

CROATIA

UNITARY COUNTRY

BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: HIGH INCOME

LOCAL CURRENCY: CROATIAN KUNA (HRK)

POPULATION AND GEOGRAPHY

Area: 56 594 km²
Population: 4.154 million inhabitants (2017), a decrease of -0.4 % per year (2010-2015)
Density: 73 inhabitants / km²
Urban population: 56.7% of national population
Urban population growth: -0.7% (2017 vs 2016)
Capital city: Zagreb (16.5% of national population)

ECONOMIC DATA

GDP: 108.5 billion (current PPP international dollars), i.e. 26 108 dollars per inhabitant (2017)
Real GDP growth: 2.9% (2017 vs 2016)
Unemployment rate: 11.2 (2017)
Foreign direct investment, net inflows (FDI): 2 040 (BoP, current USD millions, 2017)
Gross Fixed Capital Formation (GFCF): 19.9% of GDP (2017)
HDI: 0.831 (very high), rank 46 (2017)

MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

The parliament adopted the current Constitution of Croatia on 22 December 1990 and decided to declare independence from Yugoslavia on June 1991. The Constitution established the Republic of Croatia as a “unitary and indivisible democratic and social state”. Croatia is a parliamentary republic whose Parliament was initially a bicameral institution, which comprised a “House of Regional Representatives”. This chamber was abolished in 2001 but the Parliament’s Committee for Local and Regional Self-Government continued to play a role representing subnational governments. The unicameral Parliament (*Sabor*) is currently composed of 151 representatives elected by popular vote to serve a four-year term while the President is elected through direct democratic elections for a term of five years, and acts as Chief of State. The Government is headed by a Prime Minister appointed by the President, with the approval of Parliament.

Croatia is a unitary country with two subnational government levels: counties and municipalities. The principle of local government and subsidiarity are recognised in articles 4 and 133 of the Constitution. Article 133 in particular states that “citizens shall be guaranteed the right to local and regional self-government”. The main characteristics of the subnational government system are established through articles 133-138 of the Constitution.

Following the establishment of the administrative territorial division of the country through the 1992 Act on Territories of Counties, Towns and Municipalities (later amended in 1997), a major phase of decentralisation took place in 2001-2002. The Organic Law on Local and Regional Self-Government and the Law on Local and Regional Self-Government Financing (LLGF) was adopted in 2001, as was the Law on Public Utilities. The new legal framework initially transferred a set of responsibilities (particularly primary and secondary education, healthcare and social welfare) to counties and to the 32 towns with the strongest fiscal capacity. It was then gradually extended to other units on an individual basis. Amendments to the Law on Local and Regional Self-Government in 2005 and the Physical Planning and Building Act in 2007 transferred new functions to counties and major cities related to spatial planning and issuance of building permits. In 2009, amendments were made to the Law Concerning the Financing of Local and Regional Self-Government Units to introduce shared taxes and financial equalisation. The Law on Regional Development was also adopted in 2009 (and amended in 2014), introducing a competitiveness index that serves as a basis for the financial equalisation system.

In 2010, the government adopted guidelines for decentralisation and territorial reform. The document, accompanied by an action plan, has three main objectives: functional decentralisation, fiscal decentralisation, and territorial decentralisation. However, no package of essential reforms has been implemented yet.

The 1992 Act on the Territories of Counties, Towns and Municipalities was amended in September 2015 to introduce a mechanism for voluntary mergers of local self-government units.

At regional level, counties are governed by county assemblies that are composed of members elected by direct universal suffrage for a four-year term. Counties are also governed by county prefects (*župan*) who constitute the counties’ executive branch. At the local level, municipalities, towns and cities each have their own local councils, with members elected by direct universal suffrage for four-year terms. In addition, they have mayors who constitute their jurisdictions’ executive bodies. In 2007, the last reform on SNG introduced the direct election of mayors (for municipalities and cities) and county governors (for counties). Indeed, the Law on Elections of Municipality Heads, Mayors, County Governors and the Mayor of the City of Zagreb took effect starting in the 2009 elections.

TERRITORIAL ORGANISATION

2018	MUNICIPAL LEVEL	INTERMEDIATE LEVEL	REGIONAL OR STATE LEVEL	TOTAL NUMBER OF SNGS
	428 municipalities (<i>općina</i>) 128 towns (<i>grad</i>)		20 counties (<i>županije</i>) Capital city (<i>grad</i>)	
	Average municipal size: 7 472 inhabitants			
	556		21	577

OVERALL DESCRIPTION. Croatia subnational level is composed of counties (*županijas*) at the regional level and of towns (*grad*) and municipalities (*općina*) at the local level.

REGIONAL LEVEL. Re-established in 1992, counties are regional self-government units with a large degree of autonomy. The number of regions includes the City of Zagreb, which has a special status including the competences of both a town and a county (separate from the surrounding Zagreb County). There are significant socio-economic disparities across regions. While the average county size is around 204 000 inhabitants, the least populated county

(Lika-Senj) has 51 000 inhabitants while the city of Zagreb has almost 800 000 inhabitants. In 2018, the City of Zagreb and four counties (Međimurje, Istria, Dubrovnik-Neretva and Zagreb) accounted for half of national GDP, whereas most counties from Adriatic Croatia were lagging behind. Counties are gathered into two units for statistical purposes: Adriatic Croatia (7 counties) and Continental Croatia (14 counties).

MUNICIPALITIES AND INTER-MUNICIPAL CO-OPERATION. The municipal level comprises 128 towns (*grad*) and 428 municipalities (*općina*), a number which has more than trebled since 1990, when there were just 172 municipalities. “Town” status is given to municipalities with more than 10 000 inhabitants. The average town size is 24 000 inhabitants. In 2005, a specific category was created for “large towns” with more than 30 000 inhabitants (currently 17), with a wider scope of competences. Municipalities are smaller and mainly rural. Overall, Croatian towns and municipalities have around 7 500 inhabitants on average (with a median size of 2 900 inhabitants), although approximately 73% of municipalities have less than 5 000 inhabitants, and even 32% less than 2 000 inhabitants. There are also 6 762 settlements, which are sub-divisions that can be established by municipalities and towns, with their own councils. The City of Zagreb has a two-tier sub-municipal organisation with 17 urban quarters and 218 neighbourhood boards. Its status is guaranteed by a separate piece of legislation, i.e. the Act of the City of Zagreb.

In 2015, a new piece of legislation on voluntary mergers of local government units was introduced to streamline territorial divisions and improve the delivery of public services. However, no financial incentives were included in the measure and no mergers took place in 2017. To limit the effects of municipal fragmentation, the Strategy of Public Administration Development 2015-2020 also mentions inter-municipal co-operation as part of local government co-operation, but no specific framework has been implemented yet.

There is a state territorial administration, represented by a State Administration Office at county level, which performs the tasks of the central government whose Head is appointed by the government. In the City of Zagreb the mayor is responsible for central government administration.

SUBNATIONAL GOVERNMENT RESPONSIBILITIES

The distribution of responsibilities is determined by the Organic Law on Local and Regional Self-Government as well as by the Act on the State Administration System (as amended in 2007) concerning state-delegated functions.

Counties have both exclusive and delegated competences, which must be approved through ministerial consensus. They include the granting of building permits, social protection, education and fire safety. At local level, towns and municipalities perform tasks of local significance, which directly address the needs of citizens and which are not assigned to state bodies by the Constitution or by the law. However, the assignments of responsibilities is asymmetric according to the type of municipality. Most responsibilities transferred since 2001 have been made to towns with the strongest fiscal capacity. Overall, many smaller local government units have limited powers due to their relative lack of capacity. The distribution of responsibilities across levels of government is considered complex because of this asymmetric process and overlapping responsibilities between the central and subnational levels of government.

MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

	REGIONAL LEVEL	MUNICIPAL LEVEL
1. General public services	Regional administration; Issuance of construction and renting permits (except in large towns)	Municipal administration; Construction and renting permits (only for large towns)
2. Public order and safety		Fire protection and civil protection
3. Economic affairs/transport	Economic development; Transport and traffic infrastructures; Maintenance of county and local roads	Maintenance of municipal roads (towns); Traffic management; Local transport
4. Environmental protection		Protection and improvement of natural environment
5. Housing and community amenities	Regional and urban planning	Spatial and urban planning; Utility services; Organisation of settlements and housing
6. Health	Healthcare (including hospitals)	Primary health protection
7. Recreation, culture & religion	Social and cultural institutions	Culture; Sports
8. Education	Secondary education	Primary education
9. Social protection	Social welfare (cash benefits); Child care	Social welfare; Child care

SUBNATIONAL GOVERNMENT FINANCE

Scope of fiscal data: counties, municipalities, towns, Capital City of Zagreb, hospitals, schools and kindergartens, as well as county road authorities.	SNA 2008	Availability of fiscal data: High	Quality/reliability of fiscal data : High
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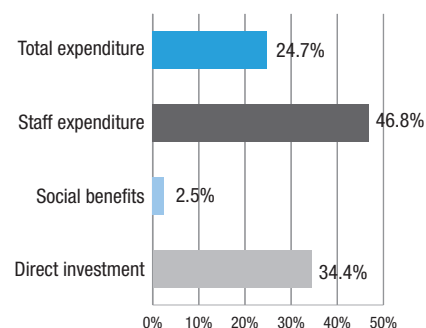
GENERAL INTRODUCTION. The 2001 Law on Local and Regional Self-Government Financing (LLGF) and the amended Budget Acts regulate the local finance system and budgets. They define sources for financing for the counties, the towns and municipalities, including the various types of taxation, non-tax revenues and the equalisation fund distributed among the different levels and non-tax income. They state that SNGs’ own revenues should be proportional to their tasks, and they should be able to use them freely. The LLGF was amended in December 2017, with the aim to simplify the financing system and to increase transparency. It introduced a new system of fiscal equalisation, through a new revenue-sharing model across subnational governments.

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SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

2016	DOLLARS PPP / INH.	% GDP	% SNG EXPENDITURE	% GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY)
Total expenditure	2 769	11.7%	100%	
Incl. current expenditure	2 427	10.2%	87.6%	
Staff expenditure	1 262	5.3%	45.6%	
Intermediate consumption	805	3.4%	29.1%	
Social expenditure	94	0.4%	3.4%	
Subsidies and current transfers	260	1.1%	9.4%	
Financial charges	6	0.0%	0.2%	
Others	0	0.0%	0.0%	
Incl. capital expenditure	343	1.4%	12.4%	
Capital transfers	72	0.3%	2.6%	
Direct investment (or GFCF)	270	1.1%	9.8%	

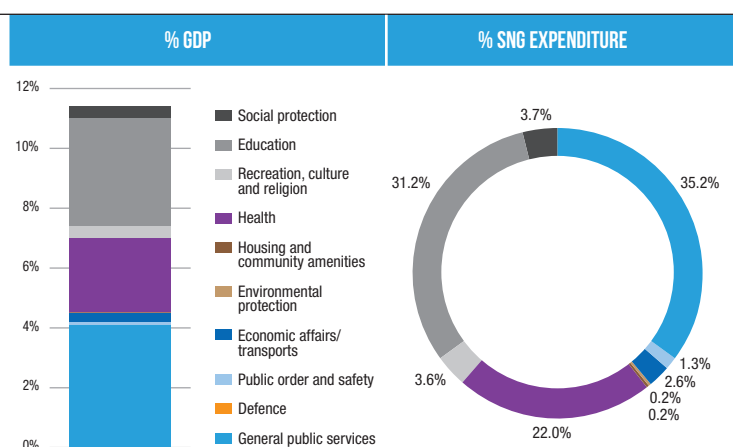


EXPENDITURE. Despite the decentralisation process, SNG spending as a percentage of both GDP and public expenditure is lower than the EU28 average (15.5% of GDP and 33.4% of public expenditure in 2016). Municipalities and towns are responsible for the bulk of spending at the subnational level. SNG staff expenditure account for a significant share of SNG expenditure (45.6% vs 32.9% in the EU28) and total public staff expenditure (46.8% vs 50.9% in the EU28). The increase in the number of municipalities and towns and decentralised tasks has also resulted in an increase in SNG staff (it increased by almost 7% between 2010 and 2015). New fiscal rules set limits on the salaries of local officials. Overall, per capita spending is the highest in the smallest municipalities, where administrative expenditure is the highest line item.

DIRECT INVESTMENT. SNG investment represents a low share of public investment compared to the EU average (34.3% vs 50.9% in 2016). However, SNG investment as a share of GDP is on par with the EU28 average. Since the crisis and 2014, SNG investment has decreased due to increasing operational costs and wages. It decreased by 6.2% per year in real terms between 2007 and 2017. It currently constitutes 9% of subnational spending. In 2016, 74% of SNG investment was channelled to general public services, and 6.4% to education infrastructure.

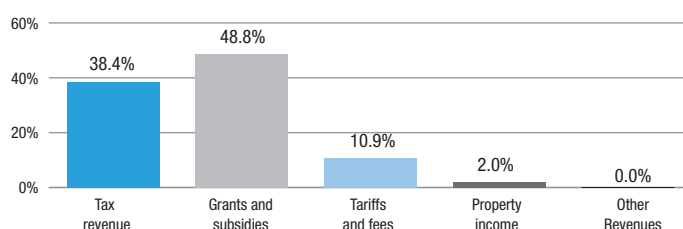
SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG

Two SNG spending areas stand out: general public services and education. In 2016, general public services as a percentage of overall SNG spending was much higher than the EU average (35.2% vs 16.5% in 2016). Public administration costs are high and administrative functions absorb more than one-third of SNG expenditure. For smaller municipalities this figure can reach one half. SNG spending on education comes next (31.2% vs 19.6% in the EU28), yet SNGs do not cover teacher and staff wages (which are funded by central authorities). They are, however, responsible for construction, maintenance, school equipment, etc. The share of healthcare is also significant, above the EU average (13.1% in 2016), as SNGs are responsible for the structural upkeep of facilities and equipment in health institutions owned by the municipalities. They are also in charge of modernising health institutions. Municipalities and towns are responsible for the bulk of spending in primary education, housing, transport and roads and recreational activities, whereas counties spend more on other educational areas and healthcare. On the other hand, spending on transport and R&D is low and has decreased over the past few years.



SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY

2016	DOLLARS PPP / INH.	% GDP	% GENERAL GOVERNMENT REVENUE (SAME REVENUE CATEGORY)	% SNG REVENUE
Total revenue	2 767	11.7%	25.2%	
Tax revenue	1 061	4.5%	17.2%	
Grants and subsidies	1 351	5.7%		
Tariffs and fees	300	1.3%		
Property income	54	0.2%		
Other revenues	0	0.0%		



OVERALL DESCRIPTION. The SNG financing system relies on both intergovernmental transfers and tax revenues, on levels that are equivalent to those found elsewhere in the EU28. The share of grants and subsidies is however slightly higher in Croatia than in the EU28 (48.8% vs 44.1% while the share of tax revenue is smaller: 38.6% vs 41.1%). The percentage of transfers in total revenues has recently decreased (it amounted to almost 60% in 2013) due to reforms in the SNG financing system.

TAX REVENUE. SNGs account for 17.2% of public tax revenue and 4.5% of GDP, which are slightly lower than the EU averages (respectively 24.0% and 6.4% in 2016). Tax revenue comprise both shared taxes and own-source tax. 67% of SNG tax revenue (26% of SNG revenue and 3.0% of GDP) come from the PIT. The PIT is both a shared tax and an own-source tax. As a surtax, it corresponds to a surcharge of up to 18% of the PIT owed by taxpayers to the national government. The windfall only benefits towns and municipalities. Municipalities determine the rates of the surcharge within the limits set by the central government. The current maximum rates have been reduced for Zagreb City since 2015 and are now 10% for municipalities, 12% for towns up to the 30 000 citizens and 15% for cities with more than 30 000 citizens, and up to 18% for the City of Zagreb (30% before the reform). As a shared tax, towns and municipalities receive 60% of the PIT collected in their jurisdiction, whereas 17% go to counties. The City of Zagreb receives 76.5%.

The second source of shared tax revenue is the tax on real estate transactions. In 2016, 80% of this tax was assigned to towns and municipalities. In 2018, its tax rate, determined at national level, has been reduced, from 5% to 4%, with 100% now earmarked to local governments. Other own-source local taxes are the “communal fee”, the consumption tax, tax on vacation homes, and the tax on public area use. The “company name” tax was abolished in 2017. The “communal fee” is a quasi-property tax. It represented 16.6% of SNG tax revenue and 6.4% of SNG in 2016. Municipalities set the base of the fee and decide on the frequency of collection. The 2016 national reform programme plans to replace the communal fee by a simple property tax first, followed by a value-based property tax. As of November 2016, 96% of local government units had properly registered all properties within their jurisdiction. In 2016, the property tax amounted to 0.7% of GDP, below the OECD average of 1.1% for 2016. Counties’ own-source taxes include the tax on inheritance and gifts, motor vehicles, boats and vessels, and gambling machines. County tax rates are set by the state government only. In contrast, the rates on municipal, town and city taxes are set by the municipal authority, within a range that is controlled by the central government.

GRANTS AND SUBSIDIES. The intergovernmental grant system comprises two main equalisation grants. The “Fiscal Equalisation Fund” (FEF) is a non-earmarked fund that amounted to EUR 270 million in 2017. Money for the fund comes from a percentage of the PIT (around 17%), which is pooled at the central level. This fund aims at equalising income inequality, mostly due to the inequalities in PIT revenue, across SNGs. It is redistributed according to local governments’ individual shares set annually in the budget, calculated based on 5-year per capita PIT revenue and target revenue. The central government has set “minimum financial standards” for the provision of public services devolved to SNGs. These standards are based on a set of indicators that define the minimum expenditure at the local government level in each individual decentralised activity.

In addition, 6% of the PIT is earmarked for specific decentralised functions (primary and secondary education, social care, health care and firefighting). It is redistributed through the Equalisation Fund for Decentralised Functions (EFDF). This earmarked grant, determined annually by line ministries, amounted to approximately EUR 200 million in 2017. Overall, current grants represented 94% of total grants and almost half of total SNG revenue in 2016, while capital grants are minimal.

OTHER REVENUES. SNGs receive revenues generated from fines, administrative charges and fees for the use of public, municipal or city land. They are solely in charge of setting rates and collection. Additionally, there are “shared fees”, such as a fee on the use of mineral and thermal water resources (50% is directed to the local budget) and a fee on the use of drinking water (30% goes to the local and 70% to the central budget). Tariffs and fees accounted for 10.9% of SNG revenues in 2016 (11.6% in the EU28). Revenues from the sale and rental of municipal assets are a significant part of municipal revenue. SNGs also receive revenues from financial assets (profits of municipal-owned companies). They are usually used for the construction and maintenance of utilities infrastructure. They account for a relatively high level of revenues, compared to the EU28 average (1.2%).

SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

2016	DOLLARS PPP/INH.	% GDP	% GENERAL GOVERNMENT DEBT	% SNG DEBT
Total outstanding debt	707	3.0%	3.1%	100%
Financial debt*	346	1.5%	1.7%	49.0%

* Currency and deposits, loans and bonds

FISCAL RULES. The first Croatian law on fiscal responsibility was adopted in 2010, and it was amended upon Croatia’s admission to the European Union in mid-2013. It sets limits on national and SNG spending, strengthens the legal and functional accountability of budgetary resources, and introduces stronger controls for financial reporting. A new draft act was enacted in 2018, adjusted to the obligations stemming from the Stability and Growth Pact.

DEBT. Counties and local governments can borrow to finance capital investment (golden rule), with previous approval by the central government. In addition, there are two main prudential rules: a general limit on the aggregate borrowing of all SNGs (2.3% of current revenues of the previous year) and an individual limit (20% of current revenues of the previous year). These percentages are determined annually by the Act on the State Budget Execution. These limits do not include municipal utility companies and/or guarantees issued by local governments, which is why local government units have ‘hidden debt’. SNG debt in Croatia is relatively low, both as a share of GDP and of public debt, well below the EU28 average (14.3% of GDP and 14.4% of public debt). Half of outstanding debt is composed of financial debt (“Maastricht debt”), the other half being made up of “other accounts payable” (commercial debt, arrears). Loans made up the bulk of financial debt (1.5% of GDP and 1.7% of public debt in 2016) and bonds accounted for less than 1% of debt stock in 2016.



Socio-economic indicators: OECD // Eurostat // World Bank // UNDP // UN Desa // ILO.

Fiscal data: Eurostat // OECD (2018) Subnational governments in OECD countries: key data // OECD (2018) Key Data on Local and Regional Governments in the European Union // Croatian Bureau of Statistics // Croatia Institute of Public Finance.

Other sources of information: Teles F., Swianiewicz P. (2018) Inter-municipal cooperation in Europe, Institutions and governance // NALAS (2018) Fiscal Decentralisation Indicators for South-East Europe Seventh Edition // World Bank (2018) The Republic of Croatia: Systematic country diagnostic // Magas, D. (2016) Regionalism in Croatia. The Assembly of European Regions // European Committee of Regions (2016) Division of Powers // International Monetary Fund. (2016) Selected Issues: Republic of Croatia // Council of Europe (2016) Local and regional democracy in Croatia Congress of Local and Regional Authorities.