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Local Government Budgeting in Croatia

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FOREWORD

As part of its lasting research interests, the Institute for Public Finance deals with matters relating to local government financing and budgets. The text presented here stems from this long-lasting interest.

The research was headed by Katarina Ott and Anto Bajo from the Institute for Public Finance, and the quality of the final text was much enhanced by contributions from employees of the Institute itself as well as from colleagues from other institutions. The project leaders, then, would like to thank the following (arranged alphabetically): Vjekoslav Bratiæ (Institute for Public Finance), Ivana Jakir (Ministry of Finance), Danijela Kuliš (Institute for Public Finance), Brankica Kušić (Ministry of Finance), Jelena Ladavac (Economic Institute), Ljerka Linzbauer (National Auditing Office), Maja Lukeš-Petroviæ (Ministry of Finance), Ivana Maletić (Ministry of Finance), Mira Masteliæ (Ministry of Finance), Branka Mauhar (National Auditing Office).

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We are bringing this account to a close at the very time when in the Croatian Parliament changes to the laws that govern affairs of local government financing and local government budgets are being voted in. The changes should come into force at the beginning of July 2001, and the readers – decision-makers, researchers, or anyone who is quite simply interested in the area - can themselves estimate to what extent the most recent statutory changes coincide with or diverge from the recommendations given here.

As leaders of this interesting and comprehensive research project, we would like to express our thanks to all our associates and all those who helped to finance the project.

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Local Government Budgeting in Croatia

Summary

A lot of time and energy has been expended on fiscal decentralisation issues. However, all our research has so far supported the approach that probably it is not so important where the budgeting functions have been performed but how. This particular piece of research, into local government budgeting in Croatia, leads us to similar conclusions.

Problems in Croatian local government budgeting could be divided into those connected with the number and the size of the local government units (LGUs), the budget itself and the budgetary process.

Croatia is a small country with too many LGUs. This causes the accumulation of oversized administrative machinery at several tiers of government and inadequate division of functions and responsibilities. The situation has been aggravated by the creation of areas of special national concern in response to damage caused by the war.

Budget related problems could be seen as inadequate classification of budgets, lack of budgetary classification, lack of fiscal capacity indicators, the absence of any 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. On the revenue side there is an inadequate system of financial equalisation and allocation of subsidies, the frequent foundation of new local units without secured funds, insufficient shared taxation, low level of own tax revenue heavy reliance on non-tax revenue such as utility charges and contributions. On the expenditure side the main problems lie in the lack of long-term capital project planning, the non-separation of current and capital budgets. Finally, we could mention that the principle of balancing budgets and borrowing is not respected, capital expenditure is financed without proper studies, and we also encounter the inadequate recording of potential obligations (guarantees).

The budgetary process lacks internal controls, evaluations of activities, evaluations and rewards for the work of employees, treasury system audits of joint stock enterprises and firms owned by local units, and collaboration between LGUs and the Ministry of Finance. Besides, budget planning guidelines are over-generalised.

After recognising the main structural fiscal problem manifested in the absence of a good budgetary system, clearly separated functions and competencies for financing, one can draw basic recommendations for the government and the economic policy makers.

Reform of the budgetary system of the LGUs should be carried out in several phases, for which additional concrete research into the financial position of the LGUs still needs to be carried out, however. The main problem about reform is the excessive politicalisation that might attend 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 and the technique of budgeting, the budgetary process in the LGUs, and the construction of a more powerful financial control mechanism on the part of the central government. All the main participants in the budgetary process should be educated to understand the aims and intentions of the steps proposed for the future.

Local Government Budgeting in Croatia

PROBLEMS AND RECOMMENDATIONS FOR REFORM

Everything said above about the system of local government financing leads us to conclude that there is a structural fiscal problem, manifested in the absence of any good budgetary system, clearly separated functions, and competencies for financing. Accordingly, below we shall emphasise problems and give recommendations for the reform of the budgetary system of the local units.

1. Territorial Organisation.

Croatia is a small country with a very great number of local government units: 422 communes, 122 cities and 20 counties (not to mention the city of Zagreb). 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 are incapable of justifying the title either by revenue or by the functions that are statutorily stipulated. It is the same thing with communes. The fashionable trend to found communes that took Croatia by storm in 1993 permitted any petty rural area to found a commune of its own. The main problem inheres in the amassing of administrative bodies and employees in these communes. Such local government units are simply incapable either of financing current expenditure or of providing the basic services in their areas. And so they have to depend on direct transfers from the national Budget. This leads, in spite of the theoretical territorial decentralisation, to the actual centralisation of government.

- **Decide on an optimum number of local units. Make a detailed analysis of the financial situation of local units and determine their ability to finance themselves and provide public services. After that, decide on a reduction in the number of existing communes and counties, which is unsustainable, and is too much of a burden upon the national Budget.**

2. Administrative functions.

It is the counties that are in charge of administrative functions at the level of the local units. The administrative bodies of the counties, i.e., the bodies of the national civil service, are financed from the national Budget, for the performance of administrative functions, but from the county budgets, when they undertake matters proper to the sphere of local self-government. These marks of duality can be seen in the prefect, who carries out functions of central government and of local self-government. New laws envisage these functions being split between two officials. But for this to be done the National Administration System Law will have to be changed – something no one seems to have thought about.

In this case too the question has arisen about the accumulation of administrative machinery at the level of the counties. Bearing in mind the numerous criticisms by the local units – the cities and communes – about the work of the counties and the county bodies, it is essential to settle on the number of administrative bodies and the people employed in them. Existing administration at county level is ineffective. Another problem is the level of the salaries in the administrative bodies of the local units, which frequently surpasses that in central government bodies. There are no criteria for

evaluation of the work done in the administrative services of local units; in most cases the system for rewarding and penalising the performance or non-performance of work is based upon the internal regulations of the local units. Central government has practically no control over these regulations, or knowledge of their contents.

- **In all local units (counties, communes and cities), determine the number (situation) of the administrative units and the employees in them.**

3. Functions and division of responsibility.

There is no clear delimitation of function between the levels of government, even in spite of the many laws that regulate the financing system. 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 upon the counties, which are incapable of financing them.

- **Clearly distinguish between the functions of the national and the local governments. The authorities and responsibilities for the financing of functions, and the provision of public services at the local level, should be united in a single law.**
- **There should be a clear distinction made between the rights and obligations of local units and those of the central government. In this way individual local units will have an interest in executing their obligations, and if they are not performed, it will be easy to affix individual responsibility for mistakes and oversights.**
- **Re-evaluate the effectiveness of the financing of local unit public expenditure from the central government budget. Particularly in the case of financing elementary and secondary education, health care, welfare, fire protection, road maintenance and construction at local and regional levels. As well as decentralisation of expenditure, the gradual decentralisation of revenue to local units should be ensured.**

4. Areas of special national concern.

These areas were set up for the sake of 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. However, these development measures have not been accompanied by any serious analysis, nor are there any tested economic indicators for the degree of development of the regions. And there is no precise number of employees in the administrative services, or employees in industry and business. The government provides current subsidies from the national Budget. However, the criteria are very questionable, as are the amounts of the funds that are sent year after year to these areas.

- **Determine the realistic conditions and indicators of development in the areas of special national concern, and ascertain the effectiveness of state incentive measures to do with the functioning of the public sector in these regions.**

5. Fiscal equalization and fiscal capacity

The system of financial equalisation and the allocation of subsidies. From the national Budget, central government provides numerous subsidies – current, capital, specific and general – to local units. The subsidies are sent to the counties, and the

counties provide funds to the local units with below-average fiscal capacities according to the size of their revenues. Areas of special national concern to which the government gives subsidies directly are a story to themselves. The government has no clearly defined criteria for the subsidies it gives. There is complete confusion when an attempt is made to work out the total amount of funds that the state gives to local units. It is impossible to arrive at these sums, because numerous subsidies are given via the various ministries. The Finance Ministry has no way of checking on and making sure that these funds are used, to what extent and for what purposes. Local units do not have the obligation (except for areas of special national concern) to report to the Finance Ministry about the level of funds used. It is questionable to what extent the subsidies are used for fiscal equalisation, because most of them go on the financing of current expenditure.

- **Fix fiscal equalisation criteria. Make sure that funds for fiscal equalisation are given not only by the central government, but also by the richer counties and the more developed cities and communes.**

Fiscal capacity. It is hard to measure the fiscal capacity of the local units because there are no precise figures about the populations involved. It is also hard to get a realistic account of the revenues and expenditure of the LGUs. An additional problem inheres in the tax bases and the rate of local taxes, which are not systematically controlled at the level of central government. The government has in outline terms, according to per capita revenue, determined the criterion for the allocation of the subsidies used for fiscal equalisation. However, the criteria and the equalisation of fiscal capacity on the basis of income are not applied.

The local units' own tax revenues. In practice to date, 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, and the possibility of all local units prescribing rates of surtax (on personal income tax). There is a question to what extent the introduction of new local taxes will affect the increase of tax revenue, for in current practice, local taxes figure in the budgets of local units but to a small extent.

- **The central government should oblige local units to send information about the size of the base for local taxes, and the rate that is imposed in each unit.**

6. Foundation of new local units

In spite of the excessive number of local units, even today new units are being founded by splitting up existing units. The problem of the founding a new unit is intimately related to the division of assets. Many local units, that is, 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 fighting court cases about the division of assets. The management of assets belonging to local units is a further complication, since there are no departments or individuals with the expertise required for this. Asset management is not institutionally settled even in the central ministries.

- **Once and for all determine the value of the assets of local units, and the responsibility for managing these assets.**

7. Shared taxes

The central government has stipulated the sharing of the main kinds of taxes with the local units. The main taxes like income tax and profits tax are thus shared in percentages among all levels of government. A special problem however is value added

tax, which goes only to the central government. Many local units have a consumption tax, the rate of which they set autonomously. There are then problems of the double taxation of the same product – alcoholic and non-alcoholic beverages for example. Has the central government made a suitable determination of the amount that remains at local government unit? An analysis of revenue shows that the main resource of individual local units (especially the communes) is not tax but non-tax revenue. The small percentage of the local units in shared taxes needs increasing.

- **Increase the share of local units (or reduce the share of central government) in the tax revenue sharing arrangement (above all, personal income and profits tax).**

8. Participation of citizens in the provision of public services

Apart from the principle saying that citizens have the right to elect, and encourage the election of, representatives in the representative and executive bodies of government, no way, in which citizens can take part in the provision or financing of public services has been foreseen. Citizens do appear as the initiators of the financing of individual programmes and projects, but their participation is not regulated by statute. However, among the non-tax revenues, we can come across income from **self-contributions**. These are self-imposed levies of citizens that they on their own initiative introduce for the financing of items of the utility infrastructure – water mains, local roads and the like. However, self-contributions are not governed by statute, even though local units do introduce them and use them as a result of grassroots initiatives.

- **Ensure a more active role for citizens in providing and financing public services. Regulate the self-contribution system by statute.**

9. Non-tax revenue

Because of the low fiscal capacity and the low level of revenue of from local (own) taxes, many LGUs have non-tax revenue as their main source of revenue. The main role in filling the local budgets, especially of cities and communes, is played by utility charges and contributions.

Utility charges and contributions. This area is regulated by the law. The issue is that many local units autonomously prescribe high rates of utility charges and contributions. Eighty per cent of cities (or utility firms) illegally charge for connections to the infrastructure, for which reason the population has to pay high prices for charges and contributions. There are whole series of charges and fees that the local units levy without the central government having any control of the rates, or records of the accounts.

- **The central government should control the rate of utility contributions and charges that can be set autonomously by local units.**

10. The position of the utility companies

Little is known about the privatisation and ownership of these companies. Many local units do not evaluate the value of their assets realistically, nor have the responsibilities with respect to the management of these assets been institutionally allocated. Thus the value of the utility firms is not known either. An additional problem is the connection of the local budget and the utility firms. These firms operate as companies, i.e., on a profit basis. And yet the losses of these firms are covered from the budgets of then LGUs, which pay their debts.

- **Determine the ownership of utility firms and the possibility of privatising individual functions at the local government level.**

11. Balancing budgets, borrowing and potential obligation.

In principle, there is the budgetary principle that a local budget has to be balanced. Every year the local units are enjoined to observe the “golden rule” that borrowing is resorted to only for the financing of capital expenditure. However, in many cases the balancing principle is not respected, and local units rely on borrowing for the financing of current expenditure as well, with the commercial banking sector, 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 are presented. Many transactions, such as the issue of budget guarantees for utility firms, are simply not registered, nor is there a unified or unitary register of local government-backed guarantees. Guarantees are often kept in the financing account of the LGUs, even if they have not become a real obligation of the unit.

- **Step up financial control of the borrowing of local units and determine the size of the loans and potential obligations of local units.**

Potential obligations (guarantees).

Local units record and book loans given and made and guarantees in various ways. Some units enter given guarantees as loans given. While planning the budget, many local units deliberately exaggerate the size of revenues and expenditure, and in this way, formally, provide for a greater level of borrowing than if they estimated budgetary expenditure and revenue more realistically, and at lower levels.

Exaggeration of the size of the budget has become a means for local units to arrive at greater amounts of money from borrowing. We should recall that the state has limited borrowing of local units to the level of 20% of the expenditure for the previous year. According to this logic, a bigger budget means a bigger borrowing ceiling the following year. For this reason financial reports can be consolidated only with difficulty, and one cannot be at all sure of the correctness of the information obtained from data shown.

- **Bring in the obligation for all units to keep registers (off-balance sheet) of guarantees issued.**
- **It is necessary to keep special auxiliary records about guarantees that have been made. On the basis of the instructions of the central government, local units plan a guarantee reserve. However, in the instructions it is necessary to determine what amount, i.e., percentage, of the guarantees should be set aside in the guarantee reserve.**

12. Internal control, treasury and audit

Internal control is not organised, either in ministries or at the local unit level.

- **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 treasury system does not work at the national level, nor is there a national financial information system. There are no long-term plans for the structuring of treasuries at the level of local government units. **Cash management practice.** The

function of cash management is not separated at central government level from debt management. Both functions are linked organisation-wise in the Finance Ministry in a single administration or agency – the Cash and Public Debt Administration. 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 via the many accounts of the budget kept at the commercial banks. An additional problem is the absence of an effective national financial information system.

It is the same thing with 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 at the commercial banks and ZAP (the Payments Clearance Institute).

- **The Finance Ministry should draw up a plan for organising a treasury at the local government level, and also of course get the treasury going at the national level. The Finance Ministry should also determine the way in which cash is to be managed, and oblige local units to keep their funds in a single budgetary account.**

Auditing of joint stock enterprises or firms owned by local units. These enterprises are subject to state and to commercial auditing, as are other, privately owned companies. It is not clear that both kinds of auditing are required.

- **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 auditing system would then carry out the audits of these firms within the required time limits.**

13. Classification and Consolidation

Classification of the budgets does not support the separation of functions according to 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 kinds of revenue and expenditure.

It is impossible to present data about current and capital expenditure, and data about utility charges, according to an economic and functional classification. Thus, for example, some local units, within the framework of subsidies and current and capital transfers, include the pay and material expenses of employees, which should be shown in the framework of employee expenditure. The problem lies in the account plan of the budget(s), which does not enable the acquisition of 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 state of affairs.

Consolidation of local units' budgets is still not performed, nor is consolidation at the same level of government (county, commune and city) done. In outline, for all local units, a summary balance sheet is drawn up. One of the main problems is the classification of the budget(s), which makes consolidation of local unit level budgets impossible, and this is exacerbated by the absence of any instructions about how to carry out consolidation.

- **Bring in a new account plan of the budget for the country as a whole and for the local units, to make sure that there is a review of public expenditure in terms of functions and economic categories.**

There is no **classification of expenditure by programme and subprogramme**. For this reason many LGUs do not programme expenditure for more than a year ahead. If expenditure were programmed for several years ahead (with an effective estimate of revenue), in the first year it would become clear that there would not be adequate funds for the completion of many capital projects in the year(s) to come. In this way all the preventable expenditure that arises when projects are uncompleted would be avoided.

- **Introduce a programme and subprogramme classification of public, especially capital, expenditure, and apply it at both national and local levels.**

14. The planning and financing of capital expenditure.

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 or monitoring of the execution of capital projects is made or done, and the current and capital budgets are not clearly separated. This is not even stipulated by the laws about local government financing.

When they make decisions about capital financing, local units make neither investment studies nor social justifiability studies. Such a manner of working leaves an impression of lack of seriousness, which puts off potential domestic and foreign investors.

The financing of capital projects by borrowing is practically impossible because of the low fiscal capacities of the local units. The question of the asset balance sheets of some of the units is still unsettled.

The planning of capital projects. Local units do not undertake any long-term planning for 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. Nor at the central government, alas, is there any programmatic classification of public expenditure.

Local governments do not estimate the consequences 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 at the central government level that, however, does not have a complete oversight of the use of budgetary resources at the local level. No programme of capital financing or sectoral analysis of programmes exists, either at the local or at the central government level.

- **Separate the budget of local units into current and capital parts and oblige all local units to keep a financing account.**
- **Stipulate registers of capital projects at local and central government levels.**

15. Performance indicators

The system of performance in local units comes down to a comparison of planned and realised. There are individual examples of steps forward towards programmes.

However, there is still no monitoring of the performance of programmes in the sense of the production of some general good or citizen satisfaction.

Information about performance does not have to be, and largely is not, part of the documentation of the annual budget. What is fundamental is monitoring of the level of revenue and expenditure, and it is budgetary balance that is in the foreground, as well as control of the borrowing of the local units. Local units do not keep up with expenditure in terms of individual activities, nor do they measure effectiveness and the costs of the activity by making a cost benefit equation, nor do they insist on quality, efficiency and management. Performance is not an imperative even at the level of central government, and hence not at the local levels either.

- **Every budgetary financial transaction should be able to identify the budget and centre of costs, its purpose or the service it provides, the source of funds and the kind of revenue or expenditure.**

Evaluating and rewarding the work of employees. The work of employees is not evaluated in local units. There is no system for monitoring success and quality of work, nor any incentive system for better performance. Performance is not evaluated at all. Thinking goes on within the framework provided by statute, and concrete shifts in the direction of change and improvement are expected from elsewhere, i.e., from the central government. The model of initiative and independent, active and creative, work has not been internalised. Because of the lack of existence of incentive measures or of any criteria for incentives to be awarded, individuals cannot be expected to perform creative, high-quality work. Ideas interest nobody, and the final result, in which there is no systematic effort to raise the level of the quality of the work of the employees, is inertia and red tape.

- **The national government and the local units should be able to prescribe an incentives system for work well done, and penalties for substandard work.**

16. Accounting and methodology

Accounting of the budget is complicated and regulated by numerous regulations that overlap with each other and yet are conceptually and substantially unclear. Thus budget accounting underrates obligations, overrates assets and makes consolidation impossible.

There is no single model or **methodology** for showing revenue and expenditure for all the budgets. The lack of a unified methodology makes it impossible to keep up with and consolidate local unit budgets.

- **The Finance Ministry should clearly inform all local units about the prescribed form or model for financial reporting.**
- **A review of the whole budgetary accounting and reporting system is necessary; this should be embodied in a single law. Various different regulations should be terminologically unified, because local units understand and apply them in different ways.**
- **The Finance Ministry should lay down the obligation to adopt the annual accounts of the budgets of local units as financial reports. Changes should start from the creation of the classification of revenue and expenditure according to a certain number of modified categories. This would make the financial data gathered analysable in various ways and for various requirements.**

17. Budget planning.

At the beginning of the planning of LGU budgets there appears the problem of the use of the Finance Ministry guidelines, which are over-generalised for most local units. For this reason the Finance Ministry has to pay more attention to specificities and adapt the guidelines to the units (communes, cities, counties). The problem lies in the MF sending the budget preparation and making guidelines first of all to the counties and the city of Zagreb. In line with these guidelines, the counties draw up draft estimates of their own budgets, and draw up guidelines for the cities and communes in their own areas. However, the counties do not fulfil their obligations, nor do they draw up guidelines with indicators for the cities and communes in their regions. This is the basic reason why most of these units consider the guidelines too generalised and partially inapplicable.

As well as this, the communes, cities and counties are bound to draw up a budget by 15 December for the year to come. It is not rare for the budget to be passed in the very last days of December. Many of the units have at least one and perhaps two revisions of the budget during the year – some as many as three or four.

- **Adapt Finance Ministry guidelines to individual levels of local units, with the obligation being placed on local units to draw up their own indicators. Prescribe a single model of budgetary planning for all local units.**

The plan and estimate of the budget. The basic elements for the making of the plan and the estimate of the budget are not always uniform or detailed. They depend on the size of the budget, the structure of public expenditure and revenue, and the kind of public functions financed from the budget. Methods and quality of estimating LGU budgetary revenue and expenditure do not depend on the size of the budgetary unit or its economic power, but on the interest of the executive bodies, and the expertise and personnel of the finance departments charged with planning and preparing the budget

- **Local units should base the planning of their budgets upon their own indicators. Local units that get transfers from the national Budget have to keep to guidelines about pay and expenditure trends. And so they have to keep up with expenditure in terms of items.**

18. Public investment planning.

The government has not to date dealt in any serious way with the planning of public investment, nor has any overall approach to the financing of capital projects at local unit level been set up. Only at the beginning of 2000, for the 1996-1999 period, for the first time, was a complete list of capital investment per sector. This list cannot even be found in the Finance Ministry, nor do decision-makers in the Finance Ministry know of its existence. It was made and signed by the government of the country. Because of this information blockage, the competent institutions, above all the Finance Ministry, find it hard to control to what degree local government capital investments are financed and carried out. Capital projects are not grouped into programmes of public investment.

- **At the central government level, keep a complete and detailed list of capital projects financed at local levels, in order to make possible control of capital subsidies transferred to local units.**
- **It is necessary to introduce into the procedure of planning capital investment the practice of making investment studies with consideration of possible sources of financing. Since this is to do with projects that are important for**

the society as a whole, the obligation to make a social justifiability study of each investment should be imposed.

- **Local administration should be equipped and trained to work with contemporary ways of planning capital projects.**
- **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.**

Reform of the budgetary system of the local units should be carried out in several phases, for which additional concrete research into the financial position of the local unit still needs to be carried out, however. The main problem about reform is the excessive politicalisation that might attend any new initiative. For this reason it would be better to concentrate on possible improvements to the present system of local units, with the emphasis on strengthening the budget and the technique of budgeting, the budgetary process in the local units, and the construction of a more powerful financial control mechanism on the part of the central government. All the main participants in the budgetary process should be educated to understand the aims and intentions of the steps proposed for the future.

Local Government Budgeting in Croatia
PROBLEMS AND RECOMMENDATIONS FOR REFORM

Part One

THE LOCAL GOVERNMENT SYSTEM

Introduction	8
1. The local government structure	10
1.1 The institutional framework of local self-government and administration in Croatia	10
1.2 The main characteristics of the local units system	11
1.3 The size of local units	15
1.4 Central control of local units	16
1.5 Cooperation among different levels of government	17
2. Local politics and administration	17
2.1 Administrative bodies of local units	18
2.2 Financing the administrative bodies of the local units	20
3. Functions of local government and service delivery	21
3.1 Difference in functions among individual levels of government (national, county, commune and city)	30
3.2 A financial analysis of functions	32
3.3 Current expenditure of the budgets of local units according to economic categories	33
3.4 Macroeconomic control of fiscal policy at the local government level	34
4. Local government finance and financial management	36
4.1 Structure of revenue	36
4.2 Taxation revenue	38
4.3 Non-tax revenue	41
4.4 Utility charges	44
4.5 Subsidies	47
4.6 Fiscal equalisation	48
4.6.1 Vertical fiscal equalisation	49
4.6.2 Horizontal fiscal equalisation	49
5. Capital investment financing and capital budgeting	50

Part Two

LOCAL GOVERNMENT BUDGETING	54
1. Fiscal policy making and budgeting at national level	54
2. Strategic planning and short term (annual) budgeting at local level	57
3. The basic structure of a local budget	61
3.1 The fund system	61
3.2 Fiscal planning units	64
3.3 Extra-budgetary funds, off-budget units	64
3.4 Consolidation of the Budget	65
3.5 Classification of expenditure	66
4. Budgeting techniques	67
4.1 Performance budget – role of performance indicators	68
4.2 Accrual (cost based) budgeting or cash based budgeting	69
4.3 A multi-year, guaranteed budget	71
5. Participants and actors in local government planning	72
6. Major stages of budgeting	72
7. Information systems	77
7.1 Fiscal information in budget document	77
7.2 Performance information	78
8. Budget implementation	80
8.1 Cash management practice	80
8.2 Controlling the budget of service organisations (expenditures and own revenues)	82
8.3 Audit system	83
9. Capital budgeting	85
9.1 Capital planning methods	85
9.2 The financing of the capital projects of units of local government	87
Appendix I: Tables	99
Appendix II: Questionnaire	104
Appendix III: Analysis of the Questionnaire	107
Appendix IV: Glossary of Terms	126
Appendix V: Taxes in the fiscal system of Croatia	131

Part One

THE LOCAL GOVERNMENT SYSTEM

Introduction

Since 1990, when the first attempts were made to work out a concept for the local government financing system, the practical financing of the new communes has been bedevilled by a problem composed of four essential elements.

First, there were no reliable data about the fiscal capacities of the communes. Data about public revenue were available for the communes as they were then set up. There was a problem that some regions (or counties), in spite of having an appropriate tax burden, still did not have adequate sources of financing of their own. This problem showed up with some communes as well, since there were no data about per capita revenue, which would have been needed for the communes to be able to obtain the right to prescribe their own rates of tax, or for the central government to cede them a percentage of its revenue.

Secondly, the foundation of the new communes entailed the foundation of new commune records about potential revenue. Without such an insight into the financial capacity of the communes it was not possible to make a proposal about their own revenue. These communes could be financed only via the intermediacy of the counties. Funds were provided for the counties and for the communes in their area. There was a question of whether the central government should finance the local units directly from the national Budget or via the counties. According to previous experience about public revenue, it was realised that the cities needed to bring in taxes bigger than the average in order to cover the greater per capita expenditure.

Thirdly, the problem of fiscal equalisation became still more complex because of the war, since the earlier model of financing through supplementary funds became unworkable. Reform of the tax system and the introduction of a new manner of local government financing took place in conditions that because of reconstruction and the consequences of the destruction brought by the war made the finding of optimum solutions for the vertical and horizontal division of budgetary revenue and expenditure more difficult.

Fourthly came the still current problems of the renewal and reconstruction of areas severely damaged in the war. Such expenditure could not be included in the regular local government financing system. There could only be speculation about the possible relative range of the revenues of the communes, that is, the extent to which they were discrepant with the national or county average.

As a result of this, the Law concerning the Financing of Units of Local Self Government and Administration (*Official Gazette* 117/93, below referred to as the Local Government Financing Law) was passed. With the passing of this law, the present local government financing system was set up in Croatia. The new territorial organisation and the new manner of financing the local units, from the moment they began to be applied, have shown certain shortcomings, complicated by the need to find and determine measures for the fiscal equalisation system. The necessary question of palliating the differences through transfers to lower levels of government arose, as did that of the best estimation of the taxes that remained at the local unit level, that is, to what extent they

were shared with central government. For this reason we shall detail some of the problems that have arisen since 1994.

Firstly, the constant territorial changes, and the unnecessarily large number of communes additionally slowed down the acquisition of data about the real financial situation. It is hard to determine to what measure revenue apportioned by the law was collected, which was necessary to determine the amount required for fiscal equalisation.

Secondly, most of the new local units had in 1994 no balance sheet of their assets, and did not know what they had at their disposal, or what the value of their assets was. Neither did the communes and cities have properly organised figures about their assets because they had ceded a certain amount of assets to the newly formed units, while the figures that did exist about assets and final accounts for earlier years became completely unusable, for the value of the assets, irrespective of revaluation, was put very low and had no relation with the real market value.

Thirdly, the regions of the Republic of Croatia have very different economic and demographic conditions, thanks to changes over the course of time. The constant changes in the size of local government areas require some consideration of not only the historical but also the economic, political and demographic features of a given area. The wealth or poverty of a local unit has stemmed from the unequal distribution of natural and economic resources and further conditions the system of the financing of local units. The estimation of such inequalities entails a decision about the best division of the transfer funds to local units that cannot meet even the minimum needs of the population in their areas.

Fourthly, the importance and development of the tourist industry has added to the urgency of the question of the development of the islands, and the determination and presentation of a national development programme for the islands and the way they should be financed. In a selective approach to the financing of the poorest local units (which include the islands) there are no other options but subsidies from the central government. Such programmes should exist and be implemented over the entire area of the counties, communes and cities, but in fact the practical problem of determining the criteria for the allotment of subsidies has remained.

Fifthly, according to the National Auditing Office, at local unit level, fiscal surpluses do occur¹. The existence of surpluses shows that the extents to which local

¹ There are several reasons for the occurrence of local unit surpluses. Firstly, local units obtain capital grants from the central government for the financing of the construction of capital projects. In numerous cases the dynamics of the implementation of the capital project is not temporally co-ordinated, so that the local units obtain the grants and then do not use them in the current year for the financing of the given capital project. Local units then carry over the resources into the next year or use them for the financing of the continuation of the implementation of projects of capital investment.

Secondly, there is the nature of non-tax revenue. Local units must use non-tax revenues for purposes defined precisely by the law. It does happen that local units do not use the funds of special purpose revenue for the financing of projects such as environmental protection in the current year but carry them forward into the next year. The problem here is that in some local units, non-tax revenues make up to 50% of all budgetary revenue, and have to be used according to special purposes, because this is legally required. On the other hand, the remaining 50% of budgetary revenue is not adequate for the financing of the other expenditure of the local units.

Thirdly, the local units borrow to finance capital projects. Sometimes the local units do not spend the amounts borrowed within the budgetary year. Then a budgetary surplus occurs and the resources of the surplus are carried forward and used in the subsequent fiscal year for the financing of capital projects.

None of these three cases of budgetary surplus can really be said to represent a classical budgetary surplus arising as a result of the inflow of budgetary revenue that is greater than expenditure; rather, they are all the result of poor allocative efficiency, on the part of both central and local government.

public needs are satisfied are uneven. Great need on the one hand, and surpluses on the other, raise the question of just how optimal the local government financing system is.

Sixthly, the revenues of LGUs are not planned realistically, and it is often found that in the accounting books of local units, not all revenues and expenditures have been recorded, nor has revenue been collected when due. Individual expenditures are made in amounts greater than planned, and some have been made although not planned. Some of the budgetary resources have been used for purposes they were not intended for.

Seventh, not all the prescribed auxiliary books are kept, nor are the inventories of capital assets drawn up, and there are irregularities in financial reports because the statutory representative does not control them.

Eighth, some of the units have not adhered to the provisions of the Decree about the procedure for the procurement of goods and services and the contracting of works. Contracts about the performance of works are not made, or contracts do not have all the prescribed items, or expert supervision of the carrying out of the works is not ensured.

Ninthly, the authorities and the representative bodies of local units do not give monthly or quarterly reports about the use of current reserves. A large number of units are constantly in breach of the Local Government Financing Law, because they borrow with the banking sector and give guarantees for current expenditure. Many of the units take on loans above the permitted percentage of the expenditure of the previous year.

These shortcomings in the financing of local government in the first phase of the application of the new system require research to make possible adjustment to do with the choice of financing instruments, and the increase of the efficiency of the financing. For this reason it is necessary to take a look at the solutions and measures carried out in some other countries, which might be applied in the local government financing system in Croatia. There is no need to aim at the literal copying of other people's successful solutions. Attention should be paid to the special conditions, so that the solutions should be applied in the best possible manner. It is clear that within the fiscal system there is the problem of the clear division of fiscal authority, financial management, the construction of an institutional structure, and settling the financial resources required for a given local unit to be able to carry out the tasks that have been placed within its sphere of competence.

1. The local government structure

1.1 The institutional framework of local self-government and administration in Croatia

With the passing of the Constitution (1990) and the proclamation of independence (1991), the units of local self-government and administration were defined. The counties have a dual character, being units of local self-government, and local administration. The Constitution states that communes and cities are units of local self-government.

Until 1992, Croatia had 115 communes. With the new Local Self-Government and Administration Law (*Official Gazette* 90/92) the organisation and competence of self-government was defined, and a delimitation of the affairs proper to the national administration and those that are proper to local self-government was made. Pursuant to the Areas of Counties, Cities and Communes in the RC Law (*Official Gazette* 10/92), after 1992 Croatia had 20 counties, the capital city, Zagreb, two districts (Knin and Glina), 67 cities and 434 communes.

Until 1993 there was a handed-down system for financing the communes, but this did not fit the new organisation. The transfer of administrative functions to the county and the definition of communes and cities as units of local self-government determined the next step, which related to the way the financing of the units was arranged.

The Local Government Financing Law (*Official Gazette* 117/93) set up the current system for the financing of the local units. This encompasses the counties, cities and communes and the city of Zagreb, which has a special status in the financing system. From 1990 to 1993 it was impossible to get a realistic picture of the revenue and expenditure of local units precisely because of the founding of the new units and also because of the destruction of the war. New statistical data concerning the revenue of the local units are adjusted to the methodology of the IMF. This methodological adjustment additionally slowed down the acquisition of a picture of the financial condition of the local units. Only since 1993 have revenues that remain at the local levels been defined, and the criteria for vertical and horizontal fiscal equalisation been in outline determined. However, the effects of the new system of financing on the fiscal capacities of the local units remain an unknown.

After the passing of the new Areas of Counties, Communes and Cities Law (*Official Gazette* 10/97), new local units were founded. The result is that in Croatia in 2000 there are 20 counties, 122 cities, 422 communes and the city of Zagreb, which has a dual status, being both county and city.

The principal laws regulating local self-government and administration in Croatia

1. The Local Self-Government and Administration Law (1992).
2. The Local Self-Government and Administration Units Financing Law (1993).
3. The Areas of the Counties, Cities and Communes in the RC Law (1993 and 1997).
4. The Budget Law, (1994) and
5. The City of Zagreb Law (1997). On 11 November 1997, Croatia ratified the European Charter about local self-government, accepting the principles laid down in the Charter.

1.2. The main characteristics of the local units system

Croatia has a rather complicated political system with three tiers of government – central government, counties, and communes and cities. The local self-government units are the counties (administration and self-government) and cities and communes (local self-government). The counties, cities and communes regulate their own internal organisation and structure and the way they work in their statutes.

A county is at once a unit of local administration and one of local self-government. The county is the basic unit of the central administration, in which the communes and cities of its area express their interests. This dual role affects the work of the counties' bodies, which also have a certain dualism.

These are present in the financing of its functions. Expenditure that relates to the administrative functions of the county, carried out by the county office qua body of the national civil service (above all the pay of senior and junior civil servants and material costs) is financed from the national Budget. Matters proper to the sphere of self-government are financed from the county budget.

Matters from the county's self-government sphere of competence

A county carries out activities directed at the even economic and social development of the units of local self-government in its area. It frequently adjusts the views of units of local self-government (the communes and cities in its area) about questions that central government bodies decide on. It also adjusts or harmonises the settlement of matters of common interest about which the bodies of local-self government that are part of the county decide on.

A county adjusts the development and network of educational, cultural, healthcare, welfare, utility service and other institutions, as well as infrastructure facilities that are important for the county as a whole. The county also carries out business that the cities and communes have devolved upon it (it sets up public establishments and other legal entities in order to achieve the joint objectives of the cities, communes and the county as a whole).

A county provides funds for the financing of the work of the county bodies, environmental protection and health care, public needs and the establishments that it has founded.

Counties had an essential role in the allocation of supplementary funds to cities and counties in their territories that suffered the direct impact of war and the destruction it brought (up to 1995 almost 25% of the national territory was temporarily in the hands of the rebels). The communes and cities that underwent substantial damage during the war, particularly the areas of the Vukovar and Srijem and the Osijek and Baranya counties received supplementary resources from the national budget via the county budget.

The central government gave subsidies to the counties and the counties sent resources down to the cities and communes in their areas. It was considered that in this way the appropriate size of the financial resources needed in a given area could be evaluated easier and more realistically.

Since 2000, grants have been given directly from the national Budget to all counties, cities and communes in *areas of special national concern*.

In practice, there are a great many criticisms of the work of the counties, because frequently they do not carry out their tasks related to equalisation of development in undeveloped areas. Because of the passive role of the county and the weak coordination between the counties and the cities and communes in their areas, it is quite common for the cities and communes to address central government directly for financial support in the provision of public services.

A city is a unit of local self-government; it may include not only the city proper but also the settlements grouped around it. A city is any town that has more than 10,000 inhabitants. If there are reasons (historical, economic, transportation), a place that does not satisfy the numerical requirement can also become a city.

A city looks after the same matters as a commune. City and commune functions will frequently overlap, and it is hard to tell them apart. With respect to the amount of budgetary resources and population size, there are cities that could be communes, and vice versa.

In Croatia there are 122 cities that are units of local self-government. The financial situation of cities with populations over 40,000 is a good deal better, because they are able to impose a surtax on personal income tax, up to 30%. Zagreb can impose surtax up to 60% of the amount of personal income tax paid.

Table 1. Rates of surtax in individual cities

City	Rate (%)
Zagreb	18.00
Pula	7.50
Rijeka	6.25
Varaž din	6.50
Split	6.25
Osijek	6.00
Dubrovnik	7.50
Karlovac	7.50
Vinkovci	7.50
Šibenik	6.00
Slavonski Brod	6.00
Velika Gorica	7.50

As of 2001, the rate of tax on income is 15, 25 or 35%. On the total tax base, first of all tax is paid, and then, according to the calculated income tax, the rate of surtax is assessed. Revenue from income tax is joint (shared) revenue, shared among the central government, the counties and the communes. Of 100% of income tax collected, 32% goes to the communes and cities, 8% to the counties and 60% to central government².

The city of Zagreb. As capital, Zagreb represents special and unique territorial and administrative whole. It has both the status and carries out the functions of city and of county. It means that local self government and administration are organised at the level of the city as a whole, and that there are no smaller divisions of local units for the individual parts of the town. The division of local self-government into city quarters and local committees is foreseen. However, these will not have the status of either local unit of government or of legal entities.

The area and organisation of the administration of the city often change, so that since the beginning of 1997, through a new law, Zagreb has been taken out of the county of Zagreb, but with a considerably smaller territorial spread. The city of Zagreb qua county has less autonomy than other cities and communes in Croatia, because the counties are primarily units of the local administration, i.e., the national civil service. The specificity of the position and administration of the city of Zagreb can be seen in its direct subordination to bodies of central government, which also shows the degree of existing centralisation. The executive bodies of the city hold the city government in their own hands, and are responsible to a great degree to the government and the ministries.

Local self government at lower levels (which the citizens are particularly interested in) does not exist, and so there is no decentralisation of affairs, authorities and sources of finances, which the central government keeps in its own hands.

It is necessary to amend the existing City of Zagreb law, so as to give it complete autonomy, with the building of local self-government, with as little interference from the bodies of central government as possible.

² It should be also mentioned that communes and cities can diminish personal income tax (some sort of negative surcharge) on that part (share) or the personal income tax that belongs to the cities or communes.

A commune is a unit of local self-government and administration that is founded for a region of several settlements that represent a natural, economic and social whole, linked by the common interests of the population.

The self-governing sphere of interest of the commune or city

A commune or city provides the conditions for the development of economic, social, service and other matters in its areas. These units carry out a series of functions that relate to the provision of conditions for urban planning, protection of the environment, concern for the arrangement of the settlement, quality of life, utility facilities, and other service matters, as well as local infrastructure. They manage assets, ensure the provision of services to the population in the area of physical culture, sport, care for children, welfare, found public establishments in the area of social, economic, utility and other social affairs.

The number of communes has been on the increase ever since 1990. Territorial organisation is based on a large number of relatively small communes and, unfortunately, the merely formal distinction of communes (mainly rural units) and city local units. There are an increasing number of communes that are financially, organisationally and personnel-wise incapable of carrying out their functions independently and providing the services that have been placed within their competence, and depend upon financial assistance from central government. This enables greater centralisation of the system. The desirable size of local units should certainly be ascertained, so that they can meet the needs of the citizens, and encourage them to want to take part in local affairs.

The borders between communes or cities are the borders of the marginal cadastral areas. Borders can be altered or adjusted by agreement. The need to set up new communes or cities often arises. The reasons for founding new units are mostly the desire for the stronger or more rapid economic development of a given new commune or city, combined with the conviction that this is impossible with the current territorial organisation. Such views are frequently overstated, since the new local units are incapable of supporting even the most basic functions in their territory.

Procedures for founding new local units (communes and cities)

The founding of a new unit can be proposed by the commune or city council or a third of the citizens living in the area for which the change is requested. The consent of the Finance Minister is required, a proposal of sources of financing for all the future obligations of the city or commune, and the opinion of the relevant county assembly.

After the founding of the new unit, an agreement is made splitting the assets. Within ten days of the signing, it is delivered to the Ministry of Justice and Local Administration and Self-Government. If no agreement can be reached, the units have 15 days in which to inform the ministry.

After the foundation of a new unit, one of the most common problems is the splitting of the assets and obligations, frequently leading to court cases that go on for years.

When new local units are founded or when there are changes of the areas or centres of local units, the criteria should be laid down that a local unit ought to have to meet so as to be able to organise or reorganise itself (area, population, basic economic preconditions, justification for the existence of a new unit and so on).

Areas of special national concern have been laid down in the Areas of Special National Concern Law for the sake of getting rid of the consequences of the war, the more rapid return of refugees and displaced persons, demographic and economic progress and the achievement of the maximum possible degree of evenness in regional growth. In the areas of special national concern there are 111 units of local government (29 cities and 82 communes) that receive current grants from the central government Budget. The communes and cities in these areas are divided into three groups, which are the objects of special measures for settlement and development. The incentive measures include the allocation of flats and houses, various kinds of tax exemptions (profits and income tax, real estate commerce, inheritance and gifts), increased pay for government employees and other things.

1.3. The size of local units

It is impossible to state the population of Croatia with any precision. The last available data derive from 1991 census. In the meantime we had war and large movements of inhabitants in and out of country, as well as within the country. Lacking better estimates we shall make use of these figures.

Local self-government in Croatia comprises 565 units, governing 4.7 million people living on an area of 56,541.63 km².

Table 2. Area and population by county

County	Area (km ²)**	Population * (in 000)
Zagrebačka	3,077	282
Krapinsko-zagorska	1,230	148
Sisačko-moslavačka	4,447	251
Karlovačka	3,621	184
Varaždinska	1,260	187
Koprivničko-križevačka	1,733	129
Bjelovarsko-bilogorska	2,637	144
Primorsko-goranska	3,589	323
Ličko-senjska	5,350	85
Virovitičko-podravska	2,021	104
Požeško-slavonska	1,821	99
Brodsko-posavska	2,026	174
Zadarska	3,643	214
Osječko-baranjska	4,149	367
Šibensko-kninska	2,993	152
Vukovarsko-srijemska	2,448	231
Splitsko-dalmatinska	4,523	474
Istarska	2,812	204
Dubrovačko-neretvanska	1,781	126
Međimurska	729	119
City of Zagreb	640	777
Total	56,541	4,784

Note: *Source for population – National Statistics Office, 1991 census

** Source for area: National Geodetic Administration, April 1997

There are big differences in the sizes of local units, and the number of people that live in the areas.

The biggest county is the Lika and Senj County with an area of 5,350 km². The smallest is Medimurje with an area of 729 km². The average area of a county not including the city of Zagreb is 2,795 km², and if Zagreb is included 2,692 km². The average population of a county is 227,822.

The average area of city is 167 km², the biggest city being Gospić with an area of 966 km², and the smallest Kastav with an area of 11 km². The average population of a city is 23,341.

The average area of a commune is 85 km², the biggest being Gracac with an area of 955 km² and the smallest Dekanovac with an area of 6 km². The average population of a commune is 4,859.

1.4 Central control of local units

Central government carries out the financial and administrative control of local units.

Administrative control is carried out by the Ministry of Justice, Local Administration and Self-Government, which checks to see that the work of the representative bodies of the local unit is in line with the laws. This is also applied to the byelaws and enactments passed by local units, which have to be in accordance with the laws and the Constitution.

If these enactments are not in line with the law, then the Ministry halts implementation of them, and proposes that the government starts a procedure in the Constitutional Court for a judgement on their constitutionality. Financial control of the budgets of local units is carried out by the Finance Ministry, the National Auditing Office and the local unit councils.

The Finance Ministry controls the financial reports of the local units, but does not control the local budgets. No departments of internal and budgetary control have been founded with local units, although this has been obligatory by law for a full three years. An additional problem is the lack of a national treasury system at the central level, and so automatically at the local level as well.

The National Auditing Office carries out a check on the budgets of local units once a year. It can do this more frequently when so ordered by the Finance Ministry. The Auditing Office cannot do anything about irregularities it discovers, this being left to other bodies of executive or judicial authority. A report about an audit done is sent to the Parliament, which decides on the measures to be taken.

The representative body of the local unit independently carries out checks on the execution of the budget and financial operations, as well as the use of resources that were allotted to given uses by the budget. It supervises the financial, material and accounting operations of budgetary beneficiaries and determines any irregularities with respect to purpose, range and dynamics of the use of resources. It has to inform the Finance Ministry about its findings, which indirectly controls the financial situation of the local units.

1.5 Cooperation among different levels of government

Cooperation for the joint provision of public services among local units is poor. There are, that is, individual examples in which local units together organise and jointly, through a single corporation, carry out the disposal of the city waste and removal of household rubbish. But this is more an exception than a rule. Here we can nevertheless mention that since 1971 in Croatia an organisation called the Federation of Cities and Communes has existed; this is a non-governmental and non-party organisation founded for collaboration among and the promotion of the interests of units of local self-government. The Federation has the status of observer in the standing conference of local and regional authorities in the Council of Europe. The Federation has 385 local units that have voluntarily joined it (94 cities and 291 communes) or 70 of all local units. The Federation proposes new laws aimed at the improvement of the status of local self-government. In 2000 it proposed a new law about local self-government, many experts from the field of local self-government having taken part in drawing it up.

The federation does not have a great deal of influence, because central government does not pay adequate attention to proposals from local levels of government and associations of them.

For the sake of better economic and social development, local units can make voluntary cooperation agreements among themselves. Cooperation with local units of other countries is also possible, and units can join international associations of local units.

Collaboration with other local units

A decision to go in for cooperation is passed by the representative body (the council) of the local unit. It sends a draft about the cooperation to the prefect (chairman of the county-zupan) of the unit of local government with which the agreement is to be made. The prefect sends an opinion about this draft to the Ministry of Justice, Local Administration and Self-Government. This ministry seeks an opinion from the other bodies of the national administration in whose areas of competence the proposed topics of cooperation lie. The Ministry of Justice then gives its consent to the proposed cooperation agreement.

2. Local politics and administration

As well as the Constitution and the laws that prescribe the organisation and structure and sphere of competence of local administration and self-government, local units can with their own statutes or charters regulate in more detail their own internal structure and the sphere of competence of the administrative bodies. The statutes of a local unit are adopted by the representative body.

Counties primarily carry out the affairs of the central administration that are financed from the national Budget; secondly, they carry local self-government matters.

All local units have representative and executive bodies. Managing committees of the executive are founded to carry out certain functions. The kinds and number of committees and in general the number of employees depend on the size and economic strength of the unit.

2.1 Administrative bodies of local units

The representative bodies of the local units consist of the commune council, city council (or assembly in Zagreb) and the county assembly. A representative body consists of members (councillors) and bodies (or committees, boards).

The rights and duties of members of the representative body, the internal organisation and work of them are determined by the Local Self-Government and Administration Law, the Budget Law, the statutes of the local unit, and the standing orders of the representative body. The representative body of the commune, city or county adopts its own standing orders if a majority of members is present.

The period of office of members lasts for four years, and their functions are honorary. Members have the right to refund of costs, i.e., lost earnings, for the time they are carrying out their functions. The representative body has a president and two vice-presidents. Their rights and duties are laid down in the standing orders of the representative body.

In debates about questions of financing or other questions at the sessions of the representative body, voting is public. It is possible to make a decision instituting a secret ballot about some questions. Voting is used for the statutes of the units, their budgets and final accounts. For the preparation of the adoption of some decisions, the representative body can set up standing and ad hoc committees.

The basic tasks of the representative bodies of local units

1. Adopting the statutes, decisions and other enactments that govern questions from the self-governing sphere of competence of the local unit.
2. Settling the organisation and sphere of competence of the administrative decisions of the local unit.
3. Selecting and discharging the head or mayor, deputy head or mayor, members of the authority.
4. Setting up public establishments for the performance of economic and social activities of interest to the local unit.
5. Adopting the budget, and decisions about execution of the budget, borrowing and giving guarantees for legal entities owned (majority holdings) by the local unit.
6. Making decisions about the revenues of the budget and budgetary beneficiaries.

A commune council can have from 16 to 32 councillors, a city council from 20 to 50, and a county assembly from 30 to 50. The number of members of a council is decided according to the size of the local population.

The bodies of the executive government are the *authorities* of the local units. The department of the authority in charge of finance submits to the representative body a proposal of financial enactments, the budget and the budget execution decision, as well as a proposal for a decision about revenues.

The executive body (the *authority*) informs the representative body about

1. the execution of the budget for the first half year,
2. the execution of the budget for the preceding year,
3. the profit and loss accounts of public establishments and companies,
4. spending from and the state of the reserves, and the state of the assets.

The authority makes decisions about what to do with the funds of the current reserves. The authority can authorise the president to manage the funds of the current reserves and unallocated revenue. The manner of work and the structure of the authority are determined by the standing orders.

Members of the authority are chosen by the representative body by a majority vote at the recommendation of the president [chairperson] of the authority. The members of the authority are in general made up of the heads of the administrative sections (for the economy, social affairs, finances and the budget, education, health and welfare...). A commune authority has from 5 to 11, a city from 7 to 13 and a county from 10 to 15 members.

The authority is answerable to the representative body of the local unit, which in certain circumstances may adopt a decision of no-confidence.

If a representative body makes a vote of no-confidence to the president of the authority or the whole authority, the authority has to resign. If in a period of 15 days the representative body has not chosen a new president or a whole new authority, then the president of the authority dissolves the representative body. With respect to all decisions made by the authority, the president, vice-presidents and members are personally responsible for their own areas of competence.

The representatives of the executive government are commune head, the mayor of the city or the county prefect and their deputies. They are chosen by the commune or city council or county assembly.

The head of a commune is responsible to the bodies of the central national administration for the correct performance of national administrative affairs that have been devolved upon the bodies of the local unit. The head has the right to halt the execution of a general enactment if it is not in line with the law. A mayor has the same functions as a commune head.

Obligations of a commune head, mayor and prefect

1. to submit to the authority a proposal for the budget and a budget execution decision,
2. to open an account for all payments in connection with the budget
3. to make a decision about borrowing on the basis of a decision of the authority (the representative body),
4. to monitor the execution of the budget
5. to inform the representative body about the execution for the budget for the first half year of the current year
6. to inform the representative body about the execution of the budget for the previous year,
7. to approve the use of the reserves of the budget up to the amount determined in the annual budget to cover urgent and unpredicted expenses incurred during the budgetary year.

The prefect and the county head. The prefect and the sub-prefect are appointed by the President of the country at the recommendation of the government. So far, prefects have been executive heads of the counties, combining national and local government. There are proposals that the functions of the prefect should be split, so that the prefect is responsible for the work of the national administration, and the county head, a post to be introduced, would be responsible for the work of the local self-government. However, the National Administration System Law needs changing to provide for the separation of these two functions.

2.2 Financing the administrative bodies of the local units

Local government units provide in their budgets resources for the performance of matters from the domain of self-government, and independently set up their own administrative departments and services. They regulate the founding of departments and services by their own statutes.

Communes that have less than 8.000 inhabitants found a single administrative department for the performance of affairs from the domain of self-government.

Local government units in areas of special national concern are given additional funds from the national Budget for the founding of administrative departments and services and their functioning. They also obtain funds from the county budget with the prior consent of the finance minister and the local government minister.

The Local Government Ministry [i.e., the Ministry for Justice, Administration and Local Self-Government] has to give its prior consent to all regulations governing the pay and remunerations of employees in the bodies of the local units. In practice, the number of employees and their wages are controlled, but in spite of this there are increases in the number of employees and in the amount of wages they get.

The laws do not regulate the terms of employment and salaries of people employed in local government. An exception is those local units or administrative bodies that are financed by subsidies from the national Budget.

Administrative expenditure financed obligatorily from the budgets of the local units.

The basic expenditure of the administrative bodies that are financed from the budgets of the local units (administrative departments, offices and services, authorities, councils or assemblies) consists of:

Operational expenditure (for pay, remunerations and compensations for wages, expenses to councillors, employers' contributions, expense accounts), expenditure for power, material, utilities and other services, expenditure for current maintenance (equipment and buildings, vehicles).

Current and external expenditure – financial expenditure (payments clearance costs and banking services, promotion) and other miscellaneous expenses (professional examinations, acquiring expert opinions, intellectual services).

Procurement of capital resources (office furniture and equipment, other material assets, investment maintenance of office buildings).

Financing public expenditure in: social care for children (pay and material costs), basic education, culture, technical education, sport, health care, welfare, planning and environmental protection, nature conservation, fire prevention, residential and utility work, economy, marine affairs and transportation.

The biggest share in total expenditure is of course taken by the wages and material expenses of local government employees and budgetary beneficiaries. Of the 8.4 billion kuna of total local government budgets in 1999, 2.6 billion or 31% were devoted to the pay and material expenses of the 25,500 employees who are financed from local budgets³.

At first glance this is not a very large share.

However, looking at the amounts at individual levels of local units gives a different picture. There are local units in which employee costs come to 80% of the budget. In the areas of special national concern most of the local units would be incapable, without central government subsidies, of carrying out their statutory functions and tasks, even finance expenditure for the existing number of employees (which is not limited).

It should be pointed out that there is doubling role and responsibilities of departments at various levels, in spite of the very considerable amount of decision-making that goes on at the national government level (ministries and county offices).

Certainly, the number of employees in the administrative services of local units, which has been on the rise in recent years, should be limited. In the existing state local units cannot pay out even the most urgent expenditures, or only they are actually paid. Clerks become an aim in themselves, and functions and capital projects are relegated to the background.

Functions that local governments are not capable of financing have nevertheless been devolved on them (street lighting, welfare, kindergarten staff wages, fire brigades, environmental protection and so on). In a new organisation of local government, a satisfactory relationship between fiscal capacity and responsibilities should be attained. Certainly it is necessary to prescribe those obligatory expenses that have to be financed in terms of priorities and available proper sources of revenue.

3. Functions of local government and service delivery

In Croatia, there is no very clear division of affairs among the different levels of government, and this can be seen in financial relationships. The functions of local units cannot be separated because they are duplicated and because of the unclear and very many legal regulations that govern the area of competence of the local units. Although there is an outline division of the affairs of local administration among the state, the county, the commune or city, it is very difficult to say which of them undertakes a given function. Thus in many laws, authority for financing is devolved on the local units, which are not able to finance even the most basic services in their area. Financial relationships are so excessively complex that in most cases the financing of individual functions is undertaken from all three levels. This creates space for discretionary financial decision-making, which as a result of the weak control mechanisms, makes it impossible to obtain clear financial pictures about the state of the local units.

The system of collecting revenue is centralised, while the many authorisations for financing expenditure are decentralised, that is, devolved upon local units. The non-existence of a properly ordered system of transfers and the criteria for the allocation of a

³ In this amount are included expenditure for 4,000 employees in the areas of special national concern which are financed by national budget grants

subsidy makes the financing of local units impossible. In most cases the financing of the expenditure of the local units depends on the financial assistance of the central government.

Since there are no clearly delimited functions or authorisations for financing, it is very difficult to adjust the functions envisaged at the beginning of this research. Accordingly in this part of the work, only an outline overview of functions and the methods of financing them is given, one adapted to the GFS methodology of the IMF. Because of the poor statistical monitoring of the functions and expenditure of local units, which is the result of a confused division between the levels of government, data about functional expenditure can be shown in total amounts. It is at present impossible to get data and pictures of functions according to current and capital expenditures. Additional reasons are to be found in the weak accounting system of the budgets, which does not enable a comprehensive view of the financial position of local units in terms of functions and economic categories.

According to a functional classification of public expenditure in communes, cities and counties, there are 12 groups of expenditure that are financed from the budgets of the local units:

1. general public services,
2. law and order,
3. education,
4. health care,
5. social security and welfare,
6. residential and utility matters,
7. recreation, culture and religion,
8. agriculture, forestry, hunting and fishing,
9. mining, industry and construction,
10. transport and communications,
11. other economic matters and services, and
12. any other expenditure.

In this part of the report we will emphasise them more or less in accordance with their significance.

1. General public (administrative) services. The administrative functions of local units are financed from the local budgets. Thus resources are provided in the local budgets for the working of the representative and executive bodies of local units. In the main these are expenditures for the performance of affairs from the domain of self-government (gross wages, employer's contributions, material and energy used, utility and other services). Problems arise about determining exactly the amount of resources that are used for the financing of the administration, since many local units record current expenditure in current transfers.

The administrative functions of cities and communes are financed from their own budgets. However, county bodies that carry out administrative functions are financed from the national Budget. Functions deriving from the self-government area of competence are financed from their own local budgets. A special case is constituted by the areas of special national concern, which are financed by current transfers from the national Budget.

Administrative functions are financed at all three levels of government. The main problem is the duplication of the functions at the county level.

2. *Law and order.* The working of the law and order system is within the competence of the central government. The fire service, however, is deemed to be within the purview of law and order. Since 2000, funds for the financing of fire prevention have to be provided by communes and cities.

These units set up public fire brigade units and stimulate the foundation of voluntary fire prevention societies. Local units draw up plans for fire prevention, and provide the funds for this in their own budgets. Local units can bring in utility charges for the financing of the fire service. The amount of the charge is brought into line with the needs of the fire prevention plan. Counties and the city of Zagreb also finance the functions of the fire-fighting associations, providing them funds from their budgets.

3. *Education (pre-school, elementary and secondary).* *Pre-school education.* Kindergartens are financed from commune and city budgets. The county budget provides additional resources. Resources are provided from the commune or city budget for curricula, wages, premises, equipment, and aids and for current and investment maintenance of premises they own. *Elementary schools.* Funds are provided in the city and commune budgets for the costs of school meals and all-day stays, and for other material costs not determined in the national pedagogical standard. Additional sums are provided in the local budgets for the wages of a sufficient number of teachers and for other needs of the elementary school above the level laid down by the national pedagogical standard. *Secondary schools.* This sector is centralised at the national level. In spite of this, local government units provide funds for the financing of education, although they are not required to do so by law. The founder of all the secondary schools is the government, which provides the financing. Thus programmes for financing the expenditure of secondary education are adopted by central government and counties, cities and communes as well, which also provide resources for their financing from their budgets (for example, for current investment maintenance of the schools).

Until 1 July 2001, elementary and secondary education was financed from the central government Budget. The cities financed programmes for maintaining and raising the teaching standards not laid down in the national teaching standard. The funds provided for financing elementary education are used for pupils to stay at school all day, for school meals for children with modest means, the costs of the school meals service and the maintenance of the kitchens and equipment, and urgent attention to building maintenance.

In secondary schools most of the resources are spent for investment maintenance, the most urgent attention to the buildings (roof repairs, sanitary ware repairs and so on), equipping classrooms with teaching aids, computers and so on.

Funds for material expenditure in primary school are provided in the national Budget via the Ministry of Culture and the Education. Funds for the costs of all-day stay and pupils' food and other material costs not laid down in the national teaching standard are ensured in the city or commune budget.

All school facilities and buildings are as a rule owned by the state, or the Ministry of Education and Sport. All users of facilities outside the system pay a fee for the use of the facilities, irrespective of who built them or when, and this fee is divided between the school to which the facility belongs, which from these funds covers running costs, and

the Ministry, which from its part of the fee has to take care of appropriate investment maintenance of the facility.

Irrespective of the amount of investment that cities and communes offer, decision-making about investment in school facilities is vested in the Ministry, which makes its decisions in collaboration with its county offices, which it expects to agree on a list of priorities with its own local communities.

In the national Budget up to 30 June 2001 funds have been provided for material expenditure, equipment, capital expenditure and for current and investment maintenance of elementary and secondary schools. From July 1 onwards, financial resources for the financing of local and secondary schools will be provided by the counties and cities.

4. Health care. Health care is centralised and is financed at the central government level. Thus most of the expenditure for health care is financed through the agency of the Ministry of Health, or the health care extra-budgetary fund.

Health care is largely carried out by health care institutions owned by the state, or the county, and to some extent by privately owned institutions (run by physical persons or legal entities). The county owns health centres, health care at home centres, polyclinics, general hospitals, pharmacies, sanatoria, emergency rooms, public health and transfusion institutes. There are privately owned or mixed ownership health care at home establishments, polyclinics, general hospitals, pharmacies, and sanatoria.

The competences for financing health care devolved on the counties are very large, and they cannot finance them by themselves. For this reason, a large part of the funds is provided by the national Budget.

The county provides

1. sanitary measures for the protection of the environment in the county (air, water, provisions and so on),
2. epidemiological and social medical affairs in its area, if not provided by the state,
3. health care for the population of the county or city of Zagreb above and beyond the standard determined by the mandatory health insurance system,
4. health protection of insured persons if this is not provided by the central government.

Communes and cities (except Zagreb that is in the same time a county too) are not responsible for health care. However, expenditure for health care can be found in their budgets. Which must mean that they do finance it.

5. Social security and welfare. Welfare functions are financed at the national level via the Ministry of Labour and Welfare, which implements welfare measures. Most of the funds are provided from the national Budget. Local units also in part finance the functions from their own budgets.

Communes and cities provide in the budgets 5% of the revenue to meet the costs of housing and assistance for housing costs (rent and other housing costs). Welfare establishments are: welfare centres, welfare homes, care and nursing centres. Individual local units (e.g. the city of Rijeka) also set aside funds for social assistance, although they are not statutorily obliged to do so.

6. *Housing and utility affairs.* Local units found local public companies that deal with utility affairs. In the many local units, the positions of these firms are very differently laid down, and they are either joint stock companies or they are owned by the local unit. In practice to date it has been extremely difficult to ascertain who the shareholders of such companies are.

Utilities comprise: 1. drinking water supply; 2. drainage and treatment of sewage; 3. gas and heat supply; 4. public transport; 5. cleaning; 6. deposition of garbage; 7. maintenance of public areas; 8. maintenance of unclassified roads (all areas that are used for transportation); 9. retail markets; 10. cemetery and crematorium maintenance; 11. chimney sweeping; 12. street lighting (management, maintenance of facilities and devices).

There are numbers of cases in which several local units get together to found a common company to carry out utility services in their areas.

The funds for carrying out these utilities and for the construction of facilities and purchase of devices for the infrastructure are financed out of the charge for utilities. The price, the way it is calculated, and the manner of payment are all determined by the company (public or joint stock). The price has to contain a component for the financing of the construction of facilities and plant in the communal infrastructure, and this is stated separately. It is interesting that the fire service can also be financed out of these charges, although it is not counted a utility. Utilities are financed from the utility charges, the budgets of the local units, and concession fees. The bulk of utilities are financed through the prices of utility services (besides other budget means) and rest of them (where the price can not be set and the hardly precisely defined) from utility (communal) charge.

The utility industries, such as supply of drinking water drainage and treatment of effluent, and gas supply can be carried out by a commercial company that is majority owned by the government or the county, when this industry is carried out for the area or parts of the area of several local government units via mains systems owned by the company, the manners and conditions in which the work is carried out being defined contractually with the local government unit.

Local units can confide the undertaking of utility industries financed only out of their budgets to a private or legal entity pursuant to a written contract.

The representative body of a unit of local government defines the utility industry and settles the conditions and standards for the implementation of the public tender offer or the public acceptance of tenders for the outsourcing of certain utility services on a contractual basis. After the tenders have been received, the representative body of the local unit makes a decision selecting the person to be confided with the undertaking of utility services on a contractual basis.

Then, pursuant to the decision of the Local Authority, a contract is made outsourcing the given utility service, and this contract must contain: the industry or service for which the contract is made, the time for which it is made, the kind and volume of jobs, the manner of determining the price for the work carried out, and the manner and time of payment, the contractor's performance guarantee. Such a contract can be made for a time of four years at the most.

Actually, the deliverer of the services determines the amount of the price, the manner of calculating and the manner of paying for utility services. The price of utility services can also contain an amount for financing the construction of facilities and plant of the utility infrastructure in the area of local government in which the utility services

are being delivered, in line with the Programme for the construction of facilities and plant of the utility infrastructure.

The amount for the financing of the construction of utility infrastructure facilities and plant is shown as a separate item in the bill that is given for utility services delivered, and the funds are transferred to the budget of the local unit according to the procedure prescribed by the Finance Minister.

The price of the utility service is paid to the deliverer of the service, and the person liable to pay is the owner of real estate or the user when the owner has contractually transferred the obligation to pay to the user. The deliverer of the utility services is bound, on every change in price or tariff for its services, to report the price list to all the local units in the area of which the services are delivered, at the latest 30 days before the commencement of its implementation. The price list report must contain: the kind of utility service and the manner of calculating and paying for the service, the structure of the existing price of the utility service, the proposed new price for the service and the structure of it, the percentage change in the price as against the current price, the reason for the change in price with a detailed statement of reasons and calculation, and the day from which the new prices will be applied.

The representative bodies of the local units in the area of which the service is being delivered can lodge an objection and ask the utility service deliverer to adjust the price list that has been reported, and if the deliverer does not adjust the price list in line with the objections of the majority of the local units in the area of which the service is delivered, the prices from the reported price list may not be applied.

A local unit in the area of which a utility service is delivered is bound within a period of 15 days from the day of the receipt of the new price for utility services to inform the ministry in whose sphere of competence the prices lie and the county officers in whose sphere of competence economic affairs lie. Inspectorial supervision of prices and the delivery of utility services is carried out by the National [State] Inspectorate.

Waste dumping. Local units make environmental protection programmes in which they say what is to be done with waste. Several units can carry out these measures together. Funds are provided in the budgets of cities and communes for the construction of industrial waste dumps.

Water supply. Water supply is within the competence of the public enterprise called Croatian Water[s], which has the status of an extra-budgetary fund. It is financed with its own resources, derived from the water charge. But, it runs a deficit, and its expenditure is partially financed from the national Budget.

Counties largely give their consents to the plans for managing the local waters in a given area that are made by Croatian Water. A county has the right to adopt other plans that relate to water protection, flood defences, and the amount of the water charge. Counties can give concessions for the use of public water assets on which permanent buildings are set up, and determine the amount of the concession fee. This is determined only if the concession is assigned for utility or social needs. The concession fee is paid to the budget of the county.

Cities and communes adopt regulations about the use of water, arranging or building reclamation works, restricting or stopping the use of water, and ensure conditions for carrying out flood defence plans.

The many ways of financing the water industry, like the funds of Croatian Water, various charges (for the use and protection of water, for extracting sand and gravel) and the revenues of the budgets of local units clearly show that the authority to finance and

the actual function of water supply are not clearly defined between the central government and the local units.

A local unit that has financed a reclamation or improvement system from its budget can introduce the obligation to pay a special fee in order to meet the costs involved. It can also prescribe the payment of a water charge that is paid by owners and users of land and other real estate per unit of area measurement (hectare, square metre).

Environmental protection. Local units determine, organise, finance and advance environmental protection.

In local units, environmental protection involves: 1. provision of conditions for carrying out environment protection programmes; 2. the preparation and implementation of repairs; 3. monitoring the state of the environment; 4. keeping a cadastral record of environmental pollution and 5. environment protection measures and public information.

Communes and cities provide funds for environmental protection in their budgets, and keep records about how these funds are used. These reports are delivered once a year to the National Agency for Environmental Protection. Counties prepare and implement repair programmes and determine implementation priorities.

7. Recreation (sport), culture, religion and other affairs. Sport. The basis for the financing of sports consists of local government revenue realised by the carrying out of some sporting activity (legal entities and physical persons natural), a part of the profit from the organisation of gambling, and the funds that local units and the state provide for helping sports. Communes, cities and counties themselves determine public needs for sports, and provide budgetary resources for their realisation. The proportion of the funds for this purpose in the local budgets shows that a great importance is attached to sport.

Culture. Communes, cities and counties make their own plans for the public requirements in culture, and a plan of activity and events that is financed from their own budgets. Local units finance the work of establishments of culture that they own and are the founders of. They also finance the investment maintenance of such establishments.

A county will make a programme for cultural development for the communes and cities in its area, and provide resources for cities and communes that cannot carry out such programmes. If a county is unable to provide such resources, the country can provide them in the national Budget. In practice, there is no prescribed subsidy system, although the counties do help the communes and cities with current and capital subsidies and joint financing.

The financing of societies and political parties

Societies or associations are forms of voluntary association by numbers of citizens and legal persons for the sake of accomplishing common objectives and interests with no intention of making a profit.

In local self-government there are associations with assets, made up of subsidies (from the budgets of the communes, cities and counties), membership fees, contributions and gifts, and moveable and immovable property. Local units do not have a statutory requirement to finance societies, unless they want to and to the extent they consider necessary.

Political parties gain their revenue from membership fees, contributions, publishing, the sale of propaganda material, the organisation of party events, the budgets of local self government, the profits of firms that they own, and so on.

8. Agriculture, forestry, hunting and fishing. Agriculture. Authority for agriculture has been devolved by central government on local units. They are responsible for the protection of agricultural land against the introduction of harmful materials, improvement of fertility, the use of agricultural land in a manner as laid down in the real estate cadastre. A county prescribes measures for preventing erosion, dredging channels and canals, suppressing diseases, keeping up hedges, maintaining field paths, maintaining and determining channels. The counties can cede for use agricultural land included in the reclamation system.

Communes and cities make decisions about leasing out agricultural land not cultivated in the previous period with a market value compensation to the owner of the land. Communes and cities can dispose of land owned by the country and give concessions, to domestic and foreign legal entities and physical persons. Concessions are given for plant or livestock production (10 to 30 years), for long-term plantations (20 to 40 years) and for hunting and fishing (10 to 30 years).

Funds obtained from rentals or the sale of agricultural land are the revenue of the budget of the commune, city or county in whose area the said land lies. 50% of the rental belongs to the county budget, and 50% to the budget of commune or city. The funds are used for carrying out agricultural programmes.

Hunting is within the county's competence. The right to hunt is acquired by the owners of land (setting up a chase on their own land), the lessee of a piece of land leased for the purpose of hunting, the right to use the land being obtained pursuant to a concession, and some other legal entities and physical person.

There are three kinds of chase or hunting grounds. One, one's own land; the owner of a piece of land not smaller than 1000 hectares gives written notice to the administrative body responsible for hunting rights in the county about setting up a chase. The hunting rights concessionary pays the hunting right fee to the budget of the appropriate county. Two, state chases, determined by the minister of forestry and three, joint, on land on which wholly-owned chases have not been established.

Funds from hunting lease fees are distributed in the following way: 80% goes to owners with no hunting rights in proportion to the area covered by the chase for which the hunting rights fee is paid. 20% stays in the budget of the county, which is used to pay the costs involved in leasing out the joint hunting grounds (costs of establishing joint chases, protection and conservation hunting grounds not leased, protection of game that lies on areas outside the chases and so on).

Fishing. Croatia governs the use of the sea and the coast with special laws. The financing and use of the sea is within the competence of the county. The basic instrument is the concession. Maritime laws enable concessions to be given to physical persons and legal entities for the use and economic exploitation of the sea.

The basic functions of a county come down to giving concessions for a period of up to four years for carrying out some industry in the internal sea and the territorial sea. The concession fee is revenue of the county budget. Revenue obtained from concessions for carrying out some industry on the coast and for maintaining beaches goes to the commune or city budget.

Forestry. Forestry and forest management is in the competence of the public corporation Croatian Forests. Local units, however, maintain and manage forests in their areas. Legal persons and citizens who use the forests pay the forestry contribution. The funds from this contribution are paid into a special account of the local unit in the territory of which felling takes place, and are used for the financing of the construction of the utility infrastructure.

9. Mining, industry and construction. Mining. The charge for the exploitation of mineral resources (revenue of the national Budget) has been ceded to the commune or city in the area of which the exploitation takes place. The funds obtained are used for the economic development and environmental protection of the area. These funds are shown in the budget of the commune or city, and the charge is paid by the company or small tradesman. There are local units in which revenue from this charge (which is counted a non-tax revenue) make up 80% of the revenues of the budget.

The charge for the exploitation of mineral raw materials, oil and gas is 2.5% and for other kinds of raw materials (energetic, non-metals, architectural building material, all kinds of salt, sand, gravel, brick clay) up to 2.5% of the total income realised by the sale of them. For areas of special national concern, this fee comes to 1%. For the exploitation of mineral and geothermal water from which minerals are extracted or the heat of which is used for power, the charge amounts to 1% of the total income realised by the sale of them. In areas of special national concern, this charge is 0.5%.

Construction. All local units draw up two-year programmes for land use. The owner of a building plot on which a building is put up, or the investor, has to pay the utility contribution.

10. Transport and communications. Road transport is centralised, and the state, via the public enterprise Croatian Roads, keeps up and finances the main national highways. Since 1997, the authorities for financing the roads have been devolved upon the local units. Roads are divided into local and regional.

In its area, a county carries out the maintenance, protection, reconstruction and construction of unclassified roads and supervises these roads. A county takes part in the procedure of determining the conditions for the construction or reconstruction of regional or local roads only if the Ministry of Transport gives its consent. The county provides the financial resources for the maintenance, protection, reconstruction and construction of unclassified roads with up to 40% of the annual revenue obtained from the road use fee. It also provides funds for the maintenance, protection, reconstruction and construction of unclassified roads according to the programme adopted in the amount of at least 50% of the resources.

Communes and cities provide financial resources for the maintenance, protection, reconstruction and construction of unclassified roads from the revenue derived from the annual road use fee. Road transport at the level of local units includes: decisions about the organisation of passenger transport lines (local unit representative body), giving permits for special passenger transport lines (administrative body of the county), taxi transport on the basis of a concession (competent body of the unit of local self-government).

Rail transport. The railways are financed by the government through the public corporation Croatian Railways. Local units can maintain railway facilities only if they provide the funds themselves. They can also make a contract with Croatian Railways to carry out passenger transport on lines on which Croatian Railways makes a loss.

Communes and cities determine the conditions and the manner for carrying out, and the measures for the construction, reconstruction and maintenance of, city tram services.

11. Other economic matters and services. Tourism. In order to strengthen and promote the tourist industry, tourist offices are set up for the areas of the communes, cities, communities of communes and cities, counties, the state, and the area of the islands (if on an island there are at least two communes or one commune and city). In the city or commune in the area of which there is at least one tourist spot, a city or commune tourist office is founded.

Tourist offices

Tourist offices of cities or communes stimulate, advance and promote authentic local values – traditions, customs, ethnological heritage and so on. They create the conditions for the economic use and development of tourism in places in which tourism is underdeveloped, and control the payment of the staying fees.

The staying fee is paid by the owner of a house or flat in a tourism spot and all the persons who stay in it. It is also paid by the owner of a vessel which is moored in a harbour used for nautical tourism when the said owner is on the boat and by all other persons on the boat.

Funds collected from the staying fee are used by the city or commune to arrange the settlement more suitably for tourism.

Economy. Local units stimulate the economy – small business, small trades, communes and small companies. For this purpose they provide funds from the budget, and adopt programmes for incentives to small business. These programmes are united at the county level.

Cities and communes give permission for the sale of goods at a certain location (on stalls, in kiosks, mobile units for occasional sale), prescribe hours of work, price control measures, and give their opinions about applications for concessions to set up free zones.

12. Other expenditure (interest, transactions related to the public debt, costs of issuing bonds). For this kind of expenditure, the county provides the communes and cities in its area a subsidy from the county budget.

3.1 Difference in functions among individual levels of government (national, county, commune and city)

In Croatia the functions and affairs of local units are governed by very many laws. It is impossible to say precisely who are the persons mainly in charge of these functions. This problem lies mainly in the legislation and regulations passed and proposed by national government bodies. In the division of functions, the opinions and arguments of local units were not respected. This is the result primarily of the war, which had the effect of centralising many functions and financing through the central government and the national Budget and the ministries. A stronger need for the decentralisation of

functions appeared after 1995, when consideration started to be given to the decentralisation of the financing system. Experience up to 2000 tells us that the government has primarily decentralised expenditure without a clearly defined revenue system or a regulated and defined system of transfers to local units. In 2000 an initiative was launched for fiscal decentralisation, which is still not accompanied by adequately well-informed proposals for the provision of financial resources, nor by a quality mechanism for inter-budgetary transfers.

In spite of many overlaps of functions and financial relations among the various levels of government, it is still possible to gain an outline picture of the division of functions among the levels of government.

Table 3. Division of functions among levels of government.

Title	Central	Communes	Cities	Counties
1. General public (administrative) services	X	X	X	X
2. Defence	X			
3. Law and order	X			
4. Education	X	X	X	X
4.1. Pre-school		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
13. Other expenditure				

General administrative services are financed from all levels of government. A considerable amount of the funds for the performance of administrative functions at local unit levels is provided by central government through current transfers from the national budget.

Defence and law and order are centralised at the level of the central government. Law and order are held to include the fire service, which is financed from the budgets of local units.

Education is largely centralised. However, pre-school education is looked after by communes and cities. Elementary education is in the competence of the central government, although all local units also provide for the working of elementary schooling in their area. Secondary (high) and tertiary (university) levels are financed by the

government. However, individual local units (cities) provide part of the funds for financing that the state is incapable of providing.

Health care is in the competence of the central government. Considerable responsibilities for financing has been devolved upon the counties, who provide funds from their budgets. Counties and cities also provide smaller amounts for the financing of health care. On the whole, most of the health care financing is provided from the Ministry of Health and the extra-budgetary Health Care Fund and the county.

Social security and welfare are centralised and are mainly financed out of the national Budget. Local units are not obliged to finance welfare, but there are funds in their budgets, which means that they do finance it in line with their capacities.

Housing and utility affairs are seen to be by communes and cities responsibility in their own regions. Funds are provided on the whole via the agency of the public utility companies (which levy a charge), and by transfers from their budgets.

Recreation, culture and religion are seen to be by all local units' authority, which provide the resources from their budgets. There are many cases when the government and the counties provide subsidies for financing individual culture programmes in the areas of the communes and cities.

Authority for agriculture, forestry, hunting and fishing has been devolved by the central government upon the local units (communes, cities and counties). These things are financed from the charges of the local units. The central government provides agricultural subsidies from the national Budget.

Local units, in their area, also provide incentives for the development of mining, industry and construction.

Transport and communications. Road transport is decentralised, and local units ensure and finance from their own budgets the maintenance and construction of local routes and roads. Rail and air transport is centralised.

Tramways (street-cars) are financed by the cities via the municipal public corporations that run, maintain and finance tram transportation in the city.

Other economic affairs (tourism, business, commerce and so on) are carried at the local unit level. Tourism has a particular position in this set. The tourist industry is decentralised, and communes, cities and counties carry out all the affairs related to the preparation of tourist capacities (hotels, motels, recreational facilities). Tourist offices are founded and owned by local units, sometimes by several at once. Funds are provided from charges and fees that are collected during the season and used for the advancement of the industry. Harmonisation of the workings of the local units in the tourist industry is in the province of the Ministry of Tourism.

3.2 A financial analysis of functions

The table I (see: appendix I) shows the share of expenditure in terms of individual functions in the total expenditure for all levels of government.

Most of the expenditure at the LGU level relates to general public services, making up 21% of all expenditure. At the central government level, general public services account for more than 6% of all expenditure.

Defence is entirely provided for at the central government level, almost 12% of the expenditure of which is devoted to this function. Law and order are also in the competence of the state and represent almost 10% of the total expenditure of central government, and only 0.5% of the expenditure of local budgets. This is accounted for by

the fire service, which is classified as a law and order matter but is financed by the local units.

Expenditure for education is financed by the central government, and represents 12% of total government expenditure as well as 11% of the expenditure of local units. Most of local expenditures relate to pre-school establishments that account for 9% of all expenditure from the budgets of LGUs. Expenditure for pre-school education at the level of communes and cities accounts for 66% and 10% of all the expenditure of communes and cities.

Health care expenditure accounts for 1% of all the expenditure of the national Budget, and 1% of the expenditure of local units. Health care is also partially financed at the county level, and county expenses for health care amount to 6% of all county expenditure. The reasons for the small amounts here lie in the fact that health care expenditure is largely financed at the national level via the extra-budgetary health care fund, and cannot be seen in this table.

Expenditure for social security and welfare (pensions, assistance, facilities) are financed at the central government level, and amount to 24% of all central government expenditure, and 3% of the total budgetary expenditure of the LGUs. It should be said that most of the expenditure for the financing of welfare is done via the extra-budgetary funds.

Housing and utility work is looked after by the local units. Expenditure on this is almost 26% of total expenditure of local units. Thus in the budgets of communes and cities, such expenditure accounts for 25% of the total.

Recreation, culture and sport accounts for 16% of the expenditure of the budgets of local units. It is given greater prominence in the budgets of the cities, in which it accounts for 18% of total expenditure.

The national government sets aside 2.6% of the Budget for agriculture, forestry, hunting and fishing. Local units earmark a small amount of their resources for agriculture (0.7%), and even at the level of the communes, which are most interested in this kind of activity, only 1.24% of total expenditure goes on it.

Mining, industry and construction are represented to a greater extent in the budgets of local units and account for 44% of the total expenditure of local units. In the budgets of the communes they account for 8% of all expenditure.

Transport and communications account for 13% of the budgets of local units, and 11% of the national Budget. Expenditure for other economic affairs accounts for 7% of total expenditure.

3.3 Current expenditure of the budgets of local units according to economic categories

Current expenditure in terms of function and economic classification cannot be shown in the primarily conceived form. That is, the classification of the national Budget (and so accordingly of the local budgets too) does not allow of the division of current expenditure in terms of functions and economic categories. In addition the Finance Ministry does not have a well-organised database for local units. Accordingly on the basis of available data we attempted to draw up a table containing current expenditure classified according to an outline economic categorisation (see: appendix I).

In 1999, current expenditure account for 73% and capital expenditure for 27% of total expenditure. However, the situation at individual levels is different.

Staff expenditure is 24% of all current expenditure of local units. The biggest expenditure is for the purchase of goods and services, which accounted for 38% of all current expenditure. Subsidies and transfers account for 31% of all current expenditure. A special place is occupied here by transfers to non-profit institutions (kindergartens, schools, and utility firms), which on the whole make up 19% of the current expenditure of local units.

It should be said that the beneficiaries of local budgets, kindergartens, museums, theatres, technical culture, sport and utility firms are financed partially from their own resources and partly from the local budgets. There are examples when a theatre has part of its wage bill from the city and part from the county budget. Expenditure for education and health care are financed from the central Budget, except for expenditure of all-day stays in school and school meals, and other material costs that are financed from the budgets of the city or commune.

Labour costs (employee wages and employers' contributions) represented in 1998 14% and in 1999 15% and planned in 2000 16% of the total budgetary expenditure of the local units.

The Law about Senior and Junior Civil Servants (OG 27/01) governs the rights, obligations, responsibilities and manner of determining the salaries of senior and junior civil servants in the national administration, judicial bodies, prison service and in professional services and other bodies set up for carrying out government service.

Senior civil servants are persons with tertiary or secondary level qualifications in government bodies who as their regular profession carry out affairs (general and administrative affairs, planning, material and financial and accounting and so on) from the sphere of competence of these bodies as laid down by the Constitution, the law, some decree or Regulations (as far as local units are concerned).

Junior civil servants are people with secondary or primary level education who work in government bodies in auxiliary and technical operations and other matters (drivers, printers, janitors, electricians, telephone operators, cooks, porters, cleaners and so on) the performance of which is necessary for the prompt and proper carrying out of the work of the sphere of competence of the government bodies.

Accordingly, local public senior and junior civil servants are all those who are financed from the local budget.

3.4 Macroeconomic control of fiscal policy at the local government level

According to the Budget Law, local unit borrowing is restricted to borrowing from the national Budget, other local units, and the domestic non-banking system, including the citizenry. The ability of local governments to borrow is additionally limited by the fact that borrowing is allowed only for investment or capital expenditure. In order to avoid possible problems of illiquidity (because of seasonal oscillations in the realisation of budgetary revenue) the Local Government Financing Law has let local government to borrow in the short term (up to 6 months). Local units can give guarantees to their budgetary beneficiaries, with the proviso that the level of debts and guarantees can amount to at most 20% of the budgetary revenue from the previous year. Long term borrowing decision-making is in the hands of the representative body of the local unit, and short-term borrowing is decided about by its executive government branch (the authority). Apart from that, during borrowing and guarantee operations, local units have to get the reaction of the National Auditing Office and the consent of the Finance Ministry.

While no possibility of financing from abroad for lower levels of government is foreseen in the Budget Law, this was provided for by the passing of the Credit Relations with Foreign Countries Law. Local units are allowed to borrow abroad to finance reconstruction and development projects. To borrow abroad, a local unit has to have the consent of the government, i.e., the Finance Ministry. The debt has to be secured with appropriate instruments for security of payment. Individual loans abroad are restricted to at the most 10% of the value of the previous year's budgetary expenditure, and the total debt-related expenditure must not be more than 20% per annum. Since the Credit Relations with Foreign Countries Law enabled local units to borrow on foreign capital markets, their borrowing has been limited by the Budget Execution Law. Thus according to the 1996 and 1997 Budget Execution Laws the total obligations deriving from domestic and foreign debts of local units were limited to a maximum of 30% of the budgetary expenditure for the previous year. In 1999, the total annual debt-related obligations of local units could come to at most 20% of their own budgetary revenue (not including grants) of the previous year. The Budget Execution Law for 2000 retained this framework.

Fiscal and monetary control of LGUs' borrowing

The fact is that the government has not yet given any statement of the total borrowing of local government units. This is abetted by the lack of a consolidated balance sheet of general government in which the total level of local unit deficit would be seen. The Finance Ministry does not have complete data about the borrowings of local units, which tend to show their borrowings as off-balance sheet positions (which means that they are not directly included in the budget). As well as this it is very difficult to determine what the level of indebtedness of beneficiaries of local unit budget funds is. This is particularly true of the utility firms that borrow from banks or get guarantees from local units for their bank borrowings. For this reason it is dubious to what extent the total fiscal consequences of the borrowings of local units are checked or are capable of being checked.

Monetary control of the borrowings of local units is not complete. The position of the CNB with respect to control of indebtedness and the general debt at the level of local units is more or less the same. Monetary statistics as a whole do not comprehend the total borrowings of local units at the banks, and for this reason not even the CNB is able to determine the real level of the indebtedness of the local units. However, from the existing CNB statistics it is possible to get an outline picture of the indebtedness of the local units. Thus in 2000, the debt of the local units amounts to 0.5% of GDP.

Table 4. Ratio of public debt to GDP in the 1996 to 2000 period.

(in %)	1996	1997	1998	1999	2000
1. Internal public debt	16.13	12.80	11.35	12.33	11.76
1.1. RC (national Budget)	15.99	12.49	10.54	11.16	10.03
1.2. Extra-budgetary funds	0.01	0.06	0.34	0.54	1.16
1.3. Local government units	0.13	0.25	0.47	0.63	0.58
2. External public debt	13.37	15.97	16.38	22.14	22.21
3. Total	29.50	28.77	27.73	34.46	33.97

Note: For 2000, the state as of the end of June. The local government debt relates exclusively to claims of commercial banks against local government. The external debt of the government sectors and the CNB is consolidated. GDP in current prices, according to the National Statistics Office.

Source: CNB (2000: 34, 64, 69), Ministry of Finance (2000).

Thus formal fiscal control of the borrowings of the local units does exist as does incomplete monetary control. However, the real scope and the macroeconomic effects of the borrowings of local units have not been systematically investigated.

4. Local government finance and financial management

The basic kinds of revenue of local units comprise revenue from immovable and moveable things and firms owned by them, concessions, gifts, inheritances, commune, city and county taxation, charges and stamp duty (the rate of which they set independently), and from grants and subsidies from the national Budget.

The assets of a commune or city consists of land, commercial buildings and flats that are leased or sold or used on market principles for the sake of making revenue for the financing of their tasks. The part of their revenue that units derive from assets is variable and depends on the value of the assets, but it can be large. In Opatija, for example, revenue from assets comes to 20% of all budgetary revenue.

In order to carry out matters from the sphere of competence of self-government, the local units ensure resources in their budgets. They acquire budgetary resources from their own sources (revenue from assets, county, city or commune taxes, fines, fees, charges), shared revenue from taxes (income tax, profits tax, real estate commerce, gambling tax) that are divided with the national government, and subsidies (from the national or county budget).

In the sequel we shall say something more about the basic structure of the revenue of the budgets of local units.

4.1 Structure of revenue

The revenue of local units can be divided into tax, non-tax, capital and grant (subsidy) revenue.

The following table shows the share of individual kinds of revenue in the budgets of local units in the 1995-1998 period.

Table 5. Revenue of local units in % of total budgetary revenue

Revenue	1995	1996	1997	1998
Taxation revenue	66.24	55.89	52.73	55.94
Non-tax revenue	22.69	31.41	33.32	29.25
Capital revenue	4.80	4.93	6.25	5.12
Subsidies	6.27	7.77	7.70	9.70
Total	100	100	100	100

Source: Ministry of Finance, RC, 2000

Taxes are the leading item in the budgets of the local units, although there is a clear downward trend, from 66% of the total in 1995 to 56% in 1998. The second most important are non-tax revenues, the proportion of which is constantly on the increase, from 23% in 1995 to 29% in 1998. Capital revenue comes on the whole to about 5.5% of the revenue of local units. Subsidies from the central government to local unit in 1998 came to almost 10% of the revenue of the local government units.

A more detailed survey of the revenues for 1999 for the individual kinds of local units is given in the next table:

Table 6. The structure of realisation of total revenue by kind of unit in 1999

Title of revenue	Total	Communes	Cities	Counties
I+II Total revenue and grants	100	100	100	100
I. Total revenue (1+2+3)	92.31	80.55	96.69	74.59
1. Taxation revenue	55.19	31.41	59.49	56.86
2. Non-tax revenue	30.50	41.29	30.27	15.47
3. Capital revenue	6.62	7.85	6.92	2.26
II. Subsidies (Grants)	7.69	19.45	3.31	25.41

Tax revenues dominate in the cities, where they make up 60% and in the county where they make 57% of their budgetary revenue. In the case of the communes, tax revenues account to a bit less than a third of their revenue (31%).

However, it is characteristic of all levels of local government that they rely on shared taxes. Local taxes do not have a great importance in their budgets, and account for only 4%, which shows what a small influence they have on the fiscal capacity of local units.

In the case of the communes the most important revenue is non-tax revenue, making up 41% of all budgetary revenue. Non-tax revenue makes up a third of the all budgetary revenue of the cities and 15% of the total budgetary revenue of the counties.

In the structure of totally realised revenues of all communes, cities and counties in 1999 subsidies and grants came to almost 8%. Subsidies are an important source of revenue for the county budgets, where they make up a quarter of their budgets. Subsidies represent 19% of the revenue of communes and 3% of the revenues of city budgets.

4.2 Taxation revenue

Basic taxes at the level of the counties, communes and cities.

County taxes:

1. inheritance and gifts taxes
2. motor vehicle taxes
3. vessels taxes
4. gambling taxes

Commune and city taxes

1. consumption taxes
2. holiday home taxes
3. advertisements taxes
4. taxes on trading names
5. taxes on the use of public areas and
6. taxes on uncultivated agricultural land (from 2001).

The basic source of financing of local units is the legally set division of shared taxes between the central and local governments. Income tax, profits tax, gambling tax, and real estate commerce tax are shared among the government, county, city or commune. The next table shows in what percentage the tax base is divided among the individual levels of government.

Gambling tax

The gambling tax is paid by a natural person who wins something while gambling. The tax base is the win itself; if the amount exceeds 20,000 kuna, the taxpayer has to pay tax at a rate of 10%. The revenue from the gambling tax belongs in its entirety to the national government.

It is a different matter when the gambling tax is being paid by the legal or natural person that is organising the gambling activity. Then the gambling tax base is the profit, and in this case tax is paid according to a standing charge of 400 kuna per month per slot machine. In this case the revenue from the tax is divided among the national government (70%), the counties (10%), the communes and cities (20%).

There is also a third case, regulated by the Tax on Commerce in Goods and Services Law in which the taxpayer of the gambling tax is the legal or natural person organising the gambling. The tax base for this person can be a tax on the payment made for taking part in gambling on slot machines. In this case the rate of tax is 5%, and all the revenue goes to the central government.

Table 7. Shared taxes and division among levels of government (in %).

Taxes	Central	County	Communes and cities	Zagreb
Personal income tax	60	8	32	---
Personal Income tax (including Zagreb)	50	5	---	45
Profits tax (including Zagreb)	70	---	---	30
Profits tax	70	10	20	---
Real estate sales tax	40	---	60	---

Source: Financing of Local Self Government and Administration Units Law, *Official Gazette* 117/93 and *Official Gazette* 33/2000.

In the case of the city of Zagreb, the division of the shared taxes is different, because it has the status of city and county. The share of the city of Zagreb in the personal income tax is 45%, while the remaining 55% is paid into the national Budget. The share of the city of Zagreb in profit tax amounts to 30%.

In the financing of local public expenditure, financing via shared taxes prevails, mostly on the basis of personal income tax and surtax. A proof is the share of personal income tax in the total tax revenue:

Table 8. Main tax revenues of local units in Croatia in percentage of total tax revenue

Taxes	Counties		Communes		Cities		Zagreb	
	1997	1998	1997	1998	1997	1998	1997	1998
Personal Income tax and surtax	52.57	54.02	66.61	66.28	66.78	67.46	68.59	69.23
Profits tax	28.23	27.33	6.82	7.15	17.98	19.07	20.62	22.19
Real estate tax	4.17	6.13	22.21	21.54	12.62	10.79	8.80	6.72
Inland tax on goods and services*	12.95	12.52	4.08	4.70	2.50	2.60	1.99	1.86
Other taxes	2.08	0.00	0.28	0.32	0.12	0.07	0.00	0.00
Total	100	100	100	100	100	100	100	100

Source: Ministry of Finance, RC, 1998.

*Inland tax on goods and services includes tax on: consumption of alcoholic beverages, beer and non alcoholic beverages in the hotels, restaurant and other tourist objects, organising entertainment and sporting events, gambling and slot machines tax, road vehicles tax, vessels tax.

Personal income tax and surtax have the main role in the tax revenues of local units, accounting for more than 50% of total tax revenue. The shares of other taxes in the total tax revenues of local units vary. Thus profits tax and inland tax on goods and services are an average of 27.5% or 12.7% of the tax revenues of counties. The second most important tax revenue for communes is Real estate sales tax, at an average of 22%, and so on.

The table IV (in appendix I) shows the structure of local government tax revenues in 1999.

Communes. Personal income tax and profits tax make up 73% of tax revenue, Real estate sales tax 24%, and taxes on goods and services 3%. The Real estate sales tax contains (according to IMF methodology) revenue from the trading name tax, holiday home tax, use of public spaces tax. Inland taxes on goods and services include advertising tax, consumption tax and other taxes.

In the budgets of *cities*, personal income tax and surtax and profit tax have a still greater role and make up in total 87% of their total tax revenue, while Real estate sales tax makes up 11%, and tax on goods and services 2% of their total tax revenue.

In the case of county tax revenues revenue from income tax and profits tax also are very important, together making up 84% of all tax revenue. Real estate sales tax and taxes on goods and services and other county taxes make up 16% of their tax revenues. Among these taxes, the levies on motor vehicles and vessels are shown. The share of individual taxes in their budgets differs largely because of the division of the common or shared taxes and the differences in the bases that the tax rates are applied to. However, in no local units do local taxes have a very great importance.

Taxes in areas of special national concern

In 2000, the national government brought in new tax incentives in areas of special national concern. Thus revenue from personal income and profits taxes (shared between the central government and the local units) will in the next five years be the revenue of the local units (communes and cities) in the areas of special national concern. The reallocation of personal income tax is done in such a way that the 60% of the personal income tax revenue that previously went to the central government is changed, and now the local units have the right to 92% of all the revenue from personal income tax. It is similar with profits tax, 70% of the revenue from which accrued to the central government up to 2000. In the next five years the areas of special national concern have the right to 90% of the profits tax revenue

This redistribution, or cession, will last until the end of 2005, and has been brought in by way of incentive for the development of the areas that were occupied and were directly damaged in the war.

As well as these taxes, local units in the areas of special national concern receive subsidies from the national Budget, and have other kinds of revenue brought in pursuant to special laws and decisions of the representative bodies of local government.

Assessment and collection of taxes at the local unit level

The assessment and collection of local taxes is carried out by the Tax Administration on the basis of a contract made with the local unit. The Tax Administration takes 1 per cent of the revenue collected. If the local unit does not make such a contract, then it has to assess and collect taxation independently.

The tax administration is competent for matters of assessment, collection and statistics of taxes and contributions, fiscal control and other affairs.

The tax administration, an integral part of the Finance Ministry, is an independent administrative organisation the headquarters of which is in Zagreb, there being provincial offices in the counties and the city of Zagreb. Below them, the provincial offices have their own local or branch offices. In Croatia there are 20 provincial offices, located in the county towns.

The branch offices of the provincial offices determine and collect the taxes of the national Budget and the budgets of the local units at the level of the city or at

the level of several communes. The branch offices are organised in various ways, according to their size, which is related to the number of taxpayers involved.

At the level of central government it is defined who the taxpayers are, what the bases and the rates are, tax relief, the appeals procedure, and the forcible collection of taxes. In the case of the county taxes, there is no legal opportunity for the county independently to determine the amount of the tax, for this is regulated by the Units of Local Self Government and Administration Financing Law (OG 117/93). With commune and city taxes, by law the local units are enabled to determine the amount of the tax. However, collection, dealing with appeals, and reopening procedures are handled by the Tax Administration pursuant to its contract with the local unit (city or commune).

4.3 Non-tax revenue

Among all the kinds of revenue of local units, non-tax revenues deserve to be given particular attention. Non-tax revenue comprises 30% of all the revenue of local units. In the budgets of the communes it comes to 41% of all revenue, of the cities 30% and of the counties 15%.

A rise in the share of non-tax revenue in the overall revenue of local units followed from the abolition of the utility funds in 1995. Since 1995 utility charges and contributions have been a part of the revenue of the commune and city budgets.

Non-tax revenues are specific purpose revenues and can be used only for the precise purposes they were introduced for. In the structure of commune and city budgets, the highest-yielding of these revenues are the utility charges and contributions.

Local units have other revenue determined by special regulations, such as charges and fees. They are shown in the non-tax revenues of their budgets. They are the charges and fees in the area of the utility industries, the use of maritime property, mineral raw materials, the area of power stations, public areas, hunting leases, staying fees, stamp duties and so on.

The following table shows the division (percentage) of non-tax revenue among the levels of government.

Table 9. Kinds of fees and charges and other kinds of non-tax revenue, and division between commune, county and city.

Title of revenue	National	Commune / city	County
National administrative fees	33	34	33
Administrative fees	-	50	50
Hunting leases	-	-	20 ⁴
Charge for use of maritime property	-	-	100
Charge for use of concessions on public roads	-	50	50
Fines and confiscations of gains	-	100	100

⁴The hunting law is not clearly defined hunting lease revenue sharing.

Revenue from owned real estate and movables	-	100	100
Revenue from companies and other legal persons owned	-	100	100
Revenue from concessions	-	100	100
Fees from the setting up of slot machines, one-time lotteries.	-	100	-
Concession charges	-	100	100
Revenue from work carried out	-	100	100
Revenue from the lease and sale of agricultural land owned by the state	-	50	50
Utility charges	-	100	-
Utility contributions	-	100	-
Use of public spaces	-	100	-
Charge for use of the areas of power stations	-	100	-
Charge for use of roads paid by tractors and trailers	-	100	-
Charge for the exploitation of mineral raw materials	-	50	50
Revenue from interest	-	100	100
Forest contribution	-	100	-
Staying fee	15	85	-
Gifts, inheritance and legacies	-	100	100
Revenue according to special contracts	-	100	100
Local self-contributions	-	100	-
Revenue from the sale of publicly owned flats	55	45	-
Rents and charges on flats (floor rent)	-	100	-
Other revenue laid down by a special law	-	100	100
Resources for the preparation of building land	-	100	-
Revenue from fines	-	100	100

Local units set the rates of non-tax revenue (or the price).

Non-tax revenue mainly belongs to the local units in which it was created. Thus the tables show that 100% of the revenue remains to the county, commune or city in the area of which the non-tax revenue was made.

Certainly a more detailed study should be made of all non-tax revenue and its use for particular purposes. As well as this there should be a clear definition of how these revenues are shared, because some of the legal provisions (e.g., the Hunting Law see: Hunting lease) are confused to such an extent that it is impossible to find out how and in what manner the non-tax revenue is shared. This would be a further area for research, because there are simply no such systematic analyses in Croatia.

Another area for research is that of concessions. There are numerous kinds of concession, which are statutorily regulated. However, it has not been systematically determined to what extent such legal solutions are applicable in practice, nor how many kinds of concession there are in Croatia.

Because of their low fiscal capacity, local units autonomously prescribe high rates of charge and fees. The great autonomy of local units makes it impossible for the central government entirely to supervise the amount of resources collected. It is of interest that the bodies of the central government (e.g. the Finance Ministry) do not have any way of finding out the rate of communal charges that local units prescribe. In most cases the amount of communal charges is determined without taking into account the standard of living of the population of the local units.

In the sequel we shall give an outline survey and basic characteristics of some of the most important non-tax revenues of local units.

Forest contribution. All legal entities and physical persons that use the forests pay a forest contribution equivalent to 2.5% of the sales price of their products. This money is paid into the special account of the budget of the local unit in the area of which felling took place and is used for the financing of the construction of utility infrastructure.

Staying fees belong to the tourist offices. The Croatian Tourist Office has 15% of the staying fee gathered; the commune tourist office has 20%, and if there is no city office in the commune, then the commune TO has the right to 85% of the sums collected. A city tourist office gets 65% of the sums taken in via the staying fee. If there is no tourist office in the communes, the tourist offices of the cities take 85% of the funds gathered from the staying fee. The revenue of the staying fee is used to improve the conditions in which the tourists stay, to promote tourism and for the workings of the tourist office. The amount of the funds for these purposes is determined in the Statute of the tourist office.

Leasing or selling agricultural land. Money obtained from the leasing or selling of agricultural land owned by the state is the revenue of the budget of the county, commune or city in the area of which the right to use the agricultural land was gained. 50% goes to the county budget, and 50% goes to the commune or city in the area of which the land lies.

Charge for the use of the land of power stations. Producers of electricity pay a charge for the use of the land of the commune or city in which they are located. The charge depends on the amount of the produced electricity.

Hunting leases. Funds from the hunting lease are calculated and split in such a way that 70% of the funds are obtained as fee by the owners and persons with rights to the land without the right to hunt in proportion to the area that is covered by the chases for which the hunting lease is paid. Then 20% of the funds stay in a special account of the budget for the covering of the costs of carrying out the law (determining the common

chases, leasing out the common chases, protecting and maintaining the chases that are not leased, protection of game in areas outside the chases and so on), while 10% of the funds are revenue of the central government. Actually, the provisions of the Hunting Law have been so greatly changed since 1994 that it is not completely clear what the status of the national chases is, what the status of the chases at the level of the counties, communes and cities.

The charge for the use of mineral raw materials of petroleum and gas comes to 2.5%, and for other raw materials up to 2.5% of the total earnings realised by the sale of them. This is revenue that the central government has ceded to the commune or city in the area of which the exploitation is carried out, and is used for the economic development of the area, and the protection of nature and the environment.

Charge for the use of roads is paid by motor vehicles and trailers/accessories. The money raised is the revenue of the commune or city and is used for the maintenance, protection, reconstruction and construction of unclassified roads. The money is used according to the annual programme confirmed by the public corporation *Croatian Roads*. The counties use at least 50% of these funds according to their programmes for the unclassified roads in the area of the cities and communes. If the county does not make such a programme, the revenue is used for the maintenance and protection of the public roads. The annual charge for the use of the public roads (paid while motor vehicles and trailers are registered annually) is used for the construction of roads and is transferred to the county roads authority.

The concession charge is paid to the budget of the local unit and is used for the building of facilities and the arrangement of the utility infrastructure.

4.4 Utility charges

The financing of the utility needs of the population is partially grounded on instruments of commercial financing (revenue according to the price of the services) and partially founded on instruments of public financing (utility charges, utility contributions, budgets and so on).

Utility operations are carried out by companies, public establishments or the plant founded by local units, or physical and legal entities on a concession basis. Utility affairs can be carried out jointly by several local units via companies.

The law divides the sources of income with which the carrying out of utility industries is financed from the sources of income with which their development is financed.

Funds for the operations of the utilities are provided from: 1. the price of utility services, 2. the utility charge, 3. the budget of the local unit.

The price can contain an amount for the financing of the building of utility facilities and the arrangement of the utility infrastructure. This amount has to be shown separately. The amount and determination of the utility charge depends on the location and the kind of the property. The representative body of the local unit can give a concession for the performance of some utility service or industry. A concession decision is based on a public tender invitation that has been carried out. The decision to give a concession is made by the representative body of the local unit according to the business reputation of the tenderer, its ability to carry out the concession, and how favourable the tender is from both technical and financial and environmental protection and conservation points of view.

According to this, the Local Authority makes a concession contract with the tenderer pursuant to this concession decision. A concession contract has to contain the following: 1. the industry or service for which the concession is given; 2. the time for which the concession is assigned; 3. the amount of the fee for the concession and how it is paid; 4. the price of and the manner of collecting the charge for the service provided; 5. the rights and obligations of the concession given; 6. the rights and obligations of the concessionaire; 7. concessionaire performance guarantees; 8. conditions for cancellation of the contract; 9. contractual penalties.

Accordingly, the utility charges are then determined according to the contract between the local unit and the concessionaire.

The amount of the utility charge per m² is determined by multiplying the value of the points, the coefficient of the zone and the coefficient of purpose. The values of points and coefficients are set by the representative body of the local unit, with the proviso that the zone coefficient can come to at most 1% in zone one.

Those liable to pay utility charges are owners or users of residential property, commercial property, garages, building land (which is used for some business activity) and unimproved building land.

Financing the construction of the facilities and arranging the infrastructure of the utilities is different for individual utilities, and the construction of facilities and arrangement of public areas, unclassified roads and public street lighting are financed from the utility contribution, the budgets of local units, concession charges (except for the business of undertaking) and other sources laid down by special rules.

The utility contribution is paid by the owner of a building plot on which a building is put up, per m³ of the building that is built, except for open pools and open buildings that are paid for according to m² of ground plan area.

The building of facilities and plant of the utility infrastructure and the procurement of equipment (for drinking water supply, sewage and sewage treatment, gas supply, thermal energy supply, passenger transport, cleaning, depositing household waste, retail markets) is financed from the price of the utility services, the budgets of the local units, and concession charges.

The importance of utility revenues

In the commune of Kostrena, which has the highest per capita revenue in Croatia (8,614 kuna) non-tax revenue makes up 85% of the structure of total revenue. Revenue from utility charges come to 58% of the total revenue. In the case of the city of Zagreb (the biggest centre), non-tax revenue accounts for 21%. Utility charges represent 6% of the total budgetary revenue.

The fire service

The fire service can also be financed from the utility charge money, although it is not a utility. The representative body of the commune, city and the city of Zagreb decides about the introduction or increase of the utility charge for the financing of the fire service.

The organisation and work of the fire service, and the founding of public fire brigades has been devolved from the sphere of competence of the national administration to the sphere of the commune or city, without any thought having been given to the proportionate increase of the revenue from which this activity has to be financed.

The money for the financing of the regular work of the public fire brigades and voluntary fire prevention associations are provided from the budgets of city and commune. County fire brigades are financed from the county budgets.

It is impossible to show in a single place the revenue from all user charges according to a functional classification. In spite of that, in the table V (in appendix I) we shall show the structure of revenues from the most important charges and administrative fees.

The most important kind of revenue of local units consists of revenue from utility charges, which constitute 59% of total revenue from charges and fees. In the budgets of cities and communes, this kind of revenue makes up 61% of total revenue from charges. Second most important are the utility contributions, which account for 21% of the structure of total fees and charges. In the revenues of communes and cities they make up 20% and 22% of total revenue from charges and fees. Revenue from revenue stamps accounts for 76% of county revenue from charges and fees.

The assistant minister of public works, reconstruction and construction, announced on 22 January 2001 that 80% of Croatian cities (their utility firms) illegally charge for connections to utility infrastructure, which means that citizens and legal persons pay high prices, some people, to avoid this, resorting to illegal connections.

Privatisation and revenue from the privatisation of the public corporations owned by local units, as well as the privatisation of these companies, has remained in the shadow of the privatisation of the state-owned public corporations. There is little information about the privatisation of the utility firms of the local units, and the ownership of the companies is not known. It can be seen that in quite a few cases companies that deal with passenger transportation have been privatised.

The lack of any properly ordered assets balance sheets for local units creates complete confusion. The new territorial organisation and the founding of many new local units led to the division of assets among the local units. Thus until 1994 there was not assets balance sheet of the local units, nor was it known what assets the local units had. In 2000 many local units drew up such a balance sheet of assets but the questions of the position and management of the assets still remained. A particular case is the assets of companies owned by local units. Local units are attempting to divest themselves of these assets and transfer the ownership of them to companies, which are still a large part owned by the local units. The final ascertainment of the ownership and value of the assets of these companies will very likely be the foundation for the more active privatisation of them. The question of the management of the property is still raised, because it is not institutionally clearly determined at the level of the local governments.

4.5 Subsidies (Grants)

Subsidies or grants came to 8% of the total revenues of all local budgets in 1999. In the total revenues of the counties, subsidies come to 25%, of the communes 19% and of the cities no more than 3%.

Subsidies are used only as funds for the support of financially weaker local communities. Since subsidies are used for fiscal equalisation, the right to them can be claimed only by those local communities that have a below-average fiscal capacity, or that cannot cover the necessary budgetary spending with their own revenues. The subsidies to a given local unit depend on the difference between the size of its necessary budgetary spending, and the size of its fiscal capacity. In Croatia there are two kinds of subsidy – general and specific, or purpose-related.

General subsidies and the way they are allocated are determined by Articles 48 and 49 of the Local Government Financing Law.

A county in the area of which the county, the communes and the cities, with an average tax effort, have a revenue below the national average (not including the city of Zagreb) is provided a subsidy from the national Budget in the amount of the difference between its per capita revenue and 75% of the national per capita average. No subsidy will be given to a county in the region of which the amount of surtax on personal income tax is less than 1% and the tax rates and the amount of tax are lower than the legally stipulated highest rate. According to the same criterion, a county provides a subsidy for fiscal equalisation from its own budget to a commune or city, with the proviso that as the base for fiscal equalisation it takes the county average per capita revenue. Allocation of subsidies does not apply to cities with populations over 40,000 that could introduce surtax. In the fiscal equalisation system it is envisaged that the county will provide a subsidy to a commune or city in the area of which per capita revenues assuming an average tax effort are below the county average (not including cities over 40,000). The amount of the subsidy is set as the difference between the per capita revenue realised and 75% of the county average revenue, with the proviso that no subsidy can be given to a commune or city in which the amount of surtax on personal income tax is less than 1% and the rates of local taxes and the amount of local taxes are lower than the statutory defined highest rates.

The basic guidelines for fiscal equalisation are prescribed by the Local Government Financing Law. However, no detailed statement explaining this system has ever been given. Accordingly, it is impossible to say what the amount of tax is and what the procedures for cities with populations above 40,000 to get equalisation grants. Cities with populations over 40,000 have the right to bring in surtax on income tax and so they cannot have fiscal equalisation grants. Measurements of fiscal capacity show that such cities have above average fiscal capacity. On the other hand, the low fiscal capacity of the other local units results in the grant resources being distributed according to priorities, primarily, for the reconstruction of areas destroyed in the war.

Although there are statutory criteria for the allocation of subsidies, in practice they are hardly applied. The counties independently set their own criteria for giving funds to the cities and communes in their areas.

Special laws stipulate that a county should provide the difference in funds for cities and communes that cannot ensure the provision of public needs in the area of pre-

school education and culture with their own revenues. In practice, it has been impossible so far to carry out this provision with respect to all counties, so that they have never been completely respected. An exception is the areas of special national concern (because of the effects of the war and on account of reconstruction), which are provided with current subsidies from the national Budget.

The national government can also give local units *specific purpose grants* and assistance for communes and cities that suffered damage in the war. On the whole these specific subsidies are given from the national Budget to local units in an area of special national concern. Funds are provided from the national Budget for many of the capital projects at the local unit level.

Counties, depending on their abilities, provide assistance and subsidies to communes and cities in their area either directly or by joint financing of capital expenditure.

On the whole, subsidies are given in line with the capacity of the national Budget. The national Budget provides grants to the counties, and also, directly, to communes and cities in areas of special national concern. Most of these subsidies are specific in character, and most of them capital. Getting subsidies (particularly those that relate to capital investment) depends in a large measure on the willingness of the local unit to match with its own funds in given projects. It should be repeated that the criteria for the transfer of capital grants to local units are not known, nor is the mechanism of the transfer.

4.6 Fiscal equalisation

Fiscal equalisation is the mechanism through which the central government palliates the unevenness that result from the unequal distribution of revenue at the lower levels of government. There are two kinds of fiscal equalisation – horizontal and vertical. The main instrument of vertical fiscal equalisation is tax sharing, and of horizontal fiscal equalisation subsidies (grants).

In Croatia, the new territorial organisation and the new manner of financing of local units have shown, from the very beginning, certain drawbacks that have complicated the finding and determination of fiscal equalisation measures. For this reason it was necessary to palliate the differences through the system of subsidies (grants) to lower level government, and better estimates of taxes that stay at the local government level or the extent to which they are shared with central government. Some of the problems that have occurred in the system of fiscal equalisation since 1994 are constant territorial changes, and too many communes; most of the new local units have no assets balance sheet and do not know the value of their assets; there is no good picture of the demographic and economic situation of the local units (the last available data are from 1991 census); the practical problem of determining realistic criteria for the allocation of subsidies; unreal budgetary planning and non-specific uses of budgetary resources.

Within the fiscal equalisation system there is the problem of ascertaining the financial resources needed for a given local unit to be able to carry out the tasks that have been assigned to it. Thus there is a need to work out the fiscal capacities of the local units.

While determining the fiscal equalisation of local units in Croatia, we shall start from the way in which revenue is divided. Transfers from the central government are given in the form of a share in one or a larger number of taxes (vertical fiscal

equalisation), and inter-county (horizontal) fiscal equalisation through subsidies from the central level towards the lower levels of government.

4.6.1 Vertical fiscal equalisation

Shared taxes, or the division of responsibilities for gathering and using tax revenue between the central and lower levels of government is a model used by many countries⁵, as well as by Croatia. The importance of the mechanism of sharing taxes (their tax base) between the levels of government can be seen in its stabilising effect. Determining the rate of tax and sharing the tax base between the levels of government, the central government can attain a simple effect of controlling and influencing tax, the amount of tax gathered by changing the rate or the ratios of tax revenue that remains at the lower levels of government. The central government and the local units in Croatia share: personal income tax, profit tax, real estate sales tax, and gambling tax. These taxes also represent the main sources of revenue at the level of local units. In the structure of the budgets of local units, a special place is occupied by personal income tax and profits tax, which are the highest yielding taxes for the local units.

4.6.2 Horizontal fiscal equalisation

The allocation of subsidies for fiscal equalisation depends to a great extent on the calculation of the fiscal capacities of the local units. Fiscal capacity is an indicator of the ability of a local unit to gather revenue and finance expenditure. It can be assumed, that apart from the most developed areas of Croatia, it is not to be expected that individual counties, cities and communes can provide the money necessary to cover the requirements for public goods in its area. The reason is simple, lying in the lower economic (and so taxation) base, and in particular as the consequence of great damage during the war. By measuring the fiscal capacity of a given local unit, a picture would be obtained of the extent to which a local unit can finance its needs itself, and which units have to be financed by subsidies. To define fiscal capacity it is essential to determine which dimensions to take into considerations during the calculation.

A calculation of the fiscal capacity of the local units in Croatia comes upon certain limitations that prevent the use of the best empirical analysis to obtain the best measures for horizontal fiscal equalisation. The most important problems are: 1) absence of data about the tax base of local units, or the opacity of such data, which makes it impossible to have an insight into the real situation in terms of individual tax bases of the local units; 2) the absence of any data about the precise population size, the existing figures being based on the 1991 census, which can no longer be considered realistic; 3) the absence of figures about GDP in given areas (counties). Horizontal equalisation is a requirement but not a practice and it is unknown quite to what extent in practice the system of horizontal equalisation is actually employed.

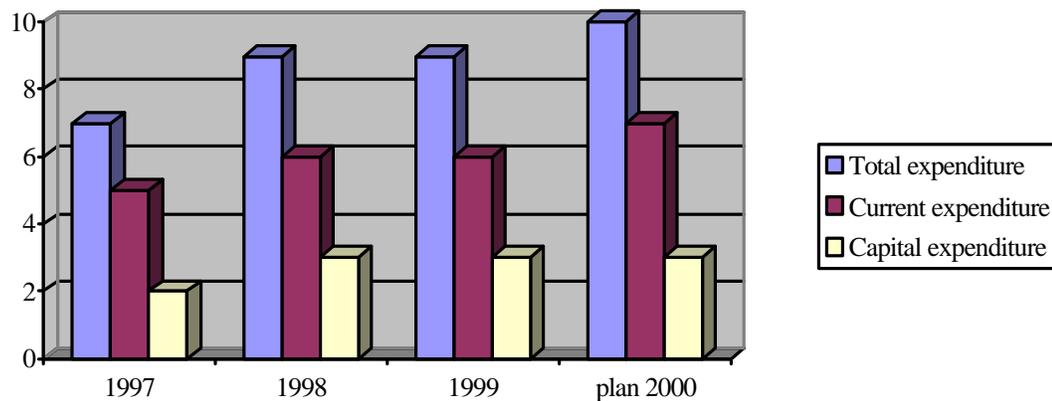
⁵ For example, Germany, Austria, Denmark, Spain, Poland and Hungary.

5. Capital investment financing and capital budgeting

The capital revenues of local units are made up of receipts from the sale of non-financial capital assets, the life of which is longer than a year. Capital expenditure is the acquisition of long-life assets, capital transfers and grants in money and things, or expenditure for the procurement of land, non-material assets, reserves, non-financial assets and other expenditure the life of which is longer than one year.

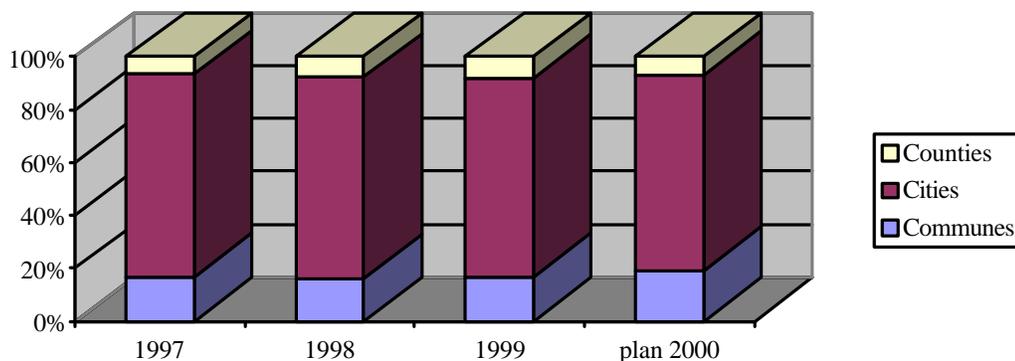
According to data for the period 1997-2000, capital expenditure accounts for more than 30% of total expenditure in the budgets of local units. (Figure 1)

Figure 1. Expenditure of local units in the period 1997-2000 (in billion kuna)



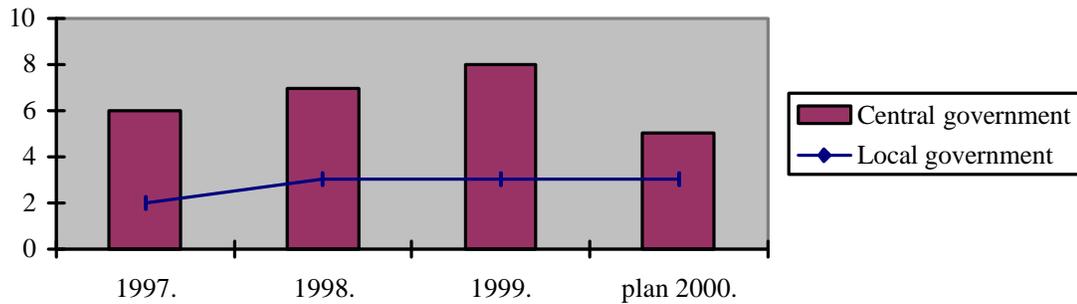
However, there are important differences in the share of communes, cities and counties (Figure 2). These differences show that the biggest responsibility for capital investment in terms of value is borne by the cities, and the smallest by the counties.

Figure 2. The share of communes, cities and counties in total capital expenditures of local units, 1997-plan for 2000. (in %)



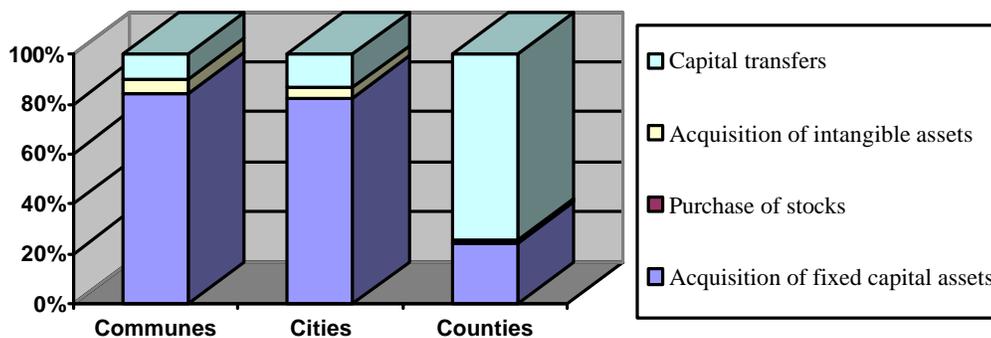
During the observed four-year period, the amount and structure of capital expenditure by local units has been relatively constant, unlike the capital expenditure of central government (Figure 3).

Figure 3. Capital expenditure of central government and local units, 1997-plan for 2000. In mill Croatian kuna.



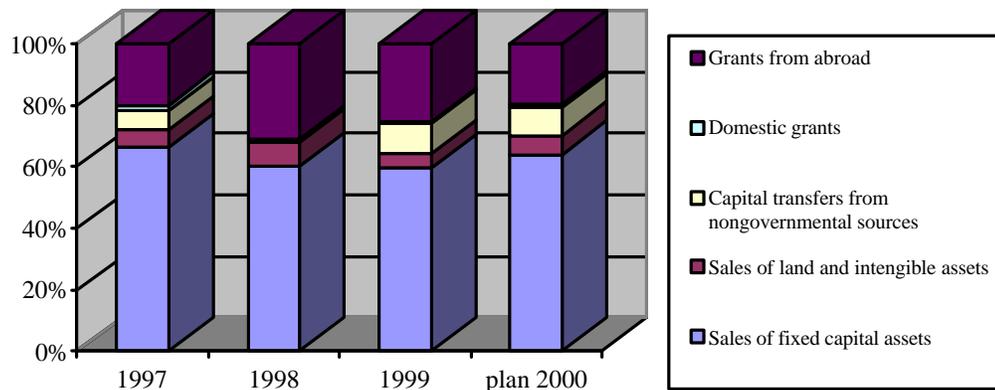
Procurement of permanent capital or fixed assets dominates in the structure of the capital expenditure of the communes and cities, while in that of the counties, capital transfers are the biggest item (Figure 4). Capital transfers contain the item of capital transfers to extra-budgetary beneficiaries, which account for more than 40% of the total capital transfers. Capital transfers to extra-budgetary beneficiaries relate to transfers for the building or purchase of business premises, the procurement of equipment, vehicles and such like investment related to the provision of an adequate infrastructure. The proportion of capital expenditure meant for the purchase of reserves has been reduced to the minimum.

Figure 4. The structure of capital expenditure of communes, cities and counties in 1999 in %)



The financing of capital projects. According to accounting principles, capital expenditure should be financed from capital revenue. Capital expenditure is also financed by capital grants from home or abroad. For the financing of the service industries (health care, education, house building and so on) specific purpose grants are given, proposed by the competent ministries, and sometimes directly given to local units. If the realisation of a capital project is of common interest to the whole county, the communes and cities can combine and transfer funds to the county, which will then finance the whole project.

Figure 5. Financing the capital expenditure of the local units (in %)



Most capital projects at the local unit level are financed from the national Budget. As well as money from the national Budget, the county also has an important role, taking the part of co-financier of capital projects.

The central government, in financing capital projects, relies on borrowing and taking loans from the World Bank. Thus the Council of Europe gave a loan used by the Ministry of Development, Immigration and Reconstruction for the project of the reconstruction of school buildings in the Osijek and Baranya and the Vukovar and Srijem counties.

For most projects financed at the level of county, the central government provides loans and government guarantees, and also bills of exchange. Of the other specific manners of financing, one should also mention the financing of capital projects via the Croatian Bank for Reconstruction and Development.

As well as these ways of financing capital investment, the Local Government Financing Law (*Official Gazette* 117/93) envisages the possibility of local governments borrowing by issuing bonds. A local unit can borrow up to 20% of the total budgetary revenue created in the previous year, with the prior consent of the National Auditing Office and the Finance Ministry. A local unit can borrow to finance the building, additional building, rebuilding or conversion of facilities and the procurement of equipment. Debt financing can be used to carry out the regular operations of the bodies and beneficiaries of the budget, except for a short time, if budgetary revenues do not come in evenly.

The Concessions Law (*Official Gazette* 89/92) set up a model of private and public partnership in the area of designing, financing and managing capital projects. The communes, cities and counties give their opinion about an application for a concession for the economic exploitation of assets in their area, and the House of Representatives of Parliament, at the recommendation of the government, makes a decision to grant the concession. Expertise about the preparation of the concession decision is provided by the competent ministries or the executive of the county or city.

When a decision to make a capital investment and about the financing of it has been made at the local government level various problems are encountered. Although local unit operations are defined by statute and the Constitution, bringing several figures into the decision making process about investments and the later implementation of the

investment, encourages passive behaviour and a manner of thinking widely divorced from market-oriented.

An analysis of the structure of capital expenditure and monitoring of the execution of capital projects are impossible without keeping the budgeting of capital expenditures separate from that of current expenditure, which the current law does not envisage.

In addition, information from practice shows that when capital investment decisions are made no investment studies or social justifiability studies are made. This way of working creates an impression of lack of seriousness, which puts domestic and still more foreign investors off.

The possibility of financing capital projects by borrowing has not produced much response, because of the low fiscal capacities of local units, which make it impossible for them to borrow. In addition, in individual local units there is still the unsolved question of the assets balance sheet, which makes it completely impossible for such units to borrow.

These problems show that a clear distinction between the rights and obligations of the local units and the rights and obligations of local units and central government should be made. In this way individual actors will then have an interest in carrying out their responsibilities, and in the event they do not meet them, individual liability for mistakes and oversights will be able to assigned.

In the procedure of planning capital investment, the practice of drawing up the necessary investment studies should be brought in, with reference to possible sources of financing. In addition, since it is a matter of projects that are important for the society as a whole, it is necessary to bring in the obligation to draw up an analysis of the social justifiability of every investment.

Through various forms of education, local administration should to be informed and trained for work with contemporary ways of planning capital projects. Since Croatia has not yet completely adopted the market oriented way of operating, the education of local units and central government needs to be addressed for the easier understanding of the countless ways of the financing of capital projects.

Part Two

LOCAL GOVERNMENT BUDGETING

1. Fiscal policy making and budgeting at national level

The Budget Law determines the contents and the planning of a budget, the manner of drawing up, approving and executing the national Budget, and the budgets of the local units, borrowing and the national debt, and budgetary accounting and supervision. Passed together with the national Budget is the Budget Execution Law, which determines the structure of revenues and expenditures for each year, their execution, the management of national assets and debts, the issuing of guarantees, the rights and obligations of beneficiaries of budgetary resources, and penalties for failure to live up to obligations.

The process of drawing up the national Budget begins in July when the Finance Ministry draws up a report about economic and fiscal policy for the coming year. The Finance Minister proposes the guidelines for and objectives of fiscal policy, and draws up an estimate of the main kinds of revenue and expenditure. The Finance Minister must draw up the guidelines and objectives of fiscal policy in cooperation with the competent bodies of government.

The government lays down the macroeconomic and fiscal policy for a three-year period. Then, in line with the objectives so defined, the government determines the public expenditure policy for the fiscal year.

The Objectives of Macroeconomic and Fiscal Policy

In 2000 for the first time in Croatia the macroeconomic objectives for the 2001 to 2003 period were set out. The main objectives of the macroeconomic policy are growth of GDP, reconstruction, promotion of the private sector, reduction of the size of the public sector. The objective of fiscal policy has been defined as controlling the amount of the deficit of the consolidated national Budget.

After the government determines the objectives of macroeconomic and fiscal policy, the Finance Minister, in September, sends Budget beneficiaries a paper about the way in which to draw up and the elements of the annual national Budget. This paper determines the basic elements of the policy of public expenditure and the key indicators that budgetary beneficiaries have to adhere to, and the procedures and deadlines for the drawing up of requests for allocation of resources.

Budgetary beneficiaries (the ministries and agencies) are responsible for the definition of the policy of public expenditure for the fiscal year.

The Contents of a Public Expenditure Proposal

A proposal for public expenditure as drawn up by budgetary beneficiaries contains:

1. expenditure for the fiscal year (classified according to the regulations about budgetary accounting),
2. expenditure for the next two years classified in groups,
3. a review of the number and structure of employees and senior officials,
4. a statement of the reason for the requirements anticipated, and
5. proposals of requests that relate to future obligations or long term expenditure (including investment projects) that are being submitted separately from the projection of the expenditures for each subsequent year.

In the process of the drawing up of the national Budget, beneficiaries include, in their proposal for public expenditures, current expenditure (operational expenses, financial and other expenditure, current transfers and grants to budgets and budgetary beneficiaries, current transfers and grants to extra-budgetary beneficiaries, current transfers of funds abroad, subsidies, and other current transfers and grants) and capital expenditures.

Capital Projects

In the case of capital expenditure, the emphasis is upon the definition and distinction of capital projects that are already under way from new projects, and on the structuring of capital projects according to the degree of their completion and the timetable for their execution. In the macroeconomic and fiscal policy laid down for 2001 to 2003, in the capital part of the national Budget priority is given to projects under way and reconstruction projects. The financing of new capital projects will depend upon the funds available in the coming three-year period.

An essential element of a proposal for public expenditure is the obligatory three-year survey of international obligations deriving from loans, domestic obligations (including maturity dates), and obligations to suppliers that are carried over into the subsequent financial year.

In line with estimated revenue and the proposals of budgetary beneficiaries the Minister of Finance will propose certain necessary modifications to budgetary beneficiaries. The Minister will also determine the need and investigate the opportunities for financing via borrowing, and draw up a draft of the national Budget, after which it will be sent to the government.

It might occur that during the debate about the Budget there will be some difference of opinion between the Finance Minister and the other ministers, who represent budgetary beneficiaries. Then the Finance Minister will draw up a report for the Prime Minister, who will make the final decision.

A draft of the Budget for the coming fiscal year is made by the Finance Minister and sent to the government by 10 October; the government discusses the proposal and is obliged to submit the proposal to Parliament for approval. The Parliament will vote in the Budget by 15 December before the beginning of the fiscal year.

Time	Actions
Phase 1. THE PREPARATION AND PLANNING OF THE NATIONAL BUDGET	
Step 1. Proposal for the fiscal policy for the coming fiscal year.	
April 1998	The Finance Ministry plans the revenues and receipts for the coming financial year and draws up a proposal for the fiscal policy for the next year.
July 1998.	The Finance Ministry delivers to the government projections of economic trends and a proposal for fiscal policy for the year to come. The government considers and adopts this proposal.
Step 2 The national Budget circular	
September 1998	The Finance Minister plans expenditure for coming year, sending beneficiaries a document called a Circular asking them to draw up applications for Budgetary resources and send them to the Finance Ministry by the end of September.
Step 3. The phase of negotiating and adjusting the demands of budgetary beneficiaries.	
The end of September and the beginning of October 1998.	The Ministry of Finance talks with beneficiaries of the Budget to adjust the expenditures they have requested with the principles of the fiscal policy adopted in July.
Until 10 October 1998.	The Ministry of Finance draws up and submits to the government some documents that it has to confirm: <ol style="list-style-type: none"> 1. Proposal for the national Budget 2. Financial plans for the extra-budgetary funds, 3. Proposals for capital projects 4. The National Budget Execution Law.
PHASE 2 PROPOSAL AND APPROVAL OR ACCEPTANCE OF THE BUDGET	
Step 4. Debate in Parliament ending with the adoption of the Budget	
by 15 November 1998.	The government supplies the Parliament with the budgetary documents for discussion by the committees and submits reports in the form of amendments.
by the end of December 1998	Final debate at a session of the two houses of the Parliament and adoption of the national Budget, and adoption of the Budget Execution Law, consent given to the financial plans of the extra-budgetary funds and the consolidated budget of central government.
PHASE 3 THE EXECUTION OF THE NATIONAL BUDGET (Implementation, supervision and control)	
Step 5. Execution of the national Budget	
from 1 January to 31 December 1999	Budgetary users gather and spend budgetary resources on the basis of quarterly and monthly plans about its execution, in line with the resources available.
Step 6 Report about the execution of the Budget for the first half year	
Before the end of July 1999	The Finance Ministry, according to reports by beneficiaries submitted, draws up a report about the execution of the national Budget for the first half year of the fiscal year and delivers it to the government.
by 5 August 1999.	The government submits the half yearly report to the Parliament, after which there is a debate in the House of Representatives.
Step 7 Execution of the Budget and the closing of the open accounts of the Budget	
by 20 December 1999.	The Finance Ministry makes instructions about closing accounts opened at the National Bank of Croatia and other commercial banks, by 31 December 1999, because the Budget has to be executed by that day.
Step 8. Drawing up the annual accounts for the preceding year and control published by the National Audit Office.	
by 15 April 2000	The Finance Ministry draws up the annual accounts of the national Budget, the budget of the extra-budgetary funds and the budget of the local units for the preceding year.
by 15 May 2000	The Minister of Finance reports to the government about the annual accounts, that is the execution of the Budget for the previous year.
by 15 July 2000	The government reports to the Parliament about the annual accounts, or the execution of the national Budget for the previous year, and the National Audit Office reports to Parliament about the audit that has been done.

2. Strategic planning and short term (annual) budgeting at local level

The planning of the budgets of local units depends on the government's fiscal policy measures and the macroeconomic indicators of economic growth for the three-year period as well as on the economic indicators of the local units.

In the process of drawing up local budgets for the 2001 to 2003 period, local units have to abide by budgetary constraints that relate to the number of employees and the reduction of budgetary expenditure. Local units in particular have to take a realistic view of the growth of revenue, particularly that part of their funds that they obtain from their share in joint taxation revenue (shared taxes) as well as the local tax and non-tax revenues that local units themselves assess and collect.

Local units, while planning budgetary expenditure, lay down their own priorities, bearing in mind the realistic growth of shared and purely local budgetary revenue. Local units must adhere to the statutory provisions about balancing the budget, according to which only capital projects can be financed from borrowing. The departments of internal supervision and control of the local units control the contents of the plan of the budget. The problem is that internal supervision and control sections are not set up in all local units, and so it is dubious whether complete control of the planning of the budget is carried out in all the units.

The budget is adopted for one fiscal year. Together with the budget, a decision about the execution of the budget is adopted, as are projections of budgetary spending for the coming two years. From the budget one has to be able to see not only the amount of the budgetary resources but also what they are meant for. All budgetary revenue and receipts are shown according to sources, and expenditures according to purpose. Revenues and receipts can be collected, and funds for expenditures may be used (executed), only after the local representative body has voted in the budget.

Temporary Financing

The decision to resort to temporary financing of public expenditure is taken by the representative body of the local unit if it judges that the budget cannot be approved by the end of the current year. Temporary financing can be prescribed for the first quarter of the fiscal year at the longest. The amount of the budgetary resources has to be proportionate to the funds used in the same period for the previous year, and can be at most up to one quarter of the total revenue of the budget for the previous year. A decision about temporary financing and a temporary budget has to be made by the local representative body (county assembly, city or commune council).

This kind of temporary budget is in terms of contents, adoption and execution just the same as the annual budget. It has to show all the revenue and expenditure and the amounts planned for allotment to the beneficiaries and special purposes (sections, heads, positions, accounts and names of purposes that are financed from the budget).

The importance of temporary financing is primarily in that it enables public services to be provided until new representatives of the government of the local unit are elected.

Local units, while drawing up their budget, have to pay attention to:

- the contents, and manner of showing, of planned revenue and receipts, and expenditure,
- financing current expenditure from current revenue, and capital expenditure from capital revenue,
- the use of individual revenue items for the purpose for which they were intended,
- borrowing and the issuing of guarantees (guarantees may only be given for capital expenditure) and
- the objectives of the macroeconomic and fiscal policy of the government for the forthcoming three-year period.

While the budget is being drawn up, all revenue and receipts are shown in the budget and allotted to those expenditures and tasks that are financed from the budgets of counties, cities and communes. These relate to tax and non-tax (stamp duties and fees and fines) and the authority's own resources (realised while carrying out its own activities in line with special regulations), grants, borrowing to finance budgetary shortfalls, and other expenditure.

The estimate of the revenue and receipts of local budgets is based on national macroeconomic indicators and upon guidelines for the preparation and plan of the national budget, as well as the units' own estimates of the growth of economic activities in their areas and of their revenues and expenditures.

The planning of the budgets of local units starts at the end of July when the Minister of Finance supplies the counties with the so-called *circular* (guidelines with basic indicators for the drawing up of a budget), so that they can draw up an estimate of their own budget. The county authority, following the national guidelines, makes its own and sends them to the communes and cities in its region.

Although the planning of the budget is part of the three-year projection of fiscal and macroeconomic policy, in practice, the counties, cities and communes mainly draw up a plan for their budget for just one year, and an outline plan of budgetary spending for the two following years.

The Contents of the Circular (Guidelines) for Drawing up the Plan of the Budget of a Local Community

In the Finance Ministry circular for the drawing up of the three-year plan for the budget of local units, the following are given:

1. Basic indicators of macroeconomic policy for the coming three-year period (rates of growth of both nominal and real GDP, inflation rate, rate of increase in wages, trends in employment, costs of living and so on) and an estimate of trends in joint taxation at the national level.
2. Recommendations to bodies of local units for them to estimate realistically the growth of revenue and receipts, and the 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 expenditure, and definition of priority expenditure that has to be adjusted with the planned rate of growth of joint and proper revenue.
5. Local units should adhere to the real dynamics of realisation of revenue through the year as a basis for the plan and the execution of tasks.

6. Adjustment, i.e., reduction of public expenditure, if because of a drop in economic activity there should be a lower realisation of public revenue.
7. Attention should be paid to the local budget's being balanced.
8. Local units that are provided with resources (current grants, transfers) from the national Budget should adhere to the conditions related to limits in the rise in pay and material costs.

The basic groups of expenses are current and capital expenditure, and loans minus repayments. Within the framework of current expenditure (we are looking here at the sum of all local budgets) most of the resources are to do with operating expenses, then for subsidies and other current transfers. The category of expenditure for subsidies and transfers includes expenditure for those employed in non-profit making institutions. Relatively small resources relate to real programmes and activities.

Within the framework of operating expenses, in local budgets plans are made for labour costs (gross wages and expenses, remunerations and contributions), resources for materials, power, utility and other services, and expenditure for current maintenance. Resources for the wages of employees are planned depending on the amount of the mean base for the calculation of wages, in line with contracts made and with the rules. In the case of capital expenditure, the procurement of capital resources and capital transfers are planned.

Local units draw up their own guidelines that are based upon the guidelines of the county and the Finance Ministry. A proposal for the guidelines is drawn up by the local budget and finance section, bearing in mind the estimate of the trends in demographic and economic indicators and the unit's own budgetary resources. The guidelines are adopted by the local authority. In most cases local units draw up their own guidelines, because the guidelines of the Finance Ministry are too general for implementation at the level of local units.

In the guidelines, not only is the growth of revenue and expenditure determined, but also the priorities for the coming three-year period, such as trends (a rise or fall) in expenditure for labour (wages and other things), expenditure for goods and services (material costs), capital expenditure per operation, and any planned borrowing.

The guidelines are handed to the budgetary beneficiaries (the sections and services) and other beneficiaries that are financed from the budget via transfers (kindergartens and the like). All budgetary beneficiaries of a local unit deliver the budget and finance department their applications for the necessary resources for the financing of current and capital expenditure.

Contents of an Application for Budgetary Resources

In its application, a budgetary beneficiary submits to the budgetary office a plan of a budget that takes in: expenditure for the next two years (in groups and sub-groups of expenditure at the second level of the account plan), a condensed review and the structure of the employees (senior officials, senior civil servants, junior civil servants) for whom the funds are required, the detailed written explanation of the anticipated needs that is required for the application to be approved, a review of future obligations or long-term expenditure including capital investment projects (separate from regular annual expenditure).

An Account Plan of the Budget

How are the Revenues and Expenditures of the Budget broken up?

An account plan of the budget shows how the individual revenue and expenditure accounts are broken up (*Official Gazette* 98/94, 15/96, 94/98 and 165/98). Thus for example value added tax, special taxes and taxes on turnover and consumption are kept in the group of account 020. Each of these individual taxes is further divided into sub-groups of accounts, for example VAT in subgroup 10, and excise in subgroup 20, and so on. Subgroups of accounts are further divided into sections and basic accounts. The same division goes for expenditure.

Group	Subgroup	Section	Basic Account	Name of budgetary position
				Revenues
020				Valued Added Tax, special taxes and turnover taxes
020	10			Value added tax
020	10	010		Valued added tax
020	10	010	10	Valued added tax
020	10	010	20	Valued added tax on import
020	10	010	30	Value added tax on the services of foreign enterprises
020	20			Special taxes (excise)
020	20	010		Special taxes on petroleum products
020	20	020		Special tax on alcohol
		030		Special tax on beer
-	-	-	-	-
				Expenditure
100				Operational expenditure
100	10			Labour expenditure
100	10	010		Gross pay and remunerations
100	10	010	10	Pay of senior and junior civil servants
100	10	010	20	Pay of trainees and other temporary employees
100	10	010	30	Civil servants' overtime pay
-	-	-	-	-

After collecting applications for budgetary resources from beneficiaries, the local budget and finance office analyses the applications provided and in line with the priorities laid down proposes the applications be adjusted with the realistic capacities of the budget. If the estimated revenue is not enough to cover all the requests, the head of the local finance and budget office will suggest that the applications be re-examined (and reduced) together with the determination of priorities.

3. The basic structure of a local budget

3.1 The fund system

In the budget of local units, revenue and receipts, and expenditure, are shown. The basic budgetary principle is that all the expenditure of the budget has to be balanced with revenue and receipts. Expenditure depends on the level, functions and tasks that are carried out by the local government unit.

Basic elements for the drawing up of budgetary plan and estimate are neither uniform nor detailed, and differ from unit to unit. That the classification of the scope of budgetary resources differs is the result of the different kinds of revenue and also of expenditure that dominate in the structures of the local budgets.

The budget of the local units is in structure similar to the budget of the central government and consists of a general and a special part.

The general part of the annual budget contains:

- the total amount of estimated revenue (according to sources and kinds of revenue) and expenditure (according to basic purposes, the groups and subgroups of the account plan of the budget),
- the balance of budgetary expenditure and revenue (total revenue, net financing, total expenditure and the difference that has to be zero, i.e., the budget has to be balanced) and
- the financing account (receipts from financing, expenditure for financing, net financing and the surplus or deficit).

The special part of the annual budget contains a schedule of totally planned expenditure according to beneficiaries, special purposes, groups of accounts, divisions, positions and purposes in line with the budget execution decision.

The Budget Consists of a General and a Special Part

The general part of the budget contains:

1. the total amount of revenue and expenditure anticipated
2. the balance sheet of revenue and expenditure:
 - total revenue
 - net financing (if there is a financing account)
 - total revenue and net financing
 - total expenditure
 - the difference surplus/deficit has to be balanced
3. the financing account:
 - receipts from financing
 - expenditure from financing
 - net financing
 - the difference surplus/deficit

The special part of the budget contains a detailed schedule of expenditure in terms of kinds, purposes and in terms of budgetary beneficiaries (divisions), heads, positions, groups of accounts and purposes in accord with the decision about the execution of the local budget.

a) The revenue side includes: current revenue (tax and non-tax), capital revenue and grants (current and capital).

b) The expenditure side of the budget shows expenditure in terms of kinds, purposes and those responsible.

Economic Classification of Expenditure

Current expenditure

1. Operational expenditure

employees (gross pay and expenses, remunerations and contributions)

goods and services (materials, energy, utility and other services for regular needs)

current maintenance (vehicles, equipment, buildings, roads, harbours, parks, monuments (and material and services so as to carry out its own work

2. Financial and other external expenditure

in agriculture and forestry,

for education,

for nature and environmental conservation,

financial expenditure (payments clearance, banking services, interest, entertainment and promotion),

statistical research,

health care,

other expenditure not detailed (membership fees, obtaining expert opinions and so on).

3. Current transfers to budgetary beneficiaries:

to citizens, households and non-financial organisations,

to institutions,

to other levels of government (counties, cities, communes),

to financial institutions.

4. Current transfers and grants to extra-budgetary beneficiaries

5. Subsidies (in agriculture and other subsidies)

6. Other current transfers, and

7. Grants (for commodity reserves, grants to students, city traffic, to non-financial public corporations).

Capital expenditure:

Expenditure for the procurement, construction and investment maintenance of capital resources (lands, forests, buildings, office furnishings and equipment, vehicles, the building of capital facilities, investment maintenance).

Capital transfers to budgets and budgetary beneficiaries (as with current transfers).

Capital transfers to extra-budgetary beneficiaries (as with current transfers).

Loans given and shares in equity

Repayment (return) of loans given.

One very basic problem with running the budget of a local unit is the absence of any uniform, statutorily defined contents and structure for a local budget, or a single and uniform plan for a local budget. There is no single form or pattern for the drawing up of the plans of local budgets.

However, there are prescribed forms for the financial report about the annual or semi-annual execution of the local budget. Irrespective of this the local communities continue to take the national Budget as the model for the elaboration of their own budgets, with the proviso that they adapt it to their own internal organisation (the bodies that are financed from the budget) and the sphere of competence of the affairs they see to.

All budgets contain capital and current expenditure. Capital expenditure can be shown in the framework of the special part of the budget (in individual heads and

sections), alongside current expenditure, or at the end of the budget according to projects and those in charge of projects.

The absence of any methodological uniformity in the budget (in the expenditure part) does not allow for a realistic estimation of the execution of projects or the control of them. For this reason it is not possible to carry out either consolidation or the grouping of investments in terms of projects and those in charge of them. This is the case at the level of both the national and the local budget.

Formally, a budgetary principle has been laid down: that of the balancing of the local budget. Similarly, every year local units are enjoined to adhere to the golden rule (taking on loans for the financing of capital expenditure). However, in quite a lot of cases the principle of balance is not respected, and local units, financing current expenditure, rely on borrowing in the banking sector, although this is quite expressly forbidden. There are many examples in which local units do not have in the separate part of the budget any clear distinction of the financing account showing borrowing and repayments of loans. Many transactions, like issuing budgetary guarantees for utility companies, are not recorded, nor is there any single and unified register of guarantees issued by local units. Often, guarantees are registered in the financing account of the local units, although they are not a real obligation of a local unit.

The weak structure of local budgets and the unevenness of the budgets of different local units does not allow the central government to have total supervision of the use of the resources of local units. Local units do not evaluate the consequences 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 at the central government level. No programme of capital financing or sectoral analysis of programmes exists at either the national or the local level.

Earmarked funds. In the national Budget resources are provided in the form of current grants for the financing of the current (budgetary) expenditure of local units. Apart from this, in the national Budget, resources for capital projects and programmes for communes, cities and counties are provided, either in part or in whole (a lot of capital projects are jointly financed by the state, communes, cities and counties). It is not unusual for a project to be co-financed with resources supplied by one of the state owned corporations.

Allotment of grants is conditional upon the obtaining of the prior approval of the Justice, Administration and Local Administration Ministry of the enactments of the local government setting the pay and remunerations for the work of the people employed in their bodies. The counties, cities and communes are obliged to provide the government a report about the use of resources for capital investment, in order to check the use of these resources for their proper purposes.

For the sake of planning current grants from the national Budget, local units in areas of special national concern have to supply their counties with data about the number of people employed in local bodies of government (and beneficiaries who are supplied with salaries and material costs from their budgets) in order to determine if they have the right to a grant (i.e., whether they are sticking to certain conditions concerning the permitted growth of funds for pay, material costs and the number of employees).

Since the Budget provides funds for 110 local units of special national concern (communes, cities and counties) the amount of grants has a very important share in some budgets, and the actual working of a local unit very largely depends on them. Grants are

allotted to the local units from the national Budget each month. For the local units, the dynamics with which the grants are received is very important, because of the need (in units in which grants make up the major part of their budgets) to ensure regular performance of the tasks. Funds for capital projects are usually provided in the national Budget.

It is impossible to determine the size of the earmarked grants at the level of the local units. The existing government classification of the extra-budgetary funds (in this case the Child Benefit Fund and the Public Water Management Fund), although done according to GFS, does not make possible any detailed analysis of the size and purpose of these grants.

3.2 Fiscal planning units

A main role in the local budget planning process is played by the local government finance and budget department, the specialised department of the authority of the local unit (executive branch). It is possible for the local authority to appoint a commission for budget planning. Members of such a commission (commune and city level) are the mayor or head, the head of social affairs, and the head of the finance and budget department.

The utility companies owned by the local unit do not take part in planning the budget, and are not actually integral parts of the budget. These companies draw up their own plans according to enterprise accounting regulations. The planning departments of these companies draw up financial plans that the representative body of the local unit usually accepts after approving the plan of the local unit budget.

The number of departments in the local budget planning procedure differs according to local unit, and in many cases depends on the number and expertise of those involved in the planning of the budget.

3.3 Extra-budgetary funds, off-budget units

Apart from the national Budget, there are in Croatia five extra-budgetary funds; these are Pension Fund, the Health Fund, the Employment Fund, the Child Benefit Fund and Public Water Management Fund. Up to 1995 the same status was enjoyed by Croatian Roads. Since 1995 the revenue and expenditure of these companies have been run within the national Budget.

The extra-budgetary funds	Sources of revenue
1. Pension Fund	Employees' and employers' contributions (10.75% and 8.75% of wages, respectively), the shortfall being made up from the Budget.
2. Health Insurance Fund	Employees' and employers' contributions (9% and 7% of wages) the shortfall being made up from the Budget
3. Employment Fund	Employees' and employers' contributions (0.85% and 0.85%), the shortfall being made up from the Budget.
4. Child Benefit Fund	Transfers from the Budget and other revenue
5. Public Water Management Fund (an establishment that has no market derived revenue)	Fees and transfers from the Budget

The extra-budgetary funds have their revenue from their own proper sources, but also receive transfers from the National Budget.

In order to take some of the pressure off the economy, since 1994 contributions have been systematically reduced or cut entirely, which constitutes an additional burden for the national Budget, in which these resources are provided as transfers to the given fund.

The operation of the funds is strictly purpose-related and non-profit making. The operations of the funds are carried out according to the financial plan adopted by its ruling body with the prior consent of Parliament. In the drawing up of the financial plan of an extra-budgetary fund, the classification system of the accounting of the Budget is used, and the procedures and chronology of the drawing up of the Budget.

Up to 1995, the financing of the utilities in the areas of local units was also done by the so-called fund system. There were so-called funds of utility activities that had their own assets and carried out their utility work on the basis of their own revenue (charges). In 1995 the fund financing system was abandoned, and local units set up public enterprises, non-profit making establishments, to carry out individual utility operations. Many local units set up public corporations for waste management, water supply, and other utility corporations that were financed out of their own revenues (charges). However, as well as their own resources, for the financing of these utility activities, these firms are financed out of the budgets of the local units as well. Thus in the budgets of the local government units there are transfers to these firms, financing their losses and obligations, which they are unable to finance with their own resources. The position of the utilities is further complicated because they have the status of companies and are organised as joint stock companies, which turns their non-profit making activity into a profit-making activity. Another problem is that the ownership of these companies is not clearly defined, nor are their rights and obligations with respect to the budgets of the local units.

3.4 Consolidation of the Budget

Consolidated central government includes a consolidated survey of the central government budget and the extra-budgetary funds. *Consolidated general government*, as well as a consolidated review of the national Budget and the extra-budgetary funds, also includes the budgets of units of local government and self-government.

Consolidation among these levels of government is done in line with the internationally comparable methodology *Government Finance Statistics*, defined by the IMF.

In practice to date of the consolidated balance sheet of central or general government it has been shown that *the national Budget, because of major transfers to the extra-budgetary funds and topping-up transfers to the county budgets, is in consolidated surplus, while the rest of the consolidated central or general government is in consolidated deficit.*

The Consolidated Budget (Balance Sheet) of Central and General Government

The *consolidated central government budget* consists of the sum of receipts and expenditures of the national Budget and the budgets of the extra-budgetary funds. During consolidation, transfers between the parts of government (the Budget and the budgets of the extra-budgetary funds) are ignored.

To arrive at consolidated central government, two steps have to be taken:

1. consolidation within the extra-budgetary funds, which means cancelling out or ignoring transfers among the individual funds (e.g. the money that the Health Fund pays to the Employment Fund and vice-versa, and so on with all the other funds),
2. consolidation (cancelling out) of money transfers from the national Budget to the extra-budgetary funds.

To obtain the budget of *consolidated general government* two extra steps have to be taken, that is:

3. consolidation of payments of local units with their budgetary beneficiaries (counties and communes or cities); in this way the so-called consolidated budget of the local units (local government budget) is obtained;
4. consolidation of payments between the central government Budget and the local government budget, by which the general government consolidated budget is obtained.

Through consolidation a realistic picture is obtained of the total revenue and expenditure of general government. Unconsolidated revenue and expenditure in 1999 came, respectively, to 56.80% and 58.78% of GDP. In 1999 the consolidated revenue came to 47.15% and expenditure to 49.11% of GDP. Transactions cancelled out in the consolidation of the budgets amount to 9.67% of GDP.

The last consolidation for all levels of the budget was done in 1998. The budgets of the local units were not consolidated with the national Budget in the subsequent two years. There is no consolidated general government budget existing as a financial document per se, nor is this budget discussed in Parliament.

No consolidation of the local unit budgets has yet been performed nor is consolidation at the level of the same hierarchical levels of government done (counties, communes and cities). In outline, for all local units, a summary balance sheet is drawn up. One of the main problems is the classification of the budgets of local units, which does not permit consolidation at the local government budget level; additionally, local units have not been instructed as to how to carry out consolidation.

Local units do not carry out the consolidation of their budgets. The Finance Ministry does not seek it, nor does it instruct local units to carry out budgetary consolidation.

3.5 Classification of expenditure

The Finance Ministry does not prescribe a methodology for or a separate economic and functional classification of the budget. Publicly available and complete data about expenditure shown according to functional and economic classifications do not exist. Expenditure is classified only according to administrative categories (budgetary beneficiaries and purposes). The expenditure of the extra-budgetary funds is not shown functionally.

No classification of expenditure in terms of programmes, sub-programmes and categories of activity is provided. This kind of classification should supplement the traditional administrative classification.

Data about functional and economic categories of expenditure at the national level can be obtained only for total amounts but absolutely not for individual parts of expenditure such as capital and current expenditure. This state of categorisation is directly transmitted to the local units, who also do not have a developed classification system. The problem is that the existing system of budget accounting supports only the classical breakdown of budgetary expenditure among individual budgetary beneficiaries.

4. Budgeting techniques

Budgeting in local units is based on planning and monitoring amounts within the framework of an individual item of revenue and expenditure (in line with the prescribed account plan of the national Budget that is applied by local units as well). What is planned is the ceiling for any given item or position. This approach to budgeting is supported by the regulations that govern the budgetary procedures, primarily the Budget Law (*Official Gazette* 92/94), the prime piece of legislation. The Budget Law states that the budget of a local unit, and the reports that along with it are put before the local assembly, have to contain:

1. a detailed review of revenue and expenditure
2. a proposal for the employment of a surplus and how to finance a deficit, if any,
3. a functional classification of expenditure, in line with the methodology prescribed by the Finance Minister⁶,
4. the revenue and expenditure of each budgetary beneficiary in line with the revenue and expenditure (by categories, sub-categories and items) of the classification of the account plan.

The local budget has to contain corresponding data for the previous fiscal year, modified estimates for the current year, and predictions for the next two fiscal years.

These provisions of the Budget Law indirectly constitute a demand by the central government for the use of the simplest possible technique of budgeting – the planning of ceilings for individual items of revenue and expenditure.

Each year, and at the latest in September, the Ministry of Finance sends the counties guidelines for the preparation and drawing up of the budget. The counties should, on the basis of these guidelines, draw up guidelines of their own for the lower levels of local government in their areas.

The guidelines are a general framework and do not oblige the local units to increase or decrease the amounts of particular expenditures. An exception is for units some of whose resources are provided from the national Budget. These units are bound to stick to the conditions about trends in wages and material costs that apply to beneficiaries of the national Budget.

The guidelines too assume the planning of expenditure according to individual items of the account plan that the Finance Ministry has ordained for budgets and budgetary beneficiaries (*Regulations concerning accounting and the account plan of the budget, Official Gazette* 94/98, 165/98 and 62/99, as in guidelines of 27 July 2000 [Class: 400-06/00-01/166, File no. 513-04/00-1]; *Guidelines for the preparation and*

⁶ The Finance Minister has not prescribed a methodology nor separately a functional classification for the budget.

drawing up of the budgets of counties, cities and communes for the period 2001-2003). The demand made can only be satisfied by local units by their planning individual items of revenue and expenditure.

In the 2001-2003 period, counties, communes and cities are bound to make:

- A plan of revenue by kinds and sources pursuant to estimated parameters of their realisation and
- A plan of current expenditure that includes expenditure for staff, material costs, current transfers and subsidies and other expenditure and grants. (These groups of expenditure are: Group 100 Operational expenditure; 200 Financial and other external expenditure; 300 Current transfers and grants to budgets and budgetary beneficiaries; 310 Current transfers and grants to extra-budgetary beneficiaries; 400 Subsidies; 500 Other current transfers and grants).

Budgetary beneficiaries should show planned current expenditure at the third level of the account plan of the budget.⁷

The institutional framework supports and encourages the use of the traditional (according to individual items) technique of budgeting. This concept is applied at the level of the central Budget and is copied in the local budgets. The local units can, for their own purposes, develop a more advanced technique of budgeting to make possible on-going checks of the successfulness of the objectives set up, the projects and programmes.

The critical statements in this part of the text are based on a comparison of the Croatian charter of account with the Manual on Government Financial Statistics of the IMF. The comparison shows that the charter of account of the RC does not enable the presentation of the expenditures of the local units (or the central government) in terms of economic and functional categorisation.

The similar critical statements are also borne out by the IMF study of June 2000, which drew attention to these shortcomings. (See: Diamond, Jack, Castro, Illona, and Last, Duncan (2000): Croatia: A Strategy for Further Developing the Treasury System, IMF)

4.1 Performance budget – role of performance indicators

Central government does not make any other demands on local units. Information about success of execution need not be, and usually is not, part of the documentation of the annual budget. There is a thorough check at the expenditure and revenue level, and primary stress is still placed upon balancing the budget, as well as controlling or checking the borrowings of local units. Checks on expenditure in terms of individual activities, measuring cost effectiveness of individual activities, comparison of investment and gain, insistence on quality, effectiveness and management are features of budgeting that local units can but do not have to adopt and apply. The techniques and methods that are applied at the central government level are largely transferred to the local units. Success of execution is no imperative for either central or local government.

⁷ In the account plan of the budget revenue and expenditure are entered at four levels. The first level contains the basic group of accounts, the second, sub-groups, the third, sections of accounts, fourth level, basic accounts.

Local units still:

- enshrine *size* of budget as criterion for success, rather than quality and the achievement of results,
- make their objectives maximisation rather than optimisation,
- regard change as threat rather than as new opportunity (they have not internalised the principle of changing) and
- they do not take on the principle of management (meaning: identification of position [where are we?], projection of desired position [where are we going?] and deciding on the manner of getting from one position to the other).

Meeting, or not meeting, the objectives that have been defined should involve accountability, depending on the power that goes with a given job, i.e., position in the hierarchical structure. Since objectives are analysed up to the task level, accountability too should be linked to the level of the fulfilment of a particular task. This can be achieved through on-going checks on and evaluation of the work of the employees. For this reason it is necessary to define evaluation criteria, because in this way transparency and objectivity is given to evaluation, desirable and undesirable behaviour is defined, and employees are motivated.

Because of the concentration on monitoring expenditure and gathering of revenue, and the orientation to inputs without any checks on efficiency or final results, there is no system of incentives for high-quality creative work, nor are there any consequences entailed by bad work, no rewards for work well done. Although such incentives and penalties are actually defined, they cannot be applied. The basic reasons for this are the low wages of employees in the civil service, who have no incentive to do their work well.

4.2 Accrual (cost based) budgeting or cash based budgeting

The accounting system of the budgets of local units and their budgetary beneficiaries is the completely separate system of accounting that is entirely different from company accounting.⁸

The Legislative Framework of Budgetary Accounting

Budgetary accounting is governed by the Budget Law (*Official Gazette* 92/94), the Budget Accounting Decree (*Official Gazette* 96/94 and 108/96), Budget Accounting and Budget Account Plan Regulations (*Official Gazette* 98/94, 15/96, 94/98, 165/98 and 62/99), the Application of the Account Plan of the Budget Regulations (*Official Gazette* 165/98), Financial Reporting for Budgets and Budgetary Beneficiaries Regulations (*Official Gazette* 62/99), and these bind both central and local budgets and beneficiaries.

⁸ Enterprise accounting is governed by the Accounting Law (*Official Gazette* 90/92) which enjoins the use of IAS (Article 15).

The Budget Accounting Decree stipulates that:

- budgets and budgetary beneficiaries keep their accounts according to the double bookkeeping principle, and according to the order of accounts from the account plan,
- the notation of revenue and receipts, expenditure and other payment (contained in the main book of the budget and of the budgetary beneficiaries) are done according to the cash principle.

This kind of budgetary accounting was brought in for reasons of simplicity of application. However it *underrates obligations, exaggerates assets and does not permit of consolidation*.

Because of these failings, the accounting system is in a passive situation, and does not have the role of backbone of the information system. The accounts plan of the budget is not based on any economic classification, but on a combination of economic, functional and institutional classifications. Thus the amounts in the financial reports do not give coherent information. For example, a local unit:

- books expenditure for employees in the subgroup of account 100-10 Staff Expenditure
- but carries out statistical research that it has contracted out to associates, entering expenditure on them in the sub-group of account 200-50 Statistical Research Expenditure,
- and starts a project and paid two persons for a feasibility study, showing expenditure for them in the basic account 600-70-050-20 Feasibility Studies.

At the end of the calculation the amount in the subgroup of the account 100-10 Staff Expenditure is not a datum about the total expenditure that the local unit had for remunerations, total pay and expenses, but this is hidden all around the account plan or financial report that is composed on the basis of the state of the account of the main books (the account plan)⁹.

An additional reason for loss of information is the complexity of the system of budgetary accounting. Required are: Main Book I (book of revenue, receipts and expenditure) and Main Book II (of assets, claims, obligations, and sources of property). Operational events are first booked as obligations or claims in Book II, then (often in parallel), when a cash flow occurs, either as expenditure or receipt, in Main Book I and one event, at best, is booked in four accounts. The more complex the system is, the more likelihood there is of error or fraud, and the less effective are checks.

Main Book II represents a movement of budgetary accounting towards the accrual principle (assets and obligations are booked according to the documentation, and not cash flow; claims for taxes for example are booked according to estimates, expectations...). Main Book II conceived in this way makes it difficult to follow transactions. Thus salaries and wages according to calculation are booked as obligations and so month by month obligations are created and settled, and after payment are entered in Main Book I.

Potential obligations (guarantees) are not solved in Main Book II. It is necessary to keep special auxiliary records about guarantees that have been issued. Pursuant to instructions from central government, local units in their budgets plan a guarantee

⁹ In the whole of the account plan of the budget, there are budgetary items that are not adequately broken down. There are many others examples in which current expenditure is run under the 600 account group, which represents capital expenditures, although they have nothing whatsoever to do with such expenditures.

reserve. However, the instruction is diffuse and has not determined what percentage of the guarantees issued has to be set aside for the guarantee reserve.

In various ways, local units record and book loans made and received, as well as guarantees. Some local units book guarantees under the heading “loans made” and in this way artificially exaggerate their real obligations. While planning their budgets, many local units consciously exaggerate the amount of revenue and expenditure and thus ensure a higher level of borrowing than in cases when revenue and expenditure are planned in realistic (and smaller) amounts.

Exaggeration of the size of the budget has turned into a device whereby a local unit gets a greater amount of resources, which it can obtain by borrowing. We should recall that the state has limited the borrowing of local units to the level of 20% of the revenue of the previous year. With this logic, a bigger budget ensures a higher level of permitted borrowing. For this reason it is hard to consolidate the financial reports and to be at all sure of the correctness of the information obtained from the data given.

Operational savings

The budgets of local units (like the Budget of the national government) must be balanced. However, there is no specifically prescribed fiscal rule about the borrowings of local units, except that the local units may borrow up to the amount of 20% of the budgetary revenue from the previous year. No principle has been laid down about the balancing of the current budgetary balance sheet, and there is still no detailed definition of the number of local units in which the current budgetary balance sheet is balanced, and accordingly the level of current saving has also not been determined. From official Finance Ministry data it can be seen through the aggregate indicators that the current budgetary balance sheets of local units (communes, cities and counties) are in aggregate expression in surplus. This means that they operate with current savings, or a current surplus. However, the question is to what extent current savings are a good fiscal indicator of the indebtedness of the local units, bearing in mind that in many local units no financing account is clearly kept. That is, in the practice of the local units, borrowing is often shown as an off-balance sheet position, which makes it impossible to determine the real position of the current budgetary balance sheet. An additional problem is that much current expenditure is classified and kept as capital expenditure. For this reason, the poor classification of budgetary items is an additional problem in any determination of the reality and size of the current level of local unit savings.

Unlike national accounting, the accounting system of enterprises is based on the standards of the profession, applying the accrual system and a very exact account plan, which each one makes according to his or her individual features and needs. Enterprises compile their financial reports clearly, with respect to both content and concept.

4.3 A multi-year, guaranteed budget

There are two basic objectives achieved by good multi-year planning and predicting:

1. the discovery of the links between capital expenditure and future current costs, and according to this, an analysis of the impact of public investment on the budget over the medium term, and

2. the provision of better information about medium term costs of current policies and thus a better field of vision for stimulating changes in the budget creation policy, the implementation of which takes more than one year.

The processes that represent a base for the development of this approach are:

- budgetary discipline (this means that the allocation of resources in the new budget should be looked at not as additional increases or reductions of certain items, rather as the distribution of resources in line with changes in the policy),
- developed processes for the evaluation of the future costs of a programme (central government does not seek checks on costs by individual programme, which is abetted by the poor classification of expenditure).

These processes do not exist, at the level of either central or local government.

The Budget Law says that revenue and expenditure have to be planned for the year to come, and that estimates of them have to be given for two further years (one plus two system).

However budgeting according to individual items of revenue and expenditure entail the basic features of a short-term orientation and an ad hoc solution of problems. No existent evidence on budget expenditure by programmes leaves no opportunity to government in checking the effect of long-term programmes and further needs for financing in each year.

Since the techniques of budgeting in terms of programmes are not developed, local government units check and consider the results of long-term capital projects for the whole, anticipated time of their life, or think in advance only in the framework laid down by the law (one year plus two years). It is interesting that most units do not on the whole withdraw from long-term projects because they have been shown to be for instance inefficient or insufficiently cost effective. The reason is the still deeply ingrained way of thinking that something that has been begun must, come what may, be completed. One imperative of the modern period – to know when to admit a mistake and give up on time – is absolutely not heeded. All this shows that local units have still not conceptually accepted the philosophy of long-term planning.

5. Participants and actors in local government planning

The planning of the budgets of local units goes on in the same way as that of the national Budget. The Budget Law is the basic piece of legislation, but gives only the basic outlines about the participants in and the process of drawing up the local budget. Those taking part in the planning of a local budget are various, and depend on the size of the local unit, as well as the level of expertise and training of the finance and budget section of the LGU. It is frequently the case that executive government (the local authority) appoints a commission for budgetary planning, including the mayor, the social affairs section head, and the head of the finance and budget section.

6. Major stages of budgeting

The basic phases of the budgetary process are preparation or planning, approval, adjustment, implementation and reporting about execution.

Time	Actions
Phase 1.	THE PREPARATION AND PLANNING OF THE LOCAL GOVERNMENT BUDGET
Step 1.	The national Budget circular
End of July 1998	At the end of July when the Minister of Finance supplies the counties with the so-called <i>circular</i> (guidelines with basic indicators for the drawing up of a budget), so that they can draw up an estimate of their own budget. The county authority, following the national guidelines, makes its own and sends them to the communes and cities in its region.
Step 2.	The phase of negotiating and adjusting the demands of budgetary beneficiaries.
At the end of August	The guidelines are handed to the budgetary beneficiaries (the sections and services) and other beneficiaries that are financed from the budget via transfers (kindergartens and the like).
At the end of October 1998.	All budgetary beneficiaries of a local unit deliver the budget and finance department their applications for the necessary resources for the financing of current and capital expenditure.
Until 10 October	The local budget and finance office analyses the applications provided and in line with the priorities laid down proposes the applications be adjusted with the realistic capacities of the budget
PHASE 2	PROPOSAL AND APPROVAL OR ACCEPTANCE OF THE BUDGET
Step 3.	Debate in Parliament ending with the adoption of the Budget
During October 1998.	The head of the executive branch of the local government unit (head, mayor, prefect) is obliged, in October, to submit to the authority a draft proposal of the budget and a budgetary execution decision for the following year. The proposal is then considered by the committees and commissions of the local authority (committees for finance and the budget, and the council).
Until 15 November	The local authority adopts the budget proposal and decision and submits it to the local representative body for approval (council or assembly). The representative body has to adopt the budget by 15 November.
Until 15 December	The budget proposal (together with a projection of budgetary spending for the subsequent two years) and the budget execution decision are considered by the committees and commissions of the representative body. The representative body of local government considers the criticisms and proposals of these committees and commissions and sends the budget back to the authority. The local authority then analyses the conclusions, criticisms and proposals of the representative body and, if they are justified, accepts them and incorporates them in the final proposal of budget and the budget execution decision. The final proposal of the budget and the decision is accepted by the authority and sent back down to the representative body for consideration and adoption.
15 December	The competent bodies (committees and commissions) of the representative body and the authorised proposer of the budget from the council can submit amendments to the final proposal of the budget and the budget execution decision. Amendments accepted become an integral part of the budget and the decision. The representative body of an LGU is obliged to approve a budget by 15 December at the latest
PHASE 3	THE EXECUTION OF THE LOCAL GOVERNMENT BUDGET (Implementation, supervision and control)
Step 4.	Execution of the LG Budget
January 1999	After the representative body has approved the budget, it is necessary to inform the beneficiaries of the sums in the budget, so that they can make their final plans for the means that they have and determine the dynamics of the spending of budgetary resources. The finance and budget department transfers the budgetary resources to beneficiaries according to their determined allocation, which each beneficiary must be advised of at least ten working days before the beginning of the period in question.
During 1999	<i>Reallocation of the budget.</i> The reallocation of the funds of a budgetary item of a given budgetary beneficiary is allowed and possible among individual items of expenditure and individual budgetary beneficiaries. This reallocation is possible only with the approval of the head of the executive of the local government. If such approval is given, then the reallocation is implemented in such a way that the resources for a given item can be augmented by up to 5%, and the items for other beneficiaries or one other beneficiary can be diminished by the same amount.
Step 5	Report about the execution of the Budget for the first half year
Until July 1999	After the close of the fiscal year local units make reports and a yearly account of the execution of the budget. Local units, as well as a yearly, also draw up a half-yearly report about the realisation of the budget.
March	The head of the executive of a local unit is bound to report to the authority about the execution of the budget by the end of the following March at the latest.
April	The local authority must report to the representative body by the end of April of the following year at the latest.
February	A local unit is bound to inform the National Auditing Office by the end of February about the annual realisation of the budget.
15 July	Half-yearly reports about the implementation of the budget are submitted to the Office by 15 July in the current year.

Planning begins at the end of July when the Finance Minister delivers the circular to the counties (i.e., the guidelines with basic indicators for the planning of the budget), so that they can draw up an estimate for their budgets and send guidelines to the local units in their region.

A document called a *circular* is an integral part of local budgets; it facilitates the implementation of a local budget. A circular is used to determine the rights and obligations of beneficiaries of a local budget with respect to the use of funds for their assigned purposes, the manner of transferring funds, the use of budgetary reserves, the management of assets owned by a local government unit, debt management and other provisions that regulate the rights and obligations of budgetary beneficiaries and the bodies of local government units.

The cities and communes by and large make a budget plan for a single fiscal year, and an outline plan of budgetary spending for the next two years.

The cities and communes draw up their own guidelines, based upon those of the Finance Ministry. The local guidelines are drawn up by the budget and finance department; bearing in mind estimates of the unit's own revenue. The guidelines are adopted by the local authority.

The guidelines are delivered to beneficiaries of the budgets (departments and services) and other beneficiaries who are financed by transfers out of their budgets (kindergartens and the like). After receipt of guidelines, all budgetary beneficiaries of LGUs submit to the budget and finance department their requests for the necessary funds for the financing of current and capital expenditures.

After all the applications for budgetary funds from beneficiaries have been collected, the local budget and finance department analyses them and in line with established priorities proposes adjustments of the requests to bring them into line with the realistic capacities of the budget.

The head of the executive branch of the local government unit (head, mayor, and prefect) is obliged, in October, to submit to the authority a draft proposal of the budget and a budgetary execution decision for the following year.

If the head of the local finance and budget department does not manage to adjust applications with means available, the final decision is made by the head of the executive (mayor, prefect, head), who then proposes the proposal of the budget to the local authority. The proposal can be presented by the head him or herself, or in concert with the members of the authority. This procedure is commonly resorted to though it is not regulated or prescribed statutorily.

The proposal is then considered by the committees and commissions of the local authority (committees for finance and the budget, and the council). The local authority adopts the budget proposal and decision and submits it to the local representative body for approval (council or assembly). The representative body has to adopt the budget by 15 November.

The budget proposal (together with a projection of budgetary spending for the subsequent two years) and the budget execution decision are considered by the committees and commissions of the representative body. The representative body of local government considers the criticisms and proposals of these committees and commissions and sends the budget back to the authority. The local authority then analyses the conclusions, criticisms and proposals of the representative body and, if they

are justified, accepts them and incorporates them in the final proposal of budget and the budget execution decision.

The final proposal of the budget and the decision is accepted by the authority and sent back down to the representative body for consideration and adoption.

Debate and acceptance of the budget. The competent bodies (committees and commissions) of the representative body and the authorised proposer of the budget from the council can submit amendments to the final proposal of the budget and the budget execution decision. Amendments accepted become an integral part of the budget and the decision.

Amendments that the authority does not accept are voted on in the representative body. Councillors, representatives of various parties, take part in the debate about the budget. Acceptance of the budget depends on the balance of political powers in the representative body. If the amendment is voted for by the majority, it becomes an integral part of the budget and the decision. The representative body of an LGU is obliged to approve a budget by 15 December at the latest. An approved budget is published in the official gazette of the unit.

Execution of the budget. After the representative body has approved the budget, it is necessary to inform the beneficiaries of the sums in the budget, so that they can make their final plans for the means that they have and determine the dynamics of the spending of budgetary resources.

The real expenditure of beneficiaries has to be brought into line with planned budgetary amounts for each quarter, or for some other period of time determined by the executive.

The finance and budget department transfers the budgetary resources to beneficiaries according to their determined allocation, which each beneficiary must be advised of at least ten working days before the beginning of the period in question.

The execution of the budget at local levels is organised in such a way that the resources are transferred to the beneficiaries who allocate them to given expenditures. Alternately, the expenditures are executed directly from the budget account, depending on what kinds of payments are at issue, and who is in charge of or the beneficiary of the resources. There is no treasury system or payment from a single unified account in the case of local units.

Reallocation of the budget. The reallocation of the funds of a budgetary item of a given budgetary beneficiary is allowed and possible among individual items of expenditure and individual budgetary beneficiaries. This reallocation is possible only with the approval of the head of the executive of the local government. If such approval is given, then the reallocation is implemented in such a way that the resources for a given item can be augmented by up to 5%, and the items for other beneficiaries or one other beneficiary can be diminished by the same amount.

A Rebalance (Revision) of the Budget

A budget has to be balanced, and thus income and expenditure has to be equal. If during a year expenditure is increased and is considerably divergent from planned amounts, or if revenue is considerably reduced, then a decision to rebalance (revise) the budget is made.

Budgetary beneficiaries are then bound to draw up new financing programmes (with smaller amounts for individual items) and send them to the representative body for consideration and approval before implementation. Amendments (the rebalance) to the budget are adopted in the same way and with the same procedure as the budget itself.

Report about the execution of the budget. After the close of the fiscal year local units make reports and a yearly account of the execution of the budget. Local units, as well as a yearly, also draw up a half-yearly report about the realisation of the budget.

Deadlines for Submitting Half-Yearly Reports about the Implementation of the Budget at Local Levels.

The head of the executive informs the authority about the half-yearly implementation by the end of July, and the authority informs the representative body by 5 August.

The half-yearly report contains a review of macroeconomic and fiscal situations, a comparative review of determined and real revenue, expenditure, deficit and borrowing, and an explanation of the differences that have arisen.

The head of the executive of a local unit is bound to report to the authority about the execution of the budget by the end of the following March at the latest. The authority must report to the representative body by the end of April of the following year at the latest.

What the Annual Accounts of the Budget Contain

The annual accounts of the budget contain: the initial and final balance of the budget, an explanation of any major divergences, data about borrowing and debt management, and data about the use of budgetary reserves and guarantees issued during the year.

A local unit is bound to inform the National Auditing Office by the end of February about the annual realisation of the budget. Half-yearly reports about the implementation of the budget are submitted to the Office by 15 July in the current year.

Budgetary documents are made publicly available. The budgets of local units are published in the official gazettes of the units. Not only the budget, but also the annual accounts of the budget are also made public in this way. Since certain local units do not have gazettes, their reports and budgets are published in the county gazette.

Direct Citizen Engagement in Local Self-Government

There is no clearly defined mechanism to ensure the participation of citizens in the operations and decision making crucial for the local unit. There is a form of direct engagement through referenda and in the local meeting.

A referendum is announced by the local council (on the proposal of one third of the members of the council or on the proposal of the local authority or one fifth of the local committees). All on the electoral roll can vote. Referenda are used to determine change of statute, proposals for some general regulations or other questions from the sphere of competence of the town or commune council. A decision made in a referendum is mandatory upon the local unit representative body.

Some local units have brought in what are called self-contributions, a form of self-taxing for the financing of certain projects (local roads, ways, culture centres and so on), citizens giving a certain percentage of their income.

However, there is no legal provision for the participation of citizens. If one does exist, the local statute has been used to stipulate it. There are situations when at the initiative of citizens local units carry out joint financing of the building of given facilities. In some cases the people provide 30% of funds, and the remaining 70% comes from the budget of the local authority.

7. Information systems

The informing system should, with its product, information, create a base for the checking of compliance with established objectives, for an analysis of alternative solutions, and as a guide for future decisions at local and central levels.

Apart from meeting the needs of central government and its control bodies, of representative bodies of citizens and bodies of local units, information should, in form and content, be adapted to the requirements that are laid down by international organisations for the purpose of international comparability.

The basis of the local government information system consists of two fundamental sources or kinds of information.

The first source is the Budget Implementation Report, which gives information about how much money has been used and whether it has been used according to the plan and the purposes as laid down.

The second source is the financial reports, the most important source of information, while in the budgetary system they are completely ignored. Accounting has relegated itself to the background. There are many pieces of evidence to back up the claim that accounting is confused. Here are a few: an account plan that makes it impossible to get at figures about the real total costs in terms of individual account groups; two main books and complicated booking; and the heart of it all, the use of the cash basis for accounting, with all its advantages and still greater drawbacks.

7.1 Fiscal information in budget document

Citizens, as taxpayers, finance the operations of local government, and have an interest in and right to know how the resources collected are used. The Local Government Units Financing Law says that the budget (and the annual account of the budget in which the execution of the general part of the budget is shown) has to be available to the population of the area, and is thus published in the official gazettes of the local units.

Apart from these reports, the local units are obliged to draw up main financial reports: balance sheet, account of revenue and expenditure, borrowing account and notes to the financial reports, which together make up an annual report, or an annual statement of accounts. Local units are obliged, by the end of February for the preceding year, to show their main financial reports to the competent regional office of the National Auditing Office and the office of the Payments Clearing Institute (the balance sheet, account of revenue and expenditure, for statistical processing). As well as the main financial reports, local units have to deliver to the Finance Ministry an annual account of the budget by the end of April for the preceding fiscal year.

The regulations also stipulate the obligation to draw up a half-yearly financial report. Local units do not need to send these reports to the Finance Ministry. The Instructions on how to draw up a half-yearly financial report of the budget and budgetary beneficiaries (*Official Gazette* 56/97) did state that half-yearly reports were to be supplied to the Finance Ministry. With the introduction of new Regulations, these Instructions have ceased to be in force, so now there is no legal obligation to make any half-yearly report to the Ministry of Finance.

Most of the financial information sought from the Finance Ministry by international organisations (about revenue, expenditure, grants and borrowing) are

gathered from the financial reports. The data sought by the IMF are based on the classification structure contained in its own *Government Financial Statistics*.

A problem is that the account plan of the budget does not make it possible to obtain total expenditure according to a purely functional or economic structure (since economic, functional and institutional classifications are all mixed). To obtain data according to functions and economic categories it is necessary constantly to adjust data from financial reports and other sources, which never gives a totally realistic picture of the state of affairs.

According to the requirements of the international organisations, Croatia is bound to determine and publish the quarterly gross domestic product. This would not be possible without the quarterly statistical report that the local units make via the form *Statistical Report of the Budget and Budgetary Beneficiaries* and give to the Payments Clearing Institute 20 days after the end of the period.

7.2 Performance information

In the fourth part we talked of the lack of measures to the success of implementation, that is, the lack of any indicators of success in the financial and accounting system. In line with this, the data about execution sent by the local units to the ministry, the National Audit Office and the Payments Clearance Institute do not differ substantially from the “planned and realised” structure.

Measurement. Half yearly and yearly a local unit makes a report about the execution of its budget. According to the Budget Law, the head of the executive branch of a local unit is responsible for the execution of the budget. He or she is bound to inform the authority about the execution of the budget for the first half of the fiscal year by the end of July, and then about the yearly execution by the following March 31. The authority is bound to report to the competent representative body about the yearly and half-yearly reports by 15 August and the next April 30.

The contents of the Execution Report have to be in line with the classifications of the accounts. The report will contain the initial and final balance of the budget’s account, the explanation of any significant discrepancies, data about all borrowing and debt management and data about the use of budgetary reserves and guarantees issued during the fiscal year.

An execution report is drawn up on the basis of data from the main financial statements. Since the execution report is also meant for the competent representative body, and not all the members are likely to have accounting skills, for the sake of intelligibility it is simplified and adapted to their needs.

Moved by the increasingly common demands by members of representative bodies for information about total expenditure by individual area of operations (infrastructure, culture, education and so on), some counties (like that of Split and Dalmatia), for the forthcoming year, alongside a report about the execution of the budget, also plan the making of a special report about execution per programme. This requires the creation of additional evidence and a different approach to accounting, because the required classification of accounts in the account plan of the Budget will not support such kinds of checks.

The Local Units Financing Law states that after the end of the year for which the budget has been made, the representative body has to adopt the annual accounts of the budget¹⁰ (not thinking here of the annual report laid down by the Regulations about financial reporting), which have a general and a special section.

With respect to the contents of the one and the other, it can only be assumed that the annual accounts are actually a report about the execution as stipulated in the Budget Law. What is very confusing is the lack of coincidence in the deadlines for the handing in of the report to the authority or the representative body of the local unit.

We should stress that local units separately check the execution of individual programmes and projects. Greater demands are made on local units to monitor those projects that are financed from the national Budget, or through the ministries (the planned resources coming within the framework of their allocations).

The Croatian Budget Execution Law, 2000, stipulates the obligation of providing reports about the use of resources transferred for capital investment. Local units send reports to the Justice, Administration and Local Self-Government Ministry (in 1999 to the Government itself) by the end of January for the preceding year.

During the year local units send the ministries various reports about resources spent on projects that are financed or jointly financed by a given ministry. Some of these reports include measurements and indicators of success of execution that depart from those standardly used, which are in the first place directed toward results. We can mostly find such indicators in investment projects in the infrastructure, because of the simplicity with which they can be applied (i.e., water mains extended expressed in kilometres, number of households additionally supplied with drinking water...).

Assessment. At the beginning of the year, no plans founded on indicators of successful execution that measure the quantity of goods produced, the quality of services and the result of every activity undertaken are laid down. As a result, it is not possible to make any evaluation of the efficiency of local units in providing goods and services for the population of their areas.

In the absence of any criteria no comparisons can be made among individual units with respect to the level and quality of public services provided.

Thus in the apportionment of subsidies from the national Budget there are criteria for comparison based on revenue realised. However, no comparison with respect to expenditure exists.

Alongside the prescribed criteria for obtaining subsidies from the county or national budgets, the government has also issued a Decree about the criteria for giving consent for communes, cities and counties to use subsidies from the national Budget (*Official Gazette* 51/98). The right to subsidy from the Budget can be claimed on the basis of a criterion composed of the number of persons employed in the bodies of the

¹⁰ The financial statement is: the state as seen in the balance sheet (assets, claims, obligations, sources of property); the revenue and expenditure account, the borrowing account, the report about own income that has been made, and the notes (in which the state of individual items is explained, in cases when there are any very great deviations from the planned amounts of the budget).

The Annual Report on Budget Execution shows the kinds and amounts of the revenue, expenditure and borrowing of the local unit during the year. The main problem lies in the lack of understanding of concepts because the annual (and half yearly) financial statements constitute the foundation for the drawing up of the annual (or half yearly) Report on Budget Execution.

unit, the amounts of employees' wages, or the remuneration for persons who carry out duties in the self-governing operations of the commune, city or county.

On the basis of an analysis of the criteria and documentation that is supplied in order to obtain consent for a subsidy from the national Budget, it would appear that equalisation is carried out on the basis of revenue. However, in fact this kind of fiscal equalisation is not carried out, although it is legally provided for.

8. Budget implementation

8.1 Cash management practice

At central government level, the cash management function is not divided from the management of debt. Both functions are linked in the Finance Ministry, organisationally, in a single administration – the Cash and Public Debt Administration. The problems with the management of the cash of the national Budget are very largely linked with the lack of any properly constructed state treasury system.

Government cash flows are split up in numerous accounts that the government keeps with the commercial banks. An additional problem inheres in the lack of existence of any effective government finance information system. There *is* a single treasury account, in the Croatian National Bank. And yet the majority of transactions and payments are made through the many accounts the government has at the commercial banks.

Local Government Treasury

The treasury system is not used at the local government level. The role of the treasury is played by ZAP. Most of the local government units have an account at ZAP. All the clearing payments are channelled through ZAP and their branches. On the other hand, local government units keep their money (deposits) at commercial banks. The head of local government is responsible for cash management and he authorises all payments from the local government account at a commercial bank. On the one hand there is ZAP, through which revenue collection is made, and on the other hand the LGUs keep their cash in banks which they use to pay their obligations. There are no clearly defined roles and responsibilities for cash management at the level of LGUs.

The numerous accounts of local government in the commercial banks have led to questions about the number of such accounts and the amount of the funds kept in them. From February 2001, the National Clearing System started working, and authority for payments clearing was transferred to the banks. However, the problem appeared of whether the banks would actually check to see whether taxes and contributions were paid. Hitherto, this had been done for the central and local government by ZAP. ZAP had so far controlled the payment and collection of taxes and contributions for the central and local government.

It is the same with cash management at local unit levels. The treasury system does not exist with local units either, and they make their payments, and manage their cash, via the many accounts they have with commercial banks and the Payments Clearance Institute. Neither is the treasury system employed in paying for the expenditures in the budgets of the local units.

The Payments Clearance Institute (known by its Croatian acronym of *ZAP*) is a public establishment that runs accounts for the central government, local governments, companies and the citizens. The data of the Finance Ministry are supplemented by data from *ZAP*; alternatively, these data are used for the establishment of the dynamics of the flow of budgetary resources. *ZAP* has prescribed accounts for the paying in of public revenue, the manner of paying this revenue, and reporting to its customers. *ZAP* offers the Ministry of Finance (i.e. the Tax Administration) data about revenue gathered for the central government, and county, commune and city budgets. Revenue is allocated from the *ZAP* accounts, in statutorily defined percentages, to budgetary and extra-budgetary beneficiaries. The key for the way shared revenue is allotted is laid down by the Tax Administration. *ZAP* collects fees for its services in connection with the paying in of revenue in line with the contract it has made with the Finance Ministry.

The direct administrative management of resources of the budget(s) is done through the agency of the heads of the executive branch (heads of communes, mayors and prefects) who are responsible for the gathering of budgetary revenue into the account of the budget and payments from the budget. Cash management, as function, does not exist, but is simply consigned to the finance and budget department of the local unit. Approval for payment from the budget accounts at banks (usually a number of them) is given by a member of the executive branch.

The central government controls only the balances of the local budgets (but not the cash available) through the accounting system.

From the national Budget, special purpose resources (subsidies) are given to local units. Subsidies are recorded in the prescribed accounts of the account plan and have to be spent for the purpose they were obtained.

By keeping transfers in prescribed accounts, the reduplication of resources from national and local budgets is avoided. Thus according to the account plan it can be seen from which budget the resources have been transferred, and for which purpose. Local units that obtain subsidies from the national Budget have to supply the government a report about the way they have used the resources transferred.

In the account plan, accounts in which the local unit's own revenues are recorded are also foreseen, especially revenue acquired in the market for the performance of basic activities that are analytically worked out in detail. In this way the national government can monitor the realisation of this revenue at local levels, that is, it can monitor the way local units realise their own revenue. Monitoring the resources of local units is facilitated by the fact that local units must supply reports for statistical requirements, reports that are handed to *ZAP*, where they are processed as well. These statistical data contain information about resources transferred and about the units' own revenues.

Budgetary surpluses and borrowing. If at the end of the year there are surpluses in the accounts of budgetary beneficiaries, they have to be returned to the national Budget. Of course, if the surplus is left over from transferred resources of the government for certain purposes, this surplus has to be spent for the purpose the resources were obtained for. If more resources than necessary were transferred, then as a rule this should be returned to the national Budget, although this is not regulated by the rules.

The amounts that remain in the accounts of local budgets are carried over to the following fiscal year. How they will be used in the following year is decided by the representative body. The proposer of the budget (i.e., the executive) proposes the

allocation of the surplus and the manner it is used. The representative body makes the final decision.

Budgetary resources at local levels can be borrowed, because the Budget Law stipulates that expenditures are taken to include the borrowing of budgetary resources. Loans, like all other expenditures, have to be planned. However, the conditions of borrowing are not regulated in detail.

8.2 Controlling the budget of service organisations (expenditures and own revenues)

The budget execution decision lays down the persons responsible for the execution of the budget: those who give orders for and directly execute budgetary expenditure, the head of the executive and the head of the budget and finance department, and the heads of departments that are financed from the local budget.

Budgetary beneficiaries cannot use resources for purposes not planned in the budget.

The budget and finance department is obligated to inform budgetary beneficiaries about the amount of resources allocated to them in the budget for the current fiscal year. The departments that are responsible for certain users (kindergartens, libraries, museums, theatres and so on) are obliged to give them the allocated resources in a special part of the budget.

Budgetary beneficiaries use the resources according to the annual financial plan and according to the dynamics laid down in their monthly, quarterly and yearly plans, which they supply to the budget and finance department of the local unit. Transferring resources from the budget is done according to harmonised plans of execution, but also according to the dynamics at which funds arrive in the budget. If there is any lack of harmony with the influx of funds into the budget, then the order at which transfers are made to beneficiaries has to be changed.

Through the Budget Law (OG 92/94) central government has laid it down that local units can take out short term loans with the banks for the purpose of financing shortfalls in the budget that can occur as a result of uneven dynamics in the inflow and outflow of the funds of the local budgets.

Unspent resources from the monthly plan of the execution of the budget are carried over into the same item for the next monthly plan for the execution of the budget. It is possible that the need to finance certain public expenditure not foreseen in the monthly plan might occur. Then this expenditure will be financed, but only with the consent of the budget and finance department.

The payment of resources for capital projects is regulated by the budget execution decision. In the national Budget, savings made in one capital project can be reallocated to another capital project, as can resources not spent.

The reallocation of resources is proposed by the competent administrative body that before doing so has to obtain the consent of the budget and finance department for the use of resources that are reallocated during the year from one capital project to another. That is, most often the transfer of resources is made in line with the deadlines for the execution of individual phases of projects. Resources for capital projects and

expenditures are transferred directly to the contractors and suppliers, or via the competent administrative department.

Every payment from the budget has to be documented, that is, there has to be verifiable documentation (invoices, contracts and the like), and such an accounting document has to be signed by a representative of the budget. This document also has to be checked, which is confirmed by the signature of the person who is authorised to do such checking.

Central government controls the balances of the local budgets through the accounting system

Local units are bound to submit half-yearly and yearly financial reports to the Finance Ministry (Administration for Budget Execution – Local Budgets Section), which carries out control of the financial reports and attempts to settle any irregularities in cooperation with the local units, or alternately sends criticisms to the department of internal supervision and control of the local unit.

The National Auditing Office carries out control of the regularity of the accounting operations of the local units. The Office informs the Parliament, government and representatives of local government yearly and half yearly about any irregularities ascertained. NAO cannot directly influence the correction of the irregularities because it has character of ex post control.

8.3 Audit system

The local unit's budget is audited each year by the National Auditing Office. In the Republic of Croatia there are 565 local units, (20 counties, 123 cities and 422 communes), all of them falling under the competence of the National Auditing Office. Apart from Central Audit Office, there are 20 branch offices located in the county centres.

Auditing of the budgets of local government units implies two kinds of audit, an audit of regularity and an audit of effectiveness. For the moment it is mainly regularity audits that are carried out, although each of them also contains elements of effectiveness auditing. Auditing procedures include the regularity of the application of the regulations in the planning, adopting and execution of the budget and submitting financial reports. The realisation of budgetary revenue is also audited, as is the execution of the budgetary expenditure and financial transactions of local units. Expenditure is taken to include all current and capital expenditure financed at the level of the local unit.

Auditing procedures investigate the documents, papers, reports, internal control systems, accounting and financial proceedings and other records to check whether the financial reports give a correct account of the financial position and the results of the financial activity of the local units.

Local units draw up reports about the execution of the budget. Fundamental financial reports are also given to the Auditing Office, twice a year. Half-yearly reports are delivered by 15 July, and annual reports are given in by the end of February for the preceding year.

After receiving the report, and pursuant to the audit of the budget and the operations of the local unit that has been carried out, the national auditors draw up a report about the audit. This is sent to the representative and to the representative body of

the local unit. Once a year reports about audits of local units that have been carried out are submitted to the House of Representatives of the Parliament.

For the moment, no prior auditing is carried out in the local units, only post hoc audits.

Local units, apart from submitting fundamental financial reports to the National Audit Office are bound to submit an annual report to the Finance Ministry, at the latest by the end of April for the preceding year.

There is also an obligation to submit semi-annual and annual financial reports to ZAP for statistical processing. These reports are submitted at the same time as reports are made to the Audit Office. In line with the programme of statistical research determined by parliament, ZAP carries out the processing of data from the main financial reports.

Budgetary and Internal Supervision

A local unit is obliged to set up some form of internal control (Regulations about budgetary control and internal control, *Official Gazette* 92/96). Internal control has to be carried out to check on the regularity of the use of budgetary resources and the application of laws and regulations. Yet, in most local units, there is no organised internal control. The basic reason for this is the lack of well-qualified staff.

The possibility of taking on commercial auditors is not foreseen by the law. The auditing of companies in which the local government unit is the major or a partial shareholder is carried out by the National Audit Office. The deadlines for such audits are neither stipulated nor defined. Audits depend on the programme of work of the National Audit Office.

However, these companies are also subject to commercial auditing, like other privately owned companies. The time for the performance of commercial auditing depends upon company size. Large and medium-sized companies (if organised as joint stock companies) must be commercially audited once a year. The auditing of small companies is done every third year. Other companies, not organised as joint stock companies, are subject to national auditing in line with their own regulations and articles of incorporation.

Briefly, The National Auditing Office carries out regular audits of the operations of the budgets of all the local units. There is a detailed analysis of the budgets of the local units, and findings about the audits done are delivered to Parliament and the government. The problem is that the local government units themselves are not informed about the findings of the national auditing, nor do they obtain a report of the auditing of their budgets. Thus, in 2000 for the first time, the NAO published a 2030 page report about the audits made of the budgets of local units in 1999, and gave short comments about the audits for 1998 and 1998. It can be said that the NAO has carried out its business correctly, however the question is to what extent the findings of the national auditing are really used and applied in correcting the irregularities in the operations of the budgets of the local units.

9. Capital budgeting

In Croatia the government has never seriously dealt with the planning of public investment, nor has a total approach to the financing of capital projects at the local unit level ever been addressed. Only at the beginning of 2000, for the 1996-1999 period, for the first time, government made a complete list of capital investments per sector made. Even this list did not find its way to the Finance Ministry, and the decision-makers in the Finance Ministry are not acquainted with the list. It is interesting to emphasise that the list was drawn up and signed by the government of the Republic of Croatia

In consequence of this kind of information barrier the competent institutions – and primarily the Ministry of Finance – find it difficult to control the extent to which work on capital projects in the local units is carried out and financed.

Capital projects are not grouped into programmes of public investment. Such a programme should contain the general framework for the overall development objectives of the country and the macroeconomic framework, a description of strategies and planned investments per sector, as well as the outline of individual projects. Such an outline should contain the description of the project and its place, the total costs of the project, the annual phases, the financing and the costs in domestic and foreign currency. Capital investments are not analysed so as to determine the relation of capital to current investment expenditure within the main programmes.

Up to 2000, government focused attention on new investments, ignoring the costs of current and investment maintenance of previous projects. There are many factors that brought about this condition – for example the belief that only new investment has an effect on economic growth, the little importance attached to such costs in the national Budget for current and maintenance costs politically less visible than new investment projects, and the absence of data about the state and magnitude of existing assets. It is questionable to what extent cost benefit analyses and estimates of public investments are used.

Nevertheless, even alongside such problems, in the sequel we shall address the basic characteristics of the planning and financing of capital projects at the level of local government.

9.1 Capital planning methods

During the preparation of the national Budget, the Finance Minister sends budgetary beneficiaries, and every local unit, the *Circular*, in which the beneficiaries are called upon to set about planning their part of the budgetary expenditures. Local units should draw up a detailed proposal of requests for budgetary resources for financing activities within their sphere of competence.

Particular attention is paid to the requests for the financing of capital investment and projects, on ready provided forms. In the planning of capital investment, there is a difference between direct capital investment and capital projects, with respect to type of investment.

Direct capital investment has a life of one year and according to its value does not exceed the set framework (direct capital investment consists of equipping a building, procurement of telecommunications equipment and the like). *Capital projects* are long-term investments of great value (e.g., the building of motorways, water mains and the like).

In the procedure for registering capital projects, new projects have to be clearly distinguished from projects that are under way. The capital part of the Budget is first of all allocated to projects under way and reconstruction projects, and then new projects in line with the criteria and priorities settled upon by the government.

Applications for capital investment and capital projects are submitted to the appropriate ministries, which decide which requests to accept and include within the ministry's proposal for the budget. All requests for the financing of capital expenditures and projects up to the middle of 2000 are kept in the Capital Projects Registry at the Finance Ministry. Substantiated requests for budgetary resources are delivered to the Finance Ministry by the end of September of the current financial year.

While making a decision about investing in a capital project, a unit of local government faces a dilemma, for several reasons. First of all, capital investments and investment projects are long-term investments that require the earmarking of very large sums, of the kind that local governments do not have. Secondly, a whole series of requests for capital investment is addressed to the local government, only a few of which can be approved. By choosing projects on the basis of planning, programming, financing and debt management, a local unit would find it easier to make a decision about investment. If to this were added a quality cost analysis, a scheme of capital investment might be drawn up according to the criterion of importance, there being a range from urgently needed investment to investment the feasibility of which is dubious. Unfortunately it is not done so.

Planning and financing capital projects in Croatia represents a problem that local government must seriously come to terms with. In the process of drawing up the national Budget, a local unit, at the beginning of each calendar year, submits to the appropriate ministries requests for the funds necessary for given capital projects (e.g., for the building of a school, one asks the Ministry of Education). This means that funds are planned only for a one-year period, ignoring the fact that capital investment is a long-term affair. Although there is no legal barrier to their being made, long term plans of capital investments are not possessed by local units. The planning of capital projects of local units is primarily restricted by the lack of the necessary sources of financing, which means that capital investment is reduced to mere stopgap coping with emergencies. However, it is precisely the elaboration of an investment plan that would enable a local unit to carry out consistent long-term economic development; in other words, the risk of uncertainty and quick-fix measures would be avoided.

A local unit largely carries out the financing of capital projects with funds from the national Budget, funds from its own budget, and other sources of funds. Of totally approved budgetary resources (national and local), no more than 10% in all are spent on capital investment, the remaining 90% being used to cover current expenses. The financing of capital projects with other means (loans, concessions and so on) is impossible in conditions in which the local unit is still grappling with the problems of its own survival.

Furthermore, although there are enough administrative personnel, there is a lack of highly competent and well-qualified administrative personnel at the state and local level, of people capable of drawing up investment plans and following them through.

Several years back, local units started on drawing up development guidelines. However, the guidelines were not accompanied by the drawing up of detailed plans of development, on the basis of which long-term capital investment plans could be made.

A step forward in the planning, financing, implementation and monitoring of capital expenditure can be seen in the Finance Ministry's announcement that a Capital Project Monitoring Department will be set up, which would finally give such investments the importance they deserve.

9.2 The financing of the capital projects of units of local government

Local governments finance capital investment largely with resources from the national Budget. They do not have the financial potential for any very large investment undertakings, nor are their revenues large enough for serious financing. The Local Government Financing Act (*Official Gazette* 117/93) enables local units to open separate accounts for the financing of capital projects. However, since the Budget Law was passed (*Official Gazette* 92/94) this provision is no longer in force, because such expenses can be financed only via the budget of the local unit. In reality, funds for the financing of capital projects are mainly allotted from the central Budget to the competent ministries. These ministries allocate funds to local projects, usually in line with some key and usually according to priorities. The funds can be given via the Croatian Bank for Reconstruction and Development (CBRD) or via the commercial banks. The financial reports of the CBRD show that in the 1992-1995 period almost 60% of funds were sent to the war-torn areas, mainly for reconstruction.

The fiscal capacity of most counties is below the average. For this reason, capital projects at the local level are financed centrally, from the Finance Ministry and other competent ministries. Local government units do not have separate capital and current budgets. They keep capital and current items within one budget. Furthermore, a considerable part of the current expenditure items are kept within capital expenditure items of the budget.

Local units can take on loans at home and abroad, but only with guarantees obtained from the Finance Ministry. Long-term borrowing is possible for investment in facilities and equipment, and for improvements in the work of the local government authorities. Local government can also issue bonds. A decision about this is taken by the local government, but it has to submit a detailed financial plan, and seek the approval of the Finance Ministry. Foreign loans can be taken up to at most 10% of the budgetary expenditure of the preceding year, again with the consent of the Finance Ministry. Before this, local government units have to obtain guarantees for the regular meeting of loan obligations, and total annual obligations abroad cannot exceed 30% of budgetary expenditure for the preceding year.

The main obstacle to any major activity by local government in public investment is the level of the funds they have available to them. On the one hand, there are local units that cannot even finance all their current expenditure without direct transfers (subsidies) from the central Budget. On the other hand, there are economically more powerful local units that are attempting to finance their capital projects independently. Here one might mention the example of Istria County and the city of Opatija (and the intentions of Zagreb, Varazdin County and Kaštela), which, by issuing bonds, are financing capital projects like the construction and repair of the hospital, making good the sewage system and so on. Local initiative is, however, very largely under the constraints of the resources available.

Priorities concerning local involvement

All local units (communes and cities) are bound to draw up financial plans for the construction of capital projects in a given year. They send these plans to the counties that co-ordinate them and draw up plans for the financing of all the capital investments in the area of the country. After that the counties send the plans to the ministries competent for the construction of the given capital project – e.g., for schools to the Ministry of Education. The competent ministries put together all the plans they get from the counties and send them to the Finance Ministry, which makes a proposal of the capital projects that have to be financed in the coming budgetary year.

Although it can be said that coordination does formally exist during the financing of capital projects at the level of the local units, the question is how much this is respected in practice. It is a fact that in Croatia there is no systematically made list of capital projects at the level of the local units, nor is it clear to what extent these projects have been completed, or how many of them are still under way. The last fairly completely list of capital projects at the local unit level was made in 2000 for the 1996-1999 period. For this reason, formal, planned equalisation of the financing of capital projects does exist, the key problem however being in the monitoring of their implementation.

Appendix I

TABLES

Table I. Functional classification of expenditure of the central government, communes, cities, and counties in 1999, in %

Title	Central government	Communes	Cities	Counties	Local government total
1. General public services	6.43	31.55	18.10	32.39	21.30
2. Defence	11.86	0.00	0.00	0.00	0.00
3. Law and order	9.77	1.00	0.35	0.69	0.48
4. Education	12.07	7.43	12.59	7.14	11.36
4.1. Pre-school education		5.69	10.49	0.44	8.90
4.2. Elementary education		1.03	1.24	4.89	1.54
4.3. Scholarships to pupils		0.51	0.42	0.59	0.45
4.4. Secondary (high) education		0.18	0.27	1.02	0.32
4.5. Tertiary (university) education		0.02	0.17	0.19	0.15
5. Health care	1.01	0.22	0.63	6.39	1.10
5.1. Hospital affairs and services		0.01	0.00	2.76	0.25
5.2. General hospital services		0.01	0.00	2.23	0.20
5.3. Specialised hospital services			0.00	0.53	0.05
5.4. Health centres		0.02	0.28	1.41	0.34
5.5. Health protection affairs and services			0.29	1.47	0.38
6. Social security and welfare	23.85	2.13	3.31	2.73	3.09
7. Housing and utility affairs and services	4.28	25.21	25.09	7.48	23.52
8. Recreation, culture and religion	1.78	6.55	18.32	13.08	16.18
9. Agriculture, forestry, hunting and fishing	2.63	1.24	0.32	3.24	0.71
10. Mining, industry and construction	5.95	8.16	2.77	4.58	3.69
11. Transport and communications	11.19	10.83	14.15	9.32	13.24
12. Other business affairs and services	1.39	4.55	2.64	9.71	3.55
Other expenditure	7.80	1.12	1.73	3.26	1.78
Total	100	100	100	100	100

Table IIa. Current expenditure of local units in terms of economic categories in 1999 (%)

Title	Communes	Cities	Counties	LGUs total
1. Wage costs	23.66	24.89	17.47	24.04
2. Employers' contributions	4.31	4.83	3.07	4.59
3. Purchases of goods and services	48.04	36.91	30.24	37.74
4. Interest paid	0.92	2.56	1.61	2.25
5. Subsidies and other current transfers:	23.07	30.81	47.62	31.38
Subsidies	2.10	9.99	4.49	8.44
Transfers to other levels of local self-government and administration	0.41	0.63	12.44	1.71
Transfers to non-profit making institutions and associations	16.47	18.81	25.42	19.13
Transfers to the population	4.09	1.37	5.26	2.09
Transfers abroad	0.00	0.01	0.01	0.01
Total	100	100	100	100

Table IV. Tax revenues according to local government level in % in 1999

Title	Communes	Cities	Counties	A	b	c	d1	d2	d3	d4	e
Income tax and surtax*	63.52	65.80	50.63						X		X
Profits tax	9.44	20.77	33.84						X		X
Second home tax	5.33	0.53	0.00	X			X				
Inheritances and gifts tax	0.00	0.02	0.72						X		X
Real estate commerce tax	12.41	8.31	0.06						X		X
Trading name tax	3.77	1.74	0.00	X			X				
Public area use tax	2.07	0.44	0.00	X			X				
Consumption tax	2.51	1.10	0.00	X			X				
Organisation of entertainment and sporting events	0.00	0.04	0.00	X			X				
Advertisements tax	0.76	0.38	0.00	X			X				
Road vehicles and vessels tax	0.00	0.68	13.70	X			X				
Gambling tax									X		X
Other taxes	0.18	0.20	0.58	X			X				
Total	100	100	100								

a) local units set the tax base and the rate

b) local units set only the rate

c) local units set only the tax base

d1) local units (municipalities) determine revenue split

d2) distribution of revenue (tax) can be only with the approval of the local unit

d3) division of tax is laid down by statute, and can be changed only at the initiative of central government

d4) the central government undertakes division of tax as part of the annual Budget

d) central government determines the tax bases and rates of local taxes

* surtax rate set autonomously by local units (there is a limit on rate for a lot of taxes).

Table V. Revenues from user charges and administrative fees in %

Title	Communes	Cities	Counties	Total
National stamp duty revenue	0.44	6.41	76.64	7.81
Road charge	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
Special fee (for putting up slot machines, opening entertainment clubs and organising gambling)	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	100	100	100

Table VII. Capital expenditure and capital revenue of local units in 1999.

Title	Total	in %		
		Communes	Cities	Counties
Capital expenditure	100	100	100	100
1. Acquisition of capital assets	77.97	83.88	82.56	24.32
2. Purchase of reserves (strategic reserves for market regulation)	0.02	0.01	0.00	0.13
3. Purchase of land and non-material assets	4.06	5.87	3.97	1.13
4. Capital transfers at home	17.96	10.24	13.46	74.42
5. Capital transfers abroad	0.00	0.00	0.00	0.00
Capital revenue	100	100	100	100
1. Revenue from the sale of capital assets:	59.55	31.35	74.79	4.92
1.1. Revenue from the sale of shares	0.52	0.18	0.30	3.97
1.2. Revenue from the sale of movables and immovables owned by the local unit	38.24	24.26	46.84	0.53
1.3. Revenue from the sale of publicly owned housing	20.79	6.92	27.66	0.41
2. Sale of land and non-material assets	4.86	6.54	4.55	1.97
3. Capital transfers from home	9.77	14.54	6.34	27.66
4. Capital transfers from abroad	0.01	0.05	0.00	0.00
5. Capital grants	25.82	47.52	14.32	65.44

Appendix II

Questionnaire

about the budgetary processes in local self-government and administration units in Croatia

This questionnaire is meant for the **heads of the financial services** in local self-government and administration units, its purpose being an analysis of the quality of existing budgetary processes and of communications between the local government units and the Finance Ministry.

Please answer the questions objectively and frankly. The data deriving from the questionnaire will be used only for the purpose of analysis.

1. You draw up the plan of the budget for the next year on the basis of (please circle one or more answers):

- a. the plan for last year
- b. last year's execution
- c. the guidelines of the Ministry of Finance (Guidelines for the preparation and drawing up of the budgets of counties, cities and communes for a given period)
- d. your own estimates of the trends in public revenue and expenditure for the coming year
- e. something else_____.

2. In what way do the guidelines of the Ministry of Finance take part in the formation of the budget for the following year?

3. The guidelines are (circle one or more answers):

- a. clear
- b. applicable
- c. unrealistic
- d. too general
- e. _____

3a. Give one or more example(s) from the guidelines bearing out the answer given to Q. 3

4. In drawing up the budget for 2000, did you take into account the following estimate from the 2000 guidelines?

- a. a 3% rise in the rate of profits tax (circle the answer)

Yes

No

Why?_____

b) a 6.5% rate of growth of nominal GDP, 3.5% rate of growth of real GDP, and a 3% rate of inflation (please circle the answer):

Yes

No

How? _____

5. What objectives do you set up during the making of the budget?

6. At the end of the year do you measure the realisation of the objectives established (circle the answer):

Yes

No

How? _____

7. Do you evaluate the work of your employees?

a. daily

b. monthly

c. quarterly

d. annually

e. not at all

f. something else _____

8. What work incentives do you provide for your employees?

9. Do you plan special projects and programmes (circle the answer)

Yes

No

9a. If the answer to Q. 9 is yes, please give some examples.

10. For how many years in advance do you determine the expenditure and burden of the total budget for long-term projects and programmes?

a. for a single year

b. for three years

c. for five years

d. for the whole time of the duration of a project

e. _____

11. In which way do you evaluate and monitor the success of the execution of projects and programmes as defined in Q. 10?

12. Do you have an example of a long-term programme or project that you abandoned after some time (circle the answer)?

Yes No

Why? _____

13. The citizens can see your financial reports (please circle one or more answers):

- a. via the Internet
- b. via brochures or other printed matter
- c. on special application
- d. financial reports are not for the public
- e. _____

14. Which data about the budget (approving and executing) do you submit to the Ministry of Finance?

15. What figures do you send during the year to ministries (specify data and ministries)?

General details:

16. The position of the person filling in the questionnaire.

17. The unit of local self-government and administration for which the questionnaire has been completed (circle the answer)

- a. county
- b. city
- c. commune

18. The size of your unit (population and area)

population: _____

area: _____

19. Size of the budget in 2000: _____

Appendix III

Analysis of the Questionnaire

Budgetary Processes in Local Government Units

For the sake of as full a handling as possible of the topic of the project *The Local Government Budgeting*, a questionnaire entitled *Budgetary Processes in Local Government Units* was made. This questionnaire was meant for the heads of the financial and budget departments of local units. The objectives of the questionnaire were an analysis of the quality of existing budgetary processes and of the communications, or collaboration, between local and central government (particularly the Ministry of Finance). At the beginning we erected certain hypotheses that we wished to confirm or knock down through the analysis of the answers to the questionnaire.

The Sample

The base set is the total number of local units and their total budgetary revenue in 1999. In this year there were:

- 422 communes, with total budgetary revenues of 1,6 bill kuna,
- 123 cities with budgetary revenues of 7,5 bill kuna, and
- 20 counties with budgetary revenues of 1,1 bill kuna.

By the random sampling method, a sample was composed consisting of:

- 17 communes with a total budget of 120 mill kuna (4% of communes with 8% of total revenue),
- 15 cities with a total budget of 800 mill kuna (12% of the total number of cities with 11% of city budgetary revenues),
- 9 counties with a total budget of 357 mill kuna (45% of the total number of counties with 33% of total county budgetary revenues).

In the questionnaire, questions of the open-ended type prevail. For this reason, because of the complexity of the analysis (reading all the answers, making conclusions, picking out some of the most interesting analyses), the sample was small. However, in terms of range of data, it is greater than the usual for this kind of research technique.

The Hypotheses

The following hypotheses were erected for testing:

1. The planning of the budget takes place with the use of the simplest possible budget-making techniques, in which the monitoring of the success of the execution of the budget is based upon the planned-realised relationship. The main objective is not the satisfaction of the needs of the population, rather the execution of the plan.
2. There is no systematic monitoring of the programme use of programmes resources, and everything comes down to control of expenditure and keeping it within planned levels.

3. Planning of the budget is short-term (the perspective is short-term). Plans are made for one or three years ahead (according to the Budget Law, revenue and expenditure are planned for the next year, and foreseen for two more years).
4. Local units do not have any system for planning and evaluating the work of their employees, and the legal approaches are used for pay rises according to the everyone-the-same-proportionally approach.
5. Local units inform the local population only in line with the regulations. Information about the budget (revenue, expenditure, and borrowing) is largely not given to the electorate. If they do get it, the information is usually unclear.
6. The collaboration of the local units with central government is within the statutorily defined framework, with the proviso that the provisions of the law (which often overlap and are unintelligible) are applied and interpreted in different ways.

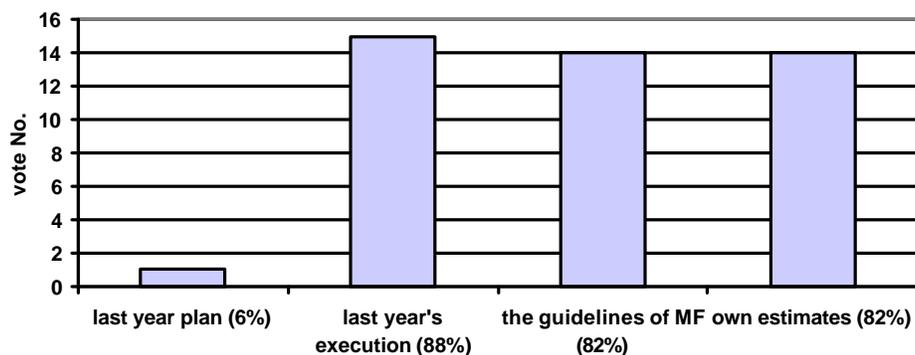
Analysis

Q. 1. *Do you draw up the plan of the budget for the next year on the basis of: the plan for last year, last year's execution, the guidelines of the Ministry of Finance (Guidelines for the preparation and drawing up of the budgets of counties, cities and communes for a given period), your own estimates of the trends in public revenue and expenditure for the coming year, or something else?*

Respondents were able to circle several options answering this question. Most of the communes (70%) based their budget plan on a combination of last year's execution, Finance Ministry guidelines and their own estimates. Three communes (17%) did not at all base their plan on the Finance Ministry guidelines.

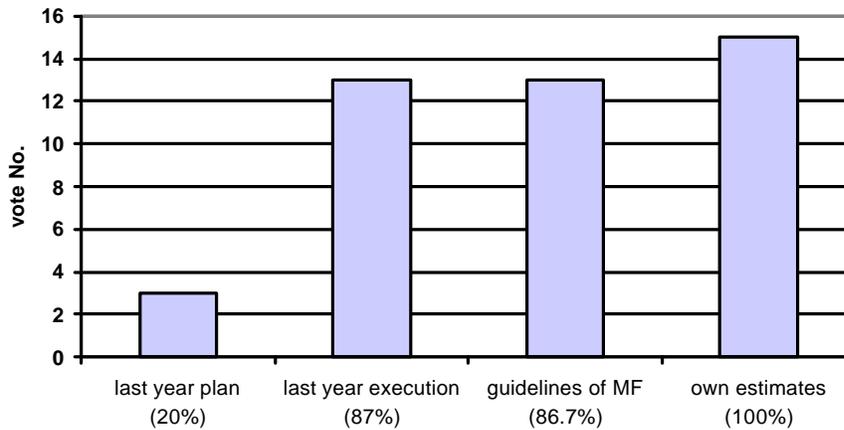
The following figures show, which part, is most used in drawing up the plan for the budgets of the communes.

Communes



Cities, on average, circled three answers each. The following figure shows the responses of the cities.

Cities

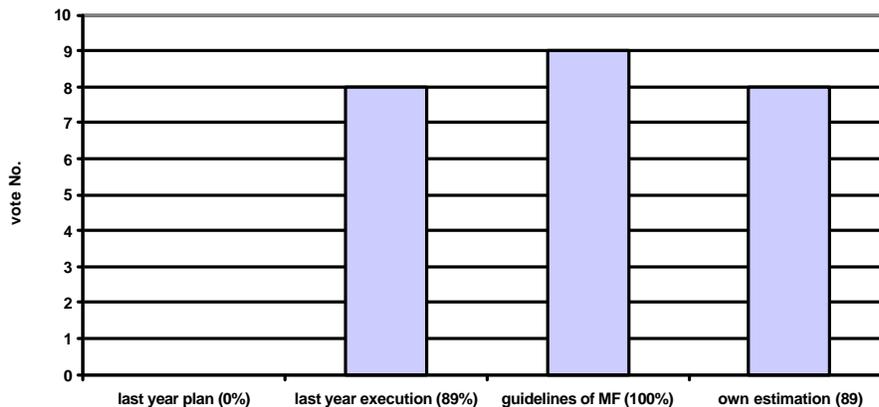


The answers of cities and communes are more or less identical. With both communes and cities we see that last year's budget plan is least used as a base for the planning of the budget for the forthcoming year. Last year's execution, the guidelines of the Finance Ministry and their own estimates about the trends in public revenue and expenditure for the year to come are the foundations relied upon during the making of the budgets and communes for the next year.

This shows that the budgetary processes in cities and communes are connected, and that with additional training, and changes in the Account Plan of the budgets, some start might be made to more advanced budget-making techniques.

The counties, unlike communes and cities, do not take last year's plan at all into account as a basis for making the plan for the next year. They most use the guidelines of the MF, and then their own estimates.

Counties



Q. 2. In what way do the guidelines of the Finance Ministry figure in the formation of the budget for the following fiscal year?

All local units (cities, communes and counties) gave similar answers.

For the communes, the guidelines and their basic indicators:

- *set the framework within which the budget is drawn up,*
- *ensure the application of statutory regulations (the Budget Law, other special laws from the region of finance, the findings of the National Auditing Office, and byelaws dealing with budgetary accounting),*
- *help in the planning of profit and income tax.*

Cities answered in the following way:

- *6 cities (40%) answered that the guidelines are the general framework for drawing up the plan of the budget, and do not essentially affect the estimate of the city revenues,*
- *9 cities (60%) answered that they used the guidelines when planning the amounts of joint or shared revenue (data about trends in profit and income tax), on the basis of data about rise in GDP, for the estimate of non-tax revenues, and in restriction of expenditure.*

We would particularly highlight the answer of one city that considers the guidelines are useful in the creation of the budget and the realistic evaluation of revenue and expenditure, and a means of giving well-argued rebuffs to beneficiaries whose demands are mostly unrealistically high.

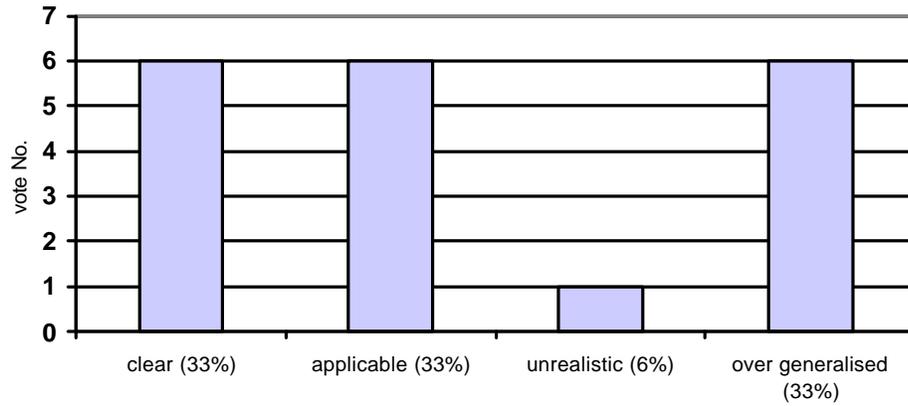
67% of counties answered that the guidelines helped them in the planning of the budget, particularly revenue from profits and income taxes. The other 33% of counties said that the guidelines were general and represented global average trends, serving them only as a framework for the drawing up of the budget.

We highlight two interesting answers from the counties. 1. The guidelines determine what the budget should be like and what should be stuck to in the drawing up of the plan of the budget, and 2., the guidelines are general and are repeated year after year. An exception is the part that relates to anticipated income and profit tax rates, and rate of inflation.

Q. 3. Are the guidelines a) clear b) applicable c) unrealistic and d) over generalised?

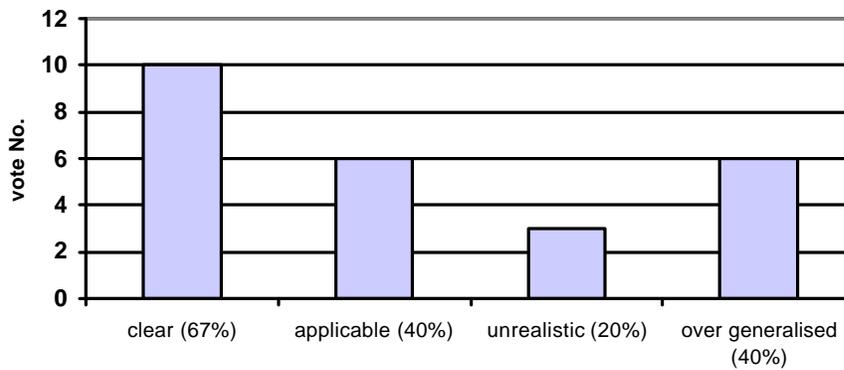
From the 17 communes, 19 answers were circled (15 circled one answer, two circled two each). Statements claiming that the guidelines were clear, applicable and too general gained an equal number of answers (6 each).

Communes



To the same question, the cities gave 25 answers. This shows that the cities on average gave two answers each.

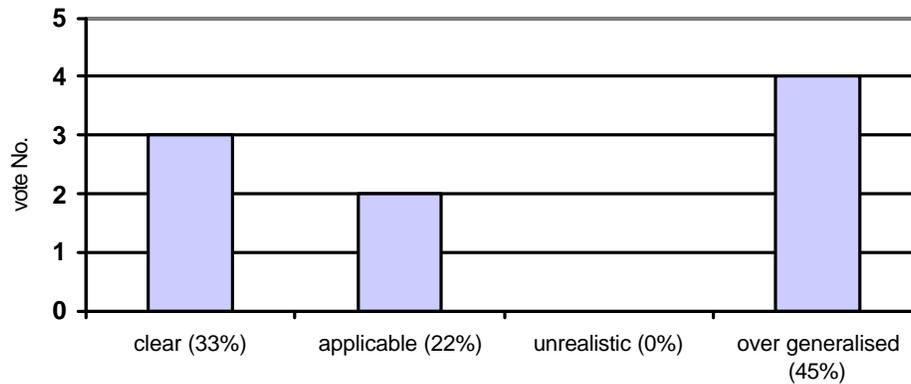
Cities



Mostly, the cities thought the guidelines were clear. However, six cities answered that the guidelines were applicable, though over-generalised.

Each county answered marking just one answer. We highlight three counties that answered that the guidelines were unclear, always the same, the data in them being known and defined by statute.

Counties



We can see that the counties did not evaluate the realism or lack of realism of the guidelines, but considered them to be over-general.

Q. 3a. Give examples from the guidelines that bear out the answer to the previous question.

Almost all the local units chose to bear out the thesis that the guidelines are too general. We pick out some of the answers.

One of the communes thought that the guidelines for communes, cities and counties should be kept separate, because of differences in investment and revenue. One city stated that the basic macroeconomic indicators are essential for drawing up the national Budget, but that they are not really useful in the local context because of the specific factors of each unit

Some counties say that funds from the national Budget (grants) make up about 20% of county budgets. However, in the guidelines, it is not stated how much of these funds will be given from the national Budget in 2001 to 2003. It is the same case with the changes in the tax laws (profit and income), which are not mentioned in the guidelines, and the counties do not know whether their share in the shared taxes will change.

The answers that we pick out as being interesting show that the guidelines are too general, and that the Finance Ministry should pay attention to the specific features of all the local units (communes, cities, counties) and adopt the guidelines to the individual levels of the local units. Thus, for example, for the county, it is important to know how much money is planned to be transferred from the national Budget, because the realisation of its plans depend on this.

The guidelines for the preparation and drawing up of the budgets are first sent by the Finance Ministry to the counties and the city of Zagreb. According to these guidelines, the counties draw up the draft estimate of their budgets, and then make guidelines for the communes and cities in their areas. However, from the answers of the communes and cities, it would appear that the counties do not meet their obligations, and do not draw up guidelines with the micro-indicators for the cities and communes in their areas. This is the basic reason the communes and cities find the guidelines too general and only partially applicable. They are, however, primarily meant for the counties.

Q. 4. In drawing up the budget for 2000, did you make use of the indicators from the guidelines: a) growth of profits tax with a rate of 3%, b) rate of growth of nominal GDP of 6.5%, real GDP of 3.5% and rate of inflation of 3.0%?

The communes gave the following answers:

Communes

A 3 % rise in the Rate of profit tax	7 (41%)	9 (53%) ¹¹
a 6,5% rate of growth of nominal GDP, a 3.5% of growth of real GDP and a 3% rate of inflation	7 (41%)	10 (59%)
	YES	NO

56% of communes in their budget making for 2000 did not take into account the estimate of the growth of profit tax of 3% given in the guidelines. 59% of communes did not take into account the estimate of the growth of nominal GDP of 6.5%, the growth of real GDP of 3.5%, and the rate of inflation of 3%.

The answers show that more than 50% of communes in planning the budget do not use the basic macroeconomic indicators. It is interesting to look at the reasons. For example, three communes planned for a greater rate of profit tax. One commune estimated there would be a greater rate of economic growth in the commune than in the state as a whole. A second stated that the real rate of profit tax would be greater than 3%. A third again that the growth rate of tax would be much greater, and yet in comparison with the budget, small. Three communes consider that the given rates of profit tax are overestimated.

As many as seven communes (41%) answered that they used the proposed rates of growth of GDP and inflation in drawing up their budgets. However, they did not answer

¹¹ One commune did not answer, so we do not have 100% results.

how. Only four communes (24%) gave it even a general answer. Only one commune stated that it was necessary to estimate the rate of the growth of inflation, because a large part of its own revenues were fixed to the exchange rate of the German mark. For this reason it can easily be concluded that the communes do not know how to use the given rates of growth particularly of nominal and real GDP.

How the cities used the given indicators will be shown below.

Cities

growth of profits tax with a rate of 3%	6 (40%)	9 (60%)
growth of nominal GDP of 6.5%, of real GDP of 3.5% and inflation of 3%	9 (60%)	6 (40%)
	YES	NO

As reasons why they did not pay attention to a rate of increase of profit tax of 3% in their planning, the cities state the constant reduction of the share of this revenue in their budgets. It is why they founded their plan on their own estimations. Of the six cities that based their plan on a growth of profit tax of 3%, not one said why. The other five gave as reasons their legal obligation to apply the guidelines. One city said that planned revenue from profit tax was reduced by 60% when they carried out a rebalance (revision).

The cities used indicators about growth of GDP and inflation in planning their wages, the compensation to the councillors of the city authority, and as a guide while planning revenue from the utility charge, income tax and other revenue. One city said that the real financial situation in the town is different, and that they do not expect such a rate of growth. We must assume that this city calculated its own indicators, for the planning of the budget.

Local units partially use the indicators given in the guidelines. They consider the guidelines as an outline that gives indicators for the planning of expenditure and revenue. However, local units ought to base their planning of their budgets on their own indicators. Local units that get transfers from the central government Budget have to keep to guidelines about trends in wages and expenditure. For this reason they have to keep up with expenditure for given items.

The *counties* used the macroeconomic indicators in the following way:

Counties

growth of profits tax with a rate of 3%	6 (67%)	3 (33%)
growth of nominal GDP of 6.5%, Of real GDP of 3.5% and inflation of 3%	4 (44%)	5 (56%)
	YES	NO

The counties use indicators of growth in tax more than those of GDP or inflation. The counties that did not use the estimate of growth of rate of tax on profits considered that their economic indicators showed reduced revenue from profit tax and so did not plan any increase.

67% of counties used the profits tax rate rise from the guidelines as a base, but also used their own estimates in the calculation of the expected rate. The other 33% used the estimates from the guidelines because it was the proposal of the finance minister. One county said that it would be better if they had not used this indicate, because on rebalance (revision) they had had to reduce revenue from this source.

44% of counties did not explain how and why they did not use indicators about the trends in GDP and inflation. The other 56% gave as reason for using these indicators: 1. the total estimate of the expenditure did not exceed an increase of 6,5%; 2. because of the realism of the plan, and in line with these estimates they planned their revenue, operational expenses and long-term obligations deriving from projects.

As their main reasons for not using the indicators about trends in GDP and inflation counties gave the allegation that these were not accurate (e.g. too low a rate of inflation), or that the indicators were unrealistic because of the decline in economic activity in the county.

An analysis shows that even the counties to a large extent do not use the indicators from the Finance Ministry guidelines. And yet, almost all the local units use the guidelines as a signpost in planning their budgets, which they usually adjust according to estimates and the use of their own indicators. Many counties (58.3%) state that they used the indicators about the rise in the profits tax rate because they were given in the guidelines and so they had a legal obligation to use them.

Q. 5. What are the objectives of drawing up the budget?

47% of the *communes* gave a realistic estimate of revenue and receipts as the goals set up while drawing up the budget. It is interesting that as many as 18% of

communes thought that the primary objective of the budget was to meet all the statutory obligations. However, there are those that go one step further, with 22.2% of communes endeavouring to satisfy in their budgets the needs of the people for infrastructure. Only one commune stated the global objective of satisfying the needs of the citizenry.

73% of *cities* stated the planning of revenue and expenditure, the reduction of expenditure in line with revenue realised, and saving as objectives. 27% stated increase of the quality of life in the city, the development of the city, and the satisfaction of public needs as the objective of the budget.

56% of *counties* stated, as the objectives that they wished to achieve with the budget, the realistic planning of revenue and expenditure, and the satisfaction of statutory and contractual obligations. One county stated that the aim was tightening the fiscal discipline of persons under obligations to the budget with respect to improving collection of revenue so that they could finance the planned expenditure. 44% of counties gave as their objective the development of the county, putting into practice the welfare programmes, the development of culture, education, the stimulation of SME. However, none of them mentioned population satisfaction.

Only one county has long-term plans, and the budgetary objectives of this county are defined by the county's long-term development plan for the period between 2001-2015.

The next question was asked for us to be able to obtain as complete as possible a picture of the objectives, particularly the way in which their accomplishment was measured.

Q. 6 At the end of the year do you measure the realisation of the objectives established?

As many as 70% of *communes* (12% did not answer, because they do not monitor the accomplishment of the objectives set up) monitor the accomplishment of objectives set up at the planned-realised level.

The *cities* measure the accomplishment of their objectives to a greater extent. As many as 87% of the cities do this, and 13% do not, without giving any explanation of why they do not.

With all cities (and with communes) measurement of the accomplishment of objectives comes down to a comparison with the plan. 27% stated that the report about the execution of the budget (submitted to the town council) is also an evaluation of the degree of success. One city stated that it draws up and adopts a report about programmes for the accomplishment of which funds were planned in the city's budget.

All counties (100%) measure the accomplishment of their objectives. 78% of counties consider measuring accomplishment as a comparison of the plan and the realisation of the budget. One of the counties stated that it monitors execution daily, and informs the authority and the assembly of the county about the execution monthly. 22% of counties analyse the fulfilment of the programmes (welfare, public needs in culture, information, sport and so on).

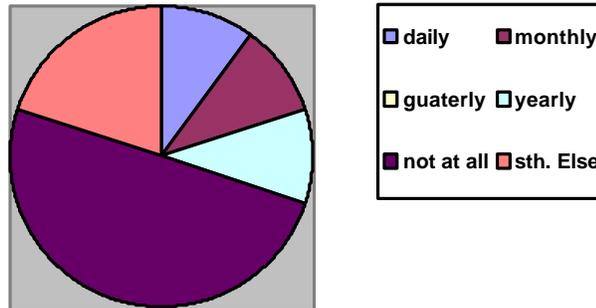
The system for monitoring the success of execution in local units comes down to a comparison of planned and realised. There are occasional examples of shifts towards programmes. However, the success of the realisation of objectives is still not monitored

in the sense of finding out what quantity of general good or, how much of citizen's satisfaction has been produced.

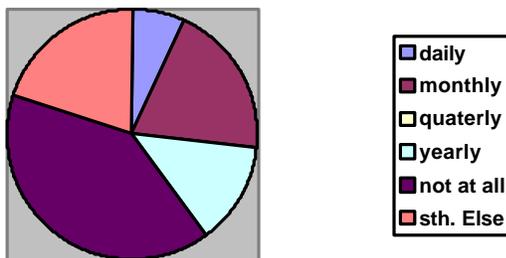
Q. 7. Do you evaluate the work of your employees daily, monthly, quarterly, yearly, not at all, or otherwise, and give the reasons why you do not.

As many as 50% of the *communes* stated that they do not evaluate the work of employees. The main reason is the small number of employees (one commune states that it has only three employees, another states that because of the small number of employees, teamwork is the norm). Daily evaluation of employees is done only in 10% of communes. The same percentage appears with both monthly and annual evaluation.

Communes



Cities



In 40% of *cities*, the work of employees is not evaluated. One city answered that it supervises only turning up to work, while it did not consider the quality of work. A graphic presentation of responses:

Counties



In 89% of *counties*, the work of employees is not evaluated. Two counties said that the work of employees is monitored, but not evaluated. Only one county circled the answer of annually evaluating the work of employees.

Q. 8. What work incentives do you provide for your employees?

Only two *communes* (12%) admitted the existence of a system of monetary incentives (10 or 20% on top of gross wages). It is interesting that these are the communes that did not reply to the previous question about whether they evaluated the work of their employees. Six communes (35%) did not give any response about the system of providing incentives, only stating the existence of a framework of standards that supported this system.

We highlight some of the answers. One commune provides incentives on the basis of the decision about the wages of the commune's employees; another in line with the collective bargain and the rules. With other communes questioned, the practice of giving incentives has not been introduced; alternatively, they do not have the financial capacity. 30% or 5 of the communes did not reply to the question.

73% of *cities* stated that though the Regulations (or decision or some other enactment) about wages, incentives were given for above-average achievements at work (incentives of 10 to 25% of monthly gross pay are given). The same amount can be taken away in cases of bad performance. 13% has no system of incentives. 14% did not reply to the question. In one city, incentives are given on the basis of number days spent on annual leave.

We would draw attention to two interesting answers. First, 10% of the variable part that the mayor gives to employees (at most 30% per employee) is added onto gross pay. The heads of department and officials have no right to incentives. Secondly, the giving of incentives is regulated by an appropriate act, usually regulations (via the coefficient).

67% of *counties* do not give incentives to employees. 33% reward employees once a year in an amount of up to 30% of gross monthly pay, depending on the decision of the prefect. In one county, the prefect alone can decide on incentives and rewards. One county applies the possibility of incentives of 20% of monthly salary for above-average performance.

Just how demotivating the lack of any system for monitoring, evaluating and rewarding employees is can best be seen in the answer of one county: whether you work or don't, the pay is just the same.

The poll shows that in most counties and cities an incentives system has been laid down, by the regulations or a decision. However, there is no system for checking on the success and quality of the work. Unlike the towns and communes, the counties do not at all have any system for evaluating and rewarding above-average performance. It is interesting that in some cases decision about incentives is given by the prefect! And this is peculiar, because the ability to give incentives results in all employees getting a bonus of 20 to 30% of salary once a year. Thus there is no encouragement to the employees to turn in better performance. Performance is not valued at all. This is, however, the subject of a separate piece of research.

How projects and programmes are planned, and in what way their execution is monitored at the level of local units, can be seen in the answers to questions 9 through 12.

Q. 9. Do you plan special projects and programmes? (If the answer is yes, give some examples.)

From the following table it can be seen that a very small number of local units (16%) plan special projects and programmes. All local units have more or less the same percentage of planned programmes and projects.

The differences can be seen if projects are looked at separately from programmes.

Thus communes and cities are more inclined to plan projects like the building of a sports hall, the completion of a culture centre or voluntary fire brigade HQ, the construction of utility infrastructure, the computerisation of the local administration. Only one commune gave the examples of programmes (welfare, and programmes of public requirements in culture and sport).

Local government	do plan		do not plan
	Programmes	Projects	
Communes	6% (1 commune)	70% (12 communes)	24% (4 communes)
Cities	13% (2 cities)	73% (11 cities)	13% (2 cities)
Counties	44% (4 counties)	44% (4 counties)	11% (1 county)

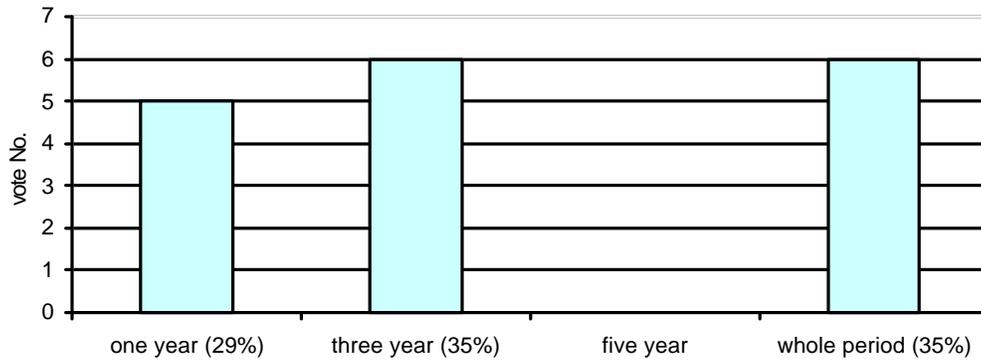
Of all the counties, only one answered that it does not plan projects and programmes. Unlike the cities and communes, half the counties gave the example of the planning of some capital project (construction of main pipelines, roads, utility infrastructure, gasification), and the other half programmes (development of tourism, the economy, social activity, programmes in culture, sport, health care, education and so on).

Q. 10. For how many years in advance do you monitor and evaluate the expenditure of long term projects: one year, three years, five years, for the whole period of the project?

We hypothesised a three-year monitoring period would most often be mentioned, especially for projects that are financed by central government. Local governments are obliged to submit prior applications to the Ministry of Finance for such projects, including a financial plan of the investment, and a projection of current expenditure and debt repayment for three years.

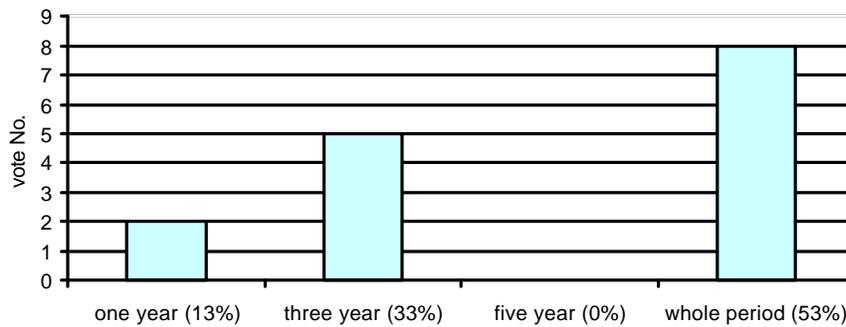
From the sample of the communes, the analysis showed that 29% or 5 communes planned the expenditure of long-term projects only for one year; 33% or 6 communes did this for three years in advance. The same number of communes planned it for the whole period of the duration of the project.

Communes



In 53% the effects of projects are monitored for the whole period of their existence. 33% of cities planned expenditure for three years in advance and 13% for one year.

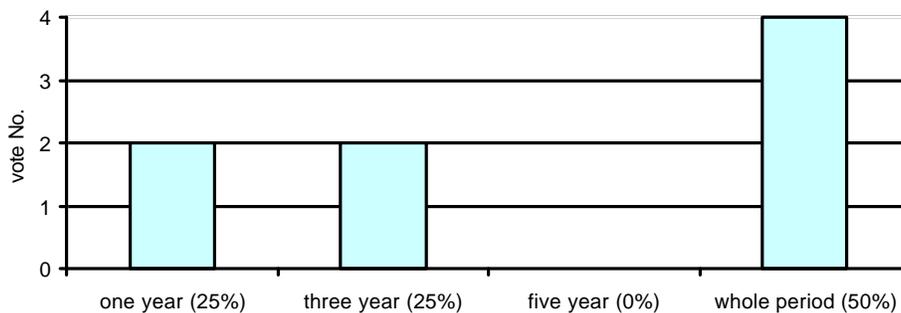
Cities



The reason for the three year monitoring of projects is found in the provisions of the Budget Law, which says that a budget has to contain estimates for the current fiscal year and predictions for the next two fiscal years. Accordingly, the 1 plus 2 planning principal is enshrined in the law.

One county did not answer question 10. 50% check the expenditure and burden of the total budget for long-term projects and programmes for one or three years in advance. This shows what a short-term orientation counties have in the planning of their long-term projects or programmes.

Counties



Q. 11. In what way do you evaluate and monitor the success of the execution of projects and programmes?

47% of communes, 73% of cities and 44% of counties consider that the monitoring and evaluation of the success of long-term projects and programmes comes down to a comparison of what is planned and what is executed (i.e. spent).

No answer at all was given to this question by 24% of communes, 13% of cities and 22% of counties.

29% of communes follow up success with various analyses (not quoted). Two cities said that they carry out evaluation of the success of programmes and projects: 1. comparing price and benefit (measurable and immeasurable), on the base of cost-benefit analysis, effectiveness, and 2. keeping up with the dynamics of the realisation of the project, and evaluation of the contribution to the level of general well being, e.g., by providing new jobs.

In 33% of counties, success of execution depends on funds available, and is determined by ongoing supervision of execution.

Q. 12. Give some examples of long-term projects that were abandoned, and the reasons.

24% of communes said that there were examples of such projects, the reason for the abandonment mostly being lack of funds in the next year. Of these four there were two that in the answer to question 10 said that they monitored long-term projects for one year.

If expenditure were programmed for several years in advance (with an effective estimate of revenue), the first year it could be decided that there would not be adequate funds in the budget the next year for the completion of the projects. In this way the unnecessary expenditure on incomplete projects could be avoided.

66% of cities do not have any long-term projects or programmes they have given up on after a certain time. 34% of cities did give up on projects and programmes because of lack of funds, or because other parties involved in the financing quit.

The last three questions (13, 14 and 15) were included in order to ascertain the way in which the local units communicate with the central government and with the citizens.

Q. 13. Are the financial reports shown to the citizens, and if so how: Internet, brochures and other printed matter, on special application, not at all, something else?

The results show that the communes and cities adhere to the provisions of the law and do let the population of their regions see the financial reports.

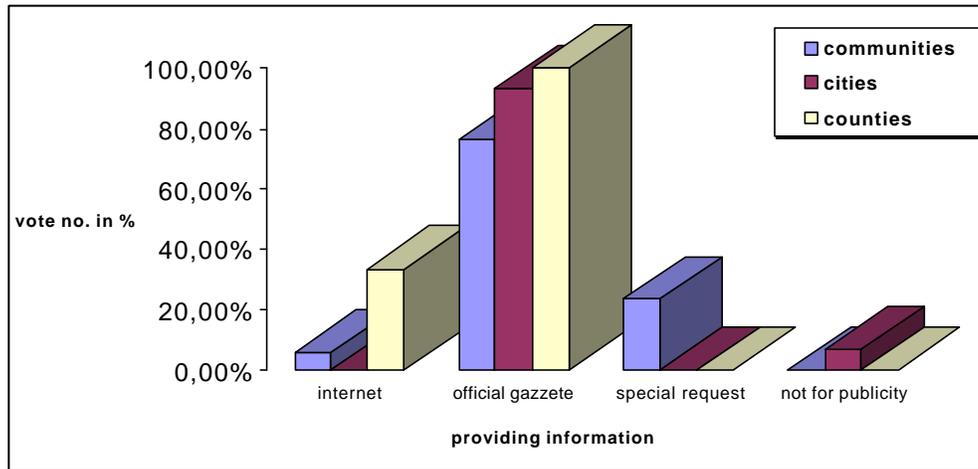
13 *communes* (76%) publish their reports in brochures. One commune has an Internet report, but with 4 communes one has to make a special application to be able to see the financial reports. 23% of communes use a notice board.

One answer is highlighted: At the sessions of the authority and the council, journalists are present, who can learn about the financial situation of the commune. They put the information in the local gazette or in the daily press.

All *cities*, save one, inform the population of their areas via brochures and other printed matter. One city says that it informs the citizens via the city's gazette, and others that the local radio stations give direct broadcasts from or record material from the sessions of the council. One city said that financial reports are not for the public.

All the *counties* polled said that citizens could inspect the financial reports in the official gazette of the county. 33% said that the local press also partially published the reports, and that the reports were put on the Internet.

Following figure has showed how LGU provide information about financial reports to their citizens.



Nevertheless, we feel that the population is poorly informed. Many people do not know that it is possible to see the financial reports, the reports about the execution of the budget or the actual budget of the local unit in which they live. The public has the feeling that such data are secret.

A big problem for local units is the existence of a mass of regulations with unintelligible explanations of concepts and terms that govern the system of informing the central governmental institutions. How local units cope in such conditions can be seen by the answers to the next question.

Q. 14. What data about the adoption and execution of the budget do you supply to the Finance Ministry?

The answers to this question should be all the same, and would be if the names of the reports and the obligations to submit were clearly defined by the law. As things are, the answers are various, though perhaps the same things are meant by different terms.

Number of answers in % of local units Kind of report	Communes	Cities	Counties
	Annual plan of the budget	88	100
Budget execution decision	18		
Amendments to the budget	59	73	100
Annual accounts (execution of the budget)	53	90	67
Semi-annual report about execution	24	47	
Annual report about execution	30		
Semi-annual financial report	30	13	22
Annual financial report	30	46	56
Statistical report	18	20	11
Official gazette of the unit		7	

Practically all the local units provide the annual plan of the budget. However, only 18% of communes give the execution decision to the Finance Ministry, and the cities and counties did not reply to the question at all.

All counties, and most cities (73%) and communes (58%) provide amendments (rebalance) to the Finance Ministry.

Almost all communes, cities and counties provide reports about the annual budget plan to the Finance Ministry.

An *annual financial report* is submitted by 29% of communes, 47% of cities and 56% of counties; while *annual accounts of the budget* are submitted by 53% of communes, 80% of cities and 67% of counties. This shows that the local units confuse the terms annual account of the budget and annual financial reports. All local units do, once a year, submit annual financial reports to the Finance Ministry on the basis of which they make up information for the GFS of the IMF. The basic reason for the lack of understanding are the regulations that have been instituted, above all the Financial Reporting Regulations, in which the financial report is defined as the annual accounts. It should be said that the Local Units Financing Law sets the annual account apart as a separate document that contains a general part (revenue, expenditure, difference between planned and actual expenditure, deficit financing etc), a review of unsettled obligations, and a special part of the budget (expenditure per beneficiary, purposes).

However, it is interesting that some local units (cities, in our questionnaire) send the Finance Ministry their official gazettes, in which information about the budget is found, although these are not necessary. Following figure has showed the way in which LGU provide information about their financial reports to LGU citizens.

The different answers show that local units cannot cope with the use of the terms and the regulations and that it is necessary to have a clear and simple regulation of the reporting system between the local units and the Finance Ministry.

It is clear that the whole budgetary accounting and reporting system should be regulated and unified in a single law or other enactment, and that the different regulations should be made conceptually uniform.

Q. 15. Which data, and to which ministries, do you send during the year?

We wanted to establish the kind and course of communications of local units with the central government (except with the Finance Ministry, which was covered in the previous question).

35% of communes (alongside the data they send to the Finance Ministry and the National Auditing Office) also state various reports about funds spent per project that are financed or co-financed by a given ministry. Thus the communes provide:

- the Ministry of Culture with a report about spending funds meant for the purchase of books and other cultural events, and data about projects for the protection of the cultural heritage,
- the Ministry of Public Works a report about water supply projects,
- the Ministry of Trades and Small Business a quarterly report about investment in small businesses,
- the Ministry of Labour and Welfare a report about sums spent in the joint financing of welfare programmes in local offices and so on.

12% of communes give the Ministry of Local Government their enactments showing the level of pay and compensation for the employees in their bodies in order to get its consent for subsidies. Thus, even in a small sample, the great dependence of communes on subsidies from the national Budget is shown.

40% of cities questioned did not state what ministries they send reports to, or what kind of data. 33% state that they report the competent ministries about the spending of sums obtained for the implementation of given programmes or projects. 27% say that they do not send anything as a matter of course, rather occasionally when specifically required to do so by a ministry.

We pick out the reply of one city that sends several reports: about allocations of loans and subsidies to business and agriculture to the Ministry of the Economy, about earmarked funds to the Ministry for Veterans, and about earmarking 2% for the housing of disabled veterans to the Ministry of Public Works.

67% of counties did not mention any data or ministries. In the questionnaire, one county said that it could not answer because it could not see into the reports that the executive departments sent to the ministries during the year. This answer shows that there are bad and competitive relations among the departments of the county.

The other 33% of counties state that they send data about earmarking 2% for building flats for veterans to the Veterans' Ministry, to the Local Government Ministry about they pay they give to employees, the compensation to officials and the number of employees in work. They send applications to other ministries for capital projects in the county.

Conclusion

The answers to the questions in the questionnaire by the respondents covered by the sample confirmed the hypotheses set up, and very vividly showed that at the level of local units (and, we can say with a good deal of certainty, at the central government level as well) market principles have not been internalised.

Budget making is founded on the maximum amounts per given items of revenue and expenditure, which occupies all the budgetary processes in the local units (planning, execution, accounting, and supervision). The fundamental aim is to keep the budget well within defined frameworks. Quality of life and citizen (or voter) satisfactions are not foregrounded, and the need for a step ahead in budgeting according to programmes has not yet arisen. Increasingly, however, local units are starting to think of this, and some are starting to apply it, in the simplest possible ways.

Thinking goes on within the statutorily defined framework, and it is expected that concrete shifts towards improvements and changes will be instituted by someone else (the central government). The model of initiative and independent, progressive and creative action has not been internalised. Because of lack of incentives, and lack of criteria for awarding incentives, there is no stimulus to creative and effective work. Ideas interest no one, and the final result (there being no work on raising the quality of the work of the employees) is inertia and red tape.

However, there are rare individual examples that did not bear out the hypotheses erected, and they are good signposts to the way that has to be taken in the improvement of the quality of life of a local unit.

Appendix IV

GLOSSARY OF TERMS

account group – the symbol or number of a given budgetary position or item that serves to record and monitor the level of revenue collected and expenditure made.

administrative classification – expenditures displayed in terms of individual budgetary beneficiaries (ministries, agencies and so on), *see: functional classification*.

amendments – proposals for changes and additions to the proposal of the Budget, which usually come down to increased or decreased amounts for individual budgetary beneficiaries.

budget – an estimate of the annual revenue and receipts and the determined amount of expenditure and other payments by the government, or local government, approved by the Parliament of the Republic of Croatia, or the assembly of a local government unit in line with the provisions of the Constitution and other laws.

budgetary deficit – the amount by which government expenditure exceeds government revenue in a given period, most often a year.

budgetary beneficiaries – the agencies, ministries and other administrative bodies and all others financed from the Budget.

budgetary position – the name for a given budgetary revenue and receipt and expenditure, which is further classified in terms of groups and sub-groups of accounts, *see: item, functional classification, administrative classification*.

budgetary item – *see: budgetary position*.

capital outlays – outlays for the procurement of land, non-material assets, reserves, non-financial assets and the like, the life of which is more than one year.

capital revenue – revenue from the sale of non-financial capital assets, such as land, non-material assets, commodity reserves and other things the life of which is more than one year.

central government – according to the public finance statistical system of the IMF, this in the Republic of Croatia includes the Budget and the extra-budgetary funds.

capital project – a project the execution of which lasts more than one year and from which a return is expected in the years after the building (schools, hospitals, roads, bridges and soon). Any capital outlay the value of which exceeds 200,000 kuna is considered a capital project.

consolidated budget of central government – the budget after transactions between the Budget and the extra-budgetary funds are cancelled out.

consolidated budget of general government – the budget after transactions between the Budget, the extra-budgetary funds and the local units budget are cancelled out. This is the real indicator of the financial position, that is, the revenue, expenditure and borrowings of the state.

contributions – a kind of public revenue in which the service provided is proportional to the contribution made. In Croatia, contributions are paid by both employers and employees. They form the revenue of the extra-budgetary funds – for health and retirement insurance. They are used to finance government services that have a welfare component.

counter-obligation – the situation when for an amount received or paid a service or good has to be given in return.

deficit – the amount expenditure exceeds revenue in a given period.

direct tax – tax that is imposed immediately upon the taxpayer, such as profits or income tax, tax on gifts and inheritances.

expenses - non-returnable current and capital payments, with or without counter-obligations, and grants and transfers made to others.

extra-budgetary funds – legal entities that are financed from special-purpose taxes, or contributions, or non-taxation revenue. In Croatia these are the Pension Fund, the Health Insurance Fund, the Employment Fund, the Child Benefit Fund and the Public Water Management Fund.

execution of the Budget – the use of budgetary resources during the year for the purposes and objectives laid down in the plan of the Budget.

financing account – that part of the Budget in which the manner of financing deficits is shown, as well as the way in which a budgetary surplus is used.

fiscal year - a period of 12 months for which the state plans revenue and expenditure. In Croatia, this is the same as the calendar year (1 January to 31 December).

fiscal capacity - the ability of the local units of government (counties, communes and cities) to finance budgetary expenditure with their own budgetary revenue.

functional classification – expenditure displayed according to individual purposes (law and order, defence, health care and so on), *see: administrative classification*.

GDP – *see: gross domestic product*.

general government – according to the public finance statistical system of the IMF, this covers all levels of government and all institutions that collect revenue and execute expenditures for the government. In Croatia, general government includes the Budget, the local units' budgets and the budgets of the extra-budgetary funds.

general grants – a set amount of resources given by the government to local units without prescribing the purposes to which they are to be applied. Local units make their own use of these funds and use them for purposes they themselves determine. The manner in which general grants are allotted is defined by Articles 48 and 49 of the Units of Local Government and Administration Financing Law.

gross domestic product (GDP) – the total value of all goods and services produced in a country during a single calendar year.

grant – a fixed amount of funds provided by the government to local government units (counties, communes and cities) according to measured fiscal inequality. The right can be claimed only by those local units that have below-average fiscal capacity, i.e., that cannot cover the required budgetary spending with their own revenue.

indirect tax – tax on goods and services that is collected indirectly, via an agent such as an importer, producer or shop; examples are VAT, excise, customs duty, turnover tax.

instruments of the public debt – loans, credits, bonds, treasury bills that the state uses to finance excessive expenditure (deficits).

internal public debt – the total borrowing of the government at home, when the main creditors are citizens, firms and domestic financial institutions.

joint taxation (tax sharing) – division or sharing of taxes (of their tax bases) between central and lower levels of government. By changing the rate and the ratios in the tax revenue of local and central government, the central government controls and affects the amount of tax that remains at the local level. The state and local government in Croatia share income tax, profits tax, real estate sales tax and the gambling tax.

loans minus repayments- state transactions with other figures at home or abroad. Loans that entail repayments are given at home to for example the counties, communes and cities, and abroad for example governments and international institutions.

local government and administration units – the communes, cities, counties.

national Budget - also state budget, the budget of the country.

National Audit Office – an independent institution that carries out auditing of the national Budget, the budgets of local government units, of the extra-budgetary funds, state and public corporations, and firms that are partially or wholly financed out of the Budget. The National Audit Office estimates the extent to which budgetary resources have been spent in line with planned and approved amounts.

public finances – that branch of economics dealing with the analysis of the policy of national revenue and expenditure.

public debt – the total indebtedness of the country to home or foreign creditors at a given moment. It represents the cumulative deficit of all levels of the Budget in which the state collects and spends resources (the national Budget, the local units budget, the budget of the extra-budgetary funds).

public sector – that part of the national economy that in the widest sense comprehends all levels of government, the welfare system, and the public corporations.

provisional budget – a budget that lasts three months. It is passed when Parliament does not adopt a budget before the beginning of the financial year, *see: temporary financing*.

revenue – money collected by the state. It includes taxes, fees and charges for various services, and income from the sale of state-owned capital assets.

rebalance (also a revision) – a change in the sums of the Budget, i.e., their reduction or increase as compared with the originally planned Budget. It is done during the fiscal year.

receipts of the budget – resources that the state obtains by borrowing via loans, issuing bonds and other securities.

supports – receipts of the state without any counter-obligation, non-repayable and non-obliging from home or foreign units of government or international institutions.

size of government – the proportion of government spending in GDP.

surplus – excess of revenue over expenditure in a given period.

surtax – a financial instrument the base for the payment of which is the amount of a tax already paid. It is usually put onto a direct tax. In Croatia, cities with more than 40,000 inhabitants have the right to introduce surtax on personal income tax.

tax – a kind of public revenue which is manifested as a forced payment to the state without there being any counter-benefit.

tax sharing – division of responsibility for collecting and using taxation revenue between the central and lower levels of government, *see: joint taxation*.

tax base – the thing or amount to which the tax rate is applied; for example, the profit of a company, the wages of a private person, real estate. The amount arrived after all losses, personal allowances and offsets have been taken into consideration.

tax rate – usually a percentage or a fixed amount of the income, profit, value of goods and services, which is paid to the state. If it is expressed as a percentage, it can be progressive, proportional or regressive. Irrespective of kind, it is applied to the tax base, which differs according to the nature of the tax concerned.

taxpayer - the person who bears the tax burden for any given status, work or transaction.

temporary financing - financing the budget for three months periods. It can be done at the most up to 25% of the budgetary resources used in the same period in the preceding year, *see: provisional budget*.

treasury – the system of budgetary and financial management of government revenue, expenditure and the public debt. It includes the planning, execution and supervision and use of the resources of the Budget.

transfers – financial resources that the central government gives local units in the form of a share in one or other tax (vertical fiscal equalisation), and in the form of inter-county (horizontal) fiscal equalisation by grants from the higher to the lower levels of government.

Appendix V

TAXES IN THE FISCAL SYSTEM OF CROATIA

TAX	TAXPAYER	TAX BASE	TAX RATE	LEGAL ACT	BELONGING OF TAX REVENUES
VALUE ADDED TAX	Legal and natural person (entrepreneur) delivering goods or performing services.	Sales price of all goods delivered or services performed	22 % and 0 %	Value Added Tax Act: NN 47/95, 106/96, 164/98, 105/99, 54/00, and 73/00 Regulation: NN 60/96, 113/97, 7/99, 112/99, 119/99-corrected, 44/00, 63/00 and 80/00	State 100%
EXCISE TAXES:					
1. COFFEE	Legal and natural person importing, carrying into and receiving coffee	Kilo of net weight of coffee or coffee product	from 5.00 to 20.00 HRK/kg, depending on the blend and type of coffee	Excise Tax Act on Coffee: NN 139/97, 55/00, and 59/00-corrected Regulation: NN 73/00	State 100%
2. OIL PRODUCTS	Producer or importer of oil products and government body for commodity reserves	Per liter of oil product at the temperature of 15 degrees centigrade or per kilo of net weight	-0.30 to 2.40 HRK/lit, -0.10 to 1.40 HRK/kg	Excise Tax Act on Oil Products: NN 55/00, 101/00, and 27/01 Regulation: NN 63/00	State 100%
3. TOBACCO PRODUCTS	Producer or importer of tobacco products	Cigarettes and tobacco	-5.00 to 8.90 HRK/ packet of cigarettes, -38.00 HRK/kg of tobacco, -1.10 HRK/ cigar, -4.40 HRK/ packet of cigarillos	Excise Tax Act on Tobacco Products: NN 51/94, 56/95, 67/99, 105/99, and 55/00 Regulation: NN 112/99, 50/00, and 55/00	State 100%
4. BEER	Producer or importer of beer	Hectoliter of beer and non-alcoholic beer	-120.00 HRK/hl of beer, -60.00 HRK/hl non-alcoholic beer	Excise Tax Act on Beer: NN 51/94, 139/97, and 55/00 Regulation: NN 59/94, 109/96, and 46/98	State 100%
5. NON-ALCOHOLIC DRINKS	Producer or importer of non-alcoholic drink	Hectoliter of non-alcoholic drink	40.00 HRK/hl	Excise Tax Act on Non-alcoholic Drinks: NN 51/94, and 139/97, Regulation: NN 59/94, and 109/96	State 100%
6. ALCOHOL	Producer or importer of alcohol and alcohol drinks	Liter of absolute alcohol contained in the ethyl alcohol or in the alcohol beverage at a temperature of 20 degrees centigrade	-80.00 HRK/l of absolute alcohol. -There is no excise tax on wine.	Excise Tax Act on Alcohol: NN 51/94, 141/98, and 55/00 Regulation: NN 59/94, 109/96, 158/98, 164/98, and 27/99	State 100%
7. CARS, MOTORBIKES, BOATS AND AIRPLANES	a) Producer or importer b) Second-hand buyer	A) new: 1.Cars and motorbikes (sales price) 2.Boats (depending on length and cabin) 3.Airplanes (depending of number of seats)	A) new: 1.HRK 0 - 70,000 + 5 - 40% 2.- without cabin HRK 6,000-48,000 -with cabin HRK 15,000-150,000 3. HRK 7,000-300,000	Excise Tax Act on Cars, Motorbikes, Boats and Airplanes: NN 139/97,105/99, 55/00, and 127/00	State 100%

		B) Second-hand (sales price)	B) Second-hand 5% -Cars and motorbikes increase of 50- 100%		
8. LUXURY GOODS	Legal and natural person importing and producing luxury goods	Sales value (without VAT) of jewelry, watches, furs, reptile leather shoes and clothes, and arms. For imported products the tariff base.	30%	Excise Tax Act on Luxury Goods: NN 105/99 Regulation: NN 112/99	State 100%
GAMES OF CHANCE TAX	a) Natural person who realizes a gain in games of chances b) Legal and natural person organizing the entertainment games c) Legal and natural person organizing the entertainment games	a) gain b) profit c) sales tax on the service of selling the tickets for the games	a) 10 % on the amounts over HRK 20,000 b) prepayment of the profit tax – monthly lump sum of HRK 400/ machine c) 5%	a) Law on the Games of Chance NN 36/98 b) Law on the Games of Chance and Entertainment Games: NN 61/91, 2/94, and 56/95 c) Law on the Sales Tax on products and services: NN 95/94, and 34/95	a) State 100% b) State 70%, County 10%, Municipality/To wn 20% c) 100% State,
PERSONAL INCOME TAX	Natural person realizing taxable income	Total income realized in Croatia and abroad (decreased by personal allowances)	15%, 20% and 35%	Income Tax Act: NN 127/00 Regulation: NN 132/00	State 60%, County 8%, Municipality/To wn 32%, Zagreb 45%
CORPORATE INCOME TAX	A company or some other legal entity that carries on some activity for the sake of making a profit.	Profit (difference between revenues and expenditures)	20 %	Profit Tax Act: 127/00 Regulation: NN 132/00	State 70% County 10% Municipality/To wn 20%
REAL PROPERTY TRANSACTION TAX	Buyer of the real property	Market value of the real property	5 %	Real Property Transactions Tax Act: NN 69/97	State 40% Municipality/To wn 60%
INHERITANCE AND GIFT TAX	Legal and natural person who have inherited property, including cash or monetary claims, or received it as a gift in Croatia	Market value of the property at the moment of tax assessment after the deduction of debts and expenses encumbering the property	5 %	Law on Financing the Units of Local Government: NN 117/93, 33/00, and 73/00 Real Property Transactions Tax Act: NN 69/97 (inheritance of property)	State 40% (property) County 100% (cash, monetary claims, and movable property) Municipality/To wn 60% (immovable property)
TAX THE ORGANIZATION OF ENTERTAINMEN T SHOWS AND SPORT GAMES	Organizer of shows and games	Tickets sold	5 %	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	State 100%

TAX ON MOTOR VEHICLES	Legal and natural person owner of registered passenger car or motorbike	Passenger cars (up to 10 years of age) and motorbikes (up to 5 years of age) according to the engine power	DM 30 to 200 for cars and DM 20 to 100 for motorbikes per year	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	County 100%
TAX ON BOATS	Legal and natural person owners of boats	Boats depending of the length, equipment and age	DM 30 to 550 per year	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	County 100%
CONSUMPTION TAX	Legal and natural person in the catering business	Retail price of alcoholic and non-alcoholic beverages sold in bars and restaurants	up to 3 %	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	Municipality/Town 100%
TAX ON COUNTRY COTTAGES	Legal and natural person owner of country cottages	Square meter of usable surface	DM 1 to 3 per year	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	Municipality/Town 100%
ADVERTISING TAX	Legal and natural person who put advertisements on public places	Advertisements on public places	up to DM 200 per year	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	Municipality/Town 100%
FIRM TAX	Legal persons and individuals liable to profit tax or income tax	Firm or name	up to DM 500 per year	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	Municipality/Town 100%
PUBLIC UTILITIES TAX	Towns and municipalities regulate the assessment and collection of the public utilities tax	size of the used public area	DM per m ²	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	Municipality/Town 100%
LOCAL SURCHARGES	Towns with more than 40,000 inhabitants can introduce surcharge on the income tax of up to 30%. Zagreb, as a capital, can introduce a surcharge on the income tax of up to 60%.	part of the income tax belonging to the town	e.g.: Zagreb 18% (NN 51/96)	Law on Financing the Units of Local Government: NN 117/93, 33/00 and 73/00	Municipality/Town 100%