

Decentralisation of Financing of Self-Government Units in the Republic of Croatia

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Abstract

Since its independence the Republic of Croatia has commenced a thorough reconstruction of its taxation system according to the market economy taxation policy. Essential taxation reforms have brought the system closer to EU systems i.e. it has been being harmonized with taxation systems of developed European countries. The Republic of Croatia has adopted solutions that are used by the majority of European countries. Current tax system of the Republic of Croatia can be viewed through three fiscal levels, but this paper deals with decentralization and revenue, especially tax revenue of local and regional self-government units. The paper will present importance and a way of collecting revenue, especially tax revenue and satisfying public needs in terms of counties, cities and municipalities. The local and central characteristics of the certain types of taxes and the specialities thereof, as well as the applied functional differences are also scrutinized, and a widely accepted opinion of the taxpayers is explained. Taking these into account, the scientific contribution of this paper is that it provides a basis for further research on tax system development.

Keywords: Decentralization, self-government units, regional and local taxes

Introduction

The trend of decentralisation of the state is strengthening in the whole world. Usually it is defined as transfer of political power and influence from higher level of government (central state) to lower levels of government (regional and local self-government units). The process of decentralisation differs from state to state, but the one thing they all have in common is the need for more successful public sector. With the process of decentralisation of public services we decide how to please in the optimal way residents of each local self-government unit because the local government has the best insight for pleasing different local interests needs for public goods and

services. Consequently, one of the most important benefits is the higher efficiency of providing public needs and services.

The others goals that can be achieved by fiscal decentralisation are reduction of share of public sector in the whole economy, mobilising public revenue and at the same time reducing costs of provision of public services, adjustment of responsibilities for local expenditures with available financial means, strengthening of own revenue of local self-government units and promoting the cooperation of different levels of government in providing public services.(Jurlina Alibegović, 2003, pp. 93-94)

Fiscal decentralization in the Republic of Croatia

The goal of every state decentralisation is to recognize and please the public needs and to encourage local and regional development. Only by achieving those goals of decentralisation can the state create motivation and satisfaction of its citizens for contributing to accomplishment of public affairs. In the Republic of Croatia decentralisation presents itself through three levels of government. We talk about the highest level, i.e. the state, the middle regional level, i.e. counties (20 of them) and the third local level, i.e. cities and municipalities (556 of them). Each of the fiscal levels has its powers and responsibilities.

The Croatian self-government systems belong to the intermediate model of the three basic types of self-governments according to economic autonomy and funding aspects. Croatian model follows the European trends, since the types move toward each other, and, as a result of European unification, the elements, which could be separated earlier, converge due to the unifying principles.

The local government models show a number of differences, however, certain similarities, some traditional values occur in all countries. Certain values are specified by the legal regulation of every EU Member State, and are also declared by the European Charter of Local Self-government (hereinafter referred to as the Charter) accepted by the Council of Europe.

Article 9 – which includes eight sections – (Financial resources of local authorities), the longest part of the Charter, regulates the finances of local governments. It provides detailed guidelines on local self-governments, and contains the following financial and economic management principles:

- principle of income: the local authorities are entitled to their own financial resources, of which they may dispose freely within the framework of their powers;
- local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the corresponding law (the principle of entitlement to the financial resources adequate to the responsibilities);

- the principle of local taxation powers (local taxation rights, and the right to introduce other local payment obligations; part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate);
- reduction of financial disparities between the local self-government units (so-called equalization principle);
- the use of funds as per the statutory limits (the principle of expenditure);
- as far as possible, grants to local authorities shall not be earmarked for the financing of specific projects (the limitation of earmarked funds);
- the autonomy of management decisions within their own jurisdiction (principle of discretionary powers);
- participation in the central decision-making concerning local self-government finances (principle of participation).

The most important principle is the entitlement to appropriate financial resources, which means, on one hand that the volume of municipal funds shall be commensurate with the extent of local government responsibilities set forth in the corresponding law in the legislation and, on the other hand, the amount of funds allocated at the local self-governments can be considered as appropriate, if they keep pace with the cost of carrying out their tasks (Paragraph 4 of Article 9 of the Charter). (Ercsey et al., 2010, p. 155)

It is in accordance with the single European principles and unifying trends, that Croatia developed its tax system in compliance with the requirements of the European Union, by fulfilling the related harmonization tasks. The current Croatian tax system can be examined through three fiscal levels. This paper deals especially with tax revenue of local and regional self-government units, by presenting the way of realizing tax revenue, levying and collecting taxes, furthermore satisfying public needs on state, county and city levels. (Jerković, 2017, p. 359.)

Since the declaration of its independence, the Republic of Croatia has commenced thorough reconstruction of its tax system as well, since it had to meet the requirements of the new political system terminating the war period, as well as the challenges of market economy closing the socialist character. Essential tax reforms have brought the system closer to systems of the EU Member States, through its harmonization with taxation systems of developed European countries.

Croatian system of financing local units can be divided into two periods: first, from 1994 to 2001 and the second, from 2001 to present. In the first period, the financing system of the self-government unit is centralized and local units have limited autonomy in collecting in collecting revenue and allocating its expenses. This period is marked by the adoption of legal solutions in which the powers of financing have been established, as well as

the allocation of fiscal and administrative powers between central state and self-government units. There are three levels of government in Croatia: central government, counties and local units (municipalities and cities). The counties, besides having the status of local self-government, were also administrative units. Since 2001, all local units and more clearly defined powers and scope of local units can be performed by the administrative and self-governing functions. (Bajo et Bronić, 2004, p. 446)

Fiscal autonomy denotes the ability of local units to independently determine the bases and rates of tax but also non-tax revenue. Self-government units in Croatia are not fully autonomous in determining the basis and rate of tax revenue. Self-government units in relatively small extent determine the rates of local tax revenues. The tax rates of shared taxes (shared between municipalities, cities, counties and counties) and county taxes are entirely determined by the central government. The rates of municipal and city taxes are mainly determined by municipal or city authorities, but within the limits set by the central government. Only for one type of municipal or city tax (tax on public land use) the local authorities fully independently determine the tax rate. (Bajo et Bronić, 2004, p. 448)

	Central government	Local government-autonomous	Local government-limited
Shared taxes	X		
Personal income tax			
County taxes			
Inheritance tax	X		
Tax on motor vehicles	X		
Tax on boats	X		
Tax on gaming machines	X		
Municipal and city taxes			
Surtax to income tax			X
Tax on consumption			X
Tax on holiday homes			X
Tax on sales on real estate	X		
Tax on public land use		X	

Table 1: Allocation of authority to determine tax rates

In the distribution of tax instruments among the levels fiscal authorities it is necessary to:

- define local types of taxes
- determine which subject chooses the tax base, which value is taken as a tax base and which subject estimates it
- which subject determines the tax rate
- which subject is administering the tax administration.

Non-tax revenue are autonomous revenue of self-government units that have a predetermined purpose. The tax rate of non-tax revenue is determined locally by the local self-government units which independently perform their collection as well. The central government determines the maximum rate of non-tax revenues that may be introduced by self-government units. The main non-tax revenue are utility charges and contributions by which local self-government units finance the construction and maintenance of communal and utility infrastructure. Utility charges and contributions are at the same time the highest revenue of local self-government units. (Bajo et Bronić, 2004, p. 450)

Scope of authority of local and regional self-government units

Law on Local and Regional Self-Government regulates the scope of functions of municipality and city separated from the scope of functions of county. Pursuant to the provision of Article 19 of the Law, local and regional self-government units in their self-governing scope perform the tasks of local importance, and especially see to jobs that are not constitutionally or legally assigned to government bodies, relating to the planning of settlements and housing, spatial and urban planning, social welfare, primary health care, education, etc.

The powers and responsibilities of counties

County conducts services of a regional importance, and which are not assigned by the Constitution and laws to the national authorities. The incidence of county can be original (self-governing) and entrusted to (services of state administration).

County in its self-management scope performs services relating to:

- education
- health care system
- spatial and urban planning
- economic development
- transport and transport infrastructure
- maintenance of public roads
- planning and development of a network of educational, health, social and cultural institutions
- issuing construction and location permits and other documents related to construction and implementation of spatial planning documents for the county outside the big city
- other activities in accordance with special laws.

By the decision of the representative body of local self-government unit in accordance with its statute and the statute of the county, some jobs of

self-government scope of the municipality or city can be transferred to the county.

Entrusted services relate to services of state administration which are carried out by a county and are defined by law. The costs of these services shall be paid from the state budget.

The powers and responsibilities of cities and municipalities

Municipalities and cities in their self-governing domain (scope) perform the services of local importance which directly actualize the needs of citizens, which are not assigned by the Constitution and laws to the national authorities and in particular services related to:

- planning of settlements and housing
- spatial and urban planning
- utility services
- childcare
- social care
- primary health care
- education and primary education
- culture, physical culture and sport
- consumer protection
- protection and enhancement of natural environment
- fire and civil protection
- traffic in their area
- other activities in accordance with special laws.

To meet its duties, counties, cities and municipalities have to find means of finance- mostly deriving from public revenue. When we talk about financing local and regional self-government units most often we talk about fiscal capacity and its strength. Fiscal strength of these units varies a lot especially when it comes to municipalities and cities.

Revenue of local and regional self-government units

Financing of local and regional self-government units in decentralized countries is of great importance, both for the development of the overall economy, as well as for the development of local and regional self-government units which carry out the logic of polycentric development. To satisfy this postulate it is necessary to find the optimal method of financing-Local and regional self-government units in their budgets have to ensure revenue which are proportional to expenditures, from its own sources, of shared taxes and grants from state and county budgets.

Revenue of local self-government units can be collected through:

- self-collecting revenue
- revenue allocation.

The autonomous right to collect revenue is defined and prescribed by law, and includes the right of local self- government units on creating their own source of funding.

The model of financing of local self-government units consists of two basic forms of fiscal revenue:

- Own sources of revenue: local taxes and user fees.
- External sources of income: aid, participation in shared tax and non-tax revenue and revenue from borrowing.

The model of financing of local self-government units can also be differently divided (within the main sources of local self-government unit revenue):

- Tax revenues
- Non-tax revenue
- Capital Revenue
- Grants.

Revenue of local and regional self-government units in the Republic of Croatia is divided as follows:

1. Income from movable and immovable objects in their possession
2. Income from companies and other entities owned and revenue from concessions granted by local self-government units
3. Revenue from the sale of movable and immovable objects in their possession
4. Gifts, inheritances and legacies
5. Municipal, town and county taxes and fees and duties, whose rates, within the limits specified by law, are determined independently
6. Government assistance and grants provided by the state budget or a special law
7. Compensation from the state budget for performing services of the state administration, which were conveyed to them
8. Other revenue determined by law.

County and municipal/city revenue

Law on Financing of Local and Regional Self-Government Units and Law on local taxes determine the resources of funds and financing services from the scope of the counties, municipalities and cities.

- a) County revenue

Revenue from own property

- a) Income from movable and immovable objects in the possession of the county
- b) Income from companies and other entities owned by the county

- c) Revenue from the sale of movable and immovable objects in the possession of the county
- d) Gifts, inheritances and legacies

County taxes

- a) Inheritance tax
- b) Tax on motor vehicles
- c) Tax on boats
- d) Tax on gaming machines

Fines and confiscated assets for the offenses that are prescribed by the county itself

Other revenue determined by special law.

- b) Municipal and city revenue

Revenue from own property

- a) Income from movable and immovable objects in the possession of the municipality or town
- b) Income from companies and other entities owned by the municipality or town
- c) Revenue from concessions granted by local self-government units
- d) Revenue from the sale of movable and immovable objects in the possession of the municipality or town
- e) Gifts, inheritances and legacies

Municipal and city taxes

- a) Surtax to income tax
- b) Tax on consumption
- c) Tax on holiday homes
- d) Tax on sales on real estate
- e) Tax on public land use

- 3. Fines and confiscated assets for the offenses that are prescribed by the municipality or town themselves.
- 4. Administrative fees in accordance with a special law
- 5. Residence fees in accordance with a special law
- 6. Utility charges for the use of municipal or city facilities and institutions
- 7. Utility charges for the use of public or municipal urban areas
- 8. Other revenue determined by special law. (Srb and Perić, 2004, p. 93)

Shared taxes

There is one very important category of public revenue that we must emphasise- shared taxes. Shared tax is personal income tax. The most important remark dealing with shared taxes is revenue belonging, so which unit of the public administration the revenue belongs to.

Personal income tax is the most significant revenue especially when it comes to cities and municipalities.

Revenue from income tax is divided between:

- municipality/city - 60%
- county - 16,5%
- part for decentralized functions - 6%
- part for position for aid of accommodation for decentralized functions - 16%
- part for position for aid for project co-financed with funds of European structural and investment funds, project managers being municipalities, cities and counties - 1,5%.

Decentralized functions are social care, education, health care and fire department. But it is very important to emphasize that the operational side of these functions is financed through Personal income tax. When it comes to personal income of people employed or taking care of these functions, their income derives from state budget. Operational side includes mostly material costs (buildings, equipment, furniture etc.) in connection to performing these functions. (Jerković, 2017, p. 362)

Primary goal of every local self-government unit is to provide satisfactory level of public services to its citizens, but we have to bear in mind that many of the local self-government units do not dispose of adequate own revenue for financing local public services. So the central state has to ensure adequate system of fiscal accommodation which needs to settle part of the means that are missing to successfully satisfy all of the local public needs. Issues of fiscal accommodation are being dealt with in the way that part of revenue collected from the personal income tax is extracted for decentralized functions in primary and secondary education, social care, health care and fire department (i.e. 6%). Local self-government units that do not earn enough revenue for financing those decentralized functions get part of the revenue collected from the personal income tax for position for aid of accommodation for decentralized functions (i.e. 16%)(Jurlina Alibegović, 2003, pp.96-97)

Structure of total revenue of local and regional self-government units

Total revenue of local and regional self-government units amounted to 16,1 billion HRK in 2014 which represents an increase of 1,1 % by comparison with 2013.

Most abundant revenue of local and regional self-government units are tax revenue. Tax revenue reached 11,5 billion HRK which makes 71,8% of total revenue of local and regional self-government units. By comparison with 2013. tax revenue increased by 0,8%. Revenue relised from state aid reached 2,3 billion HRK, i.e. 8,6% more than in 2013. So their share in the total revenue of local and regional self-government units amounts to 14,1%.

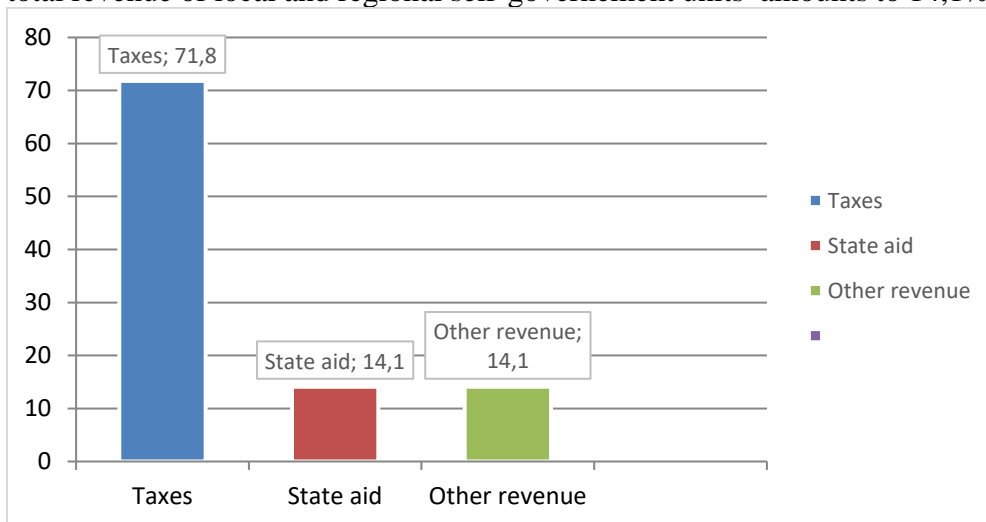


Chart 1: Structure of total revenue of local and regional self-government units in 2014. (Ministry of finance: <http://www.mfin.hr/adminmax/docs/Godisnjak%202014..pdf>, p. 66.)

Special criteria concerning local taxes

1. Tax basis should not be mobile because it can encourage tax payers to relocate to other local self-government unit.
2. Abundance and stability- local taxes should generate enough revenue or avoidance of vertical fiscal inequality
3. Allocation and location neutral taxes_ taxes should not be the reason for tax payers decision to relocate to another area.
4. Low administrative costs of collection of tax revenue should be imperative.

When we look at the structure of tax revenue we can see that the biggest share hold the revenue from personal income tax and revenue from surtax to personal income tax – 78,7 %. They are followed by property tax that amounts to 16,1% of total tax revenue of local and regional self-government units.

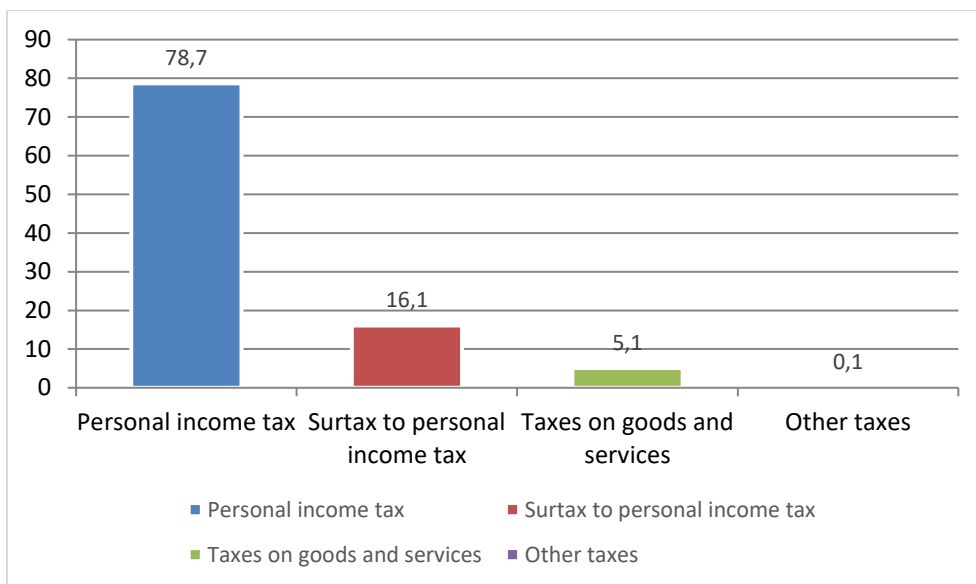


Chart 2: Structure of tax revenue of local and regional self-government units in 2014. (Ministry of finance: <http://www.mfin.hr/adminmax/docs/Godisnjak%202014..pdf>, p. 66.)

Conclusion

Fiscal decentralisation has both economic and political effects. It can serve as one of the mechanisms to promote democratic institutions and expanding the quality, quantity and diversity of public services that suit the priorities of local populations.

Fiscal decentralisation alone would not bring improved governance and ensure economic development at the local level without essential democratic institutions that responds to local priorities and preferences. Hence, fiscal decentralisation requires a favourable environment of democratic political system to operate as accountable, credible and efficient manner of mobilizing and utilizing fiscal resources, i.e. public revenue derived especially from local taxes.

The autonomy of self-governments, from the conceptual point of view and particularly from the practical approach is the assessment of the economic opportunities, the amount and structure of resources, and the freedom of use of the resource. The actual operating conditions of each system depend not on the legal regulation, but instead on the the local economic circumstances of the self-government and their involvement of local economic development, furthermore on the economic and fiscal policy of the state.

Local self-government units generate revenue for the following reasons:

- to perform self-managing functions
- to settle by the law defined public needs

- to provide the local population with the level of goods and services according to their needs.

The Croatian model, due to the important county and municipality taxes, is closer to the welfare and economic development models of self-governments, in which, besides the central dependence, a structure was established with more active self-governments providing notable services.

One of the most important things is to ensure fiscal autonomy of local and regional self-government units in executing expenditure and acquire revenue. Doing that they must ensure nearly equal possibilities for providing services to its residents and that is possible only by constant redefining aids of accommodation for decentralized functions. Also norms have to be determined in a way that current practice by which the central state regulates norms that concern units of local and regional self-government is avoided. That means that central state should not directly influence local and regional self-government units concerning their scope of authority.

Coming from the fact that degree of development of regional and local self-government units mostly differs, it is necessary to find new models of financing by which we could satisfy local needs of citizens and achieve bigger equalisation of standards. In other words it is necessary to achieve higher level of fiscal decentralisation, and that is possible only when local self-government unit has enough of own sources of financing for providing all public services within its scope of authority.

The autonomy of local self-government units in Croatia is relatively limited in determining the tax base and rates of tax revenue, but not non-tax revenue. There is also limited autonomy in defining the purpose of expenditure. Namely, local self-government units have to use most of the expenditures for legally defined purposes.

Furthermore data concerning public and local revenue are not as public and transparent as it should be. Units of local self-government do not inform citizens about efficiency of revenue collecting or its purpose and influence on economic development and improvement of life conditions. These information should be available to every citizen simply by publishing them on city or county web pages.

Also it has been established that 49% of 555 local self-government units did not impose all the revenue they could have by existing legal regulation and 29% of local self-government units did not undertake all the measures of ensuring the payment of existing debt. (Bajo, Primorac, 2013)

It is therefore important that the practice of fiscal decentralisation in Croatia be reoriented to improve the reach and quality of public services, to ensure fiscal discipline in the manner of not only paying but collecting revenue aswell, to cultivate democratic and effective institutions and in the process to

contribute to address the fundamental economic, social and political development of the local self-government unit. (Jerković, 2017, p. 366.)

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