



Local Government in Croatia

Responses to Urban-Rural Challenges

edited by

Dario Runtic

NALAS - Network of Associations of Local Authorities of South-East Europe
with the support of the Association of Cities in the Republic of Croatia





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The H2020-MSCA-RISE-2018 project aims to provide solutions for local governments that address the fundamental challenges resulting from urbanisation. To address these complex issues, 18 partners from 17 countries and six continents share their expertise and knowledge in the realms of public law, political science, and public administration. LoGov identifies, evaluates, compares, and shares innovative practices that cope with the impact of changing urban-rural relations in major local government areas (WP 1-5).

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INFORMATION

Eurac Research
Viale Druso/Drususallee, 1
39100 Bolzano/Bozen – Italy

logov@eurac.edu
www.logov-rise.eu

SCIENTIFIC COORDINATION

Eurac Research: Karl Kössler

WP 1 – Local Responsibilities and Public Services

LMU Munich: Martin Burgi

WP 2 – Local Financial Arrangements

Universidad Autónoma de Madrid: Francisco Velasco Caballero

WP 3 – Structure of Local Government

University of Fribourg: Eva Maria Belser

WP 4 – Intergovernmental Relations of Local Government

NALAS – Network of Associations of Local Authorities of South East Europe: Elton Stafa

WP 5 – People’s Participation in Local Decision-Making

Ximpulse GmbH: Erika Schläppi

EDITORIAL TEAM

NALAS - Network of Associations of Local Authorities of South-East Europe with the support of the Association of Cities in the Republic of Croatia: Dario Runtic
Eurac Research: Karl Kössler, Theresia Morandell, Caterina Salvo, Annika Kress, Petra Malfertheiner

GRAPHIC DESIGN

Eurac Research: Alessandra Stefanut

COVER PHOTO

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Local Financial Arrangements



3.1. Local Financial Arrangements in Croatia: An Introduction

Dario Runtic, *NALAS Network of Associations of Local Authorities of South-East Europe*

Total local government revenue in Croatia equals to 12.1 per cent of GDP as reported to Eurostat with local governments units managing on their own only 7.3 per cent of GDP. The most important group of revenues is shared taxes which generate about 47 per cent of consolidated local government revenues.

The single most important source of revenue is the Personal Income Tax (PIT) which generates 41 per cent of consolidated local and regional government revenues. National government sets PIT rates, levels, exemptions and credits. Local governments are allowed to impose a surcharge of up to 18 per cent on the amount of PIT taxpayers owe to the government. The surcharge currently constitutes 10 per cent of all local PIT revenues.

Since the income tax is shared between local and regional governments and also used for funding two local government equalization schemes, frequent changes of tax rates undertaken by the national government significantly affect local budgets and the predictability of revenues. This in turn affects the local governments' ability to provide uninterrupted services and demotivates any longer term planning.

About 31 per cent of local budgets come from own-sources. Most own-source revenue comes from Land Use Fees and Land Development Fees. Croatian local governments also derive a significant amount of own-revenue from the sale and rental of municipal assets and other local taxes. Fees are considered earmarked revenues, while taxes and proceeds from asset management are non-earmarked revenues. Both fees are mandatorily collected and enforced by the local government.

Local taxes include, but are not limited to: PIT surcharge, gift and inheritance tax, vehicle and vessels tax, amusement machines tax, real-estate transfer tax, second home tax, beverage sale tax, tax on use of public space, etc. Most of the taxes are either set or capped by national legislation, except for the Tax on Use of Public Space. PIT surcharge and amusement machines taxes are mandatorily collected by the National Tax Administration (NTA) and the other local taxes can be collected either by the NTA or the local government itself, pending local council decision. Croatia does not collect real-property tax, although the tax was introduced into the tax system in late 2016, but repealed by the government in September 2017, just three months shy of its effective date.

General and investment grants comprise the remainder of local government revenues. These include grants for decentralized functions, transfers of EU funds and intergovernmental transfers. Grants for decentralized functions are distributed to counties, large towns, seats of counties and a few other towns who have taken over some of the previous central government



responsibilities. Grants are based on so-called minimal standards for service provision which are calculated according to measurable indicators related to service (e.g. number of pupils in school, etc.). Funding levels for decentralized functions are rather stable and incrementally increased over the past four years. Transfers of EU funds have increased tenfold from 2014.

Over the course of last ten years, in the aftermath of the financial crisis, local government revenues dropped from EUR 3.4 billion to 2.8 billion and steadily recovered to current 3.1 billion Euro. Due to budgetary and fiscal restrictions set by law, local governments had to manage their expenditures in line with the available funding, borrowing only for investment projects. In order to maintain stable relative levels of funding for specific functions, local governments reduced funding for Housing and Community Amenities while keeping stable or increasing funding levels for social protection and education.

Current local government expenditure structure is as follows: 8.5 per cent wages and benefits, 22.8 per cent material expenditures (38 per cent of which is current and capital maintenance), 4 per cent subsidies, 24,7 per cent current and investment grants, 5.3 per cent household grants, 17.9 per cent investments in long term assets and 16.8 per cent other expenditures.

Fiscal capacities of local governments vary significantly although most of local governments have equal or similar responsibilities in terms of service provision. Rural local governments therefore provide essential public services and urban local governments provide same or similar services but in a broader scope by establishing public institutions which provide advanced level of those services (e.g. libraries, museums, etc.). The government tried to address the disparity of fiscal capacities through a complex PIT sharing mechanism which essentially failed and was replaced with new fiscal equalization scheme in 2018.

References to Scientific and Non-Scientific Publications

Legal Documents:

Local Taxes Act no 115/2016 (*Zakon o lokalnim porezima*)

Law no 127/2017 on Financing of Local and Regional Self-Government Units (*Zakon o financiranju jedinica lokalne i područne [regionalne] samouprave*)

Scientific and Non-Scientific Publications:

Bajo A and M Bronić, 'Fiskalna decentralizacija u Hrvatskoj: problemi fiskalnog izravnjanja' (2004) 28 *Financijska teorija i praksa* 445

Stafa E and others, 'Fiscal Decentralization Indicators for South East Europe: 2006-2017' (NALAS 2018)



Contacts

Local Government and the Changing
Urban-Rural Interplay
www.logov-rise.eu
logov@eurac.edu



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