasury system at the central government level.

Although there is a single treasury, at the Croatian National Bank, most transactions and payments from the budget are done across the many accounts of the budget kept with commercial banks. The problem is aggravated by the above stated absence of an efficient national financial information system.

The same applies to cash management at the level of local units. They too have no treasury system, but make their payments and manage their cash through the many accounts with commercial banks and the Institute for Payment Transactions<sup>9</sup>.

*Suggestion.* The Ministry of Finance should draw up a plan for organizing a treasury at the local government level, and, of course, get the treasury going at the national level as well. The Ministry of Finance should also determine the method of cash management, and oblige local units to keep their funds in a single budgetary account.

*The situation one year later.* Considerable progress in the development of the governmental financial

information system has been made. Payments have been ensured from the Single Treasury Account (JRR) for a large number of budgetary beneficiaries via branch treasuries mainly set up at the level of the competent ministries.

At the local unit level there are no major changes. The provisions of the National Payment System Act still apply (NN 117/01), as well as the provisions of the Budget Law (NN 92/94), pursuant to which local units can open only one bank account for regular operations, and can have a foreign currency account, and make time deposits. An account of the local self-government (which is also an independent legal entity) is opened with the same bank with which the account of the budget is opened.

A problem can lie in the so-called exceptions, according to which the budget of a local unit (county, municipality or city) can also have an account with another bank, to which it transfers budgetary resources for the implementation of programs adopted by the representative body of a local unit<sup>10</sup>.

There is an additional exception related to local units, which entered into agreements with the Ministry of Agriculture (for priority financing in agriculture) and the Ministry of Trades, Small and Medium-Sized Enterprises (for encouraging development of small businesses) before the new National Payment System Act came into force. These local units can keep budgetary resources with commercial banks with which they have no account for regular budgetary operations. The funds are used from the accounts of the bank until the end of the program for the development of small businesses and for priority financing in agriculture. However, these local units are obliged to submit to the MF and the competent ministries the data on the balances of time deposits. It is also worth noting that in 2003, the new resources for these purposes can be used for extending loans, but only through the bank with which the local unit has its account for the regular budgetary operations.

The problem with the number of accounts continues, because local units may have accounts with several other banks, apart from their budget account for regular operations.

<sup>9</sup> The Institute for Payment Transactions—IPT (since 2002—Financial Agency, FINA) is a public institution that keeps the accounts of the central government, local governments, companies and citizens. The data of the Ministry of Finance are supplemented by data from IPT; alternatively, these data are used to establish the dynamics of the flow of budgetary resources. IPT has prescribed accounts for the payment of public revenue, the manner of paying this revenue, and reporting to its customers. It provides the Tax Administration with the data on the revenue collected by the central government, as well as the county, municipality and city budgets. Revenue is allocated from the IPT accounts, in statutorily determined percentages, to budgetary and extra-budgetary beneficiaries. The allocation key for the revenue is set by the Tax Administration. IPT collects fees for its services related to the payment of revenue in accordance with the contract concluded with the Ministry of Finance.

<sup>10</sup> Decree on the amendments to the Decree on the manner of paying in budgetary revenue, mandatory contributions and revenue for the financing of other public needs in 2002 (NN 92/02).



Table 2. Revenue of Local Units as % of Total Budgetary Revenue

Revenue	1995	1996	1997	1998	1999	2000
Tax revenue	66.24	55.89	52.73	55.94	55.19	55.69
Non-tax revenue	22.69	31.41	33.32	29.25	30.50	31.48
Capital revenue	4.80	4.93	6.25	5.12	6.62	6.68
Grants	6.27	7.77	7.70	9.70	7.69	6.15
Total	100.00	100.00	100.00	100.00	100.00	100.00

Table 3. Total Revenue Realization Structure by Type of Unit in 2000 [%]

Title of revenue	Total	Municipalities	Cities	Counties
I+II total revenue and grants	100.00	100.00	100.00	100.00
I. Total revenues (1+2+3)	93.85	85.42	97.45	79.71
1. Tax revenue	55.69	34.08	59.51	61.97
2. Non-tax revenue	31.48	40.97	31.37	16.40
3. Capital revenue	6.68	10.37	6.57	1.34
II. Grants	6.15	14.58	2.55	20.29

### Problems Related to Revenues

Among the main problems on the revenue side is an inadequate system of financial equalization and allocation of grants, too many new local units without secured funding, insufficient shared tax revenues, small own tax revenue and heavy reliance on non-tax revenue such as utility charges and contributions.

### Revenue Structure

In order to perform the operations that lie within the competence of self-government, the local units provide resources for their budgets. In addition to their own resources (revenue from assets, local taxes, fines, fees and charges), they raise revenue from taxes (income, profit, real estate sale, and gambling tax) that are shared with the state government, and grants (from the government or county budget). In this paper we deal with another possible structure of revenues, i.e. the division of the revenue of local units into tax, non-tax, capital and grant revenue (Table 2).

Taxes are the leading item in the budgets of local units, although they are trending downwards. The second most important item is non-tax revenues, the proportion of which is constantly growing. The total capital revenue accounts for about 6.68% of the revenue of local units. Grants from the central government in 2000 stand at 6.15% of the revenue of the LGUs. A more detailed survey of revenues in 2000 for various local governments is given in Table 3.

Tax revenues are dominant in cities, where they account for 60%, and in counties for 62% of their total budgetary revenue. In municipalities they account for a little less than a third of the total revenue (34%).

However, all levels of local government rely on shared taxes. Local taxes account for only 4%, which shows that their influence on the fiscal capacity of local units is insignificant.

In municipalities, the most important is the non-tax revenue, with a 41% share in the total budgetary revenue. Non-tax revenue represents a third of budgetary revenue of cities and 16% of the total budgetary revenue of counties.

In the total realization structure of revenues of all LGUs in 2000 grants came to almost 6%. Grants are an important source of revenue for county budgets, accounting for a quarter of their total budgets. Grants represent 15% of the revenue of municipalities and 3% of the revenues of cities.

*The situation one year later.* In 2001, new local taxes were introduced in addition to the existing ones: tax on uncultivated but cultivable agricultural land, unused enterprise real estate, undeveloped building land, and the use of public areas. Moreover, the local and county tax rates were changed. The name of the Tax on the Organization of Sporting and Entertainment Events was changed to the Tax on Automatic Machines for Games of Entertainment. It is too early for an assessment of the first effects of these taxes on the size and structure of the revenue and expenditure of local units. The data

Table 4. Joint Taxes and their Distribution among Authorities [%]

Tax on	Central government	County	Municipality or city	Decentralised functions*	Fire brigades**	Equalisation fund***
Income	24.6	10	34	9.4	1	21
Income (including city of Zagreb)	21.6	—	47	9.4	1	21
Corporate income/profit	70	10	20	—	—	—
Real estate transfers	40	—	60	—	—	—

\* goes to the municipality or city that finances its own decentralised functions, otherwise goes to the county

\*\* goes to the municipality or city that has founded and finances regular work of public fire brigades

\*\*\* the government fund from which resources are transferred to those LGU that cannot finance their own public functions

Source: Law concerning the Financing of Units of Local Self-Government and Administration; OG 150/02 (the old laws are found in OG 117/93 and OG 33/2000.)

on the realization of local budgets for 2001 are still not publicly available.

#### Insufficient Shared Taxation

The central government has stipulated the sharing of the main types of taxes with the local units. The main taxes like income tax and profit tax are thus shared in percentages among all levels of government (see Table 4). A special problem, however, is value-added tax, which goes only to the central government. Many local units have a consumption tax, and they set the rate of that tax autonomously. There is also the problem of double taxation of the same product—alcoholic and non-alcoholic beverages, for example. Has the central government appropriately determined the amount that remains at the LGU level? An analysis of revenue shows that the main revenue of individual local units (especially municipalities) is not taxes but non-tax revenue. The small percentage allocated to the local units in shared taxes needs increasing.

*Suggestion.* The share of local units (in the tax revenue sharing arrangement, primarily the personal income tax and profit tax) should be increased (i.e. the share of the central government should be reduced).

*The situation one year later.* On July 1, 2001, the process of decentralization of elementary and secondary education, welfare and health care was started, which resulted in changes in the distribution of income tax. The financing of all decentralized functions was taken over by all the counties and the city of Zagreb. 32 cities took over the financing of elementary education only. The cities and counties that took over the decentralized functions have the right to an additional share in income tax, apart from the one they already have (Table 5).

An important role in the distribution of income tax is played by the so-called Equalization Fund (actually

a position or account within the government budget) to which funds for the financing of decentralized functions are transferred (21%).

Table 5. Additional Share of Local Units (which took over the obligation to finance the decentralized functions) in Income Tax [%]

Functions	Counties	Municipalities and cities
1. Education		
Primary	2,9	2,9
Secondary	2	2
2. Welfare	2	2
Senior citizens' homes	1,6	1,6
Welfare centers	0,4	0,4
3. Health care	2,5	
4. Fire protection	2	2

Local units that have taken over the financing of the decentralized functions derive a part of their revenue from an additional share in income tax, and obtain the difference in the funds necessary for financing the functions from the Equalization Fund.

If a given local unit gets more revenue (from its share in the income tax) than necessary according to the calculation of the government and the MF, the amount of grants is reduced by the amount provided by the local unit for the financing of decentralized functions. Revenue from equalization grants that has not been spent during the year remains in the account of the budget and is used for the payment of grants in the following year.

The share of municipalities and cities that have not taken over the decentralized functions remains the same. The share of the state in income tax is reduced by 21%, to

the benefit of the Equalization Fund, which is supervised by the MF (central government).

The share of island municipalities and cities in income tax has increased to 29.2%, provided that they conclude an agreement on the joint financing of some capital project that is important for the development of the island.

In the period from 2003 to 2005, the central government will approve an additional share in income tax to local units (from the part that belongs to the government budget that is derived in their area) for the financing of firefighting units. Since 2002, the government has ceded 2% of its share in income tax to local units for the financing of the regular activities of regular firefighting units. In 2003, the rate will be 4%; in 2004, 6%; and in 2005, 8%. Since many local units establish, finance or co-finance the firefighting units, and are therefore interested in getting an additional share in income tax, the Ministry of the Interior (the firefighting units are within its competence) has laid down the criteria that local units must meet to obtain the approval of the Ministry. FINA determines the quotas for the redistribution of the taxes (including income tax) in co-operation with the TA.

Despite being competent for public firefighting units at the level of local units, the Ministry of the Interior must not interfere with the fiscal equalization system (tax sharing), which has to remain in the exclusive competence of the MF.

#### *Low Level of Own Tax Revenue*

In practice to date, the central government has not supervised the rate of local taxes that can be set autonomously by local units. The introduction of new local taxes is envisaged, as well as the possibility for all local units to prescribe rates of surtax on personal income tax<sup>11</sup>. It is questionable what the effects of the new local taxes will be on tax revenue growth, for in current practice, local taxes do not have an important role in the budgets of local units.

*Suggestion.* The central government should oblige local units to submit information about the size of the base for local taxes, and the tax rate set by each unit.

*The situation one year later.* Since July 2001, all local units that have introduced a tax are obliged to

notify the Central Office of the TA<sup>12</sup> about it. Every local unit is obliged to explain in the budget proposal the reasons for the introduction of a new tax, to provide an estimate of the revenue from the tax, as well as the administrative costs of the tax (assessment, collection, inspection, execution and record-keeping).

Subject to certain fixed criteria, municipalities and cities can prescribe surtax on income tax, provided that they publish their decision in the official gazette. During 2001 and 2002, over a hundred local units introduced surtax, at rates ranging from 1% to 18% of the amount of income tax paid. Unfortunately, we have not been able to estimate the effects of the introduction of the new taxes and surtax because of a lack of official information.

#### *Heavy Reliance on Non-Tax Revenue (Utility Charges and Contributions)*

Owing to the small fiscal capacity and the low level of revenue from local (own) taxes, many LGUs rely on non-tax revenue as their main source of revenue.<sup>13</sup> Utility charges and contributions stipulated by law participate with the largest share in the local budgets, especially those of cities and municipalities. The problem is that many local units autonomously prescribe high rates of utility charges and contributions. 80% of cities (or their utilities) illegally impose charges for connections to the infrastructure, which result in high utility prices and contributions. To avoid this, some people resort to illegal connections. There is a whole series of charges and fees that the local units levy, while the central government does not have any control over their rates, or their accounting records (Table 6).

*Suggestion.* The central government should control the rate of utility contributions and charges that are set autonomously by local units.

*The situation one year later.* The sharing of the revenue from charges for concessions to pumping mineral and thermal water by municipalities and cities was introduced (50% goes to the local units, 50% to the central government), and the charge for the concession

<sup>11</sup> Surtax is an addition to income tax that is assessed on the basis of the tax already paid. Cities with more than 40,000 inhabitants have the right to impose surtax. The rate ranges between 6% and 7.5%, but in Zagreb (the capital) it is 18%.

<sup>12</sup> Amendments to the Local and Regional Units of Self-Government Financing Law (NN 59/01).

<sup>13</sup> For example, in the municipality of Kostrena, which has the highest per capita revenue in Croatia (around US\$ 1,000), non-tax revenue accounts for 85% of total revenue. Revenue from utility charges comes to 58% of the total revenue. In the city of Zagreb (the biggest center), non-tax revenue accounts for 21%. Utility charges represent 6% of the total budgetary revenue.

Table 6. Revenues from User Charges and Administrative Fees in 1999 [%]

	Municipalities	Cities	Counties	Total
National stamp duty revenue	0.44	6.41	76.64	7.81
Road tolls	0.26	4.98	0.00	4.09
Administrative fees	0.95	0.73	18.19	1.34
Other charges	11.34	3.41	0.96	4.54
Other fees	2.15	0.34	4.22	0.75
Entertainment and gambling fees	0.01	0.01	0.00	0.01
Utility charges	61.65	61.10	0.00	59.17
Utility contributions	20.19	21.86	0.00	20.89
Tourist tax	3.00	1.16	0.00	1.40
Total	100.00	100.00	100.00	100.00

for pumping water for the public water supply (30% goes to the local units, 70% to the central government). Amendments to the Public Utility Services Law were also passed. We were not able to establish the changes in the size and structure of non-tax revenue because there is no information available about the realization of the budgets of local units in 2001 and the first half of 2002.

#### *Citizen Participation*

Despite the principle saying that citizens have the right to elect, and encourage the election of, representatives in the representative and executive government bodies, there is no way in which citizens can participate in the provision or financing of public services. Members of the public do appear as the initiators of the financing of individual programs and projects, but their participation is not regulated by statute. However, non-tax revenues can include income from self-contributions. These are self-imposed levies of citizens introduced for the financing of items within the utility infrastructure—water mains, local roads and the like. However, self-contributions are not regulated by statute, even though the local units do introduce them and use them as a result of grassroots initiatives.

*Suggestion.* A more active role of citizens in providing and financing public services should be ensured. The self-contribution system should be regulated by statute.

*The situation one year later.* The first steps have been taken to ensure a more active participation of the local population in budgetary debates. Some cities have organized public debates on the budget, and some have issued first guides to the local budget, in order to explain

the situation in city coffers, as well as the intent of the city authorities in spending budgetary resources. The Urban Institute, MPULS, the MF and the Croatian Law Center (HPC) have provided a strong institutional and expert support.

#### *Financial Equalization and Allocation of Grants*

The central government provides numerous grants from the government budget—current, capital, specific and general—to local units. The grants are transferred to the counties, which distribute the funds among the local units whose fiscal capacities are below the average, in accordance with the size of their revenues. However, this does not apply to areas of special national concern, to which the government gives grants directly. The government has no clearly defined criteria for the awarding of grants. A complete confusion arises when an attempt is made to establish the total amount of funds that the state gives to local units. This is impossible because numerous grants are given through various ministries. The Ministry of Finance has no way of checking whether these funds are used, to what extent and for what purposes. Local units have no obligation (except for areas of special national concern) to report to the Ministry of Finance on the amount of funds used. It is questionable to what extent the grants are used for fiscal equalization, because most of them are spent for financing current expenditure.

*Suggestion.* Fiscal equalization criteria must be fixed. Funds for fiscal equalization should be allocated not only by the central government, but also by the richer counties and more developed cities and municipalities.

*The situation one year later.* There were no significant changes, except for the introduction of criteria for

the calculation of grants to all counties, including the municipalities and cities within the PPDS. The criteria were first applied for the calculation of grants within the framework of the government budget plan for 2002, and were built into the Law on the Execution of the 2002 Budget. Unfortunately, fixed criteria for the allocation of grants between the local units—richer to poorer (the so-called horizontal fiscal equalization) are still missing.

### *Too Many New Local Units Without Secured Funds*

In spite of an excessive number of local units, new units are still being founded by splitting up the existing units. The problem of founding a new unit is closely related to the distribution of assets. More specifically, many local units do not have any inventories of their assets (asset balance sheets), nor do they know the value of the assets they have. Many units are faced with legal proceedings for the distribution of assets. The management of assets belonging to local units is an additional problem, since there are no departments or individuals with the expertise required for these issues. Even in the central ministries, asset management is not institutionally organized.

*Suggestion.* Once and for all, the value of the assets of local units and the responsibility for managing these assets should be determined.

*The situation one year later.* No changes.

### *Problems Related to Expenditure*

The main problems related to expenditure lie in the lack of long-term capital project planning and the non-separation of current budgets from capital budgets. Furthermore, the principle of balancing budgets and borrowing is not observed, capital expenditures are financed without proper studies, and there is no appropriate recording of potential obligations (guarantees).

### *Long-term Capital Project Planning*

Decision making about capital investment and the financing of capital projects at the local level is one of the weaker links in the finances of local units. No analysis of the structure of capital expenditure is made, the execution of capital projects is not monitored and the current and capital budgets are not clearly separated. This is not even stipulated by the laws regarding local government financing.

When making decisions on capital financing, local units neither conduct investment studies nor social justifiability studies. Such a method gives then impression of a lack of seriousness, which discourages

potential domestic or foreign investors. The financing of capital projects by borrowing is practically impossible because of the low fiscal capacities of local units. The problem of the asset balance sheets in some of the units is still unresolved.

Local units do not undertake any long-term planning of capital projects, and most such projects are financed in line with the capacities of the local budget at any given moment in time. The reasons can be seen in the poor or non-existent registers of capital projects. Even at the central government level there is no programmatic classification of public expenditure.

Furthermore, local governments do not estimate the effects of making decisions about financing (current investment maintenance and the construction of facilities) on the execution and financing of projects in the years to come. For this reason, most projects are financed from the central government budget, which, again, does not have a complete oversight of the use of budgetary resources at the local level. No program of capital financing or sectoral analysis of programs exists, either at the local or central government level.

*Suggestions.* The budgets of local units should be divided into current and capital parts and all local units should be obliged to keep a financing account. Keeping registers of capital projects at the local and central government levels should be legally prescribed.

*The situation one year later.* The new account plan of the budget makes it possible for the capital part of the budget to be separated from the current part, and the execution of capital projects can be monitored. Local units can borrow for the financing of capital projects subject to the approval of their representative body and the Government of the Republic of Croatia. One of the basic conditions for this is that the total yearly annuity does not exceed 20% of the revenue realized in the preceding year.

Another novelty is the obligation to publish invitations to bid (Public Procurement Law) for selecting financial institutions or contractors.

A budget consists of a general and a specific section. The general part of the budget has to be planned according to an economic classification, and among other things it has to contain a financing account. In the financing account, the size and structure of debt and the debt repayment have to be shown.<sup>14</sup>

<sup>14</sup> The Local and Regional Self Government Financing Law, Article 61.



### *Classification by Program and Subprogram*

There is no classification of expenditure by program or subprogram. For this reason many LGUs do not program expenditure for more than a year ahead. If expenditure were programmed for several years ahead (with a realistic estimate of revenue), even in the first year it would become clear that the funds would be insufficient for the completion of many capital projects in the year(s) to come. In this way any unnecessary expenditure that arises when projects are incomplete would be avoided.

*Suggestion.* A program and subprogram classification of public, especially capital, expenditure should be introduced and applied at both national and local levels.

*The situation one year later.* There is no change, except with respect to capital expenditure. The guidelines that are sent to local units contain macroeconomic indicators for the next three years (specifically, the last guidelines contained indicators for 2003, 2004 and 2005). The new guidelines recommend that the plan of capital programs for 2003 (which is an integral part of the special part of the budget) be worked out in detail, for the purpose of long-term planning of capital programs and borrowing. Capital programs for 2004 and 2005 have to be planned according to the economic classification.

### *Principle of Balancing Budgets and Borrowing*

According to the budgetary principle, local budgets have to be balanced. Every year the local units are encouraged to observe the "golden rule" that borrowing should only be used for the financing of capital expenditure. However, in many cases the balancing principle is not observed, and local units rely on borrowing from commercial banks for the financing of current expenditure as well, although this is expressly forbidden. There are many examples in which local units do not have a clearly separated part of the budget for the financing account, in which borrowing and repayment of debt are presented. Many transactions, such as the issue of government guarantees for utility companies, are simply not registered, and there is no unified or single register of local government-issued guarantees. Guarantees are often recorded in the financing accounts of the LGUs, even if they have not become a real obligation of the unit.

*Suggestion.* Financial control of the local units' borrowing should be introduced and the volume of loans and potential obligations of local units should be reduced.

*The situation one year later.* The new Budget account chart has made it possible to record outlays for

extended loans and for financial assets in special outlay accounts. The limit up to which units may borrow or give guarantees has been set. The total yearly annuity can reach a maximum of 20% of the revenue realized in the previous year. Realized budgetary revenue is the total revenue reduced by receipts from domestic and foreign grants, subsidies and transfers from the government budget and the budgets of other local units, receipts derived pursuant to special contracts (local self-contributions, co-financing by citizens) and domestic and foreign borrowing.

### *Recording of Potential Obligations (Guarantees)*

Local units apply various methods of recording and booking the extended loans and issued guarantees. Some units record the issued guarantees as the loans extended. While planning the budget, many local units deliberately overrepresent their revenues and expenditures, which gives them better chances of borrowing than if they assessed their budgetary expenditure and revenue more realistically.

*Suggestions.* The obligation for all units to keep registers (off-balance sheet) of issued guarantees should be introduced.

Special auxiliary records of the issued guarantees should be kept. Pursuant to central government instructions, local units should plan a guarantee reserve. However, the instructions should specify the amount, i.e. percentage, of the guarantees that should be set aside as the guarantee reserve.

*The situation one year later.* At the beginning of 2002, the MF worked out in greater detail the procedure of borrowing and issuing guarantees by local budgets by virtue of the Law on the Execution of the Government Budget, and the Instruction for Borrowing and Giving Guarantees (NN 32/02).

Counties may now issue guarantees to the municipalities and cities within their territory area with the prior approval of the government of the Republic of Croatia. Counties, cities and municipalities may issue performance guarantees for firms or public institutions, which they founded or whose majority owners they are, even without the consent of the state government. However, in this case they are obliged to inform the MF of the size of the guarantees issued. Guarantees are included in the volume of a local unit's potential borrowing. The total annual annuity of a local unit can amount to a maximum of 20% of the revenue realized in the preceding year. All payments due in the current year for loans and guarantees from previous years, as



well as outstanding due obligations, are included in the total annual annuity.

The realized budgetary revenue includes the realized revenue of the unit that is contracting the debt, reduced by the receipts from domestic and foreign grants, subsidies and transfers from the government budget and the budgets of other local units, and reduced by the receipts related to special contracts (co-financing by citizens, local self-contributions or voluntary levies) as well as domestic and foreign debt.

It is worth mentioning that local units are required to submit a report to the MF on given approvals and issued guarantees twice a year (in July and December).

The Instruction and the decrees issued by the MF are a step forward in establishing the level of debt and guarantees in the local units. Finally, the implementation of the Instruction should give the MF a clear insight into the financial condition of local units and their abilities to finance capital projects.

#### *Position of Utility Companies*

Little is known about the privatization and ownership of utility companies. Many local units do not provide a realistic assessment of the value of their assets, and their responsibility for the management of these assets is not institutionally regulated. Moreover, the value of utility companies is not known. Another problem is the connection between the local budget and the utility companies. These companies operate as commercial, i.e. profit-making firms.

However, the losses of these companies are covered from the budgets of the LGUs, which pay their debts.

*Suggestion.* The ownership of utility companies should be established and the possibility of privatizing individual functions at the local government level should be created.

*The situation one year later.* No change.

#### **The Budgetary Process**

The budgetary process lacks internal controls, evaluation of activities, evaluation and remuneration for the work of employees, treasury system audits of joint-stock companies and firms owned by local units, and collaboration between the LGUs and the Ministry of Finance. Furthermore, budget-planning guidelines are too general.

#### *Evaluation of Activities (Performance Indicators)*

The system of performance in local units comes down to a comparison between plan and realization. There are

individual examples of progress in programs. However, the performance of programs is still not monitored in the sense of creating some general good or providing satisfaction for citizens.

The performance data are not supposed to be, and usually are not, part of the documentation of the annual budget. The most important issue is the monitoring of the level of revenue and expenditure, and budgetary balance, as well as control of the local units' borrowing. Local units do not keep a record of expenditure in terms of individual activities; they do not measure the effectiveness and the costs of activities by means of a cost benefit analysis, nor do they insist on quality, efficiency and management. Performance is not an imperative, either at the central government level, or at the local level.

*Suggestion.* Every budgetary financial transaction should be able to identify the budget and cost center, its purpose or the service it provides, the source of funds and the kind of revenue or expenditure.

*The situation one year later.* The local unit budget classification system has been improved. Local units classified the plan of the budget for 2003–2005 according to organizational, functional and economic principles. This gave insight into the place of expenditure, the purpose, the source of funds and the type of receipts/revenues and expenditures/outlays. This means that receipts/revenues and expenditures/outlays are planned and distributed according to an economic and functional classification with a clear organizational structure and budgetary beneficiaries. The introduction of a clearer classification of the budget provided a good basis for drawing up performance indicators of the execution of the functions and tasks of local units. The provision of these indicators depends heavily on the initiative and desire of individual local units to establish the quality, quantity, and costs of the provision of public goods and services to the public in their respective areas.

#### *Evaluations and Rewards for the Work of Employees*

The work of employees in local units is not evaluated. There is no system for monitoring success and quality of work, or a system of incentives for better performance. Performance is not evaluated at all. Discussions continue within the statutory framework, while a concrete shift towards change and improvement is expected from outside, i.e., from the central government. The model of initiative and independent, active and creative work has not been internalized. Owing to lack of incentive

measures or criteria for providing incentives, individuals cannot be expected to carry out creative, high-quality work. Ideas interest nobody, and the final result, in which there is no systematic effort to raise the quality of the work of employees, is inertia and red tape.

*Suggestion.* The government and the local units should be able to prescribe a system of incentives for good work, and penalties for inefficient work.

*The situation one year later.* No change.

### *Internal Control*

Internal control is not organized, neither in ministries or at the local unit level.

*Suggestion.* Set up internal control in larger local units and ensure that internal control is carried out in the counties on behalf of smaller units that are incapable of doing this themselves.

*The situation one year later.* No change.

### *Audits of Joint Stock Enterprises and Firms Owned by Local Units*

Like privately owned companies, joint stock enterprises and firms owned by local units are subject to state audit and commercial audit. It is not clear why both types of auditing are required.

*Suggestion.* It should not be necessary to carry out external commercial auditing of the utility companies, only the national auditing. For this reason the Accounting Law needs amending. This would reduce the costs of auditing, and the national audit system would then carry out the audits of these firms within the required time limits.

*The situation one year later.* No change.

### *Guidelines of the Ministry of Finance*

A problem that occurs in the early phases of the LGU budget planning is the implementation of the Ministry of Finance guidelines, which are too general for the purposes of most local units.<sup>15</sup> For this reason the Ministry of Finance has to pay more attention to the specific needs of each of them and adapt the guidelines to the units (municipalities, cities, counties). The problem lies with the MF, which gives priority to the counties and the city of Zagreb in requesting the budget preparation and submitting the guidelines. In line with these guidelines, the counties are required to make estimates of their own budgets, and draw up guidelines for the cities and municipalities in their respective territories. However, the counties do not fulfill their obligations, nor do they draw up guidelines with indicators for the cities

and municipalities in their regions. This is the basic reason why most of these units consider the guidelines too general and partially inapplicable. In addition, the municipalities, cities and counties are obliged to draw up their budgets by December 15 for the next year. Very often, budgets are passed at the very end of December. Many units make at least one or two revisions of the budget during the year—some of them even three or four.

*Suggestion.* The Ministry of Finance guidelines should be adapted to the levels of local units, and the local units should be obliged to draw up their own indicators. A unified model of budgetary planning for all local units should be prescribed.

*The situation one year later.* There are no significant changes, except for the insistence on timely submission of guidelines to local units, so as to leave them enough time for more realistic planning of the budget and the provision of their own guidelines. In 2002, the guidelines were sent to the local units in June. Still, there have been problems, because the counties are often late in making their own guidelines and sending them to the cities and municipalities. Therefore they receive the guidelines from the MF before they get those from the county. From a technical point of view, the guidelines for the preparation and drafting the budgets of local units for 2002 and 2003 were more detailed than those in previous years.

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<sup>15</sup> The Ministry of Finance sends out a circular for the preparation of the three-year plan of the LGUs budget, which includes the following items: (1) Basic indicators of macroeconomic policy for the coming three-year period (growth rates of both nominal and real GDP, inflation rate, wage growth rates, trends in employment, cost of living and so on) and an estimate of trends in joint taxation at the national level. (2) Recommendations for realistic estimation of the growth of revenue and receipts, and shared taxation in the revenue of the local budget. (3) Estimates of local tax and non-tax revenue and receipts, with financial control of their assessment and collection. (4) Determination of the amount of current and capital expenditures, and definition of priority expenditure that has to be adjusted with the planned rate of growth in joint and own revenue. (5) Local units should adhere to the real dynamics of realization of revenue through the year as the basis for planning and execution of tasks. (6) Adjustment, i.e., reduction of public expenditure, in case of lower realization of public revenue owing to a drop in economic activity. (7) Attention should be paid to the balancing of local budgets. (8) Local units that are provided with resources (current grants, transfers) from the government budget should observe the prescribed limits related to the growth of wages and material costs.

## Conclusion

After recognizing the main problem related to the fiscal structure, i.e. the absence of an efficient budgetary system and clearly separated functions and competencies both on the revenue and expenditure sides, the basic recommendations may be provided to the government and to economic policymakers. In accordance with the numerous suggestions given above, a reform of the budgetary system of LGUs in Croatia should be carried out in several phases. For this purpose, a further research into the financial position of the LGUs still needs to be carried out. The main problem about the reform is its excessive politicization that might discourage any new initiative. For this reason it would be better to concentrate on possible improvements in the present system of LGUs, with the emphasis on strengthening the budget, budgetary techniques and the budgetary process at all levels of government and activating a more powerful financial control mechanism at the level of the central government. All the main participants in the budgetary process—Parliament, Government, ministries, budget beneficiaries and citizens—should be educated to understand the aims and purposes of the measures proposed for the future.

*The situation one year later.* A year after the beginning of the reform of the local unit financing, it became clear which steps have actually been taken and what would be the direction of the reform in the future. The functions of education, health care and welfare have been partially decentralized. However, as these functions are financed from the budgets of local units, the Equalization Fund, and from a larger share of local units in income tax, we may conclude that this is not really fiscal decentralization, but rather a partial transfer of authority for the financing of partially decentralized functions.

The legal status of all local units has been equalized, so that they can all carry out administrative functions. In spite of the wish to unite some small local units and to reduce their number, a trend towards the foundation of new units continues. Unfortunately, they are usually not founded on the basis of a realistic estimation of their ability to provide independent financing.

Without the available and accessible data, it is not possible to estimate the real effects of the reform measures and compare the reformed state with the pre-reform situation. Nevertheless, it can be concluded that income tax has become the basic instrument for financing decentralized functions, and that a model of fiscal equalization founded on tax sharing is being tested. While using this model, no account has been

taken of the fiscal capacity of individual local units (Zagreb, for example, did not need a larger share in income tax because its revenue, in all its categories, is sufficient to finance the decentralized functions). It is interesting that not a single municipality has assumed the decentralized functions, although a considerable number of municipalities introduced surtax. An assessment of their fiscal capacity would show if these municipalities were really in a bad financial position, that is, incapable of financing the decentralized functions.

After the implementation of reforms, the budget should improve and become a better source of reliable information. Information from financial reports must finally be used in the planning and adoption of budgets. In principle, the consolidation of the budgets of local units has been secured. Local units can provide numerous performance indicators concerning the execution of their jobs. Neither the local units nor the MF have any reason or excuse for not publishing exhaustive information about the budget realization of local units.

However, consolidation of the budgets of local units will heavily depend on the definition of “budgetary beneficiary.” Owing to a lack of such clear definitions (particularly of property, and the balance of revenue, expenditure and debt), the quality of consolidation carried out at the level of local units is questionable.

Formally, control of borrowing and the issue of guarantees have been strengthened, and it is possible to establish the balance of borrowing as well as the structure and size of guarantees. However, no major changes are expected until the central government proves its capability of implementing the same thing with respect to its own budgetary beneficiaries.

The main task of the government is to decide what it really wants: 1) decentralization of authority and finances; or 2) decentralization of authority and centralization of financial resources.

If it wants to decentralize both the authority and revenue, then it must leave a larger part of the taxes within the competence of the local units. That, again, would result in a problem of too many small tax systems, i.e. a parallel tax system at the local unit level, where the existing tax system is already difficult to control.

If it wants decentralization of authority and centralization of revenue, then it should say this clearly, and work on the improvement of the model. In this case, the central government should provide for calculations of fiscal capacity for all categories of revenue, expenditure, and tax and non-tax revenues. To achieve this goal an appropriate institutional structure should be developed.

A public advisory institution for making estimates of fiscal capacity for lower levels of government should be established based on the U.S. model (in the U.S.A. this is the Advisory Commission for Intergovernmental Relations—ACIR).

Only the MF can make estimates of fiscal capacity, lay down the criteria for the calculation of fiscal capacity and fiscal equalization, and change the share of local units in joint taxes. No other ministry (the Ministry of the Interior, for example) should be involved in these affairs of the MF.

During 2002, the MF provided education to the local units for the purpose of their better understanding and implementation of the reform of budgetary and local unit financing. Although the dynamics of the changes are well coordinated, the application of the financial management model is behind schedule. This model should provide for the unification of all types of information in the system of financial and fiscal reporting.

However, further progress in the reform will heavily depend on the capacities and knowledge of individuals at the central government level, but also in the local units, who have to implement the ideas of the initiators of the reform on the spot. Every wrong central government decision with respect to the assignment of authority and resources can be a step backward from the main objective of providing a simple, user-friendly and reliable system of financing in the local units.

The implementation of reform measures lies within the competence of those employed in the local units. For this reason, each local unit has to determine the criteria for setting the wage levels and designing the remuneration systems for their workers based on their performance. After all, this is also the task of the government ministries.

# Development of the Budget Process and Introduction of Controlling into Slovene Municipalities

Srečko Devjak

University of Ljubljana, School of Public Administration

## Summary

*The paper presents elements of the Slovene Public Finances Act, which importantly determine the development of management in a municipality. Special features of the implementation of tasks falling within the competencies of municipalities—taking into account legal provisions of budget planning and control, as well as implementation of programs of elected officials—are factors of the budget process that can be mastered by a successful performance of the functions of controlling. Development of indicators and information support to the budget process are important elements when introducing the function of controlling and modern management in local self-government. This paper presents one of the ways of developing the system of indicators in the circumstances of the data limitations of local self-government.*

**Key words:** budgetary process, controlling, local self-government

## Introduction

Municipalities are integrated into the process of public financing in various phases of the procedure and with various documents. Municipalities with their documents:

- determine the activity programs for the tasks falling within their competence,
- define goals to be achieved by carrying out the set activities, and
- establish the deviations in carrying out the activities and achieving the planned goals.

When implementing the tasks falling within their competencies, municipalities are limited by legally determined organizational conditions and conditions of their own organizational development. If the organization of the entire process is successful, this is reflected in the

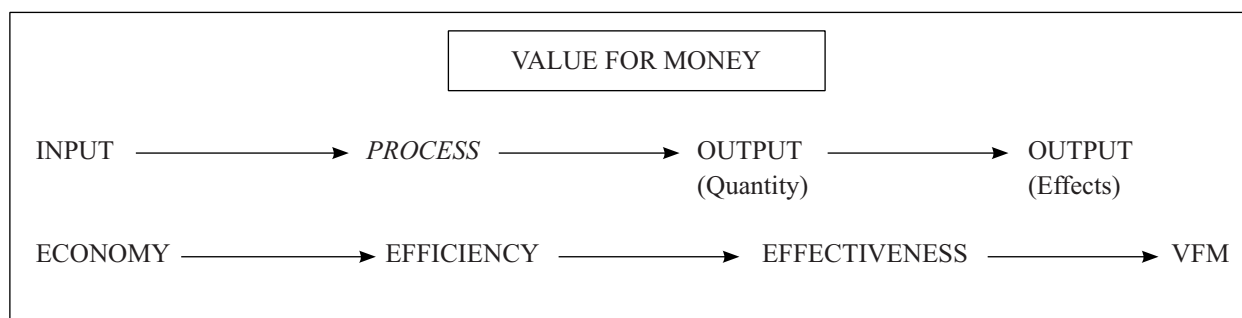
implementation of goals and the improved efficiency regarding tasks falling within the competence of the municipality.

Since the last amendments to the Local Self-Government Act and the Financing of Municipalities Act, a systemic framework of the municipalities' financing and functioning has been established in Slovenia pursuant to the principles of the European Charter of Local Self-government. The new Public Finances Act, adopted in 1999, integrally regulated the field of financing municipalities and management of assets. By putting into force the new regulations in the field of public finances, the integral reform of public finances, which happens at the state level, is also being implemented at the local level. The modified system of financing municipalities enables greater autonomy for the municipalities when making decisions on local public matters. This sets new requirements for the operations of the municipalities since they must function as "service establishments" for their inhabitants, i.e. perform the tasks falling within their competencies as successfully as possible.

In the last decade, in all developed countries the success in the public sector (including local self-government) has been examined with particular diligence. In this period, general criteria for the estimation of the successful implementation of the public sector's tasks were established. John Rouse (Kester, I.H., 1993: 73–104) determined three basic criteria for measuring success in the public sector. Success is determined as a simultaneous fulfillment of the three criteria: economy, efficiency (productivity, and the like) and effectiveness. In specialized literature this triple criterion is in short determined as the "3E" criteria (economy, efficiency, and effectiveness) and denominated by the common concept of the "value for money" (VFM). This is the comparison of consumed assets (expressed in costs) with the quantity of services and effects (quality) of services. The process of the "value for money" is systematically presented in Figure 1.



Figure 1. Management of Measuring Success in the Public Sector



Summarized according to: John Rouse, in Kester, I.H., 1993: 85.

Various authors explain concepts of the “3E” criterion by presenting examples for various tasks of the public sector. From their interpretations some basic explanations can be drawn. *Economy* marks the costs of the performed services and through these often reveals other organizational features of the performer of the services and its capacities. *Efficiency* marks the volume of services performed with regard to the ability conditioned by the capacity, or, in other words, which capacities would suffice for the performance of the treated volume of services. *Effectiveness* marks the result achieved through the performed services. The volume of services can be measured with the customers’ satisfaction with the performed services. Often performers set the criterion of the achievement of results. Nevertheless, the criteria for beneficiaries and performers may differ. Here the problem of the conflict of criteria may appear. In such cases the harmonization of all criteria and possibilities is recommended.

This paper will deal with the influence of legal regulations concerning the management of the public financing process and the factors that influence the development of the organization of management and controlling<sup>1</sup> in Slovene municipalities. We will present some necessary conditions that would enable the functions of controlling and management to contribute more substantially to the successful development of municipalities.

<sup>1</sup> Controlling could be defined as one of the instruments for the management of public finances (resources). It should include the process of realizing revenue and receipts, and the execution of budgetary expenditure with the objective of reporting to the representatives of the local executive government (local managers) concerning the opportunities for a more rational and effective collection of budgetary revenue, and the spending of budgetary resources. In this process, controlling would include the coordination

### Budget documents

The Public Finances Act (Official Gazette of the Republic of Slovenia, No. 79/99) determined the frameworks that in their core elements also determine the conditions of management in municipalities. Therefore, it is necessary to know the provisions of the Act in order to be able to establish the possibilities and methods of organizing the management processes in a municipality.

The Public Financing Act determines the composition of the budget and the financial plan, the drawing up of the budget and the financial plan, passing of the budget, implementation of the budget, management of state and municipal property, incurring liabilities, management of liabilities, guarantees of the state and municipalities, indebtedness of the public sector, accounting, final account of the budget, budget control and legal provisions. At the end, the Act stipulates transitional and final provisions. Since the Act introduced a number of novelties that lead to methodological and technological improvement in the development of the management of the budget process, the implementation of these novelties is harmonized with the creation of appropriate methodologies.

In this paper, the organization of management in a municipality will be examined from the viewpoint of increasing the success of the municipality. The basic and synthetic statements showing the condition in a municipality are the budget and the balance sheet. The

of matters in the drawing up of the budget; the coordination, harmonization and integration of the demands of budgetary beneficiaries (spending agencies) in the adoption of the budget at the local level; the monitoring of the execution of the budget as the point of departure for the adoption of the budget in future periods, and a consultative role in the process of adopting and executing the budget (after Quigley, 1999; Stiglitz, 1988).



Table 1. Elements of the Balance Sheet

A – Assets		B – Liabilities and equity	
1	Non-financial assets	33	Liabilities
9	Financial assets	49	Equity
28	Assets (from reserves, joint liability, other)		Sources of assets (for reserves, joint liability, other purposes)
31	Total assets	56	Liabilities, equity and other sources
32	Debt of the republic municipalities	58	Liabilities to budget and public administration bodies
57	Receivables from budget and public administration bodies		
0	Total assets (31+32+57)		Total liabilities (56+58)

first presents the assessed volume of the municipality's activity in a certain time period; the latter, the balance of the municipality at a certain point of time.

The balance sheet of a municipality is a synthetic indicator showing the balance of the municipality by all types of assets and the structure of sources of assets. The basic structure is presented in Table 1: Elements of the balance sheet. From the balance sheet the economic potential of the municipality is evident.

In Figure 3 the basic, legally determined breakdown of items in the municipality budget is presented.

Pursuant to the Public Finances Act, the municipality budget may have the same structure as the state budget. The difference is in the part of the budget where the allocation of budget assets to budget beneficiaries is presented. The budget structure is double; i.e. it has both economic and functional classifications. The latter is important from the viewpoint of estimating activities that increase the successful implementation of goals when performing tasks that fall within the competence of a municipality.

Both synthetic statements therefore show any change in the economic conditions in a municipality. The budget shows the economic scope of activities in a certain period, whereas the balance sheet shows the shifts that have occurred in the assets potential of a municipality due to budgetary planned and carried out activities. Figure 3 shows the gradual changing of the asset potential of a municipality through budgets.

Figure 3 Correlation of a budget and a balance sheet in the changing of the asset conditions of a municipality

The above Figure indicates a cause and effect relation between budget and asset conditions in a municipality. In the present situation in Slovenia, the assets aspect is undoubtedly neglected on account of the development of the process of budget planning.

The development of the budget process requires the assurance of the balance of budgets at the state and the municipal levels and coordination between the budget beneficiaries. These documents are different: some have a steering or coordinating role, others are binding because they are resultant and drawn up taking into account the limitations and the conditions expressed in the budget planning process. The whole process is carried out at the state level for (almost) a year, whereas at the municipal level a few months shorter. The steering and coordinating role of the documents can be seen from the planning horizons (periods) for which the document contents are determined. These periods are various, as indicated in Table 2. It is evident from Table 2 that the longest period is required for the "Budget memorandum—of the state budget" which encompasses the current year, the next year and the scenario for the following three years. This document plays a clear steering role, whereas the other documents encompass the sub-periods of the budget memorandum. The shortest period—one year—is covered by the budget, which is, however, the most binding document. The documents with the longest planning horizons are "plans of purchase and constructions," which are prepared for periods of four years according to a sliding planning method. The documents for longer periods are those that express the necessity of the introduction of controlling and enable it due to their contents. Great progress in the operative sense was made by the introduction of monthly documents of financing of municipalities. These two forms were called:

- P—budgetary revenues and expenditures for the month (according to the economic classification)
- P1—budget expenditures according to the functional classification.

Figure 2. Structure of a Municipality's Budget

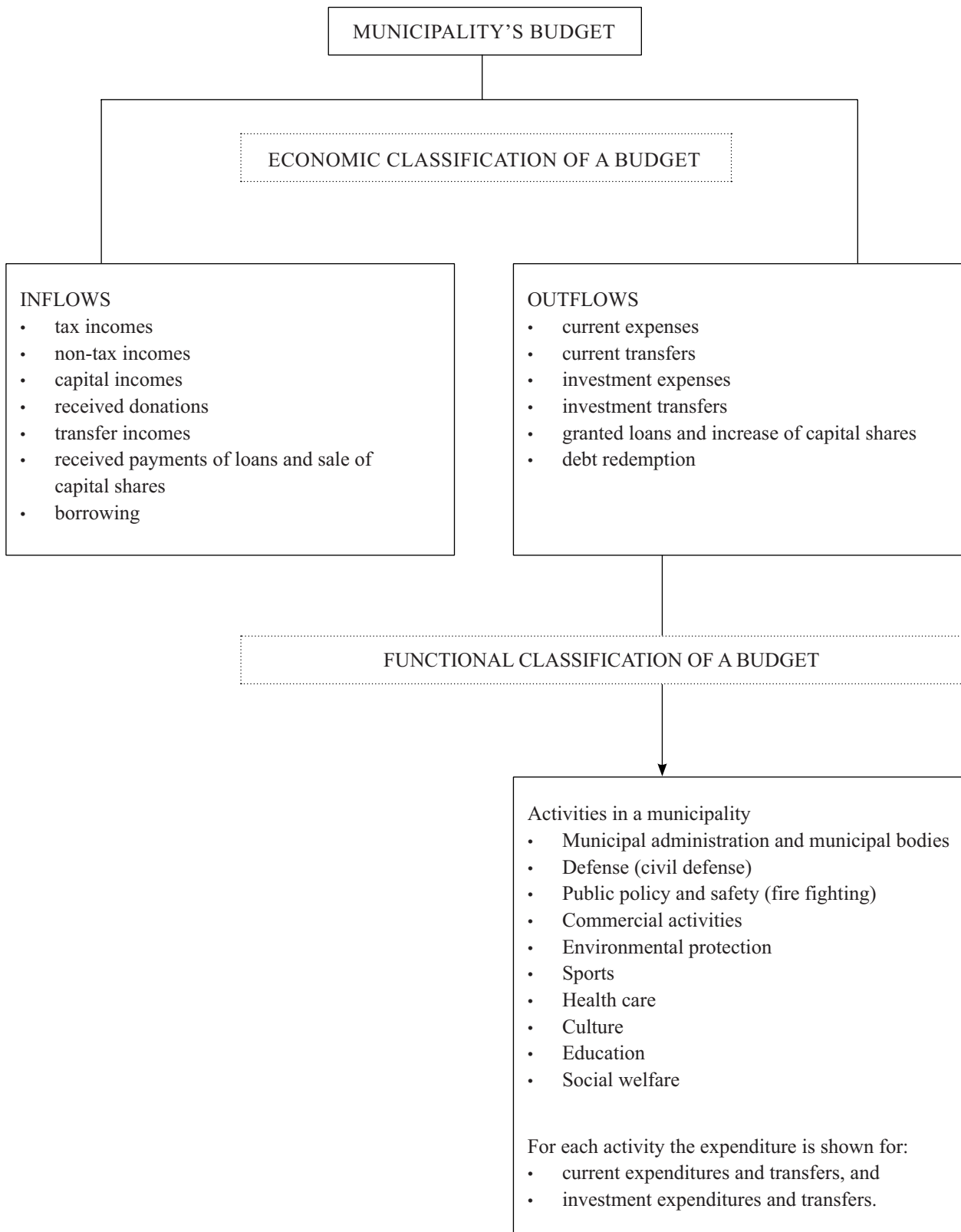


Figure 3. Correlation of a Budget and a Balance Sheet in the Changing of the Asset Conditions of a Municipality

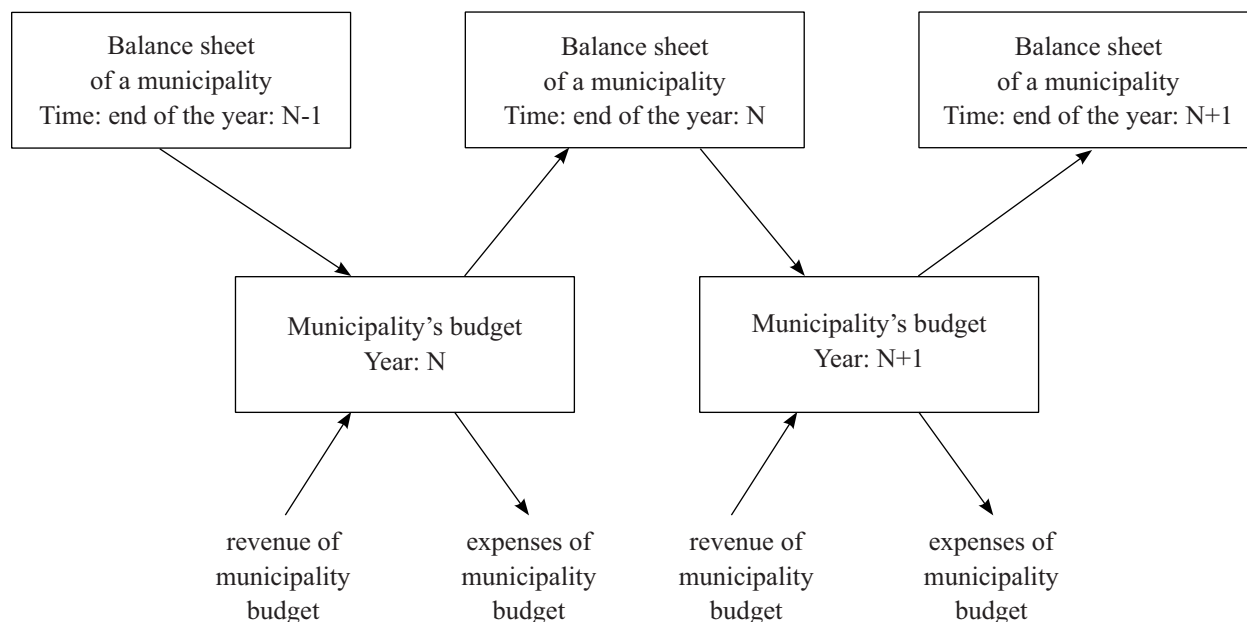


Table 2. Planning Periods for the Documents of Budget Planning

Documents	Time interval
Budget memorandum of the state budget	Current year, next year and scenario for the following three years
Instruction for the preparation of the proposal for the state budget	Next two years
Budget—special part, financial plans of the budget beneficiaries	Previous year, the estimate for the current year, the plan for the next year
Plans of the development programs of direct beneficiaries	Next four years
Proposals of financial plans of direct beneficiaries (goals, indicators, etc.)	Current year and the next two year
Instructions for the preparation of the proposal of the municipal budget with: <ul style="list-style-type: none"> <li>– the contents for the preparation of financial plans of direct beneficiaries</li> <li>– time schedule of the preparation of the state budget</li> </ul>	The estimate for the next two years
Plans of the development programs, workplaces and purchases of basic means of direct beneficiaries—preparation and coordination	
Development programs and purchase of basic means	– four years (development programs and purchase of basic means)
Workplaces	– two years (for workplaces)
Preparation of financial plans of direct beneficiaries (state—municipal budgets)	Previous year, the estimate for the current year, the plan for the next two years
State and municipal budgets—plan of incomes and expenses	With budgets, the object of adoption is only the plan of incomes and expenses for the next year
Plans of monthly implementation of budgets	For annual budget
P and P1 forms	For monthly periods (possible for several months)

## Budget process

The budget process comprises:

- the activities for the preparation of the annual budget in the state and in a municipality;
- the process of the implementation of the budget of the current budget period;
- the procedure of the preparation of the final account of the budget for the concluded budget period; and
- the procedure of drawing up a balance sheet.

The process of monitoring the implementation of the budget is planned for quarterly and monthly periods. The law emphasizes the liquidity aspect of budget monitoring.

The final account of the budget is the result of co-ordinated activities of the preparation of final accounts of municipal budgets, of budget assets beneficiaries and the state (Table 3). Table 4 Procedure of preparation of final accounts of budgets (defined in Articles 96–99 of the Public Finances Act) shows a framework plan of the preparation of final accounts of budgets after the end of a budget year. The whole process is carried out in the period from January to October.

Balance sheets are prepared according to the provisions of the Act (Public Finances Acts (PFA), Articles 93 and 94) in the period from February to May for

December 31 of the previous budget period, which is shown in Table 5: Procedure of drawing up the balance sheet and related documents. The procedure of drawing up balance sheets includes all beneficiaries of budget assets. The balance sheet of the state is discussed by the National Assembly every second year when the final account of the budget is discussed.

Table 6: Municipality activities related to budgets and balance sheets in the year “N” is a summary of the implementation of budget activities (the budget of the previous period, the implementation of the budget of the current period and the budget of the following period) and the activities of drawing up a balance sheet. The Figure shows that activities related to the analyses of budget documents and balance sheets are carried out throughout the year.

If we only observe the period of treating the selected annual budget, it can be seen from Table 6 that in a municipality each budget is treated over at least two years (from May to December it is in the preparation phase, the following year it is being implemented, and over the next six months analyses and the final account are being prepared).

It can be established that in a municipality activities related to budgets and balance sheets are running continuously and require an organized work plan to assure the development of the management of this process.

Table 3. Procedure of Preparation of the Annual Budget and the Documents Related to It

Document	Level	Framework period
Budget memorandum	D	April
Instructions for the preparation of the proposal for the state budget and the time schedule	D	May
Drawing up of financial plans of budget beneficiaries (direct and indirect)-of the state budget	D	June, July, August
Instructions for the preparation of municipal budgets	O	July
Drawing up of financial plans of budget beneficiaries (direct and indirect)-of the municipal budget	O	July, August, September, October
Plans of development programs, purchase and construction, workplaces—of the state budget beneficiaries	D	October, November, December, January (budget year)
Plans of development programs, purchase and construction, workplaces—of the municipal budget beneficiaries	O	October, November, December, January (budget year)
Discussion and adoption of the state budget	D	October, November, December
Discussion and adoption of the municipal budget	O	December, January (budget year)
Plans for monthly implementation of budgets	D O	January (budget year)

D – document of the state budget process

O – document of the municipal budget process

Table 4. Procedure of Preparation of Final Accounts of Budgets

Element (Public Finances Act, Articles 96–99)	Period
<b>State budget</b>	
Final account of a financial plan—direct beneficiaries of the state budget	February
Proposal for the final account of the state budget	March
Court of auditors—Preparation of the report on final account	April
Ministry of Finance—prepares the proposal for the final account for the Government and encloses the report of the Court of auditors	May
The Government—determination of the proposal of the final account to be adopted in the National Assembly	June to September
<b>Municipal budget</b>	
Final account of a financial plan—direct beneficiaries of the municipal budget	February
Preparation of the proposal for the final account of a municipality	April
Submission of the proposal for the final account to the Ministry of Finance	March
Preparation of the proposal for the final account for the discussion in the municipal council	March, April
Notification of the Ministry of Finance on the adoption of the final account of the municipal budget	May

Table 5. Procedure of Drawing up the Balance Sheet and Related Documents

Document	Period
<b>Balance sheets (PFA, Article 93)</b>	
Balance sheet of direct beneficiaries of the state budget	February, March, April
Balance sheet of indirect beneficiaries of the state budget	February, March, April
Balance sheet of direct beneficiaries of the municipality budget	February, March,
Balance sheet of indirect beneficiaries of the municipality budget	February, March,
Balance sheet of the municipality	March, April
Consolidated balance sheet of the state and municipalities (every two years it shall be enclosed with the final account of the state budget)	May

Table 6. Municipality Activities Related to Budgets and Balance Sheets in the Year N

Documents	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Final account for the budget for the year N – 1	_____											
Balance sheet as at 12/31 of the year N – 1	_____											
Budget for the year N	_____											
Budget for the year N+1	_____											

**Reasons for the Introduction of Controlling into a Municipality**

The majority of authors defines controlling as a function of management and distinguish between operative and strategic controlling. In order to explain the concept of controlling, many authors use the notion of a “system navigator” that prevents the ship from becoming stranded on dangerous shores.

In a condensed form, the tasks of controlling are presented in Figure 4: Basic tasks of controlling (after Ossadnik, 1998:26). This schematic presentation helps us to explain the structure of tasks taken over by controlling in any system. Figure 4 summarizes the basic tasks of controlling in the following three groups:

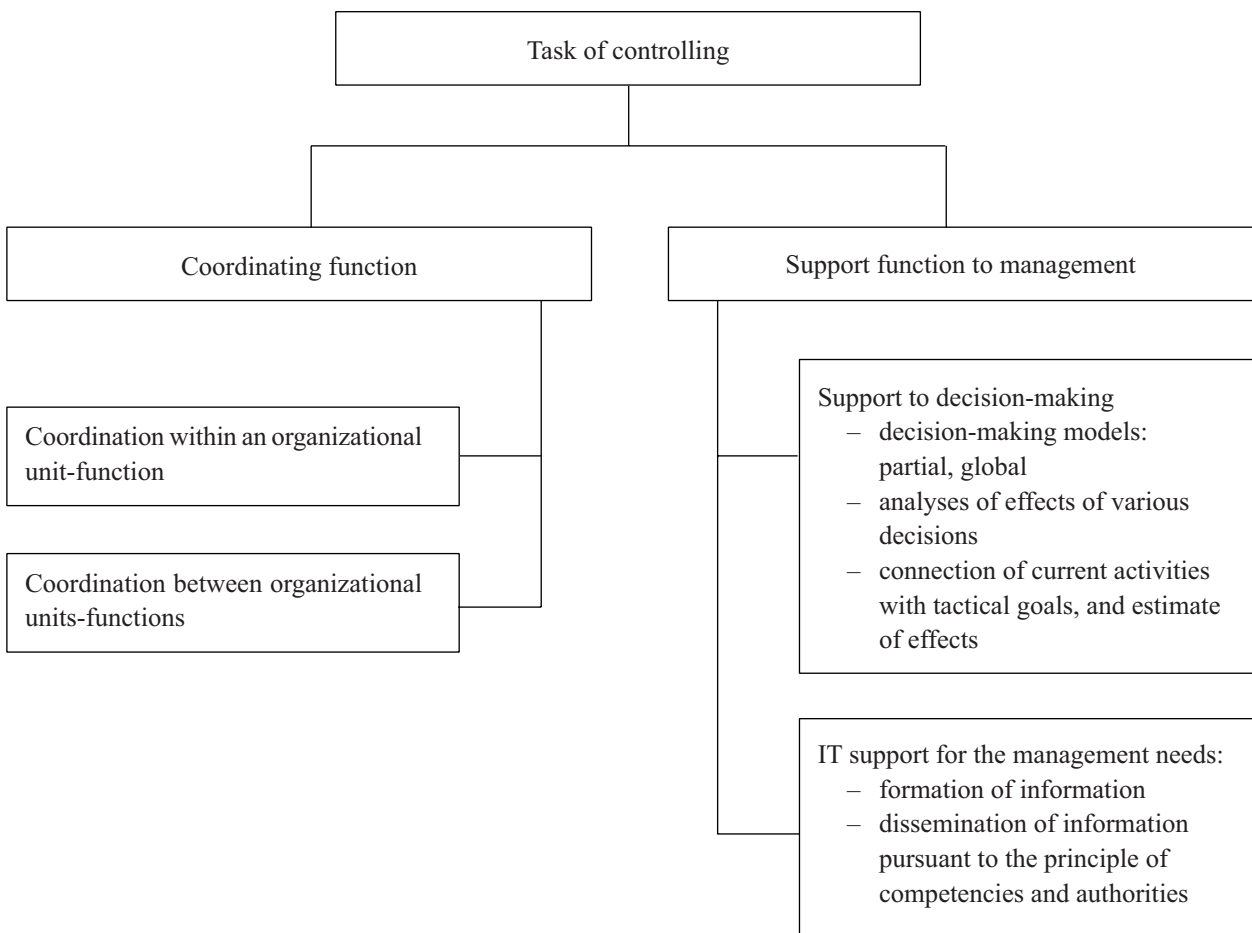
- The coordinating task in a system or between systems—within a function or between functions—presents the viewpoint of an integral treatment and direction of the system’s operation.

- Support to management for the needs of decision-making (development of models and methods that enable analyses of activities and analyses of the effects of decisions made on operative and particularly strategic goals).
- Development of information support for the needs of decision-making (definition of the type and ways of forming information is the task taken over by controlling merely because of the powers allocated to it due to the implementation of other tasks).

Introduction of controlling into a municipality must be examined from several viewpoints:

- a) The role of operative and strategic controlling: officials who were elected in municipalities present their programs (usually before elections). The contents may be understood as strategic goals that they try to realize over shorter (annual) sub-periods.

Figure 4. Basic Tasks of Controlling





The implementation of strategic goals is the task of strategic controlling, whilst the implementation of annual goals and other short-term goals (lasting less than one year) is the task of operative controlling. Controlling should draw attention to deviations occurring during the implementation of the set goals.

- b) Coordinating function: the municipality is responsible for the implementation of all tasks carried out in cooperation with indirect or direct beneficiaries of budgetary assets, in compliance with the state budget programs or independently. Thus, coordination is a task the municipality must perform:
- when implementing various tasks falling within its competence;
  - with various organizational units, budget beneficiaries and budget sources;
  - when drawing up and implementing provisions of various planning documents.
- c) Support in the decision-making process comprises documents and other analyses, which provide information on the efficiency of implementing tasks falling within the competence of a municipality. This includes econometric and other models predicting the development of issues, estimation of efficiency of implementing projects and tasks, etc. Of course, for the design of such models also the data limitations are also important, therefore the development of information support is a very important task of controlling in a municipality.
- d) Development of information support for the needs of decision-making is a task which is important for the sake of precisely (unambiguously) expressing goals and monitoring their implementation as well as for establishing the development level of a certain field falling within the competence of a municipality. As a rule, it is implemented simultaneously with the other tasks of controlling. An important area of the IT development is the development of the system of indicators. In municipalities this system may be gradually developed, but it must be according to the program assuring the final form of the integral system of indicators (i.e. data limitations, new activities, etc.).

### Possibilities of Introducing Controlling into a Municipality

Possibilities of introducing controlling into a municipality can be determined by:

- estimating legal elements which define the functions of controlling from the viewpoint of the implementation of tasks falling within the competence of municipalities and budget documents;
- assuring organizational and IT conditions necessary for the implementation of controlling in municipalities.

We have examined the budget process in the case of Slovene municipalities and it can be estimated that regarding the implementation of strategic and operative controlling in municipalities this process is legally determined in an integral and precise enough manner.

Deficiencies in this process can particularly be found in the fifth implementation phase of the thus determined process and thereby functions of controlling, such as:

- provision of appropriate information support to this process;
- economic and organizational development of municipalities and their services.

The most frequent questions are:

- how to draw up documents;
- how to coordinate the drawing up and implementation of documents;
- whether expert services have the knowledge and methodologies for the estimation of the consequences of various decisions and the influences of various factors on budgetary and other tasks falling within the competencies of municipalities;
- whether these services have an appropriate data and information base enabling the concretization of goals in the phases of drawing up documents and analyzing their implementation.

After the first steps of the mentioned budget process were made, it was obvious that the central problem was the data needed to set quantified goals regarding the implementation of tasks falling within the competence of municipalities. In developed countries these kinds of data are commonly used (predominantly in Internet forms) and are called indicators. They cover various information

needs arising from the above-mentioned “value for money” concept. These indicators are very frequently used for informing inhabitants of municipalities, since they have been proven particularly to contribute to the development of local self-government.

### **Possible Approach to the Development of the System of Indicators**

In Slovenia, and in numerous similar countries that are in the process of democratization, such databases cannot yet be found. But there is the awareness of the need for such data and indicators, therefore there are various developmental activities going on in the field of the development of such a system. Based on the acquired information, the following findings can be summarized:

- public (statistical) databases are lagging behind the changing structure of local self-government, such as: fast changes in the number of municipalities, development of regions, inappropriate measurement systems;
- structures of the accountancy data of municipalities are in the process of development;
- there are quite a lot of data that are not published by offices, since this would increase the responsibility of these offices as to the correctness of data gathering and processing of databases;
- many expert services and politicians are not in favor of making their work transparent.

The stated facts helped us to discover that in such circumstances it makes sense to develop the system of indicators pursuant to two principles:

- the system of indicators from public databases which will be public and accessible to everyone;
- supplementary systems of indicators, established on the basis of data gathered from the interested municipalities, which pursuant to the regional or any other principle decide for the IT development of areas important for the implementation of special (selected) tasks falling within their competencies.

It will be possible to develop the first group of indicators simultaneously with the development of public databases gathering the data within the framework of the state statistics, ministries, institutes, etc. The problem to be solved is related to the development of local

self-government (frequent changing of the number of municipalities, development of regions). Since indicators present the characteristics of phenomena in relative numbers, the calculation of indicators must be assured on reasonably comparative bases.

Development of the second group of indicators will be related to the development of organization and computer processing in municipalities and beneficiaries of budget assets, thus enabling comparable data for the creation of a system of indicators (e.g.: the results achieved by elementary-school pupils in secondary-school programs in relation to additional financing of elementary schools, or the presence of children in kindergartens in relation to the bonus system of nurses). We are aware of the fact that the development of this part of the system will be slow and that it is related to the development of work and values in every activity (education, health care, etc.). Already now (and hopefully also in the future) in some municipalities, or even in all of them, ministries and other public offices occasionally carry out various studies. It certainly makes sense to include the results of such studies among the indicators from which municipalities can benefit when drawing up their developmental goals.

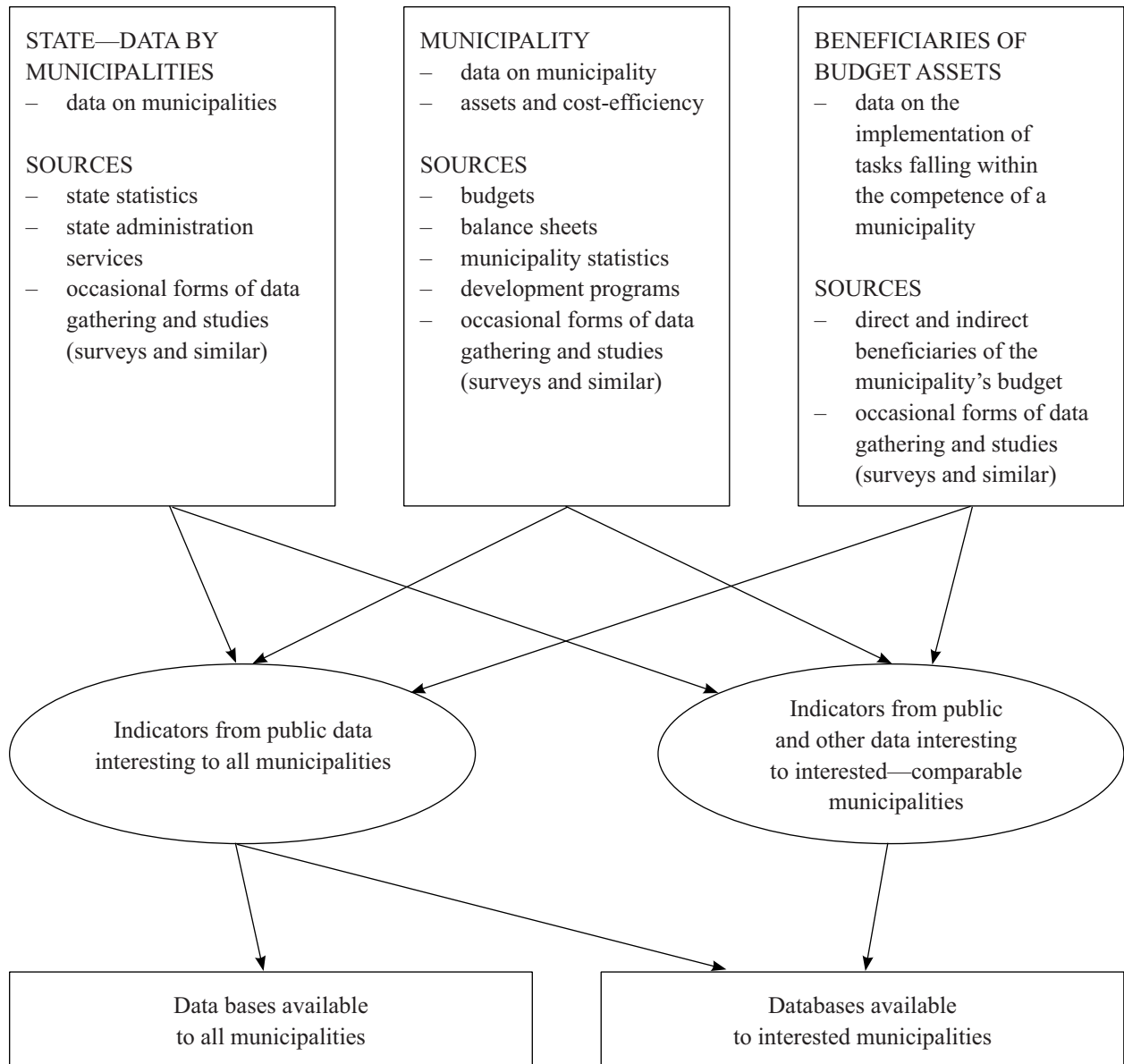
In Figure 5 the basic idea of organizing the central system of the system of indicators and its distribution is presented.

### **Conclusion**

The most important factors that speak in favor of the introduction of the controlling function into municipalities are: the contents of documents and the procedure of (sliding) budget planning, the tasks of municipalities and their connectedness, the way of controlling the budget, and programs of municipal officials. Conditions of introduction differ with regard to the size of municipalities and their organizational development. The operative monitoring of the implementation of the budget is undoubtedly one of the most important factors for the development of operative controlling, whilst political programs are important for the development of the strategic controlling in a municipality.

It can be established that the Public Finances Act creates conditions that, because of the tasks arising from the activity of budget process and efficiency of the development of fields (activities) falling within the competence of municipalities, require the development of the controlling function in Slovene municipalities. Pursuant to Reinermann (Böhret, 1995:185–196), the “New Public Management” is the concept of managing

Figure 5. Gathering of Data and Distribution of Indicators to Municipalities



public government according to which the results of work are estimated through goals and their achievement. Therefore the development of indicators as a means of expressing goals is a task which is a part of the entire program of public sector development and thereby also local self-government. It can be ascertained that controlling in local self-government is a concept that helps in implementing the basic tasks justifying the role of local self-government. Controlling in the budget process covers the field which can be a priority task due to its systemic and accounting regulation.

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# Involving the Public in the Budgetary Process —The Experiences of the City of Crikvenica

**Ivica Malatestinić**

*Mayor of Crikvenica*

## **Introduction**

The main reason for involving the public of the City of Crikvenica in the process of their local budget preparation was to give citizens an opportunity to influence the decisions that are of great importance for their everyday life by making proposals.

The most efficient ways of involving the public in the process of the City Budget preparation are the following:

- holding public forums
- conducting surveys
- organizing debates on specific groups of topics
- organizing discussions in boards and committees.

Given the size, the number of inhabitants and other characteristics of the city, we decided to hold a public forum, as the most efficient way of including the public in the preparation of the City of Crikvenica Budget.

## **Public Forum—a General View**

A public forum as a way of involving the public in the local budgetary process has many advantages, as it ensures:

- improved decision making;
- timely information on various issues and problems, which results in a more ready acceptance of certain decisions by the public;
- better understanding between the local government representatives and members of the local community;
- more accessibility and straightforwardness on the part of the local government;
- assistance to the local government representatives in setting budget priorities.

Finally, one of the objectives of a public forum is also to gain public support for the strategic goals of the budget. Therefore, it facilitates the process of budget preparation by the representative body of a local self-government unit.

Despite its advantages, a public forum also has some drawbacks and limitations, i.e.:

- it does not ensure successful debates on complex or detailed topics;
- it is not a place for a detailed discussion;
- it is unsuitable for reaching consensus;
- it carries a risk of dominating individuals who try to act in their own narrow interests.

## **Public Forum—the Experiences of the City of Crikvenica**

So far, the City of Crikvenica has held two public forums on the local budget, the first in December 2001, when the 2002 Budget Proposal of the City of Crikvenica was presented, and the second one in December 2002, presenting the Draft Proposal for the 2003 City Budget.

The public forums were organized and conducted in accordance with the following rules:

- intensive preparations resulted in open and well-attended forums;
  - invitations were sent out to the representatives of major interest groups
  - invitations to forums were published in the news-paper and broadcast over the local radio and, additionally, all interested citizens were invited by posters put up in public places
- the provision of appropriate premises and other technical conditions contributed to the high-quality of opening speeches, discussions among

the concerned and the success of the forums in general;

- the forums were moderated by persons with good knowledge of the subject matter who were not citizens of Crikvenica. This ensured a high-quality and objective conducting of the forums;
- the moderators set technical rules for holding the forums;
- all participants were provided with written materials in the form of the Mayor's Budget Message;
- high-quality technical facilities were provided to ensure a good audio-visual coverage of all presentations;
- all participants were given the opportunity to express their comments and make suggestions concerning the presented information.

### The Mayor's Budget Message

In view of the fact that a public forum is hardly a suitable place for a detailed discussion on budget planning, the debate was based on the so-called mayor's budget message, drawn up by the mayor in cooperation with a competent administrative body responsible for public finances.

The content of the budget message was supposed to ensure a quick understanding of the basic commitments and decisions of the budgetary authorities and the main trends in local budgeting.

The Mayor's message included the following:

- introduction;
  - basic changes in the budget plan compared with the previous period;
  - presentation of documents, bodies and procedures, which were the basis for setting the priorities for public expenditure financing;
- main long-term strategic goals of the City of Crikvenica;
- main guidelines for budget planning;
- main objectives of public expenditure planning:
  - basic current (operational) goals;
  - basic capital (development) goals;
- basic changes in budget financing compared with the previous year;
- the City of Crikvenica Budget for the next fiscal year:

- a numerical presentation of the overall current and capital revenue plan and the receipts from financial assets and borrowing;
- numerical and graphic presentations related to the current budget revenue plan;
- overall current and capital expenditure plan and outlays for financial assets and loan repayment;
- numerical and graphic presentations related to the expenditure plan according to the intended use;
- outlays for loan repayment by year;
- numerical and graphic presentations of budget revenue trends in the last few years;
- basic differences compared with most other Croatian cities.

### Conclusion

Inclusion of the public in the budgetary process through public forums met expectations of the City of Crikvenica authorities and won the support of the public.

The goals of organizing a public forum were almost entirely achieved, with a satisfactory turnout of almost all age and interest groups, given the fact that this is a new way of communication between the local government representatives and the public.

The experience from the two conducted public forums suggests that such activities should be continued, while the discussions show the citizens' willingness to give priority to the public interest over their own narrow interests and to make helpful proposals to this effect.

In order to make such procedure obligatory, irrespective of changes in the local government, a provision was entered in the Rules of Procedure of the City Government stipulating that public forums should be conducted prior to the drawing up of the final City Budget proposal.



## Mayor's Budget Message

### Introduction

It is my pleasure and duty to present to you the City of Crikvenica Budget for 2003.

This Budget was drawn up in light of continuous changes related to two major areas:

- Further decentralization of certain functions of the central government and devolution of functions, authority, responsibilities and financing costs on the local government level;
- Amendments to the recently introduced new account plan for budget and budgetary beneficiaries.

The City of Crikvenica Budget for 2003 resulted from an estimate of revenue/receipts and the financing of the planned priority public expenditure/outlays in the territory of Crikvenica in 2003. It is based on the guidelines for the preparation of the city of Crikvenica budget for the 2003–2005 period, issued by the City Council on November 5, 2002.

Priorities for financing public expenditure/outlays in 2003 were set in accordance with:

- the legal provisions governing the obligatory financing of certain operations within the scope of activity of local self-government units;
- long-term strategic goals of the City of Crikvenica;
- proposals made by budgetary beneficiaries— institutions established by the City of Crikvenica;
- suggestions of citizens made through local administrative offices and nongovernmental organizations, as well as suggestions of citizens put forward at public forums about the budget;
- proposals submitted by utility companies owned or co-owned by the City of Crikvenica, which provide utility services in the city area;
- proposals of Local Administrative Offices within the City;
- proposals of the City Government members responsible for particular areas.

### The Main Long-Term Strategic Goals

The main long-term strategic goals of the City of Crikvenica Government as a unit of local self-government are the following:

- to facilitate economic development by realization of projects aimed at creating a more favorable business environment for entrepreneurs and to enable them to achieve their business objectives through competitive and creative work;
- to raise public utility standards for the purpose of ensuring higher standards of living for the population;
- to improve the current standard of public services in the field of preschool education, education, culture, technology, sports, social security, health care and fire protection, as well as other public services within the scope of activity of the units of local self-government;
- to facilitate sustained development of all settlements and their parts.

### Basic Guidelines for Budgetary Planning in 2003

The basic guidelines for budgetary planning in 2003 are the following:

- harmonized planning of revenue based on realistic revenue collection dynamics in the current year (2002);
- rational use of local tax and non-tax revenues in accordance with the established priorities for the financing of public expenditure/outlays;
- planning of expenditure/outlays according to the following list of priorities:
  - repayment of debt arising from borrowing;
  - financing of the basic statutory functions, including current outlays of local units arising from the devolved (decentralized) functions:
  - financing of launched but not completed capital projects in 2002;
  - financing of unrealized planned capital projects in 2002;
  - financing of new capital projects;

- financing of other expenditures and outlays;
- applying the principle of economy, cost-effectiveness and purposefulness;
- covering of the current expenditure/outlays exclusively by current revenue;
- authorized spending of capital revenue exclusively for capital project financing;
- authorized spending of total revenue from utility fees and one third of revenue from the local tourist tax exclusively for:
  - maintenance of the precipitation drainage system;
  - public area sanitation;
  - public area maintenance;
  - maintenance of unclassified roads;
  - maintenance of public lighting and energy consumption for public lighting;
  - allocation of funds to local administrative offices for financing “small” utility campaigns;
- authorized spending of total revenue from utility contributions and two thirds of revenue from local tourist tax exclusively for:
  - urban development and public facilities construction;
  - construction of unclassified roads;
  - construction of public lighting;
- authorized spending of revenue from charges for the connection to the utility infrastructure exclusively for the construction of facilities and utility infrastructure, as well as for the purchase of equipment for:
  - drinking water supply;
  - disposal of sewage and purification of waste water.
- authorized spending of revenue from surtax on income tax exclusively for financing the preparation of the physical planning documentation;
- authorized spending of revenues from charges for concessions to utilize maritime resources exclusively for the financing of projects aimed at improving the status of said resources.
- setting up of the six Local Administrative Offices and holding the elections for their bodies in accordance with the Statute of the City of Crikvenica;
- improvement of space and technical conditions of work for the members of the City Council and City of Crikvenica Government;
- increasing the allocations for City annual awards and lifetime achievement awards;
- improvement of the communication between the City Government and citizens and civil society organizations;
- improving the level of the City Government organization and qualifications of the local officials and civil servants for the purpose of more efficient management and provision of public services on the local level;
- improvement of regular and investment maintenance of school facilities;
- increasing the monthly amount of scholarships for students;
- improvement of regular and investment maintenance of sports facilities;
- participation in the Healthy City Project;
- improving the conditions for efficient fire protection by creating fire breaks in forests;
- improvement of regular and investment maintenance of the precipitation drainage system;
- improvement of the development and maintenance of parks;
- improvement of regular and investment maintenance of maritime resources—beaches;
- provision of funds for financing “small campaigns” of local administrative offices.

*The Main Capital (Development) Goals* of public expenditure planning in 2003 are the following:

- reconstruction of the central building of the Kindergarten “Radost” in order to provide additional premises for a day care center;
- provision of new business premises for the National Library and Reading Room in Crikvenica;
- refurbishment of the “Zvonko Car” studio for the purpose of carrying out cultural projects;

### **The Main Objectives of Public Expenditure Planning in 2003**

The basic *current (operational) goals* of public expenditure planning in 2003 are the following:

- arranging the surroundings and purchase of equipment in order to finalize the construction of the new sports hall;
- joining the Government Housing Incentive Program (HIP) by starting the construction of a building with 20 flats (intended for the HIP participants, Homeland War victims and socially handicapped citizens);
- procurement of the equipment and putting into operation the new weather reporting station in Crikvenica;
- activities related to the utility company “Vodovod Žrnovnica”, i.e. the completion of preparations for installing a water-supply system in the zones of Dramalj and Jadranovo which currently have no water supply systems;
- drawing up of an urban development plan (UDP) for the most important parts of the city of Crikvenica;
- preparation of the project documentation for sewage disposal and precipitation drainage systems, as well as for the maintenance of parks and local roads;
- cooperation with the Croatian Roads company on the construction project of the Selce-West Exit/ Entrance.

### Major Changes in the 2003 Budget Financing

#### *Introduction of Surtax on Income Tax*

Pursuant to the Law on the Amendments to the Local Self-Government and Administration Financing Law (NN 59/01) each local self-government unit is given the option to impose surtax on income tax. According to the quoted Law, a local self-government unit with the same population as the City of Crikvenica may introduce surtax on income tax at the maximum rate of 12%. In 2002, Crikvenica did not make use of this option.

Owing to the increased cost of financing the decentralized functions in the area of education and fire protection, and owing to the fact that larger funds will be required for the preparation of the physical planning documentation as a result of the new Physical Plan for the urban development of the City of Crikvenica, a surtax on income tax at the rate of 10% was introduced as of January 1, 2003. The total revenue from the surtax on income tax will be used for financing the preparation of the physical planning documentation.

#### *A Change in the Participation in Financing the Child-Care Services in Preschool Facilities*

In 2002, the City of Crikvenica's participation in the economic price of preschool education was 62% in kindergartens and 64% in day care centers. The share paid by parents was 38% and 36% in kindergartens and day care centers, respectively. In 2003, the City's participation will be 60% for both kindergartens and day care centers, while parents will pay 40% of the price for both programs.

#### *Financing the Decentralized Functions in Fire Protection*

As a result of the statutory transfer of decentralized functions from the central to the local level, the City of Crikvenica assumed the responsibility for financing 25% of general outlays for wages and material costs of employment in the Professional Fire Brigade of the City of Crikvenica as of January 1, 2002, and since January 1, 2003 this participation amounts to 50%. Apart from financing the general outlays for wages and material costs of employment, the City is also responsible for the procurement of new equipment and covering the costs of current and investment maintenance of facilities and equipment used for fire protection. That is why the fire protection outlays grew markedly in 2003 compared with 2002, and they are given priority in the budgetary financing.

#### *Financing of the Local Administrative Offices' Activities*

The new Law on Local and Regional Self-Government (NN. 33/01) regulates the legal status of local administrative offices that are to be established pursuant to new regulations and by-laws of the bodies within the units of local self-government. In 2003, all local administrative offices in the territory of Crikvenica will be established pursuant to the Statutes of the City. Therefore, they will be recognized as legal entities and a part of the funds from the City Budget will be allocated for the performance of their functions. Consequently, in 2003 a total of 10% of revenue from utility fees and tourist tax raised in 2002 will be distributed among local administrative offices, based on the following criteria:

- size of population;
- area covered by a particular local administrative office;

- rate of collection of utility fees for housing space in the local administrative office's territory;
- rate of inflow of tourist tax revenue into the City Budget;
- development of utility infrastructure.

#### *Tax Benefits for New Entrepreneurs*

Pursuant to the new Decision on Taxes in the City of Crikvenica, entrepreneurs who open a new business enterprise are entitled to a full or partial exemption from firm tax for the first four years of their business activities.

#### **The 2003 Budget of the City of Crikvenica**

The 2003 Budget of the City of Crikvenica amounts to HRK 47,515,000.00, which is 5.9% below the Budget plan for 2002.

If we exclude the receipts from borrowing, the 2003 Budget of the City of Crikvenica exceeds the plan for 2002 by 18.2%.

#### *Revenue/Receipts*

- The total revenue/receipts include:
  - current revenue to the amount of HRK 44,455,000.00 or 18.1% more than the planned current revenues in 2002;
  - revenue from the sale of assets to the amount of HRK 3,000,000.00 or 20.0% above the plan for the same type of revenue in 2002;
  - receipts from financial assets (repayment of granted loans) to the amount of HRK 60,000.00 which equals the budget plan for 2002.

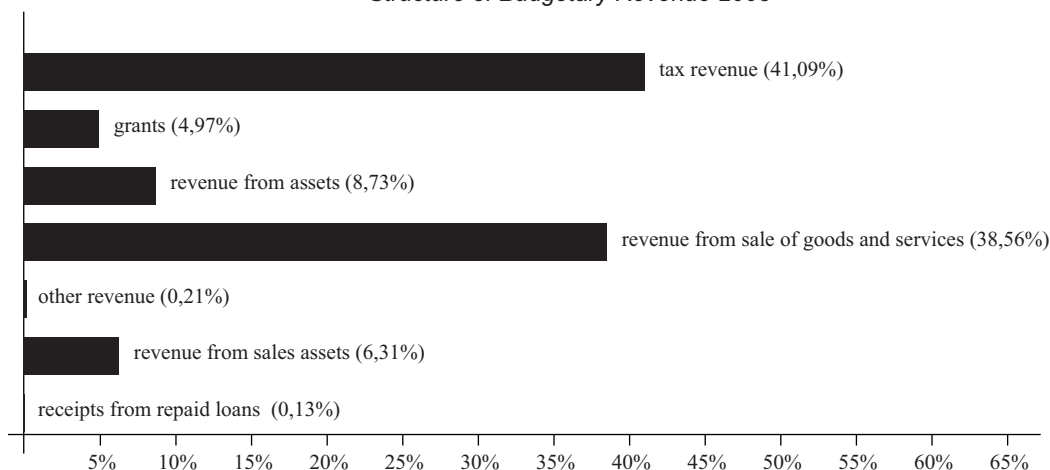
- Current Budget Revenues include:
  - tax revenues  
HRK 19,525,000 41.09%
  - supports from the Budget  
HRK 2,360,000 4.97%
  - revenues from property  
HRK 4,150,000 8.73%
  - receipts from the sale of goods and services  
HRK 18,320,000 38.56%
  - other revenues  
HRK 100,000 0.21%

The 2003 budget revenue/receipts and expenditure/outlays of the City of Crikvenica are balanced out.

#### *Expenditure/Outlays*

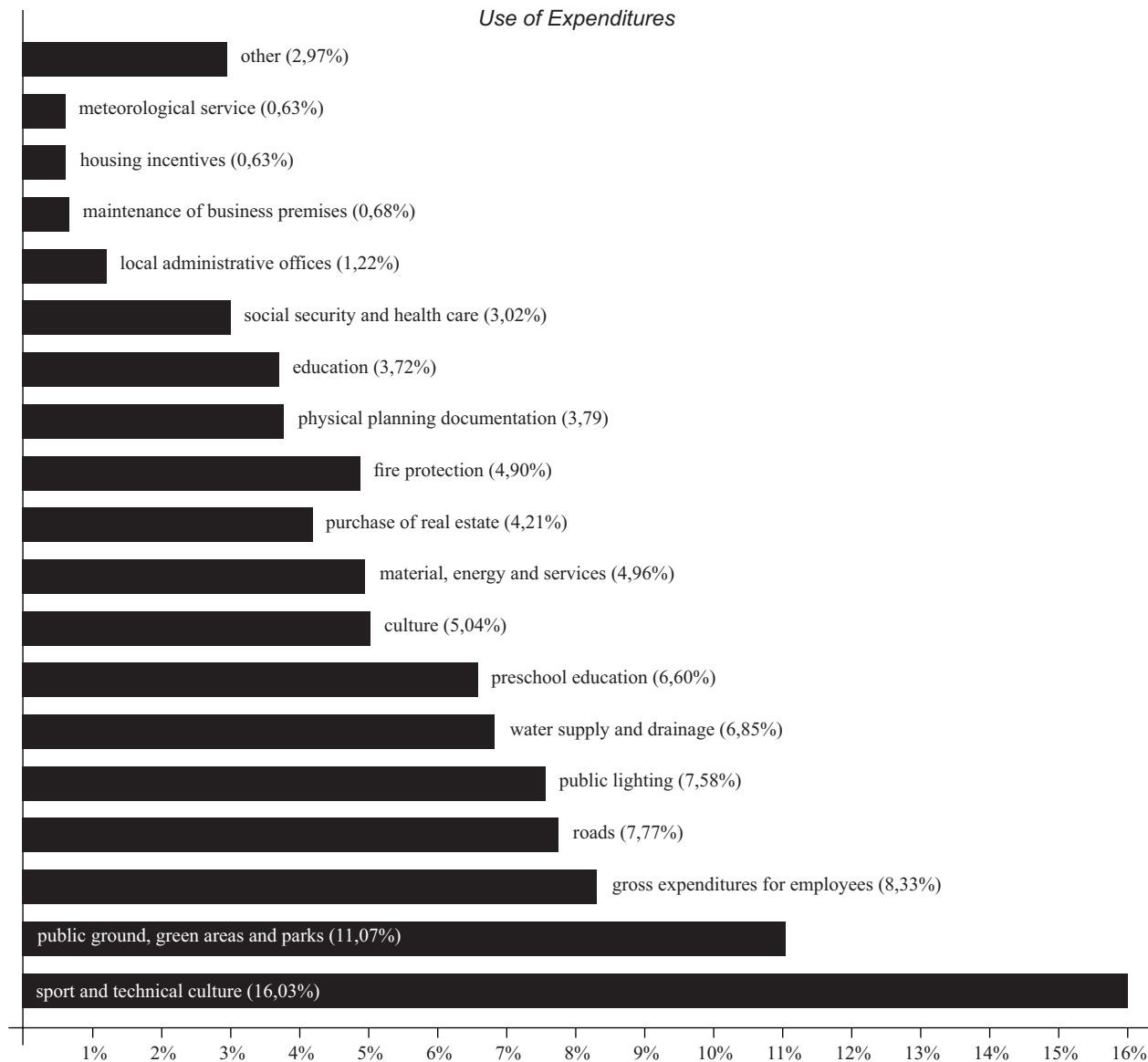
- Total expenditure/outlays include:
  - current outlays to the amount of HRK 37,172,900.00
  - capital outlays to the amount of HRK 7,992,100.00
  - outlays for financial assets and repayment of loans to the amount of HRK 2,350,000.00
- Total budget revenue/receipts shall be spent for the following purposes:
  - sport and technical culture  
HRK 7,619,000 16.03%
  - public ground, green areas and parks  
HRK 5,262,000 11.07%
  - gross expenditures for employees  
HRK 3,959,800 8.33%

*Structure of Budgetary Revenue 2003*



– roads	HRK 3,690,000	7.77%	– physical planning documentation	HRK 1,800,000	3.79%
– public lighting	HRK 3,600,000	7.58%	– education	HRK 1,766,100	3.72%
– water supply and drainage	HRK 3,253,500	6.85%	– social security and health care	HRK 1,434,500	3.02%
– preschool education	HRK 3,135,600	6.60%	– local administrative offices	HRK 580,000	1.22%
– culture	HRK 2,396,000	5.04%	– maintenance of business premises	HRK 325,000	0.68%
– material, energy and services	HRK 2,355,000	4.96%	– housing incentives	HRK 300,00	0.63%
– purchase of real estate	HRK 2,000,000	4.21%	– meteorological service	HRK 300,00	0.63%
– fire protection	HRK 2,327,000	4.90%	– other	HRK 1,411,500	2.97%

*Use of Expenditures*



### Loan Repayment

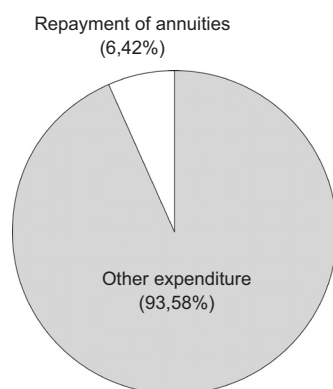
The outlays for the repayment of loans include annuities for used credits in 2002 and previous years, as well as annuities for the repayment of planned loans in 2004.

The budget plan represents the amounts reduced by:

- revenues from increased income tax sharing intended for financing decentralized functions in education and fire fighting;
- revenues from grants;
- receipts from financial assets and borrowing.

Year	Annuities (HRK)	Budget plan (HRK)	Annuities as a Share in the Previous Year's Budget [%]
2002	4,346,000.00	37,125,000.00	14.58
2003	3,050,000.00	44,195,000.00	8.21
2004	4,080,000.00	34,915,000.00	9.23
2005	3,985,000.00	38,369,640.00	11.41

### annuities in the Structure of Expenditure, 2003



### The Budget Revenue Trends in the Period 1999–2003

#### Budget Revenue Exclusive of Receipts from Financial Assets and Borrowing

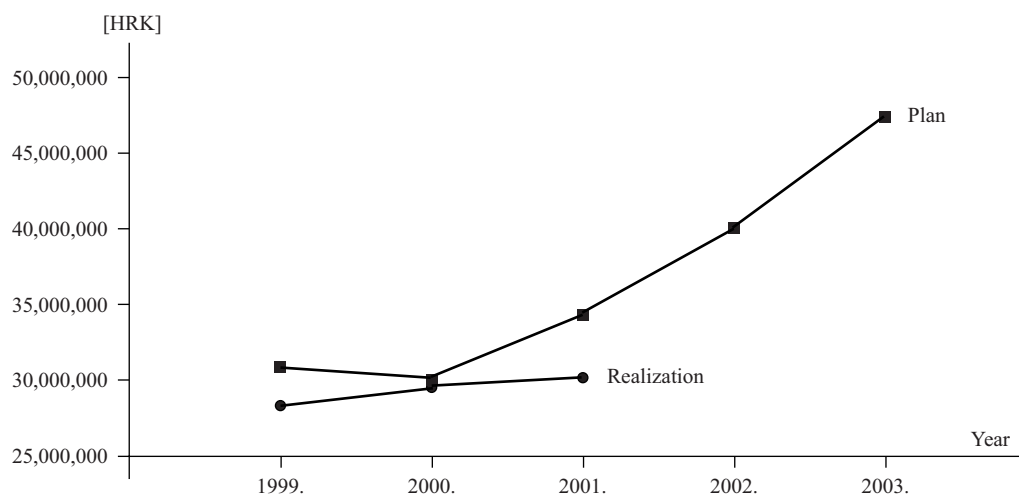
Year	Plan [HRK]	Budget Plan [HRK]	Realization [%]
1999	30,924,522.00	28,389,546.00	91.80
2000	30,118,300.00	29,597,538.00	98.27
2001	34,405,000.00	30,235,001.00	87.88
2002	40,125,000.00	—	—
2003	47,455,000.00	—	—

### Comparison with Most Croatian Cities

- The budget revenue structure of the City of Crikvenica varies from the average budget revenue structure of other cities in the Republic of Croatia.
  - The share of revenues from taxes and supports from the state budget is much smaller, while the share of other current revenue is significantly larger;
  - The structure of tax revenue departs from the average structure;
  - Income tax and profit tax are not dominant sources of revenue.
- The City of Crikvenica is one of the 32 cities (out of 122) eligible to assume the decentralized functions in the area of primary education.
- The structure of budget expenditure of the City of Crikvenica departs from the average structure of budget expenditure of cities in the Republic of Croatia, i.e.:
  - outlays for maintaining the level of utility services are smaller;
  - outlays for sports and technology are larger;
  - outlays for fire fighting are larger;
  - outlays for preschool education are larger;
  - outlays for social protection and health care are smaller;
  - outlays for employees are smaller.
- The ratio of current revenue to current expenditure is higher than in most Croatian cities.



*Trends in Budgetary Revenue*



# Drawing up of the City of Varaždin 2002 Budget in a Nutshell

**Jerka Kezele**  
*City of Varaždin*

Together with four more Croatian cities (Rijeka, Osijek, Crikvenica and Bjelovar), Varaždin has been chosen as a “pilot” city to participate in a project, carried out in cooperation with the American Urban Institute and sponsored by the American and Croatian Governments, to improve the functioning of local self-government and to support the democratic process in Croatia. To this effect, local officials have been engaged in various projects concerning asset management, public finance management, economic development strategies, etc., with a special emphasis laid on active participation of citizens in the decision-making process. As this is impossible without a reliable information system and an appropriate training of citizens, in early September 2001 a workshop was organized on a “budget in a nutshell” or the so-called summary budget.

Being aware of the importance of this issue and wishing to finally demystify the city finances and bring them closer to citizens in a simple and easy-to-understand way, the city of Varaždin government decided to make a step forward by drawing up its own “budget in a nutshell”.

## **Making a Plan of a Budget in a Nutshell**

The plan of a budget in a nutshell includes a definition of:

- the purpose and goals of the budget in a nutshell;
- the form, structure and contents of the budget in a nutshell; and
- the method of presenting the budget in a nutshell to citizens and its distribution.

## **The Purpose and Goals of the Budget in a Nutshell**

- To inform citizens of the plans and activities of the city concerning the utilization of the city budget;

- To provide insight into the city revenues and expenditures to all citizens, i.e. to provide them with complete information as to where and how their money is spent (ensure transparency of financial reports);
- To involve citizens in the decision-making process and the control of the city budget spending;
- To promote training of citizens in the management of city funds.

## **The Features, Contents and Form of the Budget in a Nutshell**

### *Features*

A budget in a nutshell is:

- brief, clear, well laid out, easy to read;
- understandable to citizens.

### *Contents*

- The mayor’s message to citizens explaining the importance of the budget and its impact on life in the city;
- A brief overview of budget revenue and expenditure presented in the form of tables, charts and descriptions.

### *Form*

- The form and design of the booklet on the budget in a nutshell were developed by printing experts and a designer who tried to bring the content of the booklet closer to its readers by way of witty text illustrations.
- The booklet includes data from the Internet.
- Ideas and contents were provided by the City Government staff.

## **Presentation and Distribution of the Budget in a Nutshell**

### *Presentation*

The mayor presented the budget in a nutshell:

- at the formal session of the City Council on the occasion of the City of Varaždin Day, held in the Croatian National Theater in Varaždin on December 6, 2001 (live coverage of the session was provided by local TV);
- In an interactive TV-show called “Open Studio”.

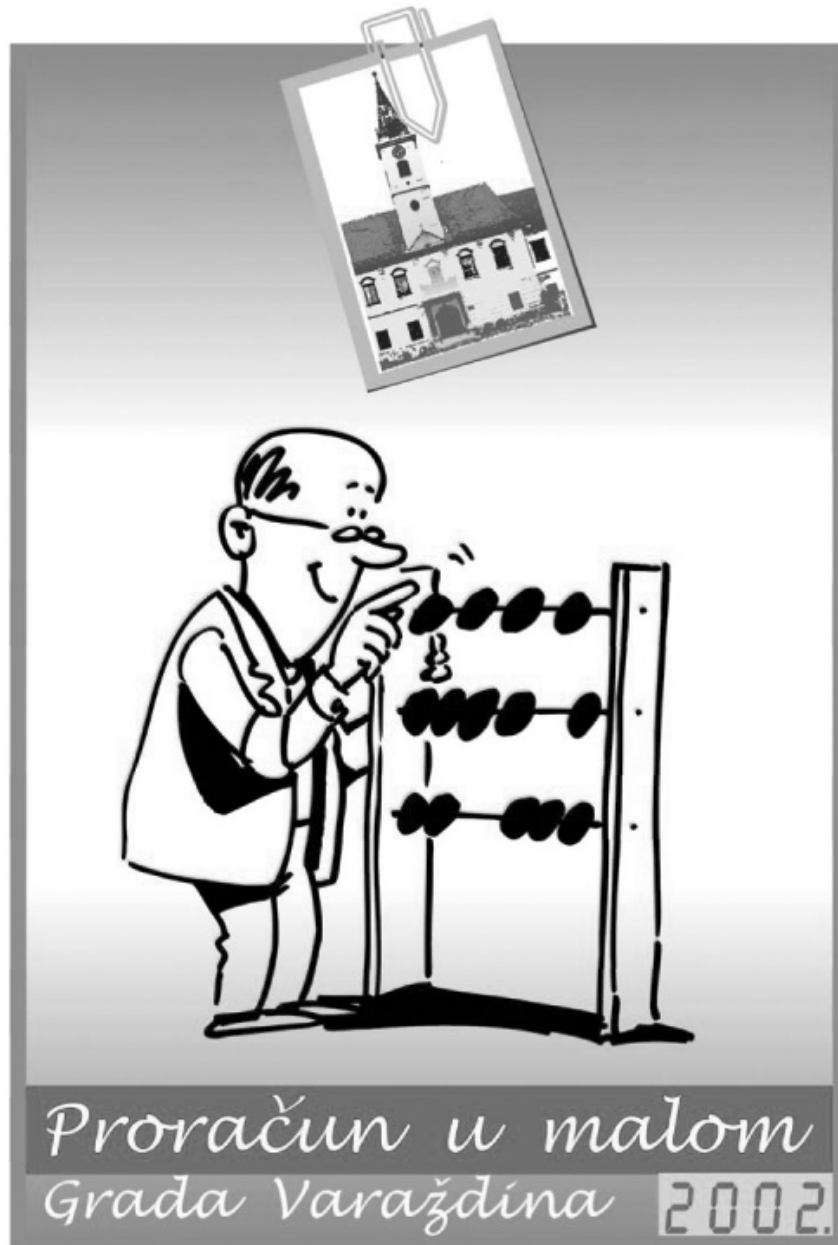
### *Distribution*

- In the form of a special supplement to the local weekly newspaper “Varaždin News”;  
Circulation: 10,000 copies  
The budget in a nutshell is also available on the Internet at [www.varazdin.hr](http://www.varazdin.hr)

## **The Effects and Feedback**

This is the first time that the plans and activities of the City Government concerning the City Budget utilization have been presented to citizens in a simple, easily accessible and transparent way. The feedback from the public was positive. The demand for booklets exceeded the supply, not only in Varaždin but in other Croatian towns as well.

Appendix



*Proračun u malom*  
*Grada Varaždina* 2002.



### Poštovane Varaždinke i Varaždinci, dragi sugrađani

Čast mi je prvi put u povijesti našega grada u Vaše ruke predati kratki prikaz Proračuna grada Varaždina, temeljni dokument financijskog i gospodarskog poslovanja gradske uprave kojoj sam na čelu. Proračun je dokument u kojemu je zabilježeno kako se prikuplja, kako se raspodjeljuje i kako se nadzire korištenje našeg zajedničkog novca – sredstava koja s različitih osnova pritiječu u gradsku blagajnu i koje smatramo javnim, općim dobrom.

Dopustite mi da Vam u nekoliko, nadam se ne odveć zamornih i suhoparnih podataka predstavim Proračun.

Tri su ključne značajke ovog Proračuna:

- **nema dodatnih opterećenja građana**, poglavito gospodarstva, novim ili povećanim porezima ili prerezima, premda postoje zakonske mogućnosti za to;
- **štedljivost**—gradska uprava štedi, prije svega na vlastitim izdacima—plaće, materijalni troškovi, oprema itd.; bitno su smanjeni financijski izdaci za vanjske usluge, poglavito troškovi odvjetnika, intelektualne usluge, administrativne usluge, reprezentacija itd., jer se uprava oslanja na svoje vlastite sposobnosti;
- **ulaganje u obrazovanje, šport i komunalnu infrastrukturu**: bitno su povećana izdvajanja za obrazovanje i socijalnu skrb, sredstva za učenički sport kao i investicije u komunalnom gospodarstvu—uređenje ulica, nogostupa, biciklističkih staza, infrastrukture.

Kao gradonačelnik, zajedno sa svojim suradnicima, stavljajući pred Vas kratak prikaz Proračuna, želio bih da dogodine još aktivnije sudjelujete u samom procesu pripreme i donošenja Proračuna, te Vam stoga stojimo na raspolaganju. Svoje primjedbe možete pismeno uputiti nadležnim tijelima u Gradskom poglavarstvu i iznijeti ih na našim Internet stranicama [www.varazdin.hr](http://www.varazdin.hr). Naša je dužnost i spremni smo saslušati mišljenja građana oko raspolaganja zajedničkim sredstvima za opće dobro.

S poštovanjem,

dr. sc. Ivan Čehok

## Što je Proračun ?

Proračun je temeljni financijski dokument u kojem su iskazani svi planirani godišnji prihodi i primici, te svi izdaci i rashodi Grada koje odobrava Gradsko vijeće. Proračun se odnosi na fiskalnu godinu i važi za godinu u kojoj je donesen. **Fiskalna godina** je razdoblje od dvanaest mjeseci, a počinje od 1. siječnja i završava 31. prosinca svake kalendarske godine.

**Proračun u malom** je sažetak proračuna Grada Varaždina za 2002. Godinu. On u kratkim crtama objašnjava planove i aktivnosti grada u vezi korištenja gradskog novca u idućoj godini.

Želja nam je da ovakvim prikazom gradskog Proračuna svim građanima omogućimo uvid kako u prihode tako i rashode Grada te da građani dobiju potpunu informaciju gdje i kako se troši njihov novac.

## Što sve možete saznati iz Proračuna?

- Koliki su i koji su ukupni prihodi Grada
- Koliki su ukupni rashodi Grada
- Što sve Grad financira
- Koliko se novca troši na gradsku upravu
- Koliko novca odlazi na komunalnu, stambenu djelatnost i uređenje prostora
- Koliko se novaca troši na kulturu, znanost i šport
- Koliko novaca Grad izdvaja za financiranje dječjih vrtića, a koliko za osnovne škole i socijalnu skrb

## Gdje možete pronaći Proračun ?

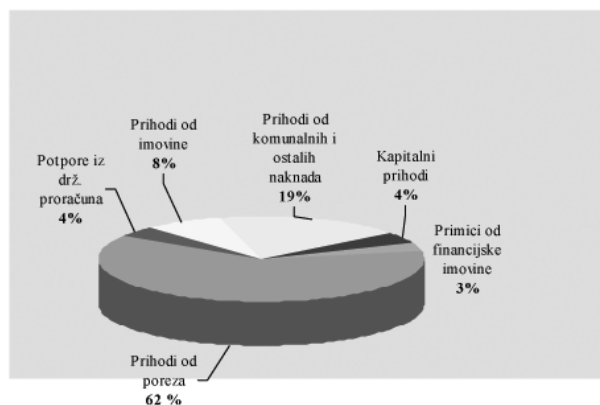
- U "Službenom vjesniku grada Varaždina" broj 10/01
- U Upravnom odjelu za gospodarstvo, financije i javne prihode, Trg slobode 12, 42 000 Varaždin
- Web stranice grada Varaždina, [www.varazdin.hr](http://www.varazdin.hr)

Stranica 4

Grad Varaždin 2002. - Proračun u malom

**Odakle novac dolazi u proračun ?**

Prihodi od poreza	63.000.000,00
Potpore iz državnog proračuna	4.130.380,00
Prihodi od imovine (npr. prihodi od zakupnina)	8.105.000,00
Prihodi od komunalnih i drugih naknada	19.008.820,00
Prihodi kapitalni (prodaja zemljišta i građevinskih objekata)	4.345.000,00
Primici od financijske imovine i zaduživanja (npr. primljene obročne otplate od prodanih stanova)	3.505.000,00
<b>UKUPNO PRIHODI :</b>	<b>102.094.200,00</b>

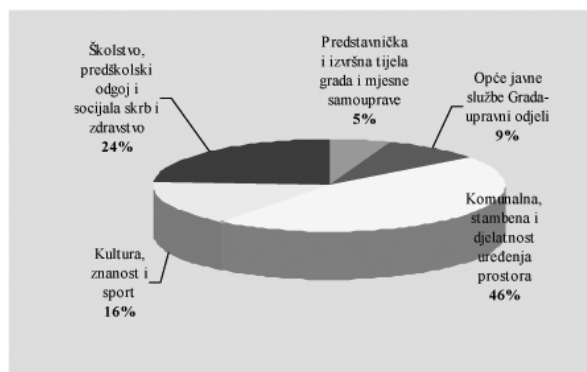
**PRIKAZ PRORAČUNSKIH PRIHODA 2002.**

Grad Varaždin 2002. —Proračun u malom

Stranica 5

**Kamo novac odlazi ?**

Predstavnička i izvršna tijela Grada i mjesna samouprava	5.675.000,00
Opće javne službe Grada— Gradska uprava	9.480.500,00
Komunalne, stambene djelatnosti i uređenje prostora	46.691.880,00
Kultura, znanost i sport	15.917.800,00
Školstvo, predškolski odgoj i socijalna skrb	24.329.020,00
<b>UKUPNO RASHODI :</b>	<b>102.094.200,00</b>

**PRIKAZ PRORAČUNSKIH RASHODA 2002.**



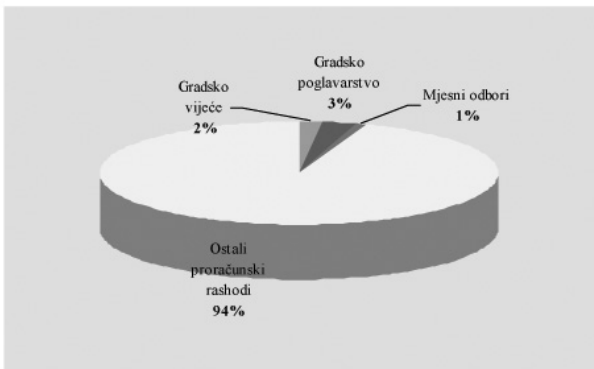
Stranica 6

Grad Varaždin 2002. - Proračun u malom

### Predstavnička i izvršna tijela Grada i mjesne samouprave

Gradsko vijeće	1.922.000,00
Gradsko poglavarstvo	2.846.000,00
Mjesni odbori	907.000,00
<b>UKUPNO TROŠKOVI :</b>	<b>5.675.000,00</b>

#### PRIKAZ TROŠKOVA PREDSTAVNIČKIH I IZVRŠNIH TIJELA GRADA I MJESNE SAMOUPRAVE



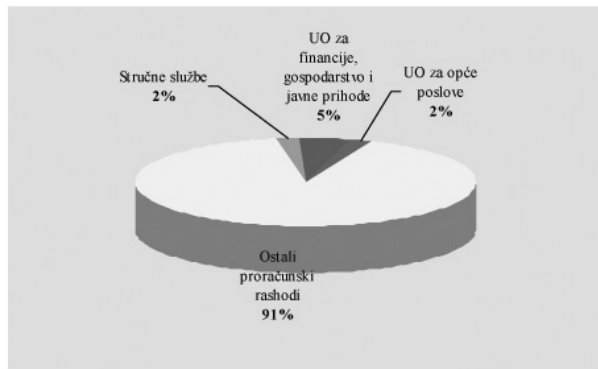
Grad Varaždin 2002. — Proračun u malom

Stranica 7

### Opće javne službe Grada - Upravni odjeli

Stručne službe	2.171.900,00
Upravni odjel za gospodarstvo, financije i javne prihode	4.787.000,00
Upravni odjel za opće poslove	2.521.600,00
<b>UKUPNO TROŠKOVI :</b>	<b>9.480.500,00</b>

#### PRIKAZ TROŠKOVA OPĆIH JAVNIH SLUŽBI GRADA



Stranica 8

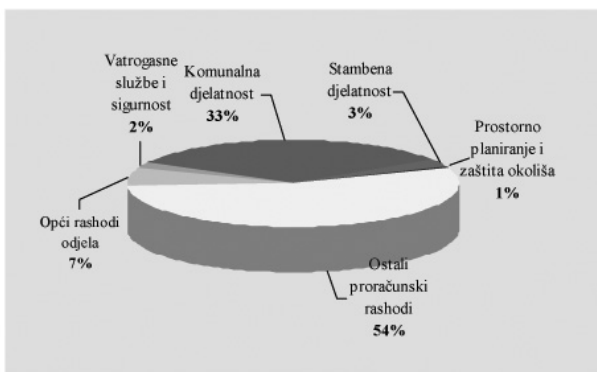
Grad Varaždin 2002. - Proračun u malom

### Komunalno, stambene djelatnosti i uređenje prostora

Opći rashodi odjela za komunalne djelatnosti i

uređenje prostora	6.881.700,00
Komunalna djelatnost	33.854.400,00
Stambena djelatnost	2.675.000,00
Prostorno planiranje i zaštita okoliša	1.080.000,00
Vatrogasne službe i sigurnost	2.200.780,00
<b>UKUPNO TROŠKOVI:</b>	<b>46.691.880,00</b>

### PRIKAZ TROŠKOVA ZA KOMUNALNO, STAMBENE DJELATNOSTI I UREĐENJE PROSTORA



Grad Varaždin 2002. - Proračun u malom

Stranica 9

**Komunalna djelatnost: 33.854.400,00**
**Program gradnje objekata i uređaja komunalne infrastrukture: 15.168.000,00**

- Izgradnja i uređenje cesta 3.010.000,00
- Uređenje javnih površina, dječjih igrališta, biciklističkih staza, nogostupa 1.945.000,00
- Proširenje groblja, izgradnja sustava navodnjavanja na groblju 590.000,00
- Izgradnja javne rasvjete 3.000.000,00
- Izgradnja plinske mreže 973.000,00
- Izgradnja vodovoda 2.040.000,00
- Izgradnja kanalizacije 3.310.000,00
- Ostalo 300.000,00

**Program očuvanja prirode i okoliša sa zbrinjavanjem otpada: 2.120.000,00**

- Deponiranje otpada (odlagalište Turčin) 1.600.000,00
- Ostalo 520.000,00

**Program održavanja komunalne infrastrukture: 13.320.000,00**

- Čišćenje gradskih ulica 2.000.000,00
- Održavanje i obnavljanje zelenih površina Grada 3.000.000,00
- Javne rasvjete Grada 4.100.000,00
- Održavanje nerazvrstanih (gradskih) cesta 2.700.000,00
- Održavanje groblja 920.000,00
- Održavanje slivnika 600.000,00

**Program održavanja poslovnih zgrada: 3.246.400,00**

- Redovno održavanje poslovnih prostora 546.400,00
- Investicijsko održavanje poslovnih prostora 2.000.000,00
- Investicijsko održavanje spomenika kulture 700.000,00

<b>Program korištenja sredstava od prodaje stanova:</b>	<b>2.025.000,00</b>
• Izgradnja stanova	800.000,00
• Kupnja zemljišta za kolektivnu izgradnju	400.000,00
• Vraćanje dijela duga državi za otkup konf. stanova	825.000,00
<b>Program održavanja stambenih zgrada:</b>	<b>650.000,00</b>
• Tekuće održavanje stambenih zgrada	250.000,00
• Investicijsko održavanje stambenih zgrada	400.000,00

<b>Prostorno planiranje i zaštita okoliša:</b>	<b>1.080.000,00</b>
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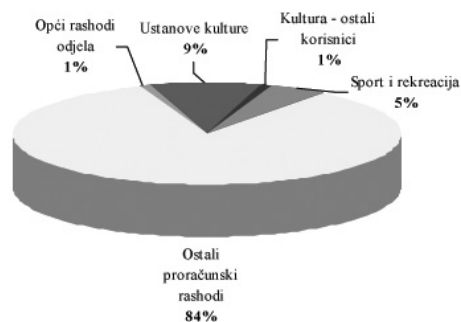
<b>Program izrade prostorno planske dokumentacije:</b>	<b>1.080.000,00</b>
• Izrada prostornog planske dokumentacije i GUP-a grada Varaždina	1.080.000,00

Ono što nije vidljivo u Proračunu za 2002. Godinu, a zasigurno je jedan od inicijalnih gospodarskih poticaja za budući razvoj Grada može se sažeti u naziv: rad i djelovanje oko opremanja i dovođenja u funkciju SLOBODNE ZONE VARAŽDIN, ZONE ZA OBRTNiŠTVO I PODUZETNiŠTVO te PODUZETNiČKOG INKUBATORA.

### Kultura, znanost i sport

Opći rashodi odjela za kulturu, znanost i sport	908.900,00
Ustanove kulture	9.367.500,00
Kultura— ostali korisnici	741.400,00
Šport i rekreacija	4.900.000,00
<b>UKUPNO TROŠKOVI :</b>	<b>15.917.800,00</b>

### PRIKAZ TROŠKOVA ZA KULTURU, ZNANOST I SPORT



Stranica 12

Grad Varaždin 2002. - Proračun u malom

**Kultura:** 10.108.900,00**Financiranje ustanova kulture:** 9.367.500,00

• Hrvatsko narodno kazalište	4.860.750,00
• Gradski muzej	2.266.750,00
• Knjižnica i čitaonica M. Ožegović	1.500.000,00
• Varaždinske barokne večeri	430.000,00
• Koncertni ured Varaždin	200.000,00
• Ljeto u Varaždinu	60.000,00
• Pučko otvoreno učilište	50.000,00

**Financiranje ostalih korisnika u kulturi:** 741.400,00

• HAZU	120.000,00
• Hrvatski povijesni arhiv	120.000,00
• Varaždinski komorni orkestar	204.000,00
• KUD-ovi, udruge, mažoretkinje i ostali	297.400,00

**Sport i rekreacija:** 4.900.000,00

• Zajednica sportskih udruga Grada Varaždina	3.900.000,00
• Sanacija atletske staze na stadionu "Sloboda"	900.000,00
• Donacije sportskim klubovima i društvima	100.000,00

Ove godine izdvojeno je 100.000,00 kuna više za sport. Ovaj novac je namijenjen prije svega mladima, odnosno razvoju sporta u osnovnim i srednjim školama.

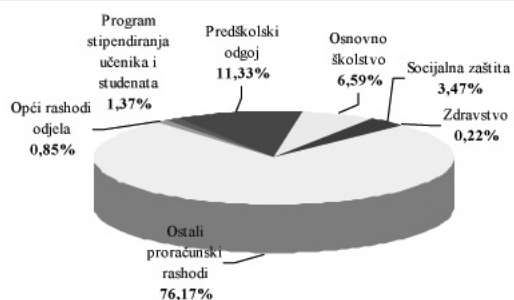
Grad Varaždin 2002. - Proračun u malom

Stranica 13

**Školstvo, predškolski odgoj, socijalna skrb i zdravstvo**

Opći rashodi odjela za školstvo, zdravstvenu i

socijalnu djelatnost	872.500,00
Stipendiranja učenika i studenata	1.400.000,00
Osnovno školstvo	6.725.080,00
Predškolski odgoj— dječji vrtići	11.566.640,00
Socijalna zaštita	3.544.800,00
Zdravstvo	220.000,00
<b>UKUPNO TROŠKOVI:</b>	<b>24.329.020,00</b>

**PRIKAZ TROŠKOVA ZA ŠKOLSTVO, PREDŠKOLSKI ODGOJ I SOCIJALNU SKRB**

Stranica 14

Grad Varaždin 2002. - Proračun u malom

<b>Osnovno školstvo:</b>	<b>6.725.080,00</b>
Financiranje osnovnih škola (zakonski standard)	3.830.380,00
Javne potrebe u osnovnim školama (iznad standarda)	650.000,00
Društvo inovatora, zajednica tehničke kulture, Savez športskih učeničkih klubova	102.000,00
Kapitalna ulaganja u osnovne škole	2.142.700,00
<b>Financiranje osnovnih škola (zakonski standard)</b>	<b>3.830.380,00</b>
• Glazbena škola (180 djece, 9 razreda)	89.400,00
• Centar "T. Špoljar" (255 djece, 27 razreda)	966.980,00
• I osnovna škola (667 djece, 24 razreda)	397.460,00
• II osnovna škola (880 djece, 34 razreda)	524.200,00
• III osnovna škola (445 djece, 18 razreda)	514.900,00
• IV osnovna škola (659 djece, 25 razreda)	402.420,00
• V osnovna škola (363 djece, 16 razreda)	244.940,00
• VI osnovna škola (761 djece, 31 razred )	462.080,00
• VII osnovna škola (320 djece, 16 razreda)	228.000,00

Grad Varaždin osnovno školstvo financira 20 % više od zakonom propisane obveze. Takvo izdvajanje iznad standarda iznosi **792.700,00** kuna i njime se financiraju troškovi dječjeg boravka, prijevoz učenika izvan standarda, natjecanja učenika, prehrana socijalno ugroženih učenika i razne izvannastavne aktivnosti kao i projektna dokumentacija za školsko-sportsku dvoranu III osnovne škole.

2002. godine iz proračunskih sredstava će se sa **1.850.000,00** kuna obnoviti pročelje na I osnovnoj školi, a sa 150.000,00 kuna će se obnoviti blagovaonica u VII osnovnoj školi.

Grad Varaždin 2002. - Proračun u malom

Stranica 15

<b>Predškolski odgoj:</b>	<b>11.566.640,00</b>
Gradski dječji vrtić Varaždin	9.386.840,00
Privatni dječji vrtići	2.179.800,00

Gradski vrtić Varaždin zbrinjava ukupno 1200 djece s područja grada Varaždina. Ekonomska cijena boravka djeteta iznosi 1200 kuna mjesečno po djetetu, od čega Grad plaća 54% ili 648,00 kuna po djetetu mjesečno. U privatnim dječjim vrtićima smješteno je 519 djece. Za djecu smještenu u privatnim vrtićima Grad također plaća 350,00 kuna mjesečno po djetetu.

<b>Socijalna zaštita i zdravstvo:</b>	<b>3.764.800,00</b>
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<b>Programi iz područje socijalne zaštite</b>	<b>3.544.800,00</b>
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• Program za prevenciju i liječenje ovisnosti	188.000,00
• Ostali programi socijalne skrbi	114.000,00
• Jednokratne pomoći u novcu i naravi	150.000,00
• Ljetovanje soc. ugrožene djece	70.000,00
• Poklon paketi za soc. ugroženu djecu	50.000,00
• Vjerske zajednice	100.000,00
• Crveni križ	120.000,00
• Društvo "Naša djeca"	110.000,00
• Centar za socijalnu skrb	1.999.800,00
• Caritas javna kuhinja	121.000,00
• Caritas ljekarna	36.000,00
• Donacije raznim udrugama, savezima i klubovima	486.000,00

<b>Programi u zdravstvu</b>	<b>220.000,00</b>
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• Program "Zdravi grad "	20.000,00
• Opća bolnica Varaždin	200.000,00

Grad Varaždin Centru za socijalni rad transferira 1.999.800,00 kuna od čega 1.800.000,00 kuna pokriva troškove stanovanja korisnicima pomoći za uzdržavanje, a 199.800,00 kuna troškove prenoćišta za beskućnike.

# Appendices

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## Biographies

**Teodor Antic**, M.A., received his first degree at the Rijeka Law Faculty (1981), his master's at the Law Faculty in Zagreb (2001), and passed his bar exam in 1988. He did his specialization at the John F. Kennedy School of Government, Harvard University (1999). Since March 2000 he has been Assistant Minister for Justice, Administration and Local Self-Government of the Republic of Croatia. He is a member of the secretariat of the Institute for Public Administration in Zagreb, and of the editorial board of the journal *Croatian Public Administration*. He is a lecturer in the Department of Administration, Social Polytechnic, Zagreb, where he teaches Administrative Communal Law. He has written a number of professional articles in the area of law published in domestic and foreign law literature, as well as a manual on the application of regulations concerning local self-government.

**Anto Bajo**, M.A., completed his first and master's degrees at the Economics Faculty in Zagreb. In 2002 he enrolled in a doctoral course at the Faculty of Economics in Ljubljana. He has studied in the USA (Harvard University, the John F. Kennedy School of Government), in Hungary and the RSA. Since 1996 he has worked at the Institute of Public Finance, Zagreb, and has been since 1998 an occasional external associate of the Economics Faculty Zagreb, in public finance. He has published a number of scholarly and professional papers in domestic and foreign journals and books related to the topics of the system of government budgeting and fiscal federalism. His current particular interests are in the financial management of the public sector, the system of government budgeting and fiscal federalism.

**Srecko Devjak**, Ph.D., Associate Professor, graduated from the Faculty of Natural Sciences and Technology, Department for Mathematics and Physics. He holds a master's degree in operations research from the Faculty of Economics in Ljubljana (1975) and a doctorate in information management sciences from the same Faculty (1987). He was elected Associate Professor for quantitative analysis at the University of Ljubljana. He is a member of GMÖOR—Gesellschaft für Mathematik, Ökonomie und Operations Research, HDOI—Croatian Association of Operations Research and of the Slovenian Society Informatika. His work encompasses the fields of economics, organization, as well as management and information systems. Since 1992 he has been employed at the University of Ljubljana; at the Biotechnical Faculty, Department for Wood Industry until 1997 and at the School of Public Administration since then. He teaches quantitative methods for management analysis in the undergraduate and postgraduate study programs and he is the author of two textbooks as well as the co-author of a third. He conducts research projects aimed at implementing quantitative methods of performance measurement in the public sector.

**Robert Ebel** is the Lead Economist for programs in Public Finance, Decentralization and Poverty Reduction at the World Bank Institute of the International Bank for Reconstruction and Development. While at the World Bank, he has written and directed studies on decentralization in Central and Eastern Europe, South Asia, and the Middle East and has also developed learning modules for a global audience. He is also an authority on state and local finance in the United States, having served as Director of Public Finance Research for the United States Advisory Commission on Intergovernmental Relations (ACIR), Director of comprehensive tax studies for several US state governments, and as Chair of the District of Columbia Tax Revision Commission. A co-editor of the *Encyclopedia of Taxation and Tax Policy* (Urban Institute Press), he is also an Honorary Member of the National Tax Association (NTA) and the recipient of the Steven D. Gold Award for a record of applied scholarly work on intergovernmental relations. The Gold award is conferred by the Association for Public Policy Analysis and Management (APPAM), National Conference of State Legislatures (NCSL) and the NTA. He holds a Ph.D. in Economics from Purdue University.

**Dubravka Jurlina Alibegovic**, M.A., is assistant director of the Economics Institute, Zagreb. She runs and takes part in scientific research projects and publishes papers in the broader area of public sector economics. The main area of her scholarly and professional interests relates to public sector reform, local public finances, urban and regional development and the new public management.

**Jerka Kezele**, B.A., worked in the Varaždin public service company *Varkom* from 1977, as planning and analysis manager. She took up an appointment in Varaždin City Hall in 1994 as head of accounting, and in 1997 was appointed head of the administrative section for economy, finances and public revenue.

**Ivica Malatestinic** took his first degree at the Civil Engineering Faculty in Rijeka. He is mayor of Crikvenica, and Vice-Chairman of the Association of Cities of the Republic of Croatia. In 1983-1986 he was employed in *Jadran* company, and between 1986 and 1991 in the *Zrnovnica Waterworks* public service firm. He is author of several articles in the area of local government and self-government. He is a member of the Croatian Social Liberal Party (HSL).

**Katarina Ott**, Ph.D., is director of the Institute of Public Finance, the editor of the journal *Financijska teorija i praksa*, trustee of the Professor Dr Marijan Hanzekovic Foundation, and Associate Professor in postgraduate studies at the Economics Faculty in Zagreb, Fiscal Federalism Course. She conducts research projects and publishes papers in the general area of public sector economics. Her main area of interest is the relationship between the government and the economy, specifically the unofficial economy, the budget, public sector reform, local finances, with special reference to transparency and accountability in the public sector, and participation of citizens.

**Mihaela Pitarevic**, MPhil, took her first degree at the Economics Faculty, Zagreb, where she won the Dean's Prize. Subsequently she took a master's in Development Studies at the University of Cambridge. She is employed as junior assistant in the Institute of Public Finance. She has specialized at LSE and the John F. Kennedy School of Government, Harvard University. She worked as an intern at the Chartered Institute of Public Finance and Accountancy, London. In addition, she has authored several papers published in domestic and foreign publications, while her current particular interests are fiscal decentralization and the tax system.

**Stanka Setnikar-Cankar**, Ph.D., is Associate Professor and Dean of the School of Public Administration, University of Ljubljana. Her research and professional works consist of approximately 60 items, most of them articles, published in national scholarly and professional periodicals, or presented at national and international meetings and conferences. She has published in the field of public sector economics, public finance, local government economics, and local government finance. She has participated in research and consultative work of the Ministry of Science, Ministry of Internal Affairs and Institute of Regional Economics. She also takes an active part in the in-service training of civil servants in Slovenia.

**Serdar Yilmaz** is a public sector specialist at the World Bank Institute (WBI). Serdar coordinates curriculum development activities of the WBI's Intergovernmental Fiscal Relations and Local Financial Management Program. In addition to his managerial assignments, he conducts research and produces scholarly work in the areas of public finance, regional development and intergovernmental fiscal design. His research interests include the analysis of the decision-making process in the public sector, intergovernmental policies in developing countries, and the role of infrastructure service provision in regional development patterns. He has participated in many learning activities of the WBI and his research has appeared in leading academic journals; he has also been the editor of books in the field. Serdar has a Ph.D. in Public Policy from George Mason University.

## List of Participants

### Republic of Croatia

Country telephone Code: 385

Abramović Milan

Općina Topusko

Topusko

Tel: (+385-44) 88 53 30

Fax: (+385-44) 88 50 12

E-mail: opcina-topusko@sk.hinet.hr

Antić Teodor

Ministarstvo pravosuđa, uprave i lokalne  
samouprave

Zagreb

Tel: (+385-1) 378 21 82

Fax: (+385-1) 378 21 92

E-mail: tantic@pravosudje.hr

Arbutina Hrvoje

Pravni fakultet u Zagrebu

Zagreb

E-mail: harbutin@pravo.hr

Babić Danijela

ZAMIRNET

Zagreb

Tel: (+385-1) 482 38 57

Fax: (+385-1) 482 38 62

E-mail: dbabic@zamir.net

Bajić Sunčica

Požeško-slavonska županija

Požega

Tel: (+385-34) 29 02 24

Fax: (+385-34) 29 02 37

E-mail: financije@pzs.hinet.hr

Bajo Anto

Institut za javne financije

Zagreb

Tel: (+385-1) 481 93 63

Fax: (+385-1) 481 93 65

E-mail: bajo@ijf.hr

Baron Mira

Karlovačka županija

Karlovac

Tel: (+385-47) 66 61 75

Fax: (+385-47) 66 62 66

Bejaković Predrag

Institut za javne financije

Zagreb

Tel: (+385-1) 481 93 63

Fax: (+385-1) 481 93 65

E-mail: predrag@ijf.hr

Berda Biljana

Virovitičko-podravaska županija

Virovitica

Tel: (+385-33) 74 31 50

Fax: (+385-33) 72 24 65

E-mail: vpzss@vt.hinet.hr

Blažić Helena

Ekonomski fakultet u Rijeci

Rijeka

E-mail: helena@efri.hr

Bogner Marijanka

Ministarstvo rada i socijalne skrbi

Zagreb

E-mail: marijanka.bogner@mrss.hr

Borić Damir  
 Grad Sisak  
 Sisak  
 Tel: (+385-44) 52 46 69  
 Fax: (+385-44) 52 11 28  
 E-mail: damir.boric@sisak.hr

Bratić Vjekoslav  
 Institut za javne financije  
 Zagreb  
 Tel: (+385-1) 481 93 63  
 Fax: (+385-1) 481 93 65  
 E-mail: vjeko@ijf.hr

Breglec Dražen  
 Mursko Središće  
 Tel: (+385-40) 54 40 02  
 Fax: (+385-40) 54 45 88  
 E-mail: dbreglec@inet.hr

Burilović Luka  
 Općina Nijemci

Čakar Nada  
 Zagreb  
 Tel: (+385-1) 377 10 24

Čengić Drago  
 Institut Ivo Pilar  
 Zagreb  
 E-mail: Drago.Cengic@pilar.hr

Čičin-Šain Ante  
 Zagreb  
 Tel: (+385-1) 487 79 00  
 Fax: (+385-1) 487 79 01

Čulo Ivica  
 Požega  
 Te: (+385-34) 29 28 40  
 Fax: (+385-34) 27 36 71  
 E-mail: ivica.culo@po.hinet.hr

Ćurković Stipe  
 Zagreb  
 Tel: (+385-1) 481 69 68  
 Fax: (+385-1) 481 69 68

Dautanac Marijan  
 Veliki Grđevac  
 Tel: (+385-43) 46 16 66  
 Fax: (+385-43) 46 10 14  
 E-mail: opcina-veliki-grdjevac@bj.hinet.hr

Dikandić Desanka  
 Novi informator  
 Zagreb

Đurek Marijan  
 Grad Zlatar

Emić Ivo  
 Općina Štefanje  
 Štefanje  
 Tel: (+385-43) 77 80 29  
 Fax: (+385-43) 77 82 76  
 E-mail: opcina-stefanje@bj.tel.hr

Fajdetić Majda  
 Medicinska škola  
 Zagreb

Filipović Katica  
 Grad Glina  
 Tel: (+385-44) 88 22 04  
 Fax: (+385-44) 88 22 03

Franić Nikica  
 Ministarstvo rada i socijalne skrbi  
 Zagreb  
 Tel: (+385-1) 616 92 59  
 Fax: (+385-1) 616 95 34  
 E-mail: nikica.franic@mrss.hr

Fudurić Kurelić Mira  
 Grad Duga Resa  
 Duga Resa  
 Tel: (+385-47) 84 14 62  
 Fax: (+385-47) 84 14 65  
 E-mail: dugaresa@hi.hinet.hr

Goleš Tonka  
 Zagreb  
 Tel: (+385-1) 377 23 25

## Golubić Franjo

Općina Donji Martijanec  
Martijanec  
Tel: (+385-42) 67 34 88  
Fax: (+385-42) 20 78 75

## Gospodnetić Boris

Ministarstvo javnih radova, obnove i graditeljstva  
Zagreb  
Tel: (+385-1) 378 39 32  
Fax: (+385-1) 378 39 31

## Grahovac Tripo

Grad Rijeka  
Rijeka  
Tel: (+385-51) 20 96 52  
Fax: (+385-51) 20 96 53  
E-mail: tripo.grahovac@hi.hinet.hr

## Grčar Ivica

Zagreb  
E-mail: grcar@yahoo.com

## Hanzl Željko

Hrvatska gospodarska komora  
Zagreb  
Tel: (+385-1) 482 83 73  
Fax: (+385-1) 482 83 80  
E-mail: makroekonomija@hgk.hr

## Herček Zlatko

Grad Vrbovec  
Vrbovec  
Tel: (+385-1) 279 11 16  
Fax: (+385-1) 279 10 15  
E-mail: grad-vrbovec@zg.hinet.hr

## Hrvoj-Šić Vesna

Srednja škola Oroslavlje  
Oroslavlje

## Ivanov Marijana

Ekonomski fakultet u Zagrebu  
Zagreb  
Tel: (+385-1) 238 33 33  
Fax: (+385-1) 233 56 33  
E-mail: mivanov@efzg.hr

## Ivanović Mladen

Hrvatski pravni centar  
Zagreb  
Tel: (+385-1) 485 45 95  
Fax: (+385-1) 483 50 13  
E-mail: hpc@hpc.hr

## Jozić Mijo

Ministarstvo financija  
Zagreb  
Tel: (+385-1) 459 10 55  
E-mail: mijo.jozic@mfin.hr

## Jurlina Alibegović Dubravka

Ekonomski institut  
Zagreb  
Tel: (+385-1) 233 57 00  
Fax: (+385-1) 233 51 65  
E-mail: jurlina-alibegovic@eizg.hr

## Kagin Justin

Ekonomski institut  
Zagreb  
E-mail: jkagin@eizg.hr

## Kasabašić Štefanija

Ministarstvo lokalne uprave i samouprave  
Zagreb

## Kezele Jerka

Grad Varaždin  
Varaždin  
Tel: (+385-42) 20 14 40  
Fax: (+385-42) 21 12 55  
E-mail: gradvz-financije@vz.hinet.hr

## Koprić Ivan

Pravni fakultet u Zagrebu  
Zagreb  
Tel: (+385-1) 456 43 32  
Fax: (+385-1) 456 40 30  
E-mail: ikopric@inet.hr

## Kos Stjepan

Srednja strukovna škola Velika Gorica  
Velika Gorica

Kovačević Vlatka

Međimurska županija  
Čakovec

Tel: (+385-40) 37 42 01

Fax: (+385-40) 39 10 05

E-mail: tajnica@med.zup.hinet.hr

Kraljić Mario

Koprivnica

Tel: (+385-48) 67 15 34

E-mail: mario\_kraljic@yahoo.com

Krtalić Vladimir

Hrvatska udruga poslodavaca

Zagreb

Tel: (+385-1) 235 95 55

Fax: (+385-1) 235 95 56

E-mail: vladimir.krtalic@hup.hr

Kutnjak Vlatka

Zagreb

Tel: (+385-1) 485 17 85

Fax: (+385-1) 485 17 85

E-mail: rainbow\_v@yahoo.com

Logožar Milan

Grad Prelog

Prelog

Lončarević Grga

Općina Semeljci

Semeljci

Tel: (+385-31) 85 63 10

Fax: (+385-31) 85 63 10

Lukeš-Petrović Maja

Ministarstvo financija

Zagreb

Luketić Nada

Općina Čavle

Čavle

Tel: (051) 25 95 79

Fax: (051) 25 02 69

Malatestinić Ivica

Grad Crikvenica

Crikvenica

Tel: (+385-51) 24 16 55

Fax: (+385-51) 24 10 60

E-mail: gc-gradonacelnik@grad-crikvenica.tel.hr

Marcelić Marija

Tehnička škola Ruđer Bošković  
Zagreb

Marić Zoran

Općina Biskupija

Knin

Tel: (+385-22) 66 12 00

Fax: (+385-22) 66 12 00

E-mail: opcina-biskupija@si.hinet.hr

Marković Milvija

Ministarstvo prosvjete i športa

Zagreb

Martek-Radonić Vesna

Ministarstvo zdravstva

Zagreb

Tel: (+385-1) 460 74 71

Fax: (+385-1) 460 75 74

E-mail: vesna.martek-radonic@miz.hr

Martinović Mirko

Općina Vojnić

Vojnić

Mašek Anka

Ekonomski fakultet u Osijeku

Osijek

Tel: (+385-31) 22 44 00

Fax: (+385-31) 2116 04

E-mail: anka.masek@os.hinet.hr

Miholić Krešimir

Zagreb

Tel/Fax: (01) 481 84 94

Mikulec Mikac Dušanka

Grad Zabok

Zabok

Tel: (+385-49) 58 77 50

Fax: (+385-49) 58 77 57

Mrduljaš Davor

Hrvatska udruga poslodavaca

Zagreb

Tel: (+385-1) 235 95 95

Fax: (+385-1) 235 95 50

E-mail: davor.mrduljas@hup.hr



Ott Katarina  
 Institut za javne financije  
 Zagreb  
 Tel: (+385-1) 481 93 63  
 Fax: (+385-1) 481 93 65  
 E-mail: kott@ijf.hr

Pali Fredi  
 Općina Velika Pisanica  
 Velika Pisanica  
 Tel: (+385-43) 88 31 13  
 Fax: (+385-43) 88 31 25

Pavić-Rogošić Lidija  
 ODRAZ-Održivi razvoj zajednice  
 Zagreb  
 Tel: (+385-1) 465 52 03  
 Fax: (+385-1) 465 52 00  
 E-mail: lidija.pavic@zg.tel.hr

Perković Ivan  
 Splitsko-dalmatinska županija

Pitarević Mihaela  
 Institut za javne financije  
 Zagreb  
 Tel: (+385-1) 481 93 63  
 Fax: (+385-1) 481 93 65  
 E-mail: mihaela@ijf.hr

Račić Domagoj  
 Ekonomski institut  
 Zagreb  
 E-mail: dracic@eizg.hr

Raukar Melita  
 Općina Viškovo  
 Viškovo  
 Tel: (+385-51) 25 62 63  
 Fax: (+385-51) 25 62 63  
 E-mail: melita.raukar@ri.hinet.hr

Rogić Lugarić Tereza  
 Pravni fakultet u Zagrebu  
 Zagreb  
 E-mail: rtereza@yahoo.com

Slijepčević Snježana  
 Njemačko veleposlanstvo  
 Zagreb

Slijepčević Sunčana  
 Ekonomski institut  
 Zagreb  
 E-mail: ssljepcevic@eizg.hr

Škaljić Elma  
 Konrad Adenauer Stiftung  
 Zagreb  
 Tel: (+385-1) 488 26 50  
 Fax: (+385-1) 488 26 56  
 E-mail: elma.kas@inet.hr

Šnit Mirjana  
 Općina Sunja  
 Sunja  
 E-mail: opcina.sunja@sk.tel.hr

Tomašković Vesna  
 Grad Donja Stubica  
 Donja Stubica

Topić Marinko  
 Ministarstvo rada i socijalne skrbi  
 Zagreb  
 Tel: (+385-1) 616 92 63  
 Fax: (+385-1) 619 64 79  
 E-mail: marinko.topic@mrss.hr

Truski Marko  
 Fakultet političkih znanosti  
 Zagreb

Tvorić Mira  
 Grad Vrbovec  
 Vrbovec  
 Tel: (0+385-1) 279 11 22  
 Fax: (+385-1) 279 10 15  
 E-mail: grad-vrbovec@zg.hinet.hr

Ulaga Dora  
 Zrakoplovna škola Zagreb  
 Zagreb

Urban Ivica  
 Institut za javne financije  
 Zagreb  
 Tel: (+385-1) 481 93 63  
 Fax: (+385-1) 481 93 65  
 E-mail: ivica@ijf.hr

Vedriš Mladen  
Zagreb  
Tel: (01) 464 14 34  
Fax: (01) 464 14 39  
E-mail: sonder@zg.tel.hr

Vučemilović-Alegić Ilija  
Općina Antunovac  
Antunovac

Vučetić Ljiljana  
Split  
Tel: (+385-21) 31 01 77  
Fax (+385-21) 31 00 34

Vukšić Goran  
Forschungsinstitut für Europafragen,  
Althanstraße 39-45 A-1090 Wien, Austria  
Tel: (+43-1) 31336-4133, (+43-1) 3133-6758  
E-mail: goran.vuksic@wu-wien.ac.at

Vuraić Marijana  
Porezna uprava  
Zagreb  
Tel: (+385-1) 459 13 23  
Fax: (+385-1) 459 14 51

Zagorac Mirela  
Ministarstvo financija  
Zagreb  
Tel: (+385-1) 459 13 81  
Fax: (+385-1) 459 13 68  
E-mail: mirela.zagorac@mfin.hr

Zbodulja Sandra  
Ekonomski fakultet u Osijeku  
Osijek  
Tel: (+385-31) 22 44 00  
Fax: (+385-31) 21 16 04  
E-mail: sandra.zbodulja@os.hinet.hr

Žanko Vesna  
ZAMIRNET  
Zagreb  
Tel: (+385-1) 482 38 58  
Fax: (+385-1) 482 38 62  
E-mail: zankov@zampir.net

Žic Turković Gabriela  
Grad Umag  
Umag  
Tel: (052) 70 29 81  
Fax: (052) 74 15 76  
financije-i-gospodarstvo@grad-umag.hinet.hr

### List of Foreign Participants

Hackett Ronald  
USAID, Barents Group  
E-mail: ronald.hackett@kpmgbarents.org

Mikelsons Maris  
The Urban Institute  
E-mail: mikelsons@aol.com

Peček Bojan  
Visoka upravna škola u Ljubljani  
Gosarjeva 5, Ljubljana, Slovenia  
Tel: (386-1) 580 5545  
E-mail: bojan.pecek@vus.uni-lj.si

Peteri Gabor  
Open Society Institute/Local Government and  
Public Service Reform Initiative  
Oktober 6. u. 12., 1051 Budapest, Hungary  
Tel: (+36-1) 327-3100  
Fax: (+36-1) 327-3105  
E-mail: gpeteri@osi.hu

Toth Timea  
Open Society Institute/Local Government and  
Public Service Reform Initiative  
Oktober 6. u. 12., 1051 Budapest, Hungary  
Tel: (+36-1)327-3100  
Fax: (+36-1) 327-3105  
E-mail: ttoth@osi.hu

Yilmaz Serdar  
World Bank Institute  
1818 H Street, NW, Washington, DC 20433, USA  
Tel: (+1-202) 473 9350, (+1-202) 676 9810  
E-mail: syilmaz@worldbank.org

Žohar Franci  
Općina Radeče  
Ulica Milana Majcna 1, 1433 Radeče, Slovenija  
Tel: (+386-3) 56 87 791  
E-mail: franci.zohar@siol.net

## Program

### Day 1, November 14, 2002

09:00–09:30    Opening Session  
Katarina Ott, on behalf of IPF  
Gabor Peteri, on behalf of FDI

#### *Fiscal Decentralization in Croatia*

Chair:            Mr. Teodor Antić, Ministry of Justice and Local Self-Government

09:30–09:50    Local Government Budgeting in Croatia  
Ms.Katarina Ott and Anto Bajo, Institute of Public Finance

09:50–10:10    Decentralization Process in Croatia: Strategy and Implementation  
Ms. Maja Lukeš-Petrović, Ministry of Finance

10:10–11:00    Discussion managed by the Chair

11:00–11:20    Coffe break

#### *Legal and Administrative Framework for Decentralization in Croatia*

Chair:            Ms. Maja Lukeš-Petrović, Ministry of Finance

11:20–11:40    Central and Local Self-Government Decentralization and Democratization  
Mr. Teodor Antić, Ministry of Justice and Local Self-Government

11:40–12:00    Decentralization in Croatia  
Mr. Ivan Koprić, Faculty of Law Zagreb

12:00–12:50    Discussion managed by the Chair

12:50–13:50    Lunch

*Fiscal Decentralization in Transitional Countries*

- Chair: Mr. Gábor Péteri, OSI, LGI
- 13:50–14:10 Fiscal Decentralization: The Experience of Other Countries and Options for Slovenia  
Ms. Stanka Setnikar-Cankar, Public Administration School Ljubljana
- 14:10–14:30 On the Measurement and Impact of Fiscal Decentralization  
Mr. Serdar Yilmaz, The World Bank Institute
- 14:30–15:20 Discussion managed by the Chair
- 15:20–15:40 Coffee break

*Intergovernmental Fiscal Relations*

- Chair: Mr. Serdar Yilmaz, The World Bank Institute
- 15:40–16:00 Fiscal Decentralization: Fiscal Decentralization and Revenue Sharing in Croatia  
Mr. Ronald Hackett, USAID, Barents Group
- 16:00–16:20 The Assessment of Croatian Equalization: Grant Scheme 1999 and 2000  
Ms. Mihaela Pitarević, Institute of Public Finance
- 16:20–17:10 Discussion managed by the Chair

**Day 2, November 15, 2002**

*Local Financial Management*

- Chair: Mr. Maris Mikelsons, The Urban Institute
- 09:00–09:20 Local Financial Management—Presentation of the Results of the Croatian Law  
Center Project “Decentralization of Public Administration”  
Ms. Dubravka Jurlina Alibegović, Institute of Economics Zagreb
- 09:20–09:40 Development of the Budget Process and Introduction of Controlling  
in to Slovenian Municipalities  
Mr. Srečko Devjak, Public Administration School Ljubljana
- 09:40–10:30 Discussion managed by the Chair
- 10:30–10:50 Coffee break

*Fiscal Transparency and Accountability*

- Chair: Mr. Ivica Grčar, journalist
- 10:50–11:10 Importance of Transparency  
Ms. Katarina Ott, Institute of Public Finance
- 11:10–11:30 Experiences of the City of Crikvenica: Participation of the Public in the Budget Process  
Mr. Ivica Malatestinić, Major of the City of Crikvenica
- Budget of the City of Varaždin  
Jerka Kezele, The City of Varaždin
- 11:30–12:20 Discussion managed by the Chair
- 12:20–13:20 Lunch

*Additional Financial Possibilities*

- Chair: Mr. Ronald Hackett, USAID, Barents Group
- 13:20–13:40 Foreign Direct Investment and Fiscal Decentralization in Croatia  
Goran Vukšić, Wirtschaftsuniversität Wien
- 13:40–14:00 Balance Sheet and Financial Policy of Local Government and Self-Government Units  
Anka Mašek and Sandra Zbodulja, Faculty of Economics Osijek
- 14:00–14:50 Discussion managed by the Chair
- 14:50–15:20 Summary/Conclusions and Recommendations  
Closing Conference

**For more information concerning FDI–CEE programs please contact:**

*Program Secretariat*

**Open Society Institute**

**Local Government and Public Service Reform Initiative (Budapest, Hungary)**

Mr. Ondrej Simek

Tel: (+36-1) 327-3862/ext. 2402

Fax: (+36-1) 327-3105

E-mail: [osimek@osi.hu](mailto:osimek@osi.hu)

*Contact Points at Partner Organizations*

**Council of Europe (Strasbourg, France)**

*Mr. Alessandro Mancini*

Tel: (+33-3) 8841-2265

Fax: (+33-3) 8841-2784

E-mail: [alessandro.mancini@coe.fr](mailto:alessandro.mancini@coe.fr)

**Organisation for Co-operation and Development (Paris, France)**

*Mr. Leif Jensen*

Tel: (+33-1) 4524-9490

Fax: (+33-1) 4524-1884

E-mail: [leif.jensen@oecd.org](mailto:leif.jensen@oecd.org)

**The World Bank Institute (Washington, USA)**

*Mr. Serdar Yilmaz*

Tel: (+1-202) 473-9350

Fax: (+1-202) 676-9810

E-mail: [syilmaz@worldbank.org](mailto:syilmaz@worldbank.org)

**UNDP**

*Ms. Anastazia Kozakova*

Tel: (+421-2) 59337-401

Fax: (+421-2) 59337-450

E-mail: [anastazia.kozakova@undp.org](mailto:anastazia.kozakova@undp.org)