

# **POLICY FAILURE OF CROATIAN DECENTRALIZATION POLICY**

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Submitted to  
Central European University  
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In partial fulfillment for the degree of Master of Arts in Public Policy

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Budapest, Hungary  
2014



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## Abstract

After it gained its independence in 1991, Croatia established a fiscally centralized and territorially inefficient structure. This situation was addressed through the decentralization policy since 2001, but as the situation largely remained the same, the policy is considered a failure. Previous literature has widely acknowledged this failure, however the question of why and how this policy failed remained mainly unanswered. In order to answer this important question, this paper uses qualitative methods and demonstrates that the sources of policy failure were twofold: 1) flaws in the formulation stage of the policy and 2) structural-underlying effects of local political-clientelism and centralism present in the system.

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## Introduction

The development and functioning of any state are significantly influenced by the arrangements concerning the centralization, decentralization, territorial structure and intergovernmental relations. Moreover, some of these concepts, particularly issues of fiscal de/centralization started to be further explored in social science (Oates, 1999: 1120).

The Croatian state had also encountered those issues soon after the country gained its independence in 1991. Many authors, some of them already in 1992, had emphasized that “the centralization of public finance in Croatia is problematic” (Petak, 1992: 104) and that future decentralization will be necessary (Petak, 1992: 104). Likewise, more recently, authors still emphasize that “mono-centric, extremely centralized system [...is...] one of the crucial characteristics of the Croatian system of public finance” (Petak, 2011: 73) and is often “depicted as the main problem of the whole political system” (Petak, 2002: 1, see also: Bajo, Alibegović, 2008; Koprić, 2014). Linked to that is the question of Croatian territorial organization. The territorial organization of the country has also often been described as “centralistic regarding the governance of public affairs”, “artificial” (Dobrić, 2009: 53), and “fragmented” (Konjhodižić, Šuman, 2009: 235). Most importantly, the fiscal centralization and adverse territorial structure are often noted as “having negative consequences” (Konjhodižić, Šuman, 2009: 235) such as inefficiency, lack of capability in providing essential public services, higher costs of service provision and worsening the disparities among jurisdictions (Konjhodžić, Šuman, 2009: 235; Mihalj, 2000: 203). These inadequate arrangements of Croatian public finances and territorial structure have been widely acknowledged.

The policy that tried to change this concerning situation started in 2001 but it largely failed, leaving the situation in approximately the same condition. The failure of the decentralization

policy in Croatia has been widely recognized in the existing literature (see Konjhodžić Šuman, 2009; Alibegović, Slijepčević, 2012; Petak, 2011; Koprić, 2014 to name a few). However, the question that is less explored is: *why and how did Croatian decentralization policy fail?* This research question is the main focus of the analysis in this thesis.

The various reasons of this policy failure are important for policy makers to understand. It is relevant to find out how and why the policy failed because the issues at stake (de/centralization, intergovernmental relations, territorial structure) will need to be resolved. The urgency of resolving these issues is even greater now when Croatia is a new European Union member and plans to rely on the EU funds for which the appropriate decentralization and territorial structures are extremely important. The decentralization policy is constantly failing despite its continued inclusion on the agenda and allocation of resources to support reform (Koprić, 2008). Recognizing and disclosing how the decentralization policy in Croatia failed highlights the reasons and factors that contributed to its failure, some of which are certainly common to many other policy issues in Croatia. In order to answer the research question and obtain some important conclusions this thesis will use several qualitative methods: process-tracing, in its explaining-outcome version, interviews, primary sources, secondary sources and academic literature.

The rest of this study is organized as follows: first, the current situation regarding the centralization and territorial organization in Croatia is presented; second, the process which created the current situation is explained; third, some theoretical and empirical arguments around the decentralization are briefly sketched; fourth, policy of decentralization in Croatia is described and assessed as failure; fifth, the decentralization policy in Croatia is analyzed in order to determine why and how the policy failed.

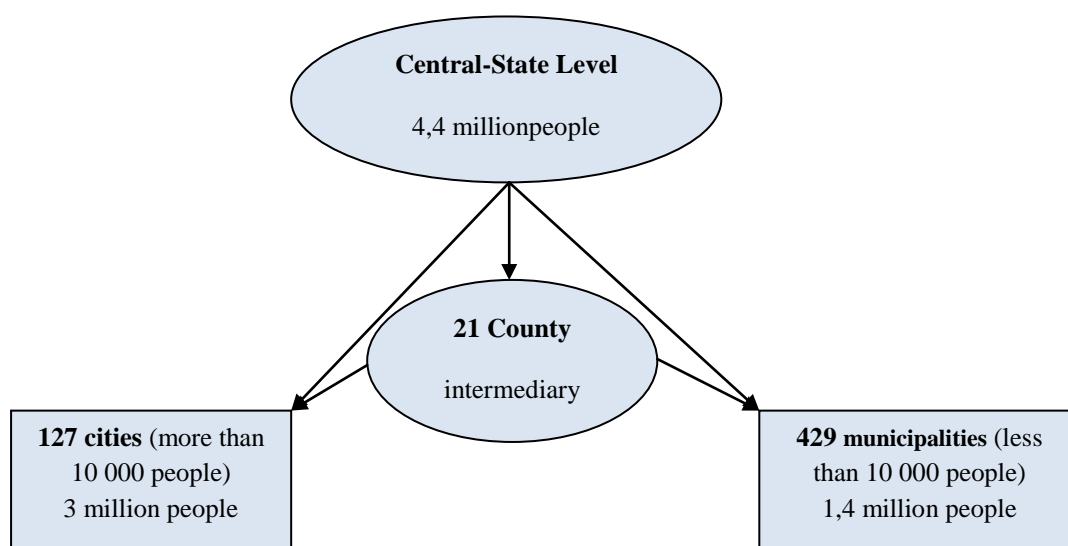


## Chapter 1: The description and background

### 1.1. Territorial organization and distribution of functions among government levels in Croatia

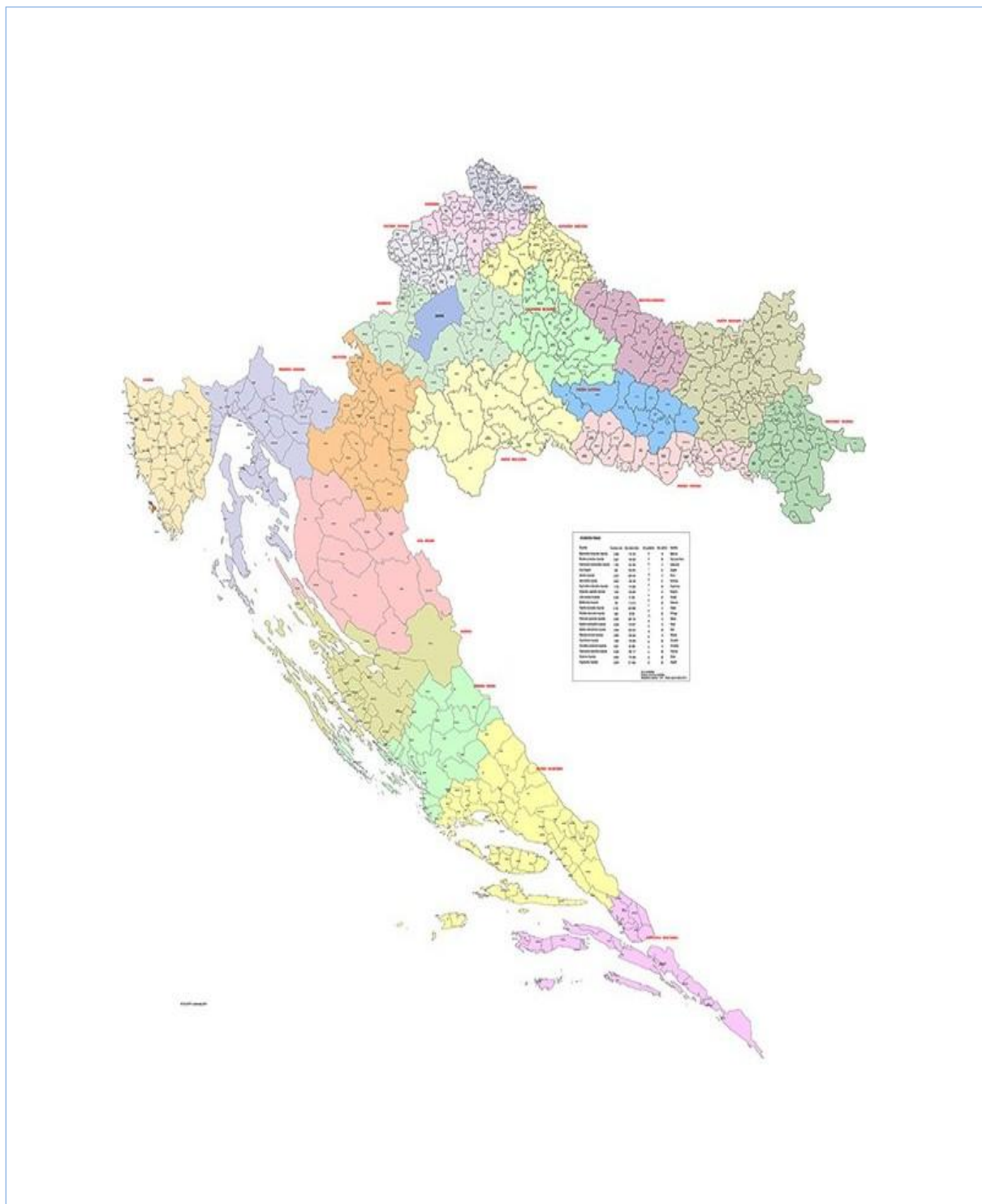
The centralized public finance system in Croatia was established in the early 1990s together with the three tier territorial structure (see Figures 1 and 2) (Petak, 2011: 73). The first tier is the national-central government tier dominating in most public functions (Konjhodžić, Šuman, 2009: 239). Units of local and regional government are established in the second and third tier (Bajo, 2007: 54). The second tier consists of counties (županije) with the regional self-government function (Bajo, 2007: 54). The third tier is municipalities (rural communities-općine), large cities and towns with the local self-government function (Bajo, 2007: 54). Although administratively divided in three tiers, the local and regional government is commonly described as “having a limited role” (Petak, 2011: 73).

**Figure 1:** Administrative – territorial organization of Croatia



Source: Bajo, 2007: 55

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The distribution of the functions among levels of government is summarized in Tables 1 and 2. The legislative framework of competences and the subnational financing are regulated in the Constitution, laws and many regulations (Bajo, 2007: 54). Moreover, some local areas are declared as being of “special state’s concern” due to economic hardship, isolation and/or the consequences of war in 1990s and they have certain benefits. Additionally, the city of Zagreb also has a special city-county status (Alibegović and Slijepčević, 2012: 3).

**Table 1:** Division of functions among different levels of government in Croatia

Public service	Central government	Municipalities	Cities	Counties
1. General public/ administrative services	•	•	•	•
2. Defense	•			
3. Law and order	•			
4. Education	•	•	•	•
4.1. Pre-school		•	•	
4.2. Elementary	•	•	•	•
4.3 Secondary	•			•
4.4. Tertiary (university)	•			
5. Healthcare	•			•
6. Social security and welfare	•	•	•	•
7. Housing and utilities		•	•	
8. Recreation, culture and religion		•	•	•
9. Agriculture, forestry, hunting and fishing	•			•
10. Mining, industry and construction	•	•	•	•
11. Transport and communications	•	•	•	•
11.1. Road transport	•	•	•	•
11.2. Rail transport	•			
11.3. Air transport	•			
12. Other economic affairs and services	•	•	•	•

Source: Konjhodžić, Šuman, 2009: 239

**Table 2:** Mandatory functions of regional and local government units in Croatia.

Local government level		Regional government level
Municipalities and towns	Large cities and county centers	Counties
<ul style="list-style-type: none"> <li>- community and housing planning</li> <li>- physical planning and zoning</li> <li>- utility services</li> <li>- child-care</li> <li>- social welfare</li> <li>- primary health care</li> <li>- primary school education</li> <li>- culture, physical culture, and sports</li> <li>- consumer protection</li> <li>- protection and improvement of the natural environment</li> <li>- fire protection and civil defense</li> <li>- local transport</li> </ul>	<ul style="list-style-type: none"> <li>- community and housing planning</li> <li>- physical planning and zoning</li> <li>- utility services</li> <li>- child-care</li> <li>- social welfare</li> <li>- primary health care</li> <li>- primary school education</li> <li>- culture, physical culture, and sports</li> <li>- consumer protection</li> <li>- protection and improvement of the natural environment</li> <li>- fire protection and civil defense</li> <li>- local transport</li> <li>- public roads maintenance</li> <li>- issuing of building and location permits</li> </ul>	<ul style="list-style-type: none"> <li>- education</li> <li>- health care</li> <li>- physical planning and zoning</li> <li>- economic development</li> <li>- traffic and transport infrastructure</li> <li>- planning and development of the network of educational, medical, social and cultural institutions</li> <li>- issuing of building and location permits and other document in relation to construction in the county area excluding the area of the big city</li> </ul>

Source: Alibegović, Slijepčević, 2012: 4

## 1.2. Situation that led to the decentralization policy initiative

There are two distinctive elements which define the creation of the problematic centralization and territorial structure in Croatia. The first peculiarity is related to the fact that the end of the 20<sup>th</sup> century is marked with the decentralization wave in the world (Oates, 1999: 1120). In order to improve the performance of the public sector, both developed and developing states are increasingly turning to the policy of decentralization (Oates, 1999:1120; Ebel, Yilmaz, 1999: 3). This process was particularly visible in the ex-socialist countries of Central and Eastern Europe in the context of achieving standards of market economy and democracy (Bird, Ebel, Wallich, 1995; Peteri, 2002). However, Croatia did not follow this trend and it experienced the opposite process of centralization in 1990s (Petak, 2011: 73). The centralization process in independent Croatia decreased the subnational share in total public expenditures from 35% to, roughly, less than 10% (Petak, 2011: 73-75). Two main reasons for this centralization process can be identified. First, the extensive war in Croatia in the

1991-1995 period highly centralized the state and public finances (Petak, 2006; Petak 2011). Second, the war period induced the central government to promote the national and central-political unity, not leaving much room for local autonomies in the times of war and nation-creation (Petak, 2011: 78).

The second peculiarity was the organization of the completely new territorial structure of the country. Croatia inherited from Yugoslavia the territorial structure that consisted of 100 communes and 1 city – Zagreb (Petak, 2011: 77). The new territorial organization established 21 regional counties, 418 communes and 69 cities<sup>1</sup> and it was organized in a way that “enabled the ruling elite a much easier control over the territory, because a number of local governments were established with the center right-wing political parties (HDZ, HSS) as ruling political parties” (Petak, 2011: 77). Hence, the 1990s territorial reorganization in Croatia was a clear example of gerrymandering and electoral engineering (Koprić, 2014: 13). Taking into consideration the size and the population, Croatia has a large number of small subnational units (Bajo, 2007: 55). The Croatian subnational units were mostly established based on political motivation and they do not contain functional, economic-fiscal, minimum inhabitant number or expert criteria (Žuljić, 2001: 13 – 16; Koprić 2014: 12; Alibegović, 2014). The territory became fragmented, meaning that a large part (35%) of small subnational units are incapable of financing their essential operating expenditures and providing essential public services (Bratić, 2008: 142). In Croatia, 71% (around 400) subnational units are smaller than 5000 inhabitants – the number which is considered to be the lower limit for providing minimum public services at minimum quality (Davey, 2002: 35). Additionally, one of the consequences of financially weak and fragmented subnational units is the prevention of the multi-centric development in Croatia (Šantić, 2014: 6). Other disadvantages of small

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<sup>1</sup> This number, eventually, increased even more on 429 communes and 127 cities in 2010, while the number of regional counties stayed the same (Petak, 2011: 77). The average population of communes fell from 45 000 to 3145 (Petak, 2011: 77).

fragmented subnational units are: loss of economy of scale, smaller financial capacity (due to a smaller number of taxpayer), loss of autonomy due to need of financial help from central government, lack of professional staff because small subnational units do not have resources to employ external experts and thus rely on the local population, which leads to the increased risk of unprofessionalism, nepotism and corruption (Dobrić, 2009: 46-47)

These two peculiar processes in Croatia created an immense centralization, not only in terms of financial resources, i.e. roughly, more than 90% of financial resources were in the hands of central government; but also in terms of control over a long list of public services that had previously been provided by subnational government (Petak; 1992: 104-105; Petak, 2011: 77-78). This extreme and paradoxical situation of fiscal centralization and in the same time subnational territorial fragmentation was recognized as problematic in 2000s (Petak, 2011: 81). In the comparative perspective, the decentralization initiative happened quite late (Konjhodžić and Šuman, 2009: 234). There are three factors which promoted the decentralization initiative, first being the end of war in 1995, the reintegration of all Croatian territories and the consolidation of the nation and democracy. There are also two other factors: centralization and territorial structure were perceived as a problem, and second, as one of the interviewee emphasized: “fiscal decentralization policy was perceived as having the ability to bring most theoretical advantages of well preformed decentralization<sup>2</sup>” (Primorac, interview). Policy reform regarding the centralization is important, especially because in almost all transition countries public finances of lower levels of government are having a crucial impact on accomplishment of economic efficiency, macro-stability and for providing the social security policy (O’Sullivan, 2001: 171). Theoretical arguments regarding the fiscal decentralization will now be briefly presented.

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<sup>2</sup> Some more specific benefits that Croatia could obtain in the case of well performed decentralization are also mentioned: stop the depopulation and overcrowding of certain areas, economic-social development, attract foreign investments in all country’s regions, increase the efficiency of administration and service provision, improve and reduce public sector and come closer to the EU standards (Mihalj, 2000: 200; Alibegović, 2002: 94)

## Chapter 2: Theoretical and empirical arguments around decentralization policy<sup>3</sup>

Decentralization can be understood as a dispersion or distribution of functions, resources and powers from a central authority to regional and local authorities (Merriam-Webster Online Dictionary, 2014; Alibegović, Slijepčević, 2012: 3). More specifically, fiscal decentralization “has to do with the degree of fiscal autonomy and responsibility given to subnational governments“ (Bahl, 1995:2). The fundamental question is the issue of aligning various public functions/services with the most appropriate level of government (national or subnational) to enhance the performance of the public sector (Oates, 1999:1120). According to the mainstream definition of Richard Musgrave (Musgrave;Musgrave,1989: 6-14), the public sector has three broad and major functions: *stabilization* (the use of fiscal-budget and monetary policy as an instrument of promoting development, growth, employment and low inflation); *distribution* (the use of the taxes and transfers in order to achieve what a particular society considers a “fair” state of distribution) and *allocation function* (due to market failure, allocation function implies the public-state provision of social services, e.g. education, health/social system).

According to the dominant theory of fiscal de/centralization, the central government should be assigned with the principal responsibility for the first two functions: stabilization and distribution (Oates,1999: 1121). The reason is that lower levels of government are limited regarding the stabilization and distribution function in a certain way compared to the central level of government (Oates,1999:1121). Namely, regarding the *stabilization function*, lower levels of government “simply have very limited means for traditional macroeconomic control of their economies” because they lack monetary authority and have relatively limited fiscal

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<sup>3</sup> This chapter contains some elements (approximately 600 words of literature review which are quoted/cited in this paper through pages 9-10) of my previous paper (Kostanjevec, 2013) submitted for the Public Finance and Emerging Economics course,CEU.

capabilities (Oates, 1999:1121). Regarding the *distribution function*, lower levels of government are restricted because, for example, a generous local social program could induce an inflow of the poor with the demand for social programs and promote the departure of those who must bear the burden of a generous social program (Oates,1999:1121). However, regarding the third function, *allocation*, economic theory emphasizes that decisions about provision of public goods/services should be distributed at different levels of government in accordance with the spillovers (Samuelson;Nordhaus,2011: 310). This implies that the central-national level of government should provide public goods/services that are national in their spillover-nature, because they provide benefits for all residents of a certain country (e.g. national defense); while the subnational government should provide local public goods/services, those whose effects are limited to a certain locality (e.g. local lightening or city library) (Saumelson;Nordhaus,2011.:310).

It is possible to highlight three main reasons why subnational levels of government have a comparative advantage in providing goods and services whose consumption is limited to the specific jurisdiction and how that should enhance welfare and the more efficient provision of public services<sup>4</sup>. The first reason is called *decentralization theorem* – the decentralized provision of public goods and services is more adjusted to local preferences and circumstances which increases the welfare (Oates, 1999:1121-1122). The second theoretical reason is the fact that decentralized levels of government are simply closer to the people, their needs, hence they will be more policy responsive, adaptable and swifter (Oates, 1999: 1120; Adamovich, Hosp, 2003). The nearness to the information (that is never centralized at one place) is an important condition of economic efficiency (see Hayek, 1945) and decentralized governance emulates the perfect market conditions more closely than centralized government. The third reason speaking in favor of decentralization is empirical. The obvious fact is that

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<sup>4</sup> There are also other reasons, such as voting with feet concept (see Tiebout, 1956) or club theorem (see Buchanan, 1965), however they are less applicable in the Croatian context.



developed countries are more decentralized than developing countries (Oates, 1985: 753–754). Oates presents the figures for 43 developed and developing countries: in developed countries, on average, the share of the subnational government is 35%, while in developing countries the share of the subnational government is only 11% (Oates, 1999: 1141)<sup>5</sup>.

Although in the Croatian case the arguments that stress the advantages of the (fiscal) decentralization policy largely prevailed, for the purpose of complete account it is conducive to present the arguments of the authors that emphasize some of the dangers of (fiscal) decentralization policy. Prud'homme points to the negative sides associated with rising regional inequalities in case of decentralization, particularly if the equalizing role of the central government is limited (1995). Other eventual drawbacks of decentralization are also mentioned: the possible problems of macro-economic instability due the limitations of the subnational governments in conducting stabilization policy; eventually insufficient fiscal revenues of central government; the more complicated coordination system due to more independent local/regional units and the increased risk of corruption due to the larger influence of locally powerful persons in particular localities (Krtalić and Gasparini, 2007: 6-7; see Rodden, 2006). Prud'homme and Tanzi report that in performing decentralization, some of the taxes are often assigned to a wrong level of government, that the administrative capacity of local governments can be weaker or that the grant system can be promoting inefficiency of certain subnational units (Prud'homme 1995; Tanzi, 1995). After this brief overview of the general discussion around decentralization, the decentralization policy in Croatia will be extensively presented.

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<sup>5</sup> Nevertheless, the question whether fiscal decentralization is the cause or the consequence of economic development is unclear and can be described as “a chicken and egg problem” (Quigley, 1997: 83) because the link between cause and consequence is vague (Quigley, 1997: 83; 99-100; see: Breuss, Ellor, 2004; Martinez, McNab, 2001).

### Chapter 3: Policy of decentralization in Croatia and its failure

Due to high levels of described centralization in Croatia, problems that were caused by that and presumed benefits of decentralization – the process and policy of decentralization started in July 2001 (Alibegović, Slijepčević, 2012: 3). In sum, based on primary sources<sup>6</sup> and secondary literature sources (Petak, 2011; Konjhodžić, Šuman, 2009; Alibegović, Slijepčević, 2012; Koprić, 2008), the decentralization policy in Croatia had two main goals<sup>7</sup>:

- first, to endow subnational levels of government in Croatia with new functions and tasks in five areas: primary and secondary education, social welfare, healthcare and fire fighting,
- second, to create a certain degree of fiscal decentralization by allocating new financial resources to subnational levels of government so they can perform newly assigned functions.

If we conceive that policy fails “if it does not achieve the goals [...] set out to achieve” (McConnell, 2010: 356) than the decentralization policy in Croatia can essentially be understood as a policy failure (see for the same conclusion: Konjhodžić Šuman, 2009; Alibegović, Slijepčević, 2012; Petak, 2011; Bajo, Bronić, 2004; Koprić, 2014). Unfortunately, although even described as “the most favored reform policy priority among the Croatian politicians of all options” (Konjhodžić and Šuman, 2009: 233) the decentralization policy in

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<sup>6</sup> The most important primary source regarding the Croatian decentralization policy is the Law on Local and Regional Self-Government (2001) passed in July 2001 in Croatian Parliament after which the decentralization policy was initiated. Important primary sources for individual areas of the decentralization policy are also: Law on Primary Education (2003); Law on Secondary Education (2003); Law on Social Welfare (2013); Law on Obligatory Healthcare (2013); Law on Firefighting (2004).

<sup>7</sup> Naturally, this specification is summarized and somewhat artificial. “Given the strong incentive of blame-avoidance, governments are encouraged to avoid the precise definition of goals...” (Werner, Wegrich, 2007: 54).

Croatia did not achieve two above mentioned goals. Therefore, two mentioned goals will be perceived, for the purposes of this paper, as main indicators of policy failure<sup>8</sup>.

### **3. 1. The first indicator of failure: failing in endowing subnational levels of government in Croatia with new functions and tasks**

The first goal of decentralization policy in Croatia implied assigning new responsibilities in providing public functions/services at the subnational level in five spheres in which the significance of subnational government units was (and still is) considerably lower than in other transitional states (Petak 2004: 29). The adopted model of decentralization was not too broad: only material expenditures and expenditures for non-financial assets in five areas were to be decentralized (Bajo, 2007: 57). Nevertheless, only 34 financially stronger cities and 20 counties had taken new responsibilities (Alibegović, Slijepčević, 2012: 5) (see Table 3).

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<sup>8</sup> Naturally, rarely it can be said that one policy is a complete success or failure (McConnell, 2010). Although the decentralization policy in Croatia is close to a complete failure, it canceled the undemocratic stipulation that the governors of the Croatian counties must be also confirmed by the President (Koprić, 2014: 10). Although this is important, it is not in our focus because it is more related to the matured Croatian democracy and less to decentralization.

**Table 3:** Financing of public expenditure for decentralized responsibilities

<b>Decentralized responsibilities</b>	<b>Counties (20) and financially stronger cities (34)</b>	<b>State budget</b>
<b>Primary education</b>	<ul style="list-style-type: none"> <li>– material and financial expenses</li> <li>– maintenance and investment expenses</li> <li>– fixed assets expenses</li> <li>– investment on nonfinancial fixed assets</li> </ul>	<ul style="list-style-type: none"> <li>– wages and salaries</li> <li>– local transport expenses for employees</li> <li>– employer contributions</li> <li>– training</li> <li>– school IT equipment</li> <li>– library supply and equipment</li> </ul>
<b>Secondary education</b>	<ul style="list-style-type: none"> <li>– material expenses</li> <li>– local transport expenses for employees</li> <li>– co-financing of expenses for housing and organized meals for students in dormitories</li> <li>– maintenance and investment expenses</li> <li>– school equipment expenses</li> <li>– investment on nonfinancial fixed assets based on standards and benchmarks set up by the Minister decision</li> </ul>	<ul style="list-style-type: none"> <li>– wages and salaries</li> <li>– local transport expenses for employees</li> <li>– training of teachers</li> <li>– expenses for teaching pupils in national minority language</li> <li>– expenses for teaching pupils with developmental difficulties</li> <li>– expenses for programmes for talented pupils</li> <li>– school IT equipment</li> <li>– library supply and equipment</li> <li>– co-financing of private schools programmes</li> </ul>
<b>Social welfare</b>	<ul style="list-style-type: none"> <li>– wages and salaries for employees in elderly persons centers</li> <li>– material and financial expenses of elderly persons centers</li> <li>– investment on nonfinancial fixed assets in elderly persons centers</li> <li>– material and financial expenses of social welfare centers</li> <li>– expense for grants to cover heating costs of social benefits users</li> </ul>	<ul style="list-style-type: none"> <li>– employee expenses in social welfare institutions</li> <li>– nonfinancial fixed assets in social welfare institutions</li> </ul>
<b>Healthcare</b>	<ul style="list-style-type: none"> <li>– structure and equipment maintenance of the health institutions owned by the municipalities and the City of Zagreb</li> <li>– informatization of health institutions</li> </ul>	<ul style="list-style-type: none"> <li>– wages and salaries</li> <li>– training</li> <li>– non-financial fixed assets</li> </ul>
<b>Fire fighting</b>	<ul style="list-style-type: none"> <li>– employee expenses in public fire brigades</li> <li>– material and energy expenses</li> <li>– financial expenses for public fire brigades</li> </ul>	

Source: Alibegović, Slijepčević, 2012: 5

The less than partial accomplishment – in other words, policy failure – of the intended decentralization goal is clear, if we know that only 54 units of subnational government out of 576 accepted new responsibilities (Alibegović, Slijepčević, 2012: 5). The failure is even more

obvious in the following quantitative indicator: only 9% of the total number of subnational units in Croatia accepted new functions<sup>9</sup> (Bajo, 2007: 57). Another 91% of subnational units simply rejected the administration of intended public services (Petak, 2011: 79) The initial intention in 2001 was to further decentralize public services in the future. However, “most of the existing ten public functions are still under jurisdiction of the central state [and] this is also the case with five public functions that are only partially decentralized” (Alibegović, Slijepčević, 2012: 23).

### **3. 2. The second indicator of failure: failing in creating a degree of fiscal decentralization**

The second goal of the decentralization policy in Croatia was creating some degree of fiscal decentralization. This goal can be understood as having two sub-goals: 1) enhancing the fiscal autonomy of the subnational units and 2) increasing their ratio in total government revenues, expenditures and in total GDP.

#### **3. 2. 2. The first sub-goal: enhancing the fiscal autonomy of the subnational units**

After the allocation of new responsibilities to the subnational units, the decentralization reform also created a new system of subnational government financing. Subnational units in Croatia generate revenues through: own sources, shared taxes, grants and borrowings (Alibegović, Slijepčević, 2012: 7). Table 4 contains a brief summary of the current system of subnational government financing in Croatia.

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<sup>9</sup> Interestingly and expectedly, those 9% of all subnational units in Croatia dispose with 70% of overall subnational units' budget (Bajo, Bronić, 2004: 447). This is also the indicator of uneven financial capacities of Croatian subnational units: all 429 municipalities generate only 15,8%, all 20 counties only 15,4%, 126 cities/towns 39,9% and Zagreb alone generates 28,9% of total subnational revenues (Alibegović, Slijepčević, 2012: 14). Nevertheless, all subnational units (except cities over 35 000 people) have equal responsibilities (Alibegović, Slijepčević, 2012: 26).

**Table 4:** Review of revenue sources of subnational units in Croatia

<b>Tax revenues</b>	<b>Municipal, town and city taxes:</b> Surtax on income tax Consumption tax Tax on vacation homes Tax on firm or name Tax on the use of public surfaces <b>County taxes:</b> Tax on inheritance and gifts Tax on motor vehicles Tax on boats and vessels Tax on gambling machines
<b>Nontax revenues</b>	Revenues of local government units' for which the purpose is set in advance (roughly 20 local government nontax revenues such as charges and fees).
<b>Capital revenues</b>	Financial asset revenues (profit revenues of municipal owned company) Non-financial asset revenues (rental revenues)
<b>Shared taxes</b>	<b>1. Personal income tax:</b> Central state – 0% <u>3 type of distribution:</u> Standard Distribution: 15% county; 52% municipality/city; 12% government level that have taken decentralized functions; equalization fund 21% Capital city: 79% Zagreb; equalization fund 21% Areas of special national concern (war damaged areas, hill and mountains areas, islands): 10% county; 90% municipality/city  <b>2. Tax on real estate transaction:</b> Central state – 40% Municipalities and towns – 60%
<b>Grant revenues</b>	Grant revenues from the state budget (personal income and profit tax returns) allocated to the subnational units which belongs to the “special state concern” area. Grant revenues from the state budget to the subnational units for the local development projects. Grant revenues from the state budget as equalisation fund allocated to the subnational units for financing decentralized functions.
<b>Borrowing</b>	Requisite of the previous approval by the Croatian Government for sub-national government borrowing. Total borrowing limits for subnational governments: up to 20% of outturn of current revenues and up to 2.3% of outturn of current revenues of all sub-national government units

Source: Alibegović, Slijepčević, 2012: 7; Konjhodžić, Šuman, 2009: 250

Most importantly, subnational government own-autonomous revenue sources in Croatia include: income from county, city, town or municipal taxes; from fees, fines and charges collected within their area; and income from subnational governments' own property (Alibegović, Slijepčević, 2012: 8). The essential part of any decentralization is to ensure the fiscal autonomy of subnational units, in other words “the capacity of local government units to fix the bases and tax rates as well as non-taxation revenue independently” (Alibegović,

Slijepčević, 2012: 8). However, there are two main indicators of weak fiscal autonomy of subnational units. Firstly, the Croatian subnational units have no authority in the tax-base and tax-rate determination except in the area of one tax: rate on the use of public surface – which is less than 1% of subnational revenue (Alibegović, Slijepčević, 2012: 8). The rates of non-tax revenues are set by the subnational units but are earmarked for certain purposes and (communal) expenditures and are within the limits stipulated by the central government and, thus, cannot be perceived as the best example of autonomous revenue (Bajo, 2007: 60-61; Alibegović, Slijepčević, 2012: 9). Secondly, as Alibegović and Slijepčević indicate, the most important revenue sources of the subnational units in Croatia are: tax revenues which are primarily shared with and determined by the central government (61,1%), subsequently, non-tax revenues (18,4%) and then grants (8,7%) from the state government (2012: 12-14). This structure also shows weak fiscal autonomy of the subnational units. Much more than half of the total subnational government revenues consist of revenues completely outside of subnational governments' reach (Alibegović, Slijepčević, 2012: 19). Thus, the financing of partially decentralized functions is still mostly done from the central budget revenues (Alibegović, 2012: 19-23). There is weak fiscal autonomy of subnational units (Alibegović, Slijepčević, 2012: 23) and the sub-goal of the increased fiscal autonomy of subnational government was not accomplished in Croatia.

### **3. 2. 3. The second sub-goal: increasing subnational government units' ratio in total government revenues, expenditures and in total GDP of Croatia**

Another signal of the fiscal decentralization and fiscal strength of subnational units are four concrete indicators: the share of revenues and expenditures of subnational government in the revenues and expenditures of the consolidated general government and in GDP. These are one of the most common and most important data for measurement of “the relative importance of sub-national levels of government in the provision of public goods/services” (Konjhodžić,

Šuman, 2009: 241; see also: Bajo, Bronić, 2004). Additionally, the following figures (Table 5) are a good proxy for showing the degree of centralization<sup>10</sup> (Bajo, 2007: 72).

**Table 5:** Revenues and expenditures of subnational government in revenues and expenditures of the consolidated general government and in GDP

Year	Revenues of subnational government			Expenditures of subnational government		
	units			units		
	Outturn in 000 Croatian Kuna's	In % of consolidated general government revenues	In % of GDP	Outturn in 000 Croatian Kuna's	In % of consolidated general government expenditures	In % of GDP
2000	8,155,966	10,93	5,35	8,263,723	10,04	5,42
2001	6,953,953	8,82	4,12	7,321,974	8,71	4,28
2002	8,332,799	10,05	4,00	8,335,141	10,25	4,00
2003	8,456,146	9,47	3,72	9,239,693	10,58	4,07
2004	9,407,683	9,76	3,83	8,599,052	9,12	3,50
2005	10,458,468	10,14	3,96	9,713,927	9,66	3,67
2006	11,901,172	10,60	4,16	10,469,573	9,72	3,66
2007	13,379,019	10,56	4,26	11,819,047	9,95	3,76
2008	14,747,477	10,95	4,31	13,650,745	10,48	3,99
2009	14,615,102	10,86	4,39	13,460,196	10,12	4,04

Source: Alibegović, Slijepčević, 2012: 21

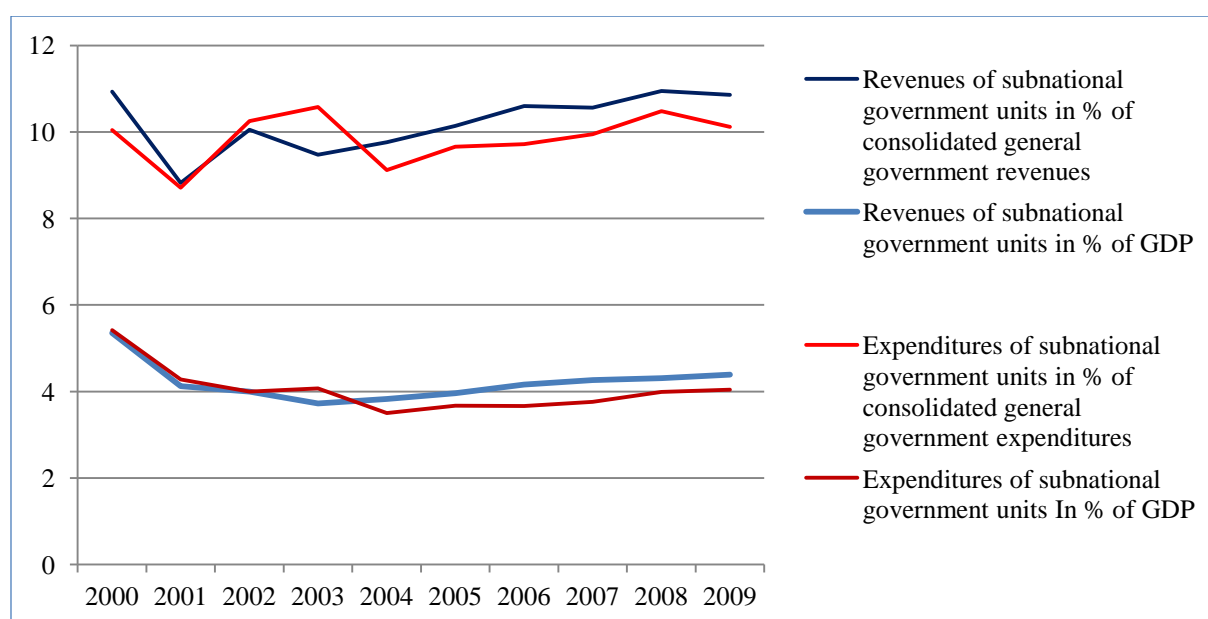
As Alibegović and Slijepčević rightly emphasize: “the share of revenues and expenditures of subnational government in the total government budget revenues and expenditures, as well as share of these revenues in GDP – before and after 2001 – could indicate the size of

<sup>10</sup> However, these measures are not perfect proxies. A large ratio of public finances can be at subnational level but with low autonomy (Krtalić, Gasparini, 2007: 7). Nevertheless, as shown in the first sub-goal, Croatian examples is the one with low autonomy and, additionally, with low percentage of finances at subnational level.



undertaken fiscal decentralization” (2012: 21). Data presented in Table 5 shows that the share of subnational government in total revenues, expenditures and in GDP change almost nothing or very slightly<sup>11</sup> (Alibegović, Slijepčević, 2012). The lack of increased fiscal decentralization is more visible in Figure 3.

**Figure 3:** Croatian subnational government in revenues and expenditures of the consolidated general government and in GDP



Source: Alibegović, Slijepčević, 2012: 22

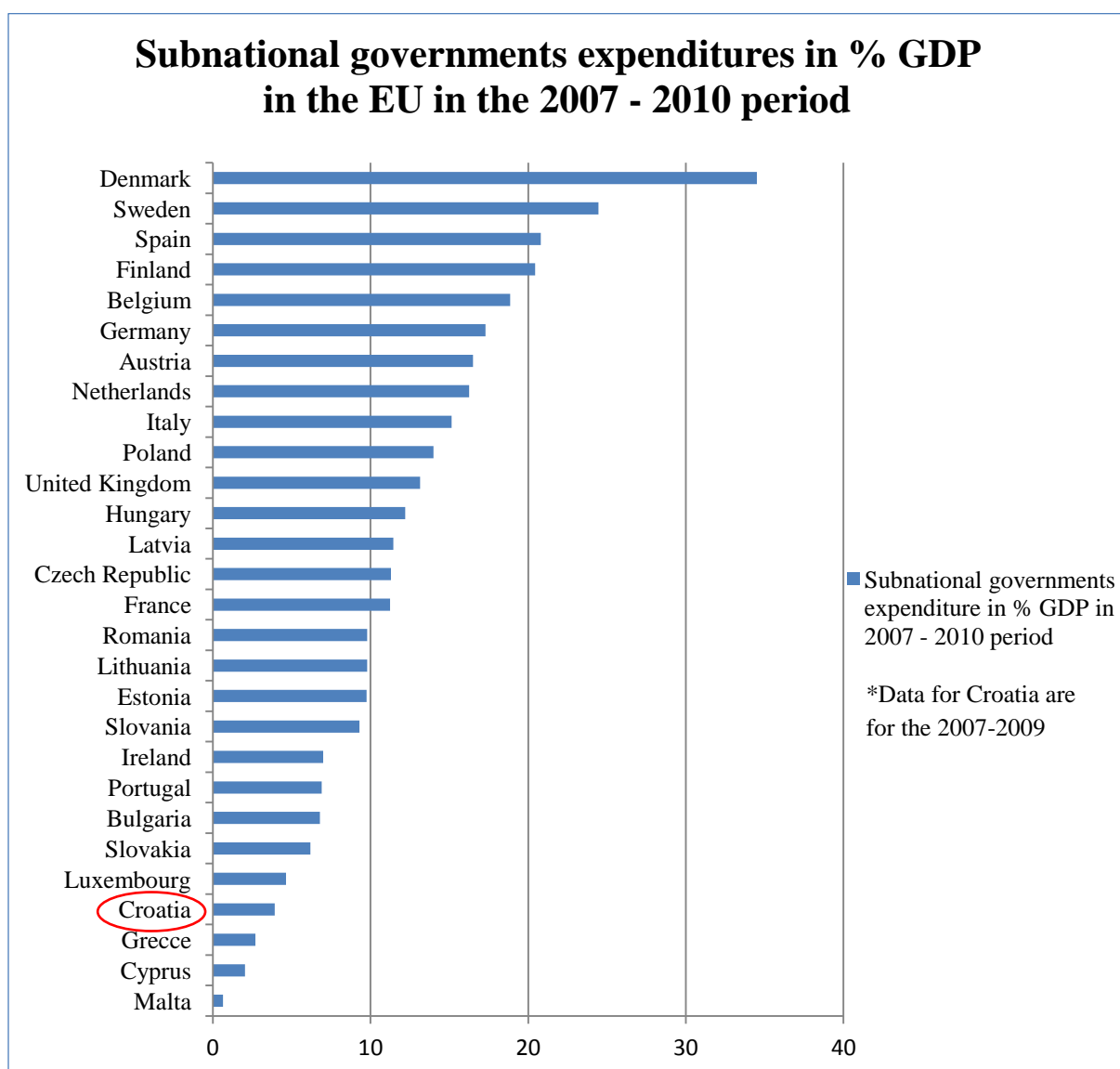
Both Table 5 and Figure 3 show that the significance of the subnational government in Croatian public finances did not increase since the beginning of the decentralization policy in 2001 and that the sub-goal of creating some degree of fiscal decentralization largely failed<sup>12</sup>. Indeed, the failure of both goals of the decentralization policy in Croatia can be supported with clear quantitative data: only 9% of the total number of Croatian subnational units accepted the conduction of newly offered public functions in five areas (goal 1) and there was

<sup>11</sup> Therefore, although some of the functions were declaratively transferred to the subnational level this was not followed with increased financial resources.

<sup>12</sup> As Konjhodžić and Šuman conclude: the share of the Croatian subnational government in the revenues and expenditures of the consolidated general government and in GDP “confirm the fact that very low degree of decentralization has been achieved in Croatia..” (2009: 255).

no change in the financial significance of the subnational level of government in Croatia as it stayed around 10% (goal 2). Consequently, even after initiating the decentralization policy in 2001, the presented “data clearly show that Croatia is still a highly centralized country” (Alibegović, Slijepčević, 2012: 22) and the advantages of properly done decentralization are not obtained. The high degree of centralization in Croatia is also confirmed in the comparative perspective, when compared with other European Union countries (see Figure 4). The lack of real decentralization is also confirmed in academic review of one of high public officials of Ministry of Finance (Lukeš-Petrović, 2002: 178). In practice, this means that decisions about public money in Croatia are still made at central level (Bratić, 2008: 152).

**Figure 4:** Croatian subnational government in comparative perspective



Source: Alibegović, Slijepčević, 2012: 21; European Commission, Economic and Financial Affairs, Workshop, 2012: 5

## Chapter 4: Analysis of the policy failure in the Croatian decentralization policy

### 4.1. Methodology and Research Question

After the failure of Croatian decentralization policy has been shown with the two most prominent indicators, the more intriguing question is: *why and how did Croatian decentralization policy fail?* This research question is the main focus of this analysis, particularly because the fact of Croatian decentralization policy failure is widely recognized in literature (see: Konjhodžić Šuman, 2009; Alibegović, Slijepčević, 2012; Petak, 2011; Koprić, 2014), but the question of why and how did failure happen is less explored.

In order to systematically answer the stated research question, the analysis will use qualitative process-tracing inspired methodology (in its most recent form by Beach and Pedersen, 2013). Process-tracing “is commonly defined by its ambition to trace casual mechanism” (Beach, Pedersen, 2013: 1). In the process-tracing context, the casual mechanism can be understood as “a complex system which produces an outcome by the interaction of a number of parts” (Glennan, 1996 in Beach, Pedersen, 2013: 1). This approach will enable us to make “strong within-case inferences” (Beach, Pedersen, 2013: 2). More specifically, this analysis will use the explaining-outcome process-tracing version, which “can be thought of as a single-outcome study, defined as seeking the causes of a specific outcome in a single case” (Gerring, 2006 in Beach, Pedersen, 2013). Explaining-outcome process-tracing is the most appropriate for this analysis, since our goal is to explain single, specific and perplexing outcome – policy failure of Croatian decentralization policy. Explaining-outcome process-tracing methodology often involves applying existing theories and literature that could provide “potential mechanisms that can explain the particular outcome” (Beach, Pedersen, 2013: 63). The existing theories used in this analysis are contained in *the two-stream explanation of decentralization policy failure in Croatia*.

The first stream will be explaining the failure from the *policy cycle perspective*. In this stream the analysis will identify defects in each stage of policy cycle that contributed to the overall failure of the decentralization policy. Thus, the sub-research question for this part is: which flaws in each stage of the policy cycle contributed to the overall decentralization policy failure in Croatia? Policy cycle perspective is the idea that the process of a certain policy can be divided into discrete stages (Werner, Weigrich, 2007: 43). The policy cycle perspective – “as most widely accepted concept of the policy sciences” (deLeon, 1999: 20) – claims that policy process is “the procedure by which a given policy is proposed, examined, [formulated], carried out, and perhaps terminated”<sup>13</sup> (deLeon, 1999: 20). According to the policy cycle framework, the common model of a policy process is as follows:

First stage: Agenda-Setting

Second stage: Policy Formulation and Decision-Making

Third stage: Implementation

Fourth stage: Evaluation and Termination

In general “the policy cycle perspective has proven to provide an excellent heuristic device” (Werner, Wegrich, 2007: 57). More concretely, the usefulness of this perspective for the analysis of the failure in Croatian decentralization policy is multiple. First, it enables us to clearly identify in which stage of the policy cycle the main causes of the decentralization policy failure happened. The policy cycle approach can help to “disaggregate complex phenomenon into manageable steps” (Bridgman, Davis, 2003: 99). Second, as Werner and Weigrich mention: “policy-cycle is based on an implicit top-down perspective” (2007: 56). Although this is sometimes mentioned as a drawback of the policy cycle perspective (Werner,

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<sup>13</sup> For critiques of this perspective as simplified and not offering “predicting capabilities” see: deLeon, 1999: 26; Werner, Wegrich, 2007. Although legitimate, these critiques are less relevant for us since we are not concerned with prediction but with the past (simplified) account of policy failure.

Weigrich, 2007), it is appropriate for the analysis of the Croatian decentralization policy which has been described as top-down or “decentralization from above” (Petak, 2011: 79). Thirdly, a considerable number of research questions in the field of public policy “are still derived from the heuristic offered by the policy cycle framework [...and...] policy cycle framework [...] *offers a yardstick for the evaluation of the success or failure of a policy*” (Werner, Weigrich, 2007: 58; emphasis added).

The second stream of explaining the decentralization policy failure in Croatia will be concentrated on, what will be termed as, *structural factors*. It is inspired by the structure-agency dichotomy in social sciences, where the structure is the context, conditions and external frame surrounding, limiting and influencing the actions of actors and events surrounding them (in our case, around the Croatian decentralization policy) (see Marsh, Stoker, 2002: 271-292). This stream can be understood as additional explanation besides policy-cycle stream explanation, which is justifiable if we know that every “policy has multiple dimension” (McConnell, 2010: 345) and that the policy cycle model has often been productively combined with other approaches (deLeon, 1999: 26-27). Thus, the sub-research question for this line of explanation is: which structural factors contributed to the overall decentralization policy failure in Croatia? The main purpose of employing the structural explanation is to include factors that also contributed to the failure but are less linked with failures in the policy cycle process.

While explaining-outcome mechanisms within process tracing inspired methodology feature prominently in this analysis, the analysis will be also based on data collected through interviews, primary sources and academic articles, some of which also have the role of secondary sources. Interviews are “one of the most commonly used sources of evidence in process-tracing research” (Beach, Pedersen, 2013: 134). Five interviews have been conducted with persons representing academic/scientific institutions important for the decentralization

policy in Croatia: The Public Finance Institute, The Economic Institute, The Faculty of Political Science, The Faculty of Economics and The Faculty of Law (all University of Zagreb). The conducted interviews could be understood as expert interviews aimed at “generating explicit, tacit, professional, [and] occupational knowledge” (Bogner et al., 2009: 99). However, since four of the five interviewees also, in some way, participated in the Croatian decentralization policy (usually, writing (mostly unnoted) expert advice to policy-makers), elements of elite interviews are also present, particularly if we know that the difference is not always clear (see Bogner et al, 2009: 98-111). Primary sources include laws that are passed and directly linked to the decentralization issue in Croatia. The academic literature is extensively used, some of which is secondary source since it is often based on primary sources.

## **4.2. Identifying the policy failure in policy cycle of the Croatian decentralization policy**

### **4.2.1. Agenda-setting**

The agenda-setting stage of policy cycle is the first stage of policy-making. An issue needs to be recognized as a policy problem, put on the policy agenda and the necessity of state intervention needs to be acknowledged (Werner, Wegrich, 2007: 45). The agenda is “the list of subjects or problems to which governmental officials [...] are paying some serious attention at any given time” (Kingdon, 1995: 3).

The agenda-setting part of the policy cycle regarding the decentralization policy in Croatia is not the source of its failure. On the contrary, putting the decentralization issue on the agenda was a commendable policy action that wanted to address a serious problem. Nevertheless, how the decentralization issue, among other problems, ended on the agenda of the Croatian government needs to be explained. In order to explain this, Kingdon’s (1995) multiple streams formulation will be used. Kingdon’s multiple stream approach argues that for each issue there are three important streams: problem, policy (solutions on problems), politics

(most commonly refers to change in government) that need to intersect in order to open the “window of opportunity” that enables a certain issue to enter the policy agenda (Kingdon, 1995; Werner, Weigrich, 2007: 47).

In the case of the Croatian decentralization policy, the “window of opportunity” approximately opened in 2001. The first stream – problem – became highlighted after the end of the war in Croatia in 1995. In the wartime period immense centralization developed, but in post-war period this became one of “the main problem[s] of the whole political system” (Petak, 2002: 1). Centralization was problematic due to its negative effects, such as: inefficiency in the public sector, lack of multi-centric development and non-capability of providing the essential public services in some of the subnational units (Konjhodžić, Šuman, 2009; Koprić, 2014). Naturally, perceiving the centralization as problematic and having negative consequences promoted the decentralization agenda.

The second stream – policy solution – was also conducive for highlighting the decentralization agenda in Croatia. The evident reason for this is that the problem of centralization is resolved with a proper decentralization policy (Davey, 2002). Another reason is contained in the fact that “decentralization was very popular at that time in Central and Eastern Europe” (Petak, interview). The European Charter of Local Self-government<sup>14</sup> that was ratified by Croatia in the process of accession to European integration also promoted the decentralization policy (see Konjhodžić, Šuman, 2009: 234-237). Decentralization as a policy solution was also advocated by international and domestic NGOs and consultant institutions such as the Open Society Institute in Croatia and the Croatian Law Center (Petak, 2002: 7)

The third stream – politics – started to promote the decentralization reform in Croatia when the new government came into power in 2001. After the long reign of the HDZ (Croatian

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<sup>14</sup> The principle of subsidiary which claims that the most optimal outcome occurs when public function responsibility is assigned to the lowest possible level that is capable of performing the function is an important part of the European Charter (Konjhodžić, Šuman, 2009: 238).



Democratic Union), in 2001 the new left-center coalition came to power led by SDP (Social Democrat Party). This was described as a “dramatic change in the national political arena” (Petak, 2002: 4). The left-center coalition opened the door for putting decentralization on the agenda (Petak, 2002: 4). This was also induced by the goal to join the EU, which also proposed decentralization.

The initiative for decentralization was well addressed to tackle the serious problem of centralization. However, it should be noted that some authors question the sincerity of the political will in regards to putting the decentralization issue on the agenda in Croatia claiming that it could just be political rhetoric (see Konjhodžić, Šuman, 2009). This is reasonable objection, but the issue of failure needs to be addressed in a more concrete way in the context of the following phases of the policy in question.

#### 4.2.2. Policy Formulation and Decision-Making

The second stage of policy-making is an intertwined process. It implies the formulation of a policy as a response to accepted problems in the agenda-setting stage, the definition of objectives and goals and the formal decision to start the policy (Werner, Wegrich, 2007: 48). The policy formulation and decision-making stage is the *main source of the Croatian decentralization policy failure*. The shortages in this stage regarding the decentralization policy in Croatia were manifold.

The first and initial reason of the failure in this stage is linked to the fact that “policy formulation and adoption includes the definition of objectives – what should be achieved with the policy; [..and..] clearly defined goals [and] output targets...” (Werner, Wegrich, 2007: 48). In the context of decentralization, Davey emphasizes the importance of a prepared blueprint for decentralization policies (2002: 40). However, in the case of the Croatian decentralization policy, there was a clear lack of any program or strategy of decentralization and lack of specific goals and objectives to which the policy should strive. Numerous sources

report that there was an evident “lack of coherent model” (Petak, 2011: 80) and “no formal paper [...] in the sense of a strategy to define the objectives, principles, effects and procedure of decentralization” (Konjhodžić, Šuman, 2009: 237). Most importantly, one of the top Ministry of Finance public officials in her academic review of the decentralization process in Croatia confirms that there was a “lack of decentralization strategy” (Lukeš-Petrović, 2002: 178). Furthermore, decentralization issues are regulated in numerous laws and bylaws<sup>15</sup> and many of them are constantly changing (Konjhodžić, Šuman, 2009: 245). Linked to this, and as a consequence, there was (and still is) complete obscurity and vagueness in the issues of decentralization. Some of the examples of ambiguity include: constant function overlapping between subnational governments and central government and lack of clear expenditure assignments to subnational governments<sup>16</sup> (Konjhodžić, Šuman, 2009: 238); grant system criteria that are unclear<sup>17</sup> (Bajo, 2007: 53), not transparent and entwined with areas of “special state’s concern”. This “enabled that various local political pressures create a paradoxical situation where there are almost more areas of 'special state’s concern' than 'normal' areas<sup>18</sup>” (Primorac, interview). Additionally, there is a lack of transparency in criteria for borrowing approval of the subnational units (Alibegović, Slijepčević, 2012: 25). All of these ambiguities and the lack of transparency are potential for increased corruption.

The second problem in the formulation phase is the fact that in the 2000-2001 period, the decentralization policy entered the agenda but it was exclusively formulated by central government officials in rough figures and percentages related to decentralization (Petak,

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<sup>15</sup> For example, according to Alibegović in 2002 decentralization area was regulated – in some instances too detailed while in other too vague (Koprić in Manojlović, 2012: 633) – with the Constitution, 23 laws, 4 regulations, 1 order, 5 decisions, 2 statutes and European Charter (2002: 95).

<sup>16</sup> “Almost all functions are financed from both central and local government levels” (Konjhodžić, Šuman, 2009: 256).

<sup>17</sup> The best demonstration of this is the fact that “the municipality revenues are in no correlation with the amount of grants received from the state budget” (Alibegović, Šuman, 2012: 20)

<sup>18</sup> Most notable examples are municipalities that have “special state’s concern” status although they belong in one of the richest in the country, such as municipality Župa Dubrovačka near the world-famous and rich tourist destination – the city of Dubrovnik (Primorac, interview). Unclear criteria and lobbying of local political factors are marked as causes of this paradox (Bajo, 2007: 67)

2011: 79). The formulation of the Croatian decentralization package, “intriguingly” (Petak, 2002: 7), did not include those who could contribute substantially: decentralization policy experts, academic institutions, subnational government or local people’s opinion (Petak, 2011: 79). As an example, the Decentralization Commission had 11 from 15 members that were central government high officials and the role of experts, subnational government representatives or civil society was negligible (Koprić, 2008: 118). The lack of cooperation between the central and subnational governments in the formulation of the decentralization policy is confirmed by high official from Ministry of Finance (Lukeš-Petrović, 2002: 178). Hence, the phase of formulating the decentralization policy in Croatia was excessively marked by the top-down policy dimension of central government (Petak, 2011: 79). It is legitimate to name this type of decentralization “decentralization from above” (Petak, 2011: 79). Unfortunately, not taking into consideration expert’s policy advise<sup>19</sup> and analysis – which is “a crucial aspect of policy formulation” (Werner, Wegrich, 2007: 51) – is not just limited to the decentralization policy example in Croatia (see Petak, Petek, 2009).

The third factor in the formulation phase contributing to the failure of decentralization policy, is the low level of preparedness in Croatia for such a complex and comprehensive reform. The important role of preparedness for the outcome of the decentralization policy has been emphasized by some authors (Davey, 2002). The low level of preparedness is visible on several levels. Although policy scholars in Croatia emphasized that the decentralization potentials and limits in regards to fiscal, demographic, institutional and functional characteristic of particular public services should be predetermined, this was not done (Petak, 2011: 80; Koprić, 2008: 116). Additionally, during the important formulation phase, there was a change in the government that additionally hindered the decentralization reform. Minister

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<sup>19</sup> Petak (2011: 81) mentions two most coherent and important policy programs of decentralization in the context of Croatia made by Croatian Law Center and 2008 Cards project. The projects were not taken into consideration by Croatian government and stayed „locked in the drawer“ (Šantić, 2014: 6).

Stjepan Ivanišević, who prepared and led the reform, was a professor of law and local self-government. He left the cabinet and after that the process virtually stopped (Petak, interview). Lastly, the decentralization requires appropriate capabilities, skills and knowledge of subnational structures (Alibegović, Slijepčević, 2012: 29). However, subnational staff, administrative and technical structures in Croatia were not prepared for the decentralization and the increase of work and responsibilities which it implied<sup>20</sup> (Lukeš-Petrović, 2002: 178).

The fourth and most crucial aspect in the formulation phase that caused the overall decentralization policy failure in Croatia is the fact that the *policy was not formulated comprehensively enough*. Decentralization is not just assigning new responsibilities to subnational levels. The decentralization reform in every context is a protracted, difficult and extensive policy reform which requires a comprehensive but clear program and sustained determination (Davey, 2002: 35; Petak, 2002: 2). None of this was present in the Croatian case. Based on interviews and literature especially dedicated to decentralization reform in Central and Eastern Europe (Davey, 2002) the Croatian decentralization package was incomprehensive in two main aspects.

The first incomprehensive factor can be named “financial”. As mentioned in Chapter 3, not enough financial resources were transferred to subnational levels of government and their share in overall state’s revenues, expenditures and in GDP stayed the same. The second incomprehensive factor can be understood as “territorial”. The decentralization policy in Croatia did not include the reform of the territorial structure that is fragmented, expansive, unsustainable and with too many small subnational units without adequate financial capacities (see Alibegović, Slijepčević, 2012; Žuljić, 2001). Although often invoked as “having negative consequences” (Konjhodižić and Šuman, 2009: 235), territorial reform was not included in the policy. The un-comprehensive nature of Croatian decentralization is also confirmed from

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<sup>20</sup> There is no special education for subnational government in Croatia (Manojlović, 2012: 633)

the theoretical point of view by Davey (2002), who mentions territorial structure reform, finance reform and assignment of competencies reform as parts of any viable decentralization policy. Only one of these three reforms happened in Croatia: the transfer of competencies in five areas.

The incomprehensiveness of the Croatian decentralization package in the financial and territorial aspects *causally prevented the success of decentralization reform*. As explained by one of the interviewees, this is due to: “if the decentralization policy reform in Croatia is ever to succeed, it needs to go in one of the two directions: it either needs to increase the financial resources of subnational units<sup>21</sup> so they can finance their greater responsibilities and tasks in new areas; or decentralization reform needs to decrease the number of subnational units and extensively merge many of them in order to increase their financial capabilities<sup>22</sup> so they can finance greater responsibilities in that way” (Koprić, interview). However, as the Croatian decentralization policy-maker in the central government did not set on and start any of two mentioned directions, the reform was destined to become a policy failure from the beginning of its formulation phase.

#### 4.2.3. Policy Implementation

The implementation of policy entails “the execution or enforcement of a policy by the responsible institution” (Werner, Wegrich, 2007: 51). Namely, implementation is “what happens between the establishment of an apparent intention [...] of the government [...] and the ultimate impact” (O’Toole in Werner, Wegrich, 2007: 51).

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<sup>21</sup> In this case, the most direct way to increase the subnational financial resources would be to transfer larger amounts of central government revenues (e.g. some of the taxes) to subnational levels.

<sup>22</sup> In this case, the most direct way of increasing the subnational revenues in Croatia would happen through merging the subnational units. This would increase the size and population of every subnational unit. Consequently, the number of tax-payers in every subnational unit would also increase (increasing the subnational revenues) and would have an economy of scale effect (decreasing the average cost of providing the same public service because of the larger number of users). It is not in vain to repeat that at the beginning of 1990s Croatia had 101 and not 577 subnational units – the territorial structure that was “quite modern” (Koprić, 2014: 10).

The flaws and failures in the formulation phase of the decentralization policy in Croatia – particularly financial and territorial un-comprehensiveness – created unfavorable conditions for its implementation. This was exacerbated with additional drawbacks in implementation process such as: non-involvement of all stakeholders at various levels of government and non-involvement of NGOs, civil society and local population (Alibegović, Slijepčević, 2012: 28); inadequate administrative preparedness on subnational levels (Lukeš-Petrović, 2002: 178); and lack of implementation strategies, i.e. which public bodies should execute and enforce the decentralization package (Koprić, 2008). As Konjhodžić and Šuman conclude: “the decentralization process is not successfully implemented in Croatia” (2009: 235). The main indicators of this weak implementation were already presented. Firstly, only 9% of the total number of subnational units in Croatia accepted the new decentralized functions, while the other 91% simply calculated that their fiscal and administrative capacities were insufficient (Petak, 2011: 79; Bajo, interview). The calculations of subnational units that rejected running the decentralized functions were in most cases correct. Their inability to run decentralized services is *the direct consequence of the fact that the decentralization policy in its formulation was not comprehensive enough*<sup>23</sup>. On the one hand, the formulation of the policy did not include the sufficient increase of subnational financial resources (they stayed at roughly 10% of overall state’s revenues and expenditures). On the other hand, the formulation of the policy did not include merging the fragmented subnational units into larger, more financially capable, units that could run newly decentralized services. Therefore, the complete failure in the implementation is the consequence of the un-comprehensive and poor formulation of the Croatian decentralization policy.

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<sup>23</sup> It should be noted that in Croatia, even if something is legally specified, it is often not respected. For example, the criteria for founding new counties/municipalities/cities legally requires the approval of the competent authority; however, some subnational units were founded without this approval (Bajo, 2007: 55).

#### 4.2.4. Policy Evaluation and Termination

The process of evaluation is the final stage in the policy cycle. Policy evaluation means that policy-making is evaluated and “appraised against intended objectives and impacts” (Werner, Wegrich, 2007: 53). If we accept the plausible notion that policy-making should contribute to a reduction or resolution of the problem, then the evaluation phase assesses whether this has been accomplished (Werner, Wegrich, 2007: 53). Subsequently, and simplified, the final stage ends with termination of the policy, redesign based on new information, or continuation if the policy will accomplish its goal and there is no need for change (Werner, Wegrich, 2007: 53). It is important to emphasize that evaluation stage is not restricted to be a final phase in the policy cycle. The idea is to apply evaluation constantly and through the entire process of policy making (Werner, Wegrich, 2007: 53). Since the decentralization reform is a gradual process and not a one-term fast reform (Lukeš-Petrović, 2002: 179), the evaluation during that process is even more important.

Regarding the evaluation process in the Croatian case, the crucial thing to emphasize is the fact that “in Croatia the evaluation of public policies is not developed. Accordingly, the evaluation of the results and outcomes of the decentralization policy and formulation of new goals is absent” (Alibegović, interview). It can be added that some evaluation was done in academic literature, but it was not considered by policy-makers. As already mentioned, in most public policy cases in Croatia, the policy maker is the central government (see Petak, Petek 2009; Petak 2011).

The idea to do a prior-trial decentralization project limited on a few subnational units and then to evaluate the results was proposed by one of the interviewees (Koprić, interview), however, the proposal was rejected and the proposer was excluded from further deliberations (Koprić, 2008: 119). One of the most obvious examples of evaluation absence is that “after 10 or 15 years, areas of 'special state's concern' still have that privileged status, although their

circumstances have significantly changed” (Bajo, interview). The lack of the evaluation in the Croatian policy making and the rejection of policy-makers to be evaluated are not the only problems. The evaluation of the decentralization policy is hampered by the fact that many relevant and official data regarding the decentralization issues are missing or incomplete (e.g. some more concrete and recent financial data, data about subnational human resources, scope of public services, etc.) (Koprić, 2008: 119; Manojlović, 2012: 633). One reason for the unsystematic collection of the data is the lack of evidence-based/expert-based policy-making in Croatia, the other is no real attention given to the issues of decentralization (Koprić, 2008) and the third reason is the large number of subnational units which “makes it impossible for the central government to get a realistic picture of their financial [and other] capacities” (Konjhodžić, Šuman, 2009: 236).

The decentralization policy in Croatia is evidently unsuccessful and inefficient not just due to the failure of the reform and the opportunity cost of spent resources on unsuccessful reform (Koprić, 2008: 106), but also because of unused European Union Funds whose usage often depends on well organized territorial structure and well decentralized subnational levels of government. Nevertheless, the Croatian decentralization policy is a good exemplification of the well known fact that “the idea of policy termination [...] seems rather difficult to enforce under real-world conditions” and that “politicians face greater incentives towards the declaration of new programs rather than the termination of old ones that include the admission of failures” (Werner, Wegrich, 2007: 55). After 2001, the decentralization reform was further “enhanced” with minor supplements in 2004, 2007 and 2012 (Konjhodžić, Šuman, 2009: 237; Koprić, 2014). The end result of all these announcements is still the same: preservation of fiscal centralization and territorial fragmentation, in other words, perpetuated policy failure.

Therefore, the answer to the first sub-research question is clear. The flaws in different stages of the policy cycle which contributed to the overall decentralization policy failure are undefined



strategies and goals, unclear differentiation of responsibilities and revenue sources among levels of government, excessive domination of the central government in policy-making, low level of preparedness, complete lack of evaluation and, most importantly, incomprehensive formulation of decentralization policy in financial and territorial aspect.

#### 4.3. Structural factors contributing to decentralization policy failure in Croatia

In the previous, first stream analysis of the flaws in the policy cycle of the decentralization policy in Croatia, most of the factors contributing to that failure were explained. However, there are still some other elements which also contributed to the decentralization policy failure. Thus, the sub-research question for this, second stream of explanation is: which structural factors contributed to the overall decentralization policy failure in Croatia? The two most important structural factors for our purpose will be highlighted.

The first and the most important structural-underlying factor contributing to the decentralization failure in Croatia is what will be termed as *the political-clientelistic system structural factor*. This is the main reason that the decentralization policy formulation did not include territorial reform of Croatia. It has to do with “vested interest” problem, which is not unusual in decentralization reforms (Davey, 2002: 35). Every subnational unit in Croatia, no matter how small, has at least 5-10 employees (Bajo, interview), who are very often employed as local associates of political parties due to their various political connections (Petak, interview). This also has a certain social function because some people are employed and are receiving a salary that otherwise they would not (Bajo, interview). The consequence of this is a strong opposition to abolition and/or merging of subnational units to an economically reasonable number, because that would imply the reduction of subnational political employees and the loss of future political leverage for political parties (Petak, Koprić, Alibegović interviews). As Koprić (2014) emphasizes: many interests at all levels of

government and society are connected to the existing territorial structure in Croatia. The survival of numerous subnational units is important for minimally 100 000 people (alderman, subnational governors and public officials) plus the interests of [national] political parties whose alderman, governors and public officials are in question, along with institutional interests of subnational units' associations, entrepreneurs with formal and informal connections with numerous subnational units, central government officials that could feel the consequence of eventual territorial reform and many other (Koprić, 2014: 11-12). Overly detailed and simultaneously vague regulations and "open channels" allowed them to easily influence national decisions (Koprić, 2014: 12). Therefore, the "lack of political will" (Šantić, 2014: 3) to make the necessary changes regarding the decentralization issue is now more understandable.

The second structural reason hindering the decentralization policy in Croatia is what will be termed as *the centralistic-structural factor*. This is the main reason why the decentralization policy formulation did not include larger transfer of financial resources from central to subnational units. As Šantić reports, there are obvious "centralistic tendencies of Croatian political elites" (2014: 7) The centralistic framework is inherited from the centralistic ruling tendencies in the Austro-Hungarian and the communist Yugoslav state, but is also a consequence of the late state-creation in Croatia as states tend to adopt centralism initially (Šantić, 2014: 7; Petak, 2002).

However, there is also a more material reason for centralism in Croatia: there is a fear of central government that it will lose the dominant role in decision-making and in the distribution of resources in the context of corruption and clientelism between central and subnational levels of government (Šantić, 2014: 7). As one of the interviewees reports: "in one hand, there are a great deal of weak and helpless subnational units and, on the other hand, high central government official (like ex-prime minister Ivo Sander) who like to present them-

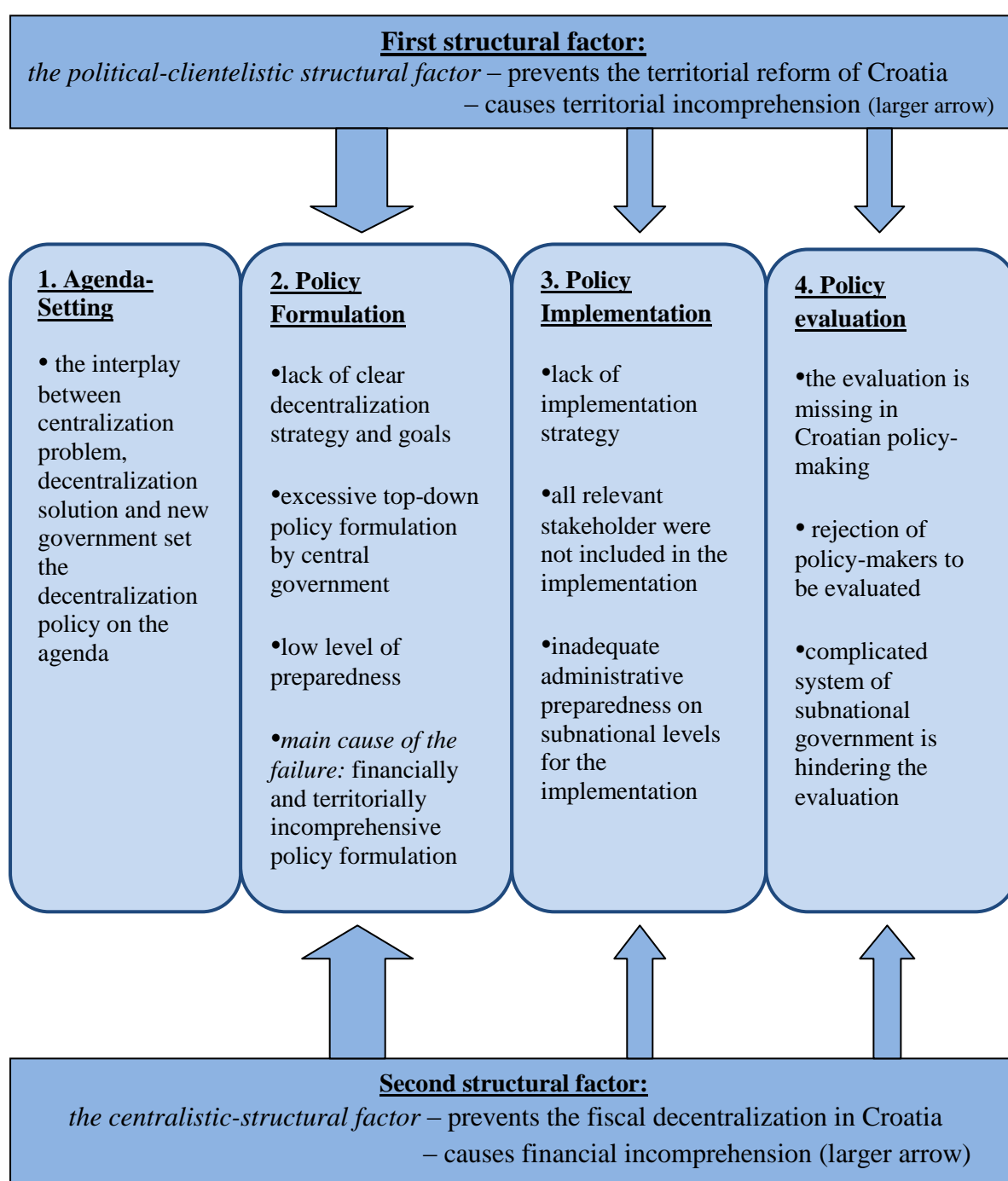
self like persons who 'solve the problems in Tito style' in order to improve their political prestige. Thus they distribute resources arbitrarily to many subnational units for expenditures such as repairing the roofs of the churches – and that created a system of interdependence, mutual benefit and capillary corruption” (Koprić, interview). Naturally, this is a particularly productive way of getting the central government grants, if the subnational government is the same party as the central government (Primorac, interview; Koprić, interview). The centralistic mannerism is also visible in the fact that Croatian decision-makers were not eager to implement models “prepared by various policy experts sitting outside the government” (Petak, 2011: 80). Instead those policy models in Croatia are mostly used for “symbolic usage” (Petak, interview). The centralistic tendencies and opposition to decentralization regarding the public finance system are also present in the Croatian Ministry of Finance (Koprić, 2008: 118) – something that is often present in decentralization policy reforms (Davey, 2002). Šantić justifiably highlights the centralistic political culture in citizens who did not extensively pressure the central government with decentralization requests (2014: 7).

Additionally, many subnational government units are not interested in decentralization. This is either due to their awareness of insufficient subnational capacities or due to fact that decentralization would “imply more responsibilities and work for the same payment” (Koprić, interview) – something for which subnational public officials are not too eager (Koprić, 2008: 117). Finally, a most recent structural reason preventing the fiscal decentralization is the contemporary economic crisis, which prevents the indebted central governments to allocate more resources out of its own budget to subnational budgets (Šantić, 2014: 8). All of these “centralistic tendencies” prevent the transfer of public finances from central to local level, in other words it prevents the fiscal decentralization in Croatia.

The structural factors that contributed most heavily to the overall decentralization policy failure were the established political-clientelistic system at the local level, which vested many

interests that prevented the territorial structure reform, and the centralistic tendencies in the system which prevented fiscal decentralization reform. After providing the answer to the two sub-research questions, the answer to the main research question (which is, in fact, the combined answer to two sub-research questions) is summarized in Figure 5.

**Figure 5:** Summarized answer on the main research question: *why and how did the Croatian decentralization policy fail?*



## Conclusion

The main purpose of this paper was to explore and expose how and why one important reform – decentralization policy in Croatia – failed. This is an important question because policy failure of decentralization in Croatia is well-known yet the reasons behind the policy failure have been less explored. In order to fill this gap, this paper employed the explaining-outcome version of process-tracing supplemented with interviews, analysis of primary and secondary sources and with extensive usage of academic accounts of Croatian decentralization policy.

The methodology and approach used resulted in a two-stream explanation of the decentralization policy failure in Croatia. The first stream explains the failure from the policy-cycle perspective. It found that the main cause of policy failure is present in the second, policy formulation stage. The formulation stage in the case of Croatian decentralization policy did not contain clear strategy or clear goals, it was excessively marked with governments' central role without the inclusion of other stakeholders (subnational units and local population), it did not include policy-expert advice and it suffered from unpreparedness, especially of subnational administrative structures. However, the most important factor in the formulation phase contributing to the overall policy failure was *the formulation of the decentralization policy that was not comprehensive enough*. Firstly, policy did not include territorial reorganization, secondly, it did not include a large enough transfer of financial resources from central to subnational government. If the goal was decentralization reform, at least one of those two options should have been chosen (Koprić, interview). Since it was not done, the complete failure of the policy is no wonder (main indicator: only 9% of subnational units accepted the decentralized functions). This un-comprehensive formulation created a main cause which prevented the successful implementation of the policy. All of this is supplemented with the complete lack of evaluation in Croatian policy-making (Alibegović, interview). The second stream of explaining the policy failure highlights the two main

structural reasons that also contributed to the failure. The first is established political-clientelistic system at the local level which vested many interests that prevent the territorial structure reform, and the second is centralistic tendencies in the whole system which prevent the fiscal decentralization reform. The two streams of explanation are also the two main reasons for the failure. The main limitation of this analysis is its single-case study orientation. Further research could utilize a more comparative perspective and cover some other countries with policy issues which are in need of reform.

The findings in this paper are significant and useful because the issue at stake (de/centralization, intergovernmental relations, territorial structure) will need to be resolved. Hence, in future dealing with those issues, the findings in this paper could be used in order to, at least partially, avoid highlighted mistakes and obstacles. The urgency of resolving these issues is even greater now that Croatia is an EU member and plans to rely on the EU funds for which the appropriate decentralization and territorial structures are extremely important. Secondly, recognizing why and how the decentralization policy in Croatia failed underlines the factors which contributed to its failure, some of which are certainly common to many other important policy issues in Croatia.

## Appendices

### Appendix I

Interview protocol:

1. Why did Croatian decentralization policy start?
2. What are the problems of current fiscal centralization and territorial fragmentation?
3. Can you assess the performance of Croatian decentralization policy?
4. What are the main reasons hindering the success of Croatian decentralization policy?

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