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Source / Izvornik: **IPF Notes, 2024, 17, 1 - 11**

Journal article, Published version

Rad u časopisu, Objavljena verzija rada (izdavačev PDF)

Permanent link / Trajna poveznica: <https://um.nsk.hr/um:nbn:hr:242:096047>

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Download date / Datum preuzimanja: **2024-07-12**



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IPF NOTES

Budget credibility of Croatian counties, cities and municipalities for 2020-2022

Simona Prijaković

*The present Note uses Ministry of Finance data and data collected from enacted budgets of Croatian local units¹ to systemise and present basic information about budget plans and budget outturns. The Note primarily focuses on deviations from planned amounts in the period 2020-2022 since local units usually plan for much higher revenues and expenditures than what they generate in the course of the year. Revenues and expenditures of municipalities recorded the highest average deviation in the observed period, followed by cities and finally by counties. In terms of budget categories, the highest deviation was recorded in revenues and expenditures pertaining to fixed assets, while operating expenditures recorded the lowest deviation. Data on revenue and expenditure deviations in the period 2020-2022 is available in **Excel** format.*



The topic of budget credibility is getting more prominence and presence in literature. For instance, since 2018 the International Budget Partnership (IBP) has been examining the scale, causes, reasons and consequences of deviations between budget outturns and budget plans at both country level and lower government levels in individual countries. IBP defines budget credibility as the government's ability to meet its own revenue and expenditure objectives (set out in the budget plan) during a fiscal year. When public spending deviates from the enacted budget, we have two possible scenarios: underspending, when real expenditures are lower than planned expenditures, and overspending, when real expenditures exceed planned expenditures.

Since it is very difficult to achieve the exact amount of budget outturns as originally planned, deviations of up to 5% are considered acceptable (PEFA, 2019). Deviations are inevitable; however, each deviation should be adequately clarified in budget execution documents. When publishing budget execution reports (mid-year and year-end reports), the authorities should offer a detailed explanation as to why a specific deviation occurred and how they plan to be tackled in the future, as well as what will happen to planned revenues and expenditures that have not been realised in future budget periods. Budget deviations could be the result of unforeseeable circumstances in national or international economies, such as recession or pandemic, but they can also be caused by the government's incompetence to plan revenues and expenditures to a realistic level, or even a deliberate act, in order to achieve the government's agenda (for instance, before the election).

The budget plan summarises the amounts of revenues and expenditures that the national, regional and local executive

governments plan to generate in the upcoming year. These plans are, in turn, approved, or enacted by their representative bodies. Budget outturns are the amounts that have been realised. Budget credibility is important because after the budget has been enacted by the representative authorities, the citizens expect from the executive authorities to implement it in accordance with the plan, channelling expenditures to planned public goods and services and sustainable development. If the government fails to execute the budget in accordance with the plan, the citizens may wonder why that happened and whether there is any connection. Repeated deviations reduce the citizens' trust in the government's ability to realistically plan and execute budgets and respect its commitments.

In order to raise budget transparency and citizen awareness levels, the Ministry of Finance publishes budget outturn data for all local units on an annual basis.² In order to familiarise the public with the differences between planned revenues and expenditures and budget outturns, the text below offers a simple and systematised analysis of key financial data. The **Excel** spreadsheet provides data on revenue and expenditure deviations in the period 2020-2022 so that the interested citizens could easily recognise deviations outturns from planned budgets of their counties, cities and municipalities and compare them to the situation in previous years as well as to the situation in other counties, cities and municipalities. To make more detailed analyses and derive definitive conclusions, the Ministry of Finance's data should be extended with other data, primarily collected from the local units' websites (such as budget explanations etc.). A few introductory notes are in order, to highlight that all this data should be interpreted with caution.

First of all, since local units at different levels have different jurisdictions with regard to collecting revenues and providing public goods and services, revenue and expenditure outturns cannot be compared between all local units. Rather, municipalities should only be compared with other municipalities, cities with other cities and counties with other counties. Second of all, many local units do not collect revenues or generate expenditures only through their own budgets but also through their budget users (kindergartens, schools, museums, hospitals etc.) and through legal entities in which they hold majority ownership or co-ownership or institutions which they founded. Third of all, we analysed 20 counties, 128 cities and 427 municipalities.³

Deviations between budget outturns and budget plans have been calculated by using the formula below:

$$deviation = \left| \frac{planned\ amount - realised\ amount}{planned\ amount} \right|,$$

“planned amount” pertains to the amount recorded in the enacted budget, while “realised amount” pertains to the amount reported in the year-end report of a local unit. For the sake of simplicity, we only regard positive values as budget outturns should match the planned amounts.

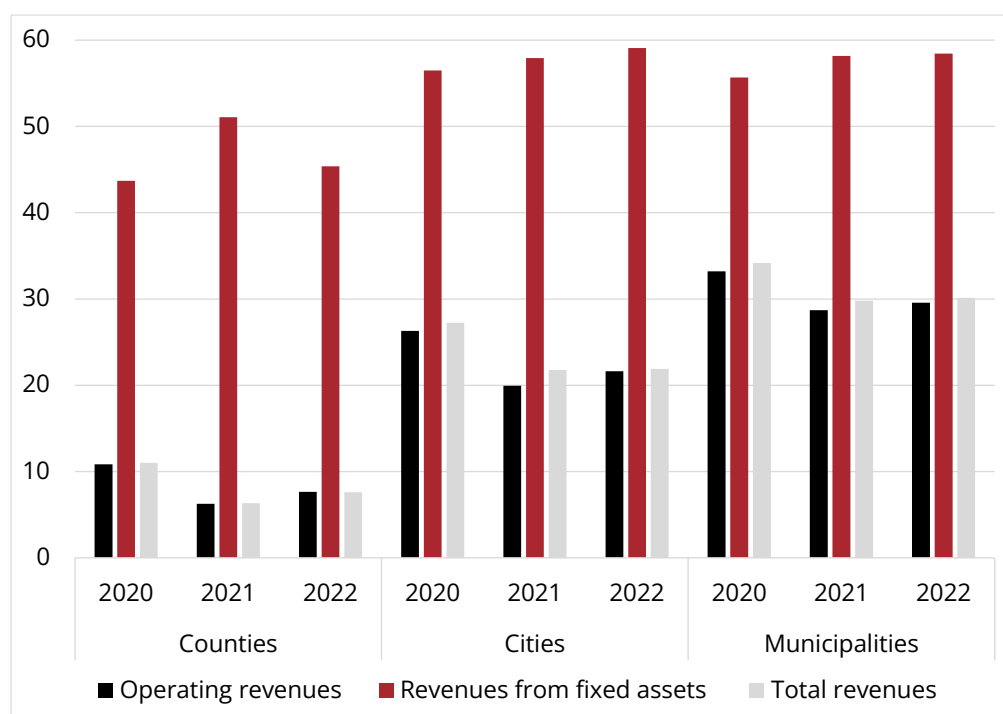
Revenue deviations

Operating revenues include revenues from regular activities of local units, such as revenues from income tax, grants and donations, various fees and charges, the use of assets etc. Revenues from fixed assets are generated through the sale of residential and business facilities, lands, vehicles and strategic stocks (Ott et al., 2009). Total

revenues are the sum of operating revenues and revenues from fixed assets.

In the observed period (2020-2022), the average deviations of operating revenues, revenues from fixed assets and total revenues were highest in municipalities, followed by cities, then by counties (Graph 1).

Graph 1. Average revenue deviations, 2020-2022 (in %)



Source: author's own calculations

Deviations in operating revenues and total revenues in all local units in 2021 were lower than in 2020, but they increased again in 2022. Average deviations in revenues from fixed assets in cities and municipalities, compared to 2020, rose in both 2021 and 2022; on the other hand, in counties these deviations increased in 2021 but declined in 2022 (Graph 1).

Average deviations in operating revenues throughout the observed period in all local units were around 28%. At 57%, average deviations in revenues from fixed assets were the highest deviation of all, while average deviations of total revenues stood at around 29%. Revenues from fixed assets make up a very small share in total revenues (around 3% throughout the observed period in all local units), so the deviations in operating revenues and total revenues follow the same trends and scale.

Very high deviations in revenues from fixed assets may arise from the fact that the **Budget Act** obliges local units to plan balanced budgets, whereby planned total revenues and receipts should cover the planned total expenditures and outlays.⁴ Higher planned revenues from fixed assets enable local units to include higher expenditures in their budget plans. If their generated revenues from fixed assets are lower than planned and their generated expenditures higher than their revenues, then they fall into debt. It is possible, however, that the local units actually did plan to sell a piece of land or building but failed to do so for one reason or another. With this issue in mind, future research should investigate potential effects of the political budget cycles.

Throughout the observed period, the highest deviations in total revenues were mostly recorded by municipalities as well as smaller cities, i.e. local units with a population below 7,500. The highest over-estimates of total revenues (more than 65%) were made in the following local units: Donja Voća, Biograd na Moru, Podravska Moslavina, Rugvica, Orle, Zagvozd, Dubravica, Vuka, Primorski Dolac, Pokupsko, Hraščina and Lišane Ostrovičke. Large deviations in operating revenues could be related to EU grants in cases when local units apply to a tender and make a reference to these funds in

their budget plans, but they eventually do not pass the tender or receive the funds later than expected.

The most realistic total revenue plans (deviations below 5%) were made by the Šibenik-Knin, Split-Dalmatia, Međimurje, Zadar, Lika-Senj and Zagreb counties, the cities of Karlovac, Križevci, Osijek and Umag - Umago and the municipalities of Voćin, Sveti Martin na Muri and Matulji.

Expenditure deviations

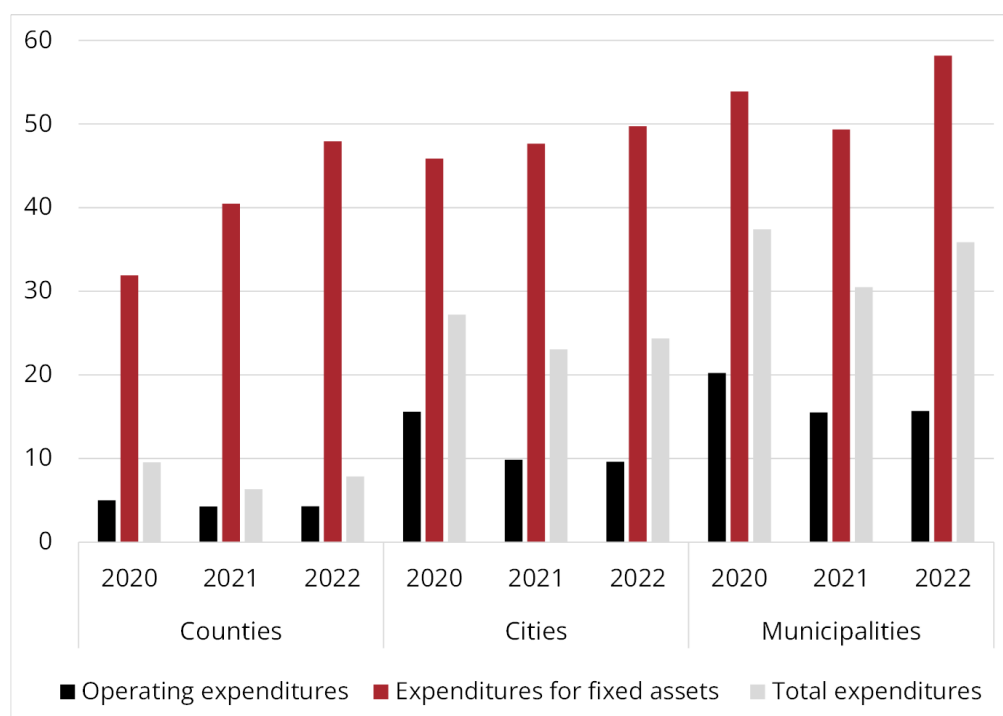
Operating expenditures pertain to local units' current operations and include employee expenditures, material expenditures, social benefits, subsidies, grants, financial expenditures. Expenditures for fixed assets pertain to long-term assets, for instance expenditures for non-produced assets, produced long-term assets, precious metals and other deposited values and further investment on fixed assets (Ott et al., 2009). Total expenditures are the sum of operating expenditures and expenditures for fixed assets.

Similar to revenues, the average deviations in operating expenditures, expenditures for fixed assets and total expenditures in the observed period (2020-2022) were highest in municipalities, followed by cities, then by counties (Graph 2).

Deviations in operating expenditures in cities in 2021 and 2022 were smaller than in 2020, while in counties and municipalities they decreased in 2021, only to increase again in 2022. Deviations in expenditures for fixed assets in counties and cities increased in both 2021 and 2022, while in municipalities they decreased in 2021, only to increase again in 2022. On the other hand, deviations in total expenditures in 2021 have been lower in all local units compared to 2020, while in 2022 they increased (Graph 2).

Throughout the observed period the smallest deviation outturn from planned amounts across all local units has been recorded for operating expenditures (around 15%), while expenditures for fixed assets recorded the highest deviation levels (around 52%). In sum, average deviations of total expenditures stand at around 31%. Throughout the observed period, the share of expenditures for fixed assets in total expenditures in all local units stands at 31%. For this reason, higher deviations in expenditures for fixed assets have a stronger effect on deviations in total expenditures.

Graph 2. Average expenditure deviations, 2020-2022 (in %)



Source: author's own calculations

High deviations in expenditures for fixed assets may arise from local units planning capital projects that should have a positive effect on the local community in the future, but the realised cost of the

project ends up being much higher than anticipated for whatever reason (e.g. rise in prices of material and services).

Throughout the observed period, the highest deviations in total expenditures have been recorded by municipalities as well as smaller cities, i.e. local units with a population below 7,500, such as Donja Voća, Podravska Moslavina, Biograd na Moru, Podravske Sesvete, Zagvozd, Rugvica, Hrašćina, Dragalić, Vuka, Pokupsko, Orle, Dubravica, Sokolovac and Antunovac (more than 65%).

The most realistic total expenditures plan i.e. with deviations below 5%, were set up by Šibenik-Knin, Primorje-Gorski Kotar, Split-Dalmatia, Međimurje, Zadar, Virovitica-Podravina, Dubrovnik-Neretva, Lika-Senj and Požega-Slavonia counties, the cities of Zagreb, Prelog, Virovitica and Ozalj and the municipalities of Hlebine and Marijanci.

Conclusion

The analysis presented above leads us to the following conclusions:

- the highest average deviations in both revenues and expenditures have been recorded in municipalities, followed by cities then by counties; the majority of local units plan for much higher revenues and expenditures than what they generate through the year; these cases call for a more detailed analysis of the problem – whether it is due to a lack of administrative staff that would be capable of quality budget planning, or are higher revenues planned on purpose so that the expenditures could be planned at higher levels too or maybe other reasons are at work;
- the lowest deviations occur in operating expenditures, while the highest in both revenues and expenditures related to fixed assets in all local units (above 50%);

- average deviations in operating revenues, total revenues, operating expenditures and total expenditures were smaller in 2021 than in 2020, but in 2022 they were higher than in 2021 (except in cities, where deviations in operating expenditures were further reduced in 2022); this is probably due to the pandemic, but the possible explanations call for a more detailed analysis;
- budget credibility should be monitored in a longer time period so that the political budget cycles could be included in the analysis.

We hope that this short analysis will have the following effects:

- to stimulate the citizens to study in more detail the databases managed by the Ministry of Finance and their local units and obtain more information on how the money in their local budgets is being collected and spent;
- to stimulate the citizens to become more involved in the budgetary process and try to impact a more realistic budget planning process in their local units in order to avoid large deviations and potential budget manipulations;
- to raise awareness of their local units about the importance of quality budget planning and the need to execute more balanced budgets (which they are obliged to do anyway as per the Budget Act) and about the need to explain to the citizens any deviation outturns from the budget plan and inform them about steps to be taken to correct previous deviations.

¹The term “local units” is used herein to cover all counties, cities and municipalities, while the term “local budgets” refers to the budgets of all counties, cities and municipalities.

²The [Ministry of Finance's](#) website provides data for the period 1995-2020. The [Financial reporting in the budgetary system and the Registry of Budgetary and Extra-budgetary Users](#) portal (RKPF) provides financial data for the period 2021-2024.

³The Municipality of Šestanovac has been omitted from the analysis due to the unavailability of its enacted budgets.

⁴The terms receipts and outlays are used in the financing account to refer to funds deposited to this account on the basis of selling financial assets, collecting loans and leases (receipts) and funds leaving that account for acquiring financial assets, taking out loans and loan repayment (outlays) (Ott et al., 2009).