



LSEE Papers on Decentralisation and Regional Policy

DECENTRALISATION AND REGIONAL POLICY IN CROATIA: THE IMPACT OF EU ACCESSION AND THE PROSPECT OF TERRITORIAL REORGANISATION

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Decentralisation and Regional Policy in Croatia: the Impact of EU Accession and the Prospect of Territorial Reorganisation

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Abstract

The paper sets out the main elements of the decentralisation and regional policy in Croatia. It describes the inherited as well as current circumstances influencing both policies, and provides an overview of the institutions involved in their implementation. It comments on some of their major drawbacks, and analyses the driving forces promoting administrative and fiscal decentralisation, the new territorial organisation, and the implementation of the new regional policy. The paper investigates the relationship between decentralisation and the new regional policy. The study is based on a literature review and on interviews with key actors at national and local government levels, as well as with several non-governmental organizations. The paper concludes with some recommendations on future policy development.

Introduction

The current system of local¹ self-government in Croatia was introduced soon after the new country achieved independence from the former Yugoslavia in 1991 with a set of laws adopted in 1992 and 1993. These laws created the counties as a mid-tier level of government, replacing the previous system of communes. They set out the responsibilities of the new counties as well as those of the towns and municipalities at the lowest tier. The main purpose of these reforms was to establish a local government system in line with the new constitution and to reduce the number and the power of local units due to general circumstances at that time (in a post-war situation and with disputed control of part of the country). The new system replaced the former system of socialist self-management at local level by a hierarchical system with relatively strong central control over the county governments². Many functions were delegated to the deconcentrated offices of central ministries at county level, thereby reducing the autonomy of local self-government, an arrangement that was arguably suitable in a time of transition and conflict. During the 1990s, county governments occasionally found themselves in conflict with the local governments of the main towns over various aspects of policy, which were often controlled by the opposition party. It was not until the fall of the Tudjman government in 2000 and the overturning ascendancy of the Croatian Democratic Union (HDZ) by the Social Democratic Party (SDP) that a new stage of decentralisation reforms were implemented which transferred some genuine powers and more substantial (although still insufficient) financial means to local counties, towns and municipalities. Decentralisation of both responsibilities and financial means has been gradually extended over the last decade. However, the small

¹ In Croatia, the word “region” is used in official strategic and legal documents to refer to one of the 21 counties, as until recently these were the only intermediate units of government. In this paper we will however use the term “region” to refer to the NUTS 2 regions. We use the term “local”, we mean the counties, cities, towns and municipalities.

² In former Yugoslavia a system of “self-managed interest communities” had functioned at commune level for health, education, housing and social welfare which coordinated financial contributions from local enterprises to the social services organisations, acting in effect as commissioners of social services (Bartlett 1985).

size of most of the local self-government units has limited the extent to which it has been feasible or effective to carry this process very far.

The most important advantage associated with a decentralised system of government is its capacity to match public spending better to the heterogeneous preferences of individuals living in different territories, thus enhancing the allocative efficiency of government expenditure. A further advantage of decentralisation lies in its capacity to mobilize underused resources, and in the competition it may create among sub-national governments incentivising them to deliver better local policies (Oates 1996). These effects may lead to a more efficient provision of public goods and services and to more policy innovation, thus increasing the overall productive efficiency of an economy. However, some negative consequences of decentralisation for local development may also occur, in particular decentralisation may widen spatial disparities. Rodriguez-Pose and Ezcurra (2009) investigated a sample of 26 countries and found no evidence that fiscal and administrative decentralisation had increased spatial disparities in high income countries. However, they suggested that the potential negative influences of decentralisation could appear in low and middle income countries if their fiscal systems are poorly designed and fail to take spatial inequalities into account. Antić and Malatestinić (2010) and Rowles (2009) identify possible negative effects of decentralisation from the potential for increased public expenditures with an increased number of elected representatives and local officials. The UNDP (2008) also identifies a danger of increased corruption due to the ties between local officials and the local business sector.

Furthermore, the small scale of local units providing decentralised services may reduce their efficiency and effectiveness, despite the positive effects of decentralisation in fulfilling local ambitions, bringing local decision-making closer to citizens, and encouraging local development initiatives and a sense of local belonging (Illner 2000, Koprić 2010, and Pavić 2011). In the Croatian case, it is difficult to identify many benefits of territorial fragmentation. The criteria of organisational rationality have rarely been a decisive factor in decisions to increase the number of towns and cities. Many municipalities in Croatia are too small and have too little capacity for good governance and efficient management, including

the mobilization and use of resources necessary for their further development (Maleković and Puljiz, 2010, Pavić 2010). Thus it is not surprising that the territorial reforms are the focus of much attention in discussions of public administration reform and further decentralisation in Croatia.

There is common agreement that the current Croatian territorial structure is too complicated, and irrational to achieve development goals (Koprić, 1: 2010). A serious drawback is the extreme fragmentation of the territorial and administrative structure. Croatia has 20 counties and the city of Zagreb, as well as 557 local units, out of which 429 are municipalities and 126 are cities. The population is distributed unevenly among local governments. More than half of all municipalities are small sized, with a population ranging between 1,000 to 3,000 people. Almost 70% of the population is located in cities, although many of these are very small, with 60 cities having a population below 10,000. Most cities are medium sized with 10,000 to 50,000 inhabitants, for one third of the urban population. Many people live in a few large cities, with Zagreb alone accounting for over one quarter of the total population living in cities. As will be discussed below, Croatia also has numerous categories of units with a special status, as well as units which took on decentralised functions at the beginning of the decade. Such a complex structure requires tremendous efforts of coordination, guidance, linkage and implementation of the more relevant tasks - all of which is extremely costly, with expected negative consequences for organisation and management. Regardless of legislative changes, the current system of administrative decentralisation still underpins a centralised management of the country, and significant changes will be possible only with a different approach to state organisation.

In 2004, Croatia was accepted as a candidate for EU membership. Since then there has been a new perspective on the relations between the central and local governments, driven by the EU perspective and approach to regional development. Although the EU supports the concept of decentralisation to the basic units of local self-government, i.e. the towns and municipalities, in line with the standards set down by the Council of Europe, it has a far more interest in issues of regional development where regions are defined at a larger scale. Until this point, the country lacked a coherent regional development policy with clearly set

goals, actors and instruments.³ But changes in the policy approach to regional development are now underway. Three 'statistical' planning regions at NUTS 2 level were adopted in 2007, and a new approach to regional development was introduced in mid-2010 which has paved the way for more effective "bottom-up" strategies, and for more constructive relations among actors at central and local levels of government. Consequently, relations between them are becoming less hierarchical, with adherence to principles of subsidiarity and partnership raising awareness of the need for further changes in both decentralisation and regional policies.

The accession process substantially affected the design of regional policy in several of the new member states of the EU, and has done so to an even greater extent in the candidate states. EU Cohesion policy in particular has promoted changes in policy thinking in Croatia, especially in supporting local "empowerment", paving the way for new opportunities for local and regional economic development, as happened in the old member states over the past two decades. The influence of Cohesion policy has been reflected through a change in approach to regional policy in Croatia where the government has started to adjust its policy to the principles and practices of Cohesion policy. The "Law on Regional Development" introduced in December 2009 as well as a set of related bylaws are in line with the main Cohesion policy principles, such as partnership, programming and coordination. However, slow progress in policy implementation so far indicates that regional policy institutions are still facing significant obstacles related to their limited administration capacity as well as to the influence of other sectoral line ministries.

Another reason for very limited policy effect of accession process so far is that many local actors in Croatia view participation in Cohesion policy mainly from point of view of new funding opportunities, and do not appreciate the real value of the policy transformation which is currently underway. One of the main reasons for this is that much of the policy transformation involves exclusively central-level institutions. Furthermore, the full

³ For more details related to supporting regional development in Croatia see Puljiz and Maleković (2007)

introduction of the new policy instruments, including the payment system and other elements requires substantial changes in the organisation of the institutions involved.

In this paper we review these developments in detail beginning in the next section with a discussion of the processes of decentralisation in Croatia, while the third section reviews the development in regional policy with a special focus on the role of EU pre-accession policies. This is followed by a discussion of the interactions between decentralisation and regional policies, identifying points of synergy and points of contradiction. The final section concludes with an assessment of the direction of decentralisation and regional policy and some recommendations for their future development in the light of the forthcoming EU accession.

The Decentralisation Process in Croatia

The existing local self-government system in Croatia was established through the Law on Local Self-government and Administration (1992) and through legislation regulating territorial organisation with the Law on Territories of Counties, Cities and Communes (1992). At the end of 1993, the new legal framework for the local self-government was supplemented by two additional important laws on the scope of affairs of self-government with the Law on the Determination of Affairs of Self-government Scope of Local Self-government Units and a Law on the financing of local self-government units, on the basis of which the new local self-government was established.

This system of local self-government was however highly centralised, with very limited autonomy for local units to carry out administrative and fiscal functions. The first decade of Croatian independence was characterised by war and its repercussions in many areas, including in the system of local self-government. One of the side effects of such circumstances was the centralisation of administrative and financial power. Although the new system re-established counties as a form of mid-tier governance (they had been abolished during socialist times it simultaneously imposed strong control of the central state over the counties until the constitutional changes in 2000. Weak decision making autonomy in combination with limited financial potential resulted in a lack of development initiatives

and projects at the county level. In such circumstances counties did not fulfil the expectations that were raised at the time of their creation. They were mainly seen as administrative units and not as initiators or coordinators of the development processes. At the local level, the most important change was an increase in the number of local units, which had both positive and negative effects. On the positive side there were increased opportunities for many deprived areas (which now became local government units) to manage their own development and to increase the living standard of its inhabitants. On the other hand, an almost five-fold increase in the number of units led to an enlarged bureaucracy and to reduced administrative capacity in many cases.

Since 2001 several initiatives aiming to strengthen the fiscal and management power of the local and county government were undertaken. Several laws were passed regulating the transfer of responsibility for the delivery of public services in areas of primary and secondary education, health care, social care (social welfare centres and homes for elderly and disabled persons) and fire protection (public fire brigades). The decentralisation process initially included all counties and 32 towns with the strongest fiscal capacity. The process was later gradually extended to other units on an individual basis. Units took over new responsibilities depending on their judgment about the costs and benefits of the process. The rationale behind this asymmetric approach was an awareness of significant disparities between local units in their capacity to manage decentralised functions, implying that the first steps in decentralisation should aim at the units with the largest fiscal and administrative capacity (Lukeš-Petrović, 2002).

Amendments to the Local Self-government Act were passed in 2005, which transferred a new set of responsibilities to the counties and major cities (issuing location and building permits, road maintenance and some other activities related to spatial planning). With the passage of the Physical Planning and Building Act in 2007, counties and major towns began to deliver their new functions from January 2008. The distribution of the decentralised functions over county and local units is presented in the following table.

Table 1: Distribution of units according to decentralised function (2011)

	Issuing building permits	Health care	Social care	Secondary education	Primary education	Fire protection	Total number of units ^b
Counties	20	20	20	20	20	20	20
Towns and Cities	30 ^a	-	-	-	34	64	66
Municipalities	-	-	-	-	-	67	67
Total	54	20	20	20	54	131	153

Source: Ministry of Finance, Ministry of Environmental Protection, Physical Planning and Construction; Note: (a) The number refers to the number of the major towns. In the meantime, additional towns took the responsibility, but their exact number is not known.

(^b) The data in this column represents the number of units which have taken over at least one of the decentralised functions.

According to the Ministry of Finance, 153 units of local self-government (out of 576) have so far taken over one or more decentralised functions. However, most of those units have only taken over the responsibility for the organization of fire protection, while the number of units in charge of other types of decentralised functions remained almost the same as at the beginning of the process of fiscal decentralisation. These results suggest that the process lost its momentum after 2001. The only exception has been the transfer of responsibilities for issuing building and location permits which started in 2008.

Furthermore, data from the table clearly suggests that counties have been the major actors of the process of decentralisation so far, while local units have had a very limited role, mainly by taking the responsibility for the fire protection and primary education and to some extent for issuing building permits (only major cities). We find particularly odd that major towns have not been given the opportunity to take over the responsibility for the field of secondary education and health care, since most of them surely possess the necessary administrative capacity and have expressed the wish to do so.⁴

⁴ Interview with the mayor of Kutina and Vice President of the National Association of Towns, 2/3/11, Kutina.

Although decentralisation has often been a hot topic for political debates, nevertheless, even ten years after the first steps in fiscal decentralisation, it is still not clear what have been its real effects with regard to the quality of transferred public services and their cost efficiency. Systematic analysis that would provide an answer to these issues is still missing, although some selective evidence points to the conclusion that local units have significantly improved their efficiency in the delivery of transferred functions.

An interesting example is the transfer of responsibility for issuing building permits from the central to the local level in the case of the City of Kutina.¹ Previously, the average time for issuing a building permit was one and a half years. Within a period of half a year after the transfer, the time taken was reduced dramatically, to somewhere between three and six months. The reason for the improved performance was that local units employed new, highly educated, personnel and equipped them with appropriate technical equipment and provided a budget for education and training, which is particularly important due to the many legislative changes. Furthermore, while working within the framework of the central administration, the level of control over their performance has been very low. After they were incorporated into the city administrations, this changed significantly, further increasing the level of administrative efficiency.

Fiscal decentralisation

The Law on Financing of Local Self-government Units determines the types of revenue, their distribution, and the limits within which they are prescribed. In addition to this regulation, local units must comply with other special laws and regulations which regulate different areas of public spending. The counties, cities and municipalities generate revenues from the following four major sources:

- Own revenues
- Joint revenues (taxes and other revenues) shared between the government, municipalities, cities and counties
- Grants from the state and county budget (to the cities, towns and municipalities)
- Receipts on the basis of borrowing in accordance with a special law.

The major part of the revenues of local self-government units, both in terms of structure as well as in absolute amount, are realised from the (shared) tax revenues, out of which, income tax is by far the most important source of revenues, covering around 60% of total revenues.⁵ Table 2 shows the distribution of shared taxes between three governmental levels.

Table 2: Distribution of revenues from shared taxes

	State Budget (Fund for Equalization)	Counties	Municipalities / Cities	City of Zagreb ^a
Personal income tax	0%; (Fund for Equalization 17.5%)	15.5%; increased further by the additional share for transferred functions	55%; increased further by the additional share for transferred functions	70.5%
Real estate sales tax	40%	0%	60%	60%

Source: Ministry of Finance; Note: (a) The City of Zagreb is a special case since it incorporates both the role of a county and a city.

The Annual Decisions of the government on minimum financial standards prescribe the criteria for financing each decentralised function. In case a unit does not have sufficient funds to cover the minimum standards from its additional share in the personal income tax, the unit has the right to receive an equalization grant to cover the gap, financed from a 17.5% share of income tax revenues.

As can be seen from Table 3, a unit which takes over all the decentralised functions can increase its share of income tax revenues by 12%, (i.e. from 55% to 67%). A particular problem is due to the fact that the Decision on Minimum Financial Standards is passed by the central government on annual basis which creates difficulties for local units in planning their resources and managing their decentralised functions effectively.

⁵ Around 90% of total tax revenues comes from income tax.

Table 3: Additional shares of personal income tax allocated for decentralised functions

	Share in personal income tax
School education	
- Primary Education	3.1%
- Secondary Education	2.2%
Social welfare	
- Centres for social welfare	0.5%
- Homes for elderly and disabled persons	1.7%
Health care	
- Health care institutions	3.2%
Fire-fighting	
- Public fire brigades	1.3%
Maximum for decentralised functions	12.0%

Source: Ministry of Finance

While grants account for a relatively low share of total revenues, they have increased almost three times since 2005. The major grant beneficiaries have been municipalities in the Areas of Special State Concern (ASSC) and in the Hilly and Mountainous Areas (HMA). According to data from the Ministry of Finance these areas receive around 35% of total grants, while the rest is distributed among the counties and other local units. Although grants represent less than 10% of all local government revenues, many units are heavily dependent on grants with over two-fifths of them (43%) deriving over 25% of their total budget revenues from grants. In such circumstances their political relations with the central government are of critical importance, since in many cases grants, as well as investments, are allocated on the basis of discretionary decisions from the centre, lacking transparency.

With regard to the overall financial position of local and county units there has been an improvement over the last decade. According to data of the Ministry of Finance⁶, the share of local budgets in the consolidated revenues of the general government has increased from 14.6% in 2004 to 16.4% in 2009. The changes in distribution of income tax between the central, county and local levels which took place in 2007 ensured a higher share for local

⁶ Interview with official in Ministry of Finance, Zagreb, 9/2/11.

units and therefore helped their financial position.⁷ To compensate for its loss of revenues, the central state took over all the revenues from the profit tax which had previously been shared between the central, county and local levels. The end result of these changes was higher tax revenues for a huge majority of local units, while only the City of Zagreb and some other local units with significant revenues from profit tax claimed to be “losers”.⁸

Despite the slight improvement of their fiscal position in recent years, it should be emphasised that the capacity of county and local units to autonomously determine the tax base and tax rate is still very limited (Jurlina-Alibegović, 2007). The tax base of the local taxes is mainly determined by the central state, while the tax rate is determined by the local government. Shared taxes and county taxes are completely determined by the central government. Since the shared taxes represent the major part of the total fiscal revenues the fiscal autonomy of county and local units is rather low. Although revenues from communal fees are considered to be genuine revenues of local units, the Utility Services Act regulates that these revenues must be spent only for prescribed activities, further reducing the local units’ autonomy in managing their own finances. The only exception is the public land use tax which is autonomously determined by the local government, although its effect on total revenues is rather negligible.

In relation to expenditures for the responsibilities that have been transferred since 2001, local units are responsible only for the costs of energy, utilities, maintenance, and other miscellaneous expenditures, while wage costs are financed from the central budget. Capital investments are usually financed jointly by all levels of government, but on a case to case basis with no pre-fixed co-financing shares.

⁷ The central level has ceded its share in income tax revenues to the regional and local level (while keeping only the share belonging to the Fund for Fiscal Equalization) while local and county units increased their respective shares.

⁸ While data on tax revenues for City of Zagreb show that its total tax revenues slightly increased after the changes, the city administration saw itself as a loser since profit tax revenues were soaring at the time when the changes took place (2006/2007). The picture would have been quite different if the changes had taken place several years later during the recession, when profit tax revenues dropped significantly, unlike the income tax, which have remained more stable.

A major problem with this system of fiscal decentralisation is that the transfer of responsibilities has not been followed by an adequate allocation of the financial means. A typical example is the running costs of elementary schools, where the fiscal equalization funds granted to local units are insufficient to fully cover the costs. The problem became acute with the increase in energy prices and the decrease in revenues from income tax during the period of the economic crisis, requiring units to allocate more and more funds from their own resources. A particular problem is that for the transferred functions, the central government has in several cases prescribed very high standards which have to be achieved, such as for the minimum surface and number of staff in kindergartens, the level of equipment of local fire brigades, and in some other areas. The costs of meeting these new standards are rather high, while the funds allocated to local units for financing their decentralised functions are insufficient so that local units have to provide extra funding from their own revenues or are unable to meet the standards.

As previously mentioned, significant disparities exist between local units in terms of fiscal capacity. The government attempts to alleviate these disparities mainly through fiscal transfers from the central budget, and through special concessions to local units belonging to ASSC and HMA in the distribution of shared taxes which places them in a more favourable position in regard to the other units. The problem with both approaches is the lack of clear and transparent criteria for determination of eligible units. ASSC and HMA areas were designated with the prime objective to speed up their economic regeneration, and tackle structural problems arising either from the effects of war (the majority of the ASSC), or from natural handicaps (in the HMA) or for other reasons (part of the ASSC). However, the criteria for the selection of eligible units have been called into question due to their lack of objectivity (Puljiz, 2006; Grčić et al, 2008). Despite the fact that the new categorisation of local and county units was inaugurated by the Law on Regional Development in 2009 (on the basis of the “development index”) with the intention to replace the ASSC and the HMA, these areas have continued to exist, so the earlier approach is still in place and confusion regarding the designation of disadvantaged areas remains a problem.

Furthermore, in the case of current transfers from the central to the county and local budgets, the rules for allocation are complicated and change on a yearly basis, preventing units from planning their budgets effectively (Bronić, 2008). There is therefore a need to separate fiscal equalization measures from the support for disadvantaged areas (Grčić et al., 2008). Moreover, there are many other local units outside the ASSC and the HMA with much lower fiscal capacity. Yet, while the proposal to allocate current transfers only on the basis of fiscal capacity criteria has been accepted and included in the National Strategy for Regional Development, no changes have been made to the existing system of transfers.

*Objectives of current local self-government reform*⁹

The process of decentralisation is related to the public administration reform which the current government announced at the beginning of its mandate in 2007. The reform aims at creating preconditions for a more rational and transparent public administration, and at increasing the accessibility, effectiveness and efficiency of public services. This political commitment has been realised through the Economic Recovery Programme which envisages a rationalisation of the territorial organisation of the country, and continued decentralisation as key measures of public administration reform. The principles of the reform have been set out in the *Guidelines and Principles for Functional Decentralisation and Territorial Reorganisation* (Croatian government, 2010). The *Guidelines* identify three basic and interconnected components of the reform process: functional decentralisation, fiscal decentralisation and territorial reorganisation, i.e. finding an optimal territorial organisation for public services. Limited fiscal capacities and a lack of human resources in most local self-government units are seen as major obstacles for the further implementation of decentralisation. While the first problem could be relatively easily tackled with changes in the fiscal system, the second one represents a major problem. This is particularly the case in the numerous smaller units in the less developed counties. Thus,

⁹ Interview with official, Ministry of Public Administration, 9/2/11, Zagreb, information obtained in the framework of the *Working Group for Decentralisation and Territorial Organisation* as well as the document: *Guidelines and principles for functional decentralisation and territorial reorganisation*, Ministry for Public Administration, 2010.

there is a common understanding that it is not possible to concede more powers to towns and municipalities without substantial interventions in territorial organisation.

The *Guidelines* suggest two possible models as well as criteria for territorial reorganisation. According to the Monotypic model, all units at the same level would, in principle, have equal legal status, assume equal functions and be subject to equal supervision by the central authorities. This implies a smaller number of larger territorial units, and requires more extensive interventions in the existing territorial organisation. As to the second one – the Polytypic model – it envisages the differentiation of units at the same level according to their scope of affairs. This option would imply smaller changes in territorial organisation, but in the course of its development it would be necessary to define the modes of financing and supervision mechanisms for various types of units, and to determine the relationships between them. The *Guidelines* also envisage further decentralisation of primary and secondary education, social welfare centres and the transfer of competences to service providers in the field of primary healthcare, as well as the financing of local authorities from the state budget aimed at eliminating disparities among them.

In order to prepare the proposals for the operationalisation of the *Guidelines*, the Ministry of Administration established a *Working Group for Decentralisation and Territorial Organisation* in 2010 including representatives from academic and professional institutions, the business sector as well as NGOs. An action plan has been defined up to May 2013 - to prepare for the implementation of a new territorial organisation. However, despite the expressed political will of the government for further decentralisation, many factors still obstruct its effective implementation.

International organisations supporting decentralisation

Many different international organisations have supported decentralisation in Croatia over the past two decades. With the assistance of internationally financed projects, local authorities and local administrative bodies are gradually becoming aware of the need to provide more transparent and efficient services, and new methods including strategic planning, project management, public consultation mechanisms and e-governance have

been introduced. However, these changes, even though needed to improve the quality of governance are taking place far too slowly.

One of the main proponents of decentralisation in Croatia has been USAID. Decentralisation was seen as a process supporting democratisation and marketisation in line with the neo-liberal agenda of the USAID programme in the region. Since the inception of its program in 1992, USAID delivered more than \$320 million in assistance to Croatia through a comprehensive program that facilitated economic and fiscal reform, strengthened democratic institutions, created agribusiness programmes and established a wide range of professional training¹⁰. USAID was active in Croatia from 1992 until 2008. Its most important project related to decentralisation was the Local Government Reform Project (LGRP) worth \$40m which addressed the needs of cities, towns and municipalities as they assumed greater responsibilities in the management of their budgets, culture, health and education. Many of these activities were conducted under the auspices of the Croatian Association of Cities and Municipalities, with the aim of strengthening this Association as a future driver of the local government reform. The programme enabled public officials in local governments to gain relevant financial and public administration skills and introduced public management models which enabled local officials to address the increased demands of decentralisation, supporting them in providing more transparent, responsive and accountable services. One result was the adoption of a computerised financial management model by dozens of local governments enabling them to develop transparent budgets and allowing, for the first time, citizens' participation and public debate on expenditures and the allocation of resources. The USAID programme was highly influential in the process of policy transfer to Croatia. It worked closely with the Central State Office for Administration and the Association of Cities and Municipalities in providing advice on national policy towards local governments.

The EU has also been active with various projects funded through the pre-accession assistance programmes CARDS and IPA. The project "Decentralisation of the Public Administration", completed in 2003, created the basis for a general strategy of

¹⁰ See: http://www.usaid.gov/locations/europe_eurasia/countries/hr/

decentralisation, while the project “Framework Programme of Decentralisation 2004-2007” led to the appointment of a Commission for Decentralisation (2004). The Croatian Decentralisation Commission (Central State Office for Administration) and the Task Force for Strengthening Fiscal Capacity in the Ministry of Finance were beneficiaries of the “Fiscal Decentralisation” project financed by CARDS and implemented in 2005-06. The objectives were improve the legal and strategic framework for fiscal decentralisation, assist in proposing and implementing reforms in financing local self-governments and to make recommendations for providing adequate financial resources to local governments. Further, the “Capacity Strengthening for Administrative Decentralisation” (CARDS), implemented in 2006-08 aimed at strengthening the overall institutional and legal framework governing administrative decentralisation. The main results of the project were policy recommendations concerning new models of organisation of public services at the regional and local level, a new model of financing decentralised services and the establishment of the National Training Strategy for Local Elected Officials and Local Civil Servants. None of these projects resulted in the official adoption of a strategy of decentralisation. However, the main documents of the government, and changes in the legal framework, demonstrate that the reform of local self-government was constantly present on the government’s agenda and that proposals from these documents were taken into consideration.

Several foundations have also supported local development and decentralisation. Excluding the example of USAID, their role was quite modest from point of view of impact on building capacities of local units. Among them, the Friedrich Ebert Stiftung with several recent projects related to local self-government and decentralisation.¹¹ A number of seminars and training courses have been organised, including specific training for town civil servants and members of town representative bodies as well as members of Youth Councils. Such projects are implemented in cooperation with the Association of Towns. Innovative projects have also recently been initiated including representatives from various town councils and schools, with the aim of fostering political dialogue and increasing capacity related to local-self-government. Young people have been actively included in the most recent projects

¹¹ Interview held with official, Friedrich Ebert Stiftung, Zagreb, 25/2/11

which are implemented through a game approach along with training, all of which support better communication, policy dialogue and understanding related to both the responsibilities as well as the problems of local self-government.

Looking from an overall perspective, one can conclude that decentralisation policies have been strongly supported by international organizations and donors. The technical assistance provided by USAID was in line with the neo-liberal concept of local self-government and the diminution of the power of the central state in post-communist transition, and raised awareness of importance of decentralisation as a policy of local empowerment. Despite this attempt at policy transfer, the government has had relatively little commitment to the process of decentralisation.

Regional policy

Since the early 1990s, regional policy in Croatia has been designed in the context of the 21 counties (županija), including the capital city Zagreb. These units are far smaller than is typical for the design of regional policy in the EU, with an average population size of just 211,000 people, compared to 380,000 in the EU-27 (Eurostat, 2008). More recently, under the influence of EU regional policy the counties have been designated as NUTS3 regions, while three NUTS2 regions have been defined (the Northwest, Panonian, and Adriatic regions).

The direct and indirect effects of war led, in the second half of the 1990s, to an approach to regional policy based on support for the war-torn areas of Croatia. This centralised approach which characterised the system of governance in Croatia throughout the 1990s and which was justified on the basis of wartime circumstances has left its trace until today. The focus on war-torn areas known as 'Areas of Special State Concern' (ASSC) led for a while to the neglect of other parts of the country which had been less directly affected by the war. This was corrected by the passing of the Law on Islands in 1999, and changes in the definition of Areas of Special State Concern in 2002 which enabled other self-governing units which had not been affected by the war to gain the same status. This legislation had numerous drawbacks, reflected in the increased fragmentation of the territorial structure and the

incompleteness of the legislation which regulated the development of the less developed areas (Maleković and Puljiz, 2009). Furthermore, the laws related only to the local level, i.e. the municipal/town level, which did not always correspond to differences in socio-economic development at the county level. Also, until the passing of the Law on Regional Development in 2009, the prevailing approach did not deal with the institutional framework for regional policy, development programming, vertical and horizontal coordination of actors on all levels or the evaluation of the development impacts of the policy.

During the 2000s, given the legacy of regional policy with its focus on war affected areas, the approach remained inconsistent, and lacked clearly defined policy goals or instruments. Regional policy was inflexible and highly centralised, with a focus on the development of physical infrastructure and with little attention to competitiveness and growth. The poor fiscal capacity of counties meant that there was no basis for promoting regional development in the terms familiar to the EU approach to regional policy.

A further “inherited” characteristic affecting the successful implementation of the new regional policy is the existence of significant inherited spatial disparities (Bićanić and Pribičević, 2009). As many as 256 out of 557 local self-government units (towns and municipalities) have a development index which is more than 25% below the average, and 11 out of 20 counties have been categorised as disadvantaged units. The most developed municipalities are mainly located in the North-West part of Croatia (Istria and the Primorje Goranska county) while the least developed ones are in the central and eastern part of the country (Lika, Banovina, Kordun and Slavonia). With the aim of decreasing these disparities the regional policy has been implemented on the basis of four territorial laws, which have recently been pulled together into an “umbrella law” on regional development, which defined the basic elements of the regional policy.

The main problems of the territorial and administrative structure of Croatia can be summarised as follows (Šimunović 2007, Maleković and Puljiz 2009, Čavrak 2009).

- The small size of counties, with limited capacity for development programming

- The weak fiscal capacity of local units
- The poor horizontal coordination among institutions at the central level, and especially among sector bodies and institutions so that sectoral policies still lack a regional dimension
- A centralised approach combined with an insufficient institutional capacity at the local and county level for managing development
- An lack of support for the development of learning regions and regional competitiveness

Consequently, the introduction of a new approach to regional development combining a focus on endogenous resources with new concepts of territorial capital and regional competitiveness has been seriously delayed.

The new regional policy and the influence of the EU

Since 2001 a range of projects dedicated to strengthening of regional policy were financed through the CARDS programme. With the imminent approach of EU accession, a change of perception towards regional policy has become evident. This has resulted in the emergence of a new regional policy in line with the EU accession requirements. The first draft Strategy for Regional Development of 2005 led to the passing of the Law on Regional Development in December 2009, and with the final *Strategy* adopted by the government in summer 2010 along with all the by-laws. This new regional policy (Croatian Strategy 2010; Maleković, Puljiz and Tišma, 2011) sought to establish a strategic approach to support regional development. Development priorities on different territorial levels – the county level, the new statistical regions, and the national level – have for the first time been clearly formalised and harmonised. The county development strategies have gained institutional backing, and development priorities have been defined on the level of the NUTS 2 statistical regions – supporting a wider inter-county consensus on the main development objectives and priorities of wider territories.

The new policy has also sought to institutionalise new regional bodies above county level for development planning. Following the principles of EU cohesion policy, Partnership Councils

have been established at the level of the new NUTS2 regions and this has introduced a new, more strategic approach to regional development. According to the new Law on Regional Development, the Councils are responsible for defining the development priorities at the level of NUTS 2 regions and proposing lists of major development projects. The Councils consist of representatives of the central bodies (mainly line ministries), regional and local units, business associations, NGOs, and the scientific community. However, it seems there are significant difficulties in making them operational, having in mind that they were established in mid-2010, while a year later only one meeting had taken place.

The new regional policy in Croatia supports the culture of partnership. The introducing of the Partnership Councils, and the obligation to draw up county development strategies as the main strategic programming documents at the regional level in line with the principle of partnership, is expected to have positive long-term effects on the development of dialogue and effective cooperation among different local actors. It is expected that this approach will contribute to the 'ownership' by the partners of key strategic development policies and projects and so make their implementation more likely.

The new regional policy also envisages a new model of fiscal equalisation. The *Strategy for Regional Development* envisages the introduction of standard criteria for awarding grants to local units, separating the assisted area status from the provision of grants to local self-government units. The new criteria for awarding grants are to be based on the level of fiscal capacity, i.e. the divergence of each individual unit from the average fiscal capacity at national level. These grants will only be available for financing capital investments, and their use will be closely monitored. However, the Ministry of Finance has still not accepted these proposed fiscal equalisation grants, so this new policy has not yet been implemented.

The passing of the Law on Regional Development and the adoption of the *Strategy of Regional Development* have created the preconditions for a new approach to regional development, largely harmonized to Cohesion policy principles. However, it is unlikely to be fully implemented before Croatia's accession to the EU, mainly due to institutional inertia. Most significant policy lag is still observable in area of financing, monitoring and evaluation

and policy coordination. First and most important, the central government bodies, the largest investors in regional development, have not yet harmonised their mechanisms for selecting and financing projects in line with the identified regional development priorities.¹² Secondly, the mechanisms for policy monitoring and evaluation are not yet in place. Thirdly, the Ministry of Regional Development, Forestry and Water Management has not yet made Partnership Councils at NUTS 2 level operational, meaning policy coordination has so far left only term on the paper.¹³

Since 2007, investments for regional development have been financed through Component IIIc of the IPA programme. However, upon accession, additional financing will be made possible through the structural funds, especially through the European Regional Development Fund (ERDF). The available resources for financing development projects at local level will therefore substantially increase, as the structural funds will become the main means for financing regional development.¹⁴ Substantial changes will occur to the current methods of financing development projects. This is because EC rules require that all member states should provide a part of financial resources (the principle of co-financing). Upon accession, Croatia will have a single system to support regional development which will be implemented according to rules and principles of cohesion policy, since all national funds will be spent as co-financing money for SF operations. A largely uniform set of main policy rules with respect to project generation, selection and financing across different policy areas will increase the overall development policy consistence and coherence, so we can expect more efficient regional and overall development policy in the future.

¹² All counties were obliged to elaborate their strategic development documents: county development strategies (CDS) by March 2011. On the basis of proposed priorities and measures within these CDS, project pipelines will be proposed in the forthcoming period. However, neither the selection criteria or the financial „envelope“ for the national co-financing of these projects has still not been agreed upon with the line Ministries.

¹³ In the light of the current situation and policy thinking within MRDFWM as well as coming elections set for December 2011 it is hard to expect any significant progress with respect to work of Partnership Councils in 2011 and the first part of 2012.

¹⁴ According to the EC Decision from 29.10.2009. Croatia will in the first 2 years after accession receive 2,4 bil. € for financing development projects, not covering resources meant for rural development, i.e. payments in agriculture (Commission of the EC, 2009).

However, it will also require bigger financial and institutional capacity necessary to effectively participate in Cohesion policy, especially from the side of the local government, as one of the main cohesion policy beneficiaries. In that respect large number of small local units with limited financial and human resources significantly reduces their overall capacity. Although local units will still be able to finance their own projects with their own resources, such cases will be relatively rare since the resources of the structural funds will be available and will dwarf the resources of the local units. Having in mind the importance of structural funds for development of local units of self-government, increasing the capacities for the preparation and implementation of development projects in line with cohesion policy procedures can be seen as the most urgent issue at all three administrative levels. In this regard, it is especially important to provide more support to the least developed units of local self-government which are in most challenging position.

Also important, the new regional policy is changing the focus from investments into physical infrastructure (mainly basic communal and traffic infrastructure) to providing more support for projects related to business and technological infrastructure, education, IT infrastructure, etc. Most of these new projects are expected to stem from the development priorities and measures in the recently elaborated county development strategies. Counties have particularly important role to coordinate the process of project proposals generation and keep in mind their potential synergy and contribution to the main development goals at the county level. However, since such policy coordination requires strong institutional capacity and developed partnership culture we may expect significant problems in the realization.

Inter-municipal cooperation and regional development

In view of the problems posed by the existence of a large number of very small administrative units in Croatia, the Association of Towns and Municipalities¹⁵ has been examining successful experiences in France, Denmark, Spain and elsewhere to study the most effective models of territorial organisation and cooperation between small towns and

¹⁵ Interview held with the President of the Association of Towns and Municipalities, Zagreb, 2/3/11.

municipalities in carrying out large projects of common interest for economic development. The model of associations of towns and municipalities provides a simple solution to the problems of a large number of small local units with weak human and financial resources, in line with the successful model of the associations of local units in France (initiated in 1999) which were faced with similar problems of poor fiscal capacity. The first associations of towns and municipalities in Croatia, known as Local Activity Groups (LAGs), have already been established based on this example. The first LAGs were established in the county of Bjelovar-Bilogora where nine municipalities joined such an association, while another has been established in the county of Slavonia-Požega where three towns and 20 municipalities have joined together in a LAG including entrepreneurs, local self-government and NGOs.

According to local actors involved in these associations, it provides an effective solution to the defects of administrative decentralisation based on small territorial units by enabling weak municipalities to join together to access EU and other donor funds for local and regional development. The Association of Towns and Municipalities (ATM) has argued that small municipalities who join an association should be provided with additional grants from the state budget. The ATM advocates this model in line with French and Spanish practice as a solution to the problem of weak capacity of fragmented units, supporting good governance and local economic development.

The above example confirms the importance of inter-municipal collaboration, particularly when focused on successful implementation of projects of common interest with an impact on local and regional development. Within such a collaborative approach, the counties can play an important strategic role by coordinating the associated municipalities and towns within their territory in preparation and implementation of development projects. As previously mentioned, the role of the established and institutionalised Partnership Councils on the NUTS 2 level will also have a relevant role in triggering both inter-county and inter-municipal cooperation.

With respect to the impact of EU Structural funds on local units it can be expected that regional inequalities will further increase due to the complexity of the procedures with

which the local units will be faced when preparing and implementing EU-funded projects. Local units with a higher administrative capacity (usually the more developed ones) will gain an advantage in comparison to those with a lower capacity, and it is likely that differences in development among the small and the large units will increase, especially since most small units, due to their insufficient experience and poor human resources, will be unable to attract EU resources while larger units, due to their greater institutional capacity will be more easily able to absorb resources from EU funds.

Small units will thus be in a difficult situation if the central government, responsible for the elaboration of Operational Programmes, supports the preparation of a small number of large projects. This approach would probably be a more efficient method of absorbing EU resources, and Croatia will have a strong incentive to adopt it since her success in using resources in the first two years after accession will be directly reflected in further possibilities for obtaining funds in the subsequent period. However, such an approach will further reduce the ability of small units to support their own socio-economic development.

Conclusions

The accession process, and especially Croatia's participation in cohesion policy, has created opportunities for the empowerment of the counties in terms of both financial means and institutional capacity. The application of the partnership principle through cohesion policy will ensure a greater role for sub-national actors in policy design and implementation. However, regardless of the proclaimed policy, it remains to be seen to what extent the county and local actors will be allowed to participate effectively by the central institutions, and to what extent they will be empowered to manage their own socio-economic development. In this regard, it is the established Partnership Councils which raise the highest expectations and which could have a relevant role in promoting regional development due to the improvement in development planning and policy design which they are expected to stimulate. However, this will depend crucially on raising capacity at the local level. The Croatian case thus confirms Rodriguez-Pose's observations (Rodriguez-Pose 2011) regarding the needs for a greater concentration of resources on investments in

developing local capacity. Deficient government structures at any level will not be capable of making the most of either the EU or the national resources that are available for specific development initiatives with major impacts on local and regional development. Due to the still very deficient quality of governance in Croatia, it may be that the less efficient local administrations would actually benefit from having less autonomy in decision making than the more efficient administrations. This emphasises the need to balance top-down and bottom-up activities, making sure they are effectively coordinated.

The government faces a stark choice between (a) ensuring real joint cooperation between units of local self-government with far greater devolved powers and finances than is currently the case or (b) reforming the current territorial structure and creating larger democratically elected regional levels of administrations. Simply carrying on with the current status quo would be likely to be a recipe for the failure of the post-accession regional policy and for widening regional disparities with dire consequences for political stability, and could well lead to permanently reduced rates of economic growth, persistent unemployment of a large proportion of the workforce in the peripheral regions, and ultimately to economic stagnation. Further, it is possible that small local units providing decentralised services, regardless of the previously mentioned positive effects of decentralisation, could suffer from reduced efficiency and effectiveness. The government therefore needs to pay special attention to creating larger units of self-government which could be more efficient than the existing counties in managing decentralised functions. By creating larger units, the unequal capacity for implementing decentralised functions could be reduced. Thus, redefinition of the territorial organisation in Croatia is a crucial step for both the decentralisation process as well as for the implementation of a more effective regional policy.

Effective decentralisation will not be feasible without ensuring the financial capacity of the local self-government units as well as their adequate human resources. The multiplicity and complexity of the tasks that will follow the envisaged administrative decentralisation and territorial reorganisation, as well as the implementation of the new regional policy – with the accession process adding even more to their initial complexity – cannot be dealt with

exclusively by way of local or national mechanisms and approaches. Their successful solution should also be supported by more effective joint cooperation, partnership and understanding between all levels of governance - from national through county to local level (Maleković and Puljiz, 2010). However, a commitment to adhere to these principles is currently more apparent in the government's various strategic programmes than in everyday practice.

Even though the ambitiously drafted *Guidelines* are based on the subsidiarity principle, and recommend partnership between all levels of government, it remains to be seen how strong the government's commitment towards implementing this approach will be. The current recession, relative political and economic instability, as well as forthcoming elections will surely not provide a fertile environment for an ambitious plan of administrative and territorial reorganisation. Moreover, the planned initiatives, taken on board at such late stage of the government's mandate, are primarily election-driven. Regardless of the current disputes and debates on the issue, one of the immediate steps that should be taken would be to ensure stronger commitment from the government to speed up the activities and to ensure the continuity of the initiatives of the Ministry of Public Administration in implementing the *Guidelines*. In this regard, the task of preparing and implementing territorial reorganisation models needs to be undertaken as soon as possible. Following that, a normative framework should be developed, including the preparation and adoption of relevant regulations on the new territorial organisation, as well as those related to financing.

Also, related to regional as well as decentralization policy, a continuous evaluation of the achieved results and impacts will be necessary in order to ensure most effective and efficient delivery of the measures, programmes and projects, as well as long-term sustainability of the policies. Such an approach could enable continuous policy improvement, including a better delivery of services as well as a more effective use of pre-accession as well as Structural and Cohesion Funds with the long-term aim of promoting local and regional development in line with the Europe 2020 priorities: smart, sustainable and inclusive growth.

Adherence to the principles of partnership, as well as programming and coordination will be of key importance in achieving the government's aims and implementing the regional development priorities¹⁶. The new approaches of cooperation of small units and inter-county cooperation in the joint preparation and implementation of development projects confirms the first successful experience in developing partnerships and applying programming , and stresses the need for their further development particularly in the smaller and border regions. However, coordination is still a very critical issue, not only in the sense of the vertical coordination of institutions at different levels of government, but even more so the inter-sectoral coordination of the line ministries. The effective implementation of the new regional policy will not be possible in the absence of consistency and synergy of sectoral policies, i.e. an integrated approach which brings together regional and sectoral policies in a coordinated framework. This particularly refers to the related (mutually reinforcing) policies which trigger regional development and competitiveness¹⁷.

All this will require a radical shift towards a results-based approach, as well as a high commitment on the part of key stakeholders at all levels of government. In this regard, effective multilevel governance and integrated development will not be possible if the capacity for stakeholder engagement is not also substantially raised. However, based on experience to date, and the apparently low commitment to change shown by the government in recent years, it may be doubted whether this approach will yield effective results in the near future, or amount to little more than fine words and wishful thinking.

¹⁶ These priorities have currently been defined on the county level in all Croatian counties and the City of Zagreb in the framework of the mentioned Regional Development Strategies.

¹⁷ For example, regional policy with research and innovation and SME development policy, as well as human resource development policy and similar. It is impossible to consider effective implementation of regional, or any other of the mentioned policies, without considering their inter-dependencies.

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