

THE ROLLE OF MANAGEMENT IN INCREASING OF FISCAL CAPACITIES OF LOCAL SELF GOVERNMENT UNITS IN BROD-POSAVINA COUNTY AND MAKING PRECONDITIONS FOR ECONOMIC DEVELOPMENT

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Abstract

Republic of Croatia belongs in group of significantly centralized countries. That means authority to make public decisions including financing system of local self government units (LSGU) is in the hands of the central government. Decentralization process began in year 2001 but central government still procures majority of state revenue and spends the most of the public expenditure.

Various aspect research and analysis of fiscal capacities produces data pointing out the problem of inadequate fiscal capacity for providing equal level of public services in all of the local communities as lay down by law. Planning process in LSGU is hampered by absence of legal acts regulating practical role of the local government and administration. Unstable affluence of finance resources presents significant bottleneck in successful management while uncertainty of financial assets availability prevents many of local governments in detailed planning and execution of any of development measures, within medium-term plan. Within many local units basis of local revenue is too weak for local government to independently carry out development measures.

JEL classification: H72, O23

Keywords: fiscal capacity, decentralization, local management, local economic development (LED)

1. Opening discussion

In the situation of strong centralization of the budget in which local government (all municipalities, cities and counties) participates with somewhat more than 10 percent in revenue and expenditure of consolidated state or with around 6 percent in gross domestic product which is inadequate for providing of quality local services in local units, critical significance is given to local management. Local management role is to establish conditions for economic development through strategic planning of local economic development, promotion of entrepreneurship and public private partnerships, creating of favorable entrepreneurship environment, attracting of foreign investments and inclusion of public. With implementation of measures in specific organizational forms¹ defined by strategic planning of local economic development together with application of modern information technology competent management can contribute in increase of fiscal capacity of local units with aim of efficient management of public financial assets and effective fulfillment of public requirements creating conditions for economic growth.

2. Local unit financing system in European countries

Lower level of local government during socialism had negligible or small number of competencies over their expenditure while budget was created and approved by central government. Economic reforms in central and east European countries after their independence at the beginning of 1990 influenced adoption of relevant legislation in the sphere of local government finances but not yet at desired level.

Most of those laws are based on European Charter of Local Self-Government² ratified by the republic of Croatia³ in September of 1997. Fundamental feature of those laws was decentralization, release of certain levels of authorities to lower levels of local self government for them to govern their expenditures. Decentralization means transfer of responsibilities from central government and their institutions to lower organizations such as local and regional self governments.

¹ Dujanić, M.: Projektni menadžment, Rijeka: Veleučilište, 2009 (Udžbenici Veleučilšta u Rijeci=Manualia Collegium Politecnic Fluminensis), str. 77-80.

² European Charter of Local Government potpisana u Strasbourgu 15. listopada 1985. godine u izvorniku na engleskom i francuskom jeziku

³ Narodne novine – međunarodni zakoni br. 14/97 Odluka o proglašenju Zakona o potvrđivanju Europske povelje o lokalnoj samoupravi

“Decentralization in transition countries is shown to be one of the key institutional steps toward market economy and establishing of democratic political system.”⁴

Level of decentralization is measured by various financial indicators such as; proportion of income and expenditure of central government ie. Unit of Local and regional self government (ULRSG), in total income and expenditure of consolidated budget of central state, proportion of central state in gross domestic product (GDP); proportion of transfers from central state in ULRGS total revenue; proportion tax and non tax generated income in total revenue of local community, it is in direct correlation with achieved level of decentralization.

In our analysis we will measure level of decentralization using first two financial indicators listed.

Increased level of revenue (expenditure) of the central state in consolidated budget of general state or in GDP indicate increased level of attained decentralization in observed country. Degree of decentralization has direct influence on efficiency of public sector, quality of public services and fulfilling of public needs of the local unit population.

Analysis of conditions in transition countries given hereafter will show achieved level of fiscal decentralization which is not optimal even in highly developed countries (Denmark, Sweden), notably in transition countries.

⁴ Bird, R.M., Ebel, R.D. and Wallich, C.I., (eds), 1995. *Decentralization of the Socialist State*, Washington, DC: The World Bank u: Bratić, V.: *Lokalna samouprava u središnjoj i istočnoj Europi: snažan, neovisan instrument upravljanja na lokalnoj razini ili tigar od papira?*, *Financijska teorija i praksa* 32(2) str. 149-150 (2008)

Table 1. Total revenue and expenditure of units of local and regional self-government in countries of central and Eastern Europe. (in % GDP)

Country	Proportion of total revenue in 2005		Proportion of total expenditure in 2005	
	in % GDP	In consolidated budget of general state	in % GDP	In consolidated budget of general state
Bulgaria	5,7	13,6	5,3	14,9
Czech Republic	10,9	27,3	8,8	21,5
Hungary	12,5	29,3	13,1	26,3
Slovakia	6,7	18,5	5,9	15,4
Slovenia	8,9	19,3	7,5	16,7
Poland	12,6	31,2	11,9	28,5
Romania	4,4 (2000)	20,5 (2002)	-	19,1
Average	9,5	22,8	8,7	20,3

Source: Bratić, V., based on IMF-a (2006a i 2006b)u dtto 3)

From the data in table 1 it is visible that by the percentage GDP in 2005 Romania (4.4) and Bulgaria (5.7) were the countries with lowest degree of decentralization. On the other end Poland (12.6) and Hungary (12.5) has the greatest percentage of revenue in GDP which indicates much higher level of fiscal decentralization in those countries.

Average degree of fiscal decentralization measurable by percentage of revenue and expenditure of units of local and regional self-government in consolidated budget of general state in 2005 in countries of eastern and central Europe of 22.8 (revenue) and 20.3 (expenditure) compared with data for the Republic of Croatia where percentage of revenue was 11.8 and expenditure (11.7) confirms statement about Croatia as significantly centralized country.

Comparing the Republic of Croatia with countries from the table the following data are drawn:

Table 2. Total revenue and expenditure of units of local and regional self-government in the Republic of Croatia (in % GDP)

Country/Year	Proportion of total revenue in 2005		Proportion of total expenditure in 2005	
	in % GDP	In consolidated budget of general state	in % GDP	In consolidated budget of general state
Croatia	5,3	11,8	7,7	11,7

Source: Authors' calculations based on data from the Ministry of Finance

Data listed in table 2 point out the fact that Croatia with percentage of total revenue in GDP in 2005 (5.3) and percentage of total expenditure in GDP (7.7) is relatively low decentralized systems. According to the data provided by Central Bureau of Statistics⁵ GDP of Republic of Croatia in 2009 was 328,672,00 kuna and total revenue of ULRSG 16,062,945,000 kuna, percentage of local units in GDP is 4.9% which points out the negative trend comparing to year 2005.

This fact will be confirmed with data in Table 3 which gives us allotment of total revenue and expenditures of units of local and regional self-government in GDP of western European countries in 2005. Out of data shown is visible that in countries with most developed degrees of democracy or decentralization that allotment is several times higher than in Croatia: Denmark (32.6) and Sweden (25.4) while still relatively low in Austria (8.1) but on average allotment of those countries is still almost 2.7 times greater than allotment of revenue and expenditures in GDP of the Republic of Croatia.

Table 3. Total revenue and expenditure of units of local and regional self-government in western European countries (in % GDP) in 2005

Country/Year	Proportion of total revenue in GDP of 2005	Proportion of total expenditures in GDP of 2005
	2005.	2005.
Austria	8,1	8,0
Belgium	21,2	21,0
Denmark	32,6	33,3
France	10,9	10,2
Italy	14,7	14,7
Netherland	15,8	15,9
Norway	15,6	15,3
Germany	19,1	20,4
Spain	20,1	19,0
Sweden	25,5	23,9
Great Britain	12,9	12,3
<i>Average</i>	<i>17,9</i>	<i>17,6</i>

Source: International Monetary Fund, (2006a i 2006b)

⁵ Priopćenje Državnog Zavoda za statistiku : Bruto domaći proizvod za Republiku Hrvatsku, prostorne jedinice za statistiku 2. razine i županije u 2009., Zagreb, 14. ožujka 2012. broj 12.1.2.

Transformation process of the finance system of local and regional self-government in European countries did not go uniformly especially in the transition countries where, after 1989, communist regimes were overthrown and established democratic systems. All the countries ratified European Charter of Local Self-Government but arranged systems of financing of their local units which is visible from the conducted analysis. Common in financing systems of all the countries is that local units were or still are greatly dependable on centralized level of government that is providing most of the public revenue and spends greatest part of the public expenditures. That way it greatly influences the size of the fiscal capacity of the local units and the providing of inadequate level of public services as lay down by law.

3. Fundamental attributes of financial system of ULRSG in the Republic of Croatia

The Republic of Croatia is, as previously mentioned, on 19th September 1997 passed Law on Ratification of the European Charter of Local Self-Government⁶ and in the September 2008 Law on Amendments to the Law on Ratification of the European Charter which entered into force on 1st October 2008. Although with this changed law and regarding the Article 9 of the Charter – Financial sources of the local units, paragraphs 4 to 8 initially not ratified, were accepted, from today's perspective it is absolutely clear that those are not yet applied in practice. That is especially applied to the legal provision regulating protection of the financially weaker units, seeking opinion on how to distribute allocated financial sources, free decision making in area responsibility of the local units etc.

6 Narodne novine – međunarodni ugovori br. 5/2008

Table 4. Swot analysis of financing system of ULRSG on the area of the Republic of Croatia and Brod-Posavina County BPC)

REPUBLIC OF CROATIA	BROD-POSAVINA COUNTY
S – STRENGTHS	
<ul style="list-style-type: none"> - Legal legislation (Act on financing of ULRSG, Finance act, VAT Act); - establishing the size of GDP per capita, value that determines fiscal power of the local unit; - developed tax system comparable and compatible with tax systems in EU countries; - commitment to decentralize financial system; - categorization of units of local self-government to Areas of special state care, the mountainous regions i islands; - help from the government budget for financially weaker units; 	<ul style="list-style-type: none"> - existence of the program for assistance to weaker units in BPC; - support of the local and county development agency to the local units during preparing and submitting programs for the EU funds; - experienced and capable local management; - introduction of the unique treasury account; - significant number of local units with special financing status (Areas of special state care);
W – WEKNESSES	
<ul style="list-style-type: none"> - numerous and frequent changes in law regulations; - the complexity of the current tax revenues distribution system (so called common taxes); - complicated manner and methods of calculating the size of the fiscal capacity due to the different concepts - large disparities in the GDP per capita in different areas; - high degree of centralization of public revenues by the central government (about 90%); - excessive dependence of regional units on the State budget funds; - low degree of decentralization; - to large number of local units with special funding status; 	<ul style="list-style-type: none"> - very modest own funding sources; - constant imposing of new obligations on the part of the legislator; - new financial obligations of the ULRSG not followed by new adequate financing sources; - inability or limited ability to participate in EU projects (due to co-financing); - reduced ability of credit borrowing for capital projects due to rigorous legal requirements; - a large number of municipalities with low fiscal capacity;
O – OPORTUNITIES	

<ul style="list-style-type: none"> - the introduction of transparent and more equitable model for allocation of subventions; - introduction of so called gradual solidarity among local - continuation of the process of fiscal decentralization; - redefinition of the role of local management through the promotion of accountability for results; - the achievement of greater degree of efficiency and accountability of local management; 	<ul style="list-style-type: none"> - consolidation and interconnection of local self-governments; - Participation in the Structural and Cohesion Funds of the EU; - financing of development projects with common interest over multiple local units; - assistance from the state budget to local units in the joint provision of public services; - reduction of the para-fiscal levies which are an important source of financing for local budgets;
T – THREATS	
<ul style="list-style-type: none"> - large “fiscal tension” between the central and lower levels of government because of the weak concept of resource allocation; - failure or incomplete execution of tasks specified by regulations ULRSG; - irregular fulfillment of financial obligations; - increased level of indebtedness, particularly for capital investments; - jeopardizing the execution of tasks within Self-governmental scope due to poor fiscal capacity; 	<ul style="list-style-type: none"> - abolition of local government units that will not be able to carry out its self-government jurisdiction due to weak fiscal capacity; - steady growth in public expenditure and a growing scarcity of funding for their financing; - losing the current special financing status (Areas of special state care); - economic impoverishment of the local community;

Source: the authors

Conditions in the financing system of ULRSG in Croatia shown in Table 4 has a direct reflection on their fiscal capacity and their ability to finance their obligations with available funds (Table 5)..

The data in Table 5 (Index2) indicate a much differentiated status of inhabitants in some of the Croatian counties.

Specifically, the data shows that only one third of the counties (7 in total) has an overall per capita income higher than the Croatian average of the 2011th amounted to 3,583 kuna, while two counties (Pozega-Slavonia, and Brod-Posavina) barely reach half the average.

Only one county (Istria) achieved more than 80% higher total revenue per capita than the national average and the City of Zagreb over 2, 2 times.

Should the review included a total income per capita of Zagreb (7.928 kuna) even more disturbing data would emerge, because in this framework Croatian average was 4,384 kuna, and would have been exceeded only in three counties (Istria, Primorje-Gorski Kotar and Dubrovnik Neretva).

Table 5 Comparative presentation of the fiscal capacities of Croatian counties 2011

County	Total revenue in 2011	Population in 2011	Per capita income	Index 1	Index 2
Zagreb	1.158.344.825	317.606	3.647	83,2	101,8
Krapina-Zagorje	289.221.368	132.892	2.176	49,6	60,7
Sisak-Moslavina	565.997.553	172.439	3.282	74,9	91,6
Karlovac	364.122.022	128.899	2.825	64,4	78,8
Varaždin	477.227.923	175.951	2.172	61,9	75,7
Koprivnica-Križevci	369.055.481	115.584	3.193	72,8	89,1
Bjelovar-Bilogora	253.293.603	119.764	2.115	48,2	59,0
Primorje-Gorski Kotar County	1.825.045.685	296.195	6.162	140,5	172,0
Lika-Senj	203.287.248	50.927	3.992	91,0	111,4
Virovitica-Podravina	180.449.842	84.836	2.127	48,5	59,4
Požega-Slavonia	150.338.547	78.034	1.927	43,9	53,8
Brod-Posavina	308.831.447	158.575	1.947	44,4	54,3
Zadar	765.442.407	170.0174	4.502	102,7	125,6
Osijek-Baranja	886.544.001	305.032	2.906	66,3	81,1
Šibenik-Knin	351.800.836	109.375	3.216	73,4	89,8
Vukovar-Srijem	397.370.273	179.521	2.213	50,5	61,8
Split-Dalmatia	1.818.704.199	454.798	3.999	91,2	111,6
Istria	1.354.078.205	208.055	6.508	148,5	181,6
Dubrovnik-Neretva	548.719.151	122.568	4.477	102,1	124,9
Međimurje	254.291.210	113.804	2.234	51,0	62,4
Zagreb district	790.017	6.263.416.405	7.928	180,8	221,3
Total Croatia	18.785.582.231	4.284.889	4.384		
Total Croatia excluding Zagreb district	12.522.165.826	3.494.872	3.583		

Source: Authors' calculations based on data from the Ministry of Finance

From the data presented in Table 5 there is a big disparity in the sizes of the fiscal capacities of some Croatian counties which are then reflected in the average income per capita. All local units in the RH achieved in 2011 total of 18.8 billion in revenues out of which the the City of Zagreb alone 6.2 billion or 33.3%. Due to the large fiscal capacity of the City of Zagreb when calculating average income per capita, we've excluded it from the calculation and got devastating data about significant differences. It is evident that the average income of inhabitants of Croatia is 3,583 kuna, while the highest is in Istria with 6,508 kuna or 181% of the Croatian average. Average income of residents of the City of Zagreb is, for the majority of Croatian citizens, elusive 7.928 kuna. The lowest per capita income has Pozega-Slavonia County with the amount of 1,927 kuna, or 53.7% of Croatian average, very close is Brod-Posavina County with only 1,947 kuna, or slightly more than 54% of the Croatian average. The greatest paradox of this data is the fact that a considerable number of local units with above-average income per capita are the areas with special status of financing (PPDS, BPP, Islands).

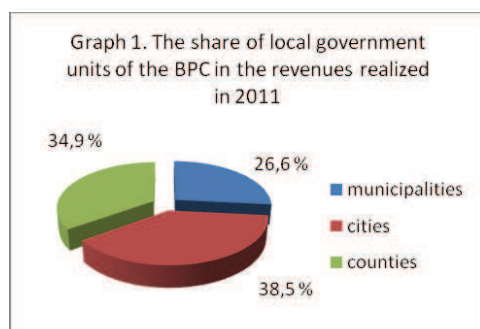
4. Results of the research of the fiscal capacities sizes in the units of local self-government in Brod-Posavina County.

The 2012th an analysis of the local government units in Brod-Posavina County (BPC) which was based on a survey of local authorities according to the data from 2011 year in the form of descriptive statistics, as well as internal documentation the Administrative Department for Budget and Finance BPC.

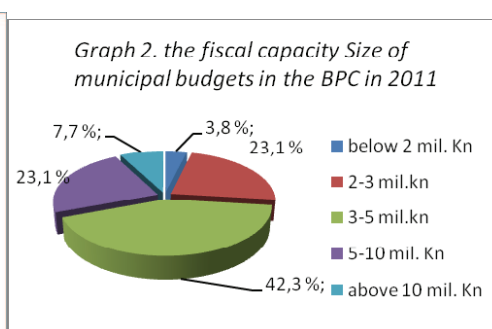
Brod-Posavina County is composed of a total of 28 local Self-government units (of which 2 cities and 26 municipalities), with 15 local government has granted the status of a special area of state concern (ASSC).

Results and conclusions of the study can be summarized as follows:

Total budget revenues and receipts of all 26 municipalities in the area BPC in 2011 amounted to 122,607,811 kuna, and the revenues of the two cities 177 335 598 kuna. Taking into account the County budget, which amounted to 160,451,326 kuna finds that the total realized on area of the BPC was 460,394,735 kuna of which to the municipality refers 26.6%, the the budgets of cities 38.5%, and the remaining 34.9 on a budget county (Graph 1)



Source: Authors' calculations



Source: Authors' calculations

Local government units budget size (municipalities and cities) varies from the lowest of 1.7 million which was in 2011 on disposal of municipalities Sikirevci, to the highest 141.0 million of the city of Slavonski Brod. The average municipal budget was 4.7 million kuna and the average budget of cities 88.6 million kuna. The largest number of municipalities (11) or 42.3% have a budget of between 5-10 million kuna and only one municipality below 2 million (Graph 2).

If we consider the population of a local self-government units, and the per capita income we can conclude that of a total of 158,575 inhabitants according to the 2011 census the municipalities lives 85,205 inhabitants or 53.7%, and in the cities total of 73,370 or 46.3%.

Average revenue per capita in municipalities was approximately 974 kuna, or only 50% of the county average, and per capita revenue in the cities was 2,098 kuna or 106% of the county average. Compared to the Croatian average which in 2011 (not including the city) was 3,583 kuna we come to devastating results. A resident of the municipality in the BPC has only 27% of the average Croatian residents income and resident of a city in the BPC about 58% of the Croatian average. For illustration, the average per capita income in city of Zagreb in 2011 was 7.928 kuna. It is evident that the average resident of a city in the BPC has only 26% of income compared to the inhabitant of the City of Zagreb.

5. Local unit Management in function of increase of the fiscal capacity and creation of conditions for economic development the BPC

Persons monitor the activities of others, and which are responsible for achieving the objectives in the organization are managers⁷. Robert Katz⁸ found that successful managers need to have three basic skills: technical (expertise), interpersonal (ability to collaborate) and conceptual (rationality).

Unlike entrepreneurial management, which measures the degree of success with the profit, success of management in local communities is primarily measured by fulfillment of the general and common needs of individuals and the community as a whole. Local management and process of management in local communities is divided into strategic level (county prefect, mayor, head of the Municipality and their deputies), tactical level (heads, assistants) and operational level (heads of departments, sectors, clerks) who perform all the functions of planning, organization, control and management of human resources, depending on their level in the hierarchy. One of the primary roles of the management of regional local self-government is strategic planning.

According to Denona Bogović⁹ the role of regional and local authorities (regional and local management) in the context of local economic development consists in the following:

- recognizing and encouragement of development initiatives;
- stimulating of local entrepreneurship;
- encouraging various forms of association and networking of -businesses such as clusters and free industrial zones, etc..;
- encouraging the development of the service sector in function of increase of the competitiveness of the region;
- encourage the development of activities that contribute to the development of human resources and technology;

⁷ Robins, Stephen P. & Judge, Timothy A.: Organizacijsko ponašanje, 12. Izdanje, Mate d.o.o. Zagreb, 2009. str.4

⁸ Katz, R.L. „Skills of an Effective Administrator“, Harvard Business Review, rujan-listopad 1974, str.90-102

⁹ Denona Bogović, N.: Menadžment u javnom sektoru, Kolegij : Lokalni ekonomski razvoj (Odabrane teme), Ekonomski fakultet Rijeka, 2008., str.25

These management activities have the task to increase the economic growth which direct impact is production sector revenue increase, the increase in GDP and increase budget revenues and fiscal capacity of local and regional self-government. In conditions of increased fiscal capacity it is possible achieve all the planned activities and strategic objectives.

County development strategy of Brod-Posavina County in 2011-2013 established strategic development goals:

1. Strengthening of the economy in a way that leads to a significant and continuous increase in employment and quality jobs
2. Environmental protection as a basis for sustainable development and economic activities
3. The continued development of the education system in line with the needs of the economy
4. Improving the quality of life, development of social infrastructure and improvement of the position of vulnerable groups

After increasing the fiscal capacity which is a priority objective of management activities can be planned towards goals 2 through 4 of the Development Strategy of Brod-Posavina County.

Local management of BPŽ through County and city development agencies, Chamber of commerce and Chamber of Trades and Crafts systematically works to support the development of entrepreneurship:

- maintaining regular contact with entrepreneurs
- by finding and preparing of locations and facilities for entrepreneurs
- assistance to entrepreneurs in obtaining various permits and approvals
- providing technical advice and professional support to entrepreneurs
- creating a positive business climate for attracting foreign companies through subsidies (cheap land, tax breaks, infrastructure construction)
- planning, preparation and execution of projects for EU funds

All these activities taken by local management are focused to increase fiscal opportunities and creating conditions for the development of the economy of the whole area of the County which, according to numerous financial and other indicators occupies infamous on the list of the Croatian counties.

In the context of the forthcoming Croatian accession to full membership of the EU countries, local management placed ahead new challenges and should focus, in addition to strategic planning and the promotion of competition on the projects such as:

1. Public-Private Partnership (PPP)
2. public involvement (community members)

Strategic planning is primarily necessary to focus on issues of employment, attracting domestic and foreign investors, access to capital, construction of the necessary infrastructure for the development of the economy.

PPP that increasingly, in Croatia, becomes a model of local community development, and involves collaboration between local government bodies with the private sector, in BPŽ, has not yet taken hold in practice.

Administrative (regional) management in the Brod-Posavina County has made the first steps related to public participation through the project of establishing Local Action Group (LAG) in the county with the main goal to motivate the civil sector on nomination and development of projects that will drive the development of local government units.

It is clear that the primary responsibility for project managers lies in the planning, integration and execution of the plan¹⁰. Such a complex tasks requires capable, educated and motivated management which is asserted by SWOT analysis.

6. Conclusion

Fiscal capacity of local and regional self-government is a major determinant of its economic and developmental abilities. Conducted SWOT analysis of the financing system of local and regional self-governments at the state level and at the level of local self-government units in the example of BPŽ, established the legal and other strengths and weaknesses. Qualitative and quantitative analysis collected data that show significant negative trends of and increasing discrepancy between the local units and the growing differentiation and the gap in the ability to cover public expenditure in performing of public authority from their self-governmental scope and fulfillment of public needs of citizens.

¹⁰ Barković,D: Uvod u operacijski management, Osijek, 1999. Str. 133

The planning process in local self-government units hampers the lack legal acts governing the practical operation of local government and administration. Unsteady influx of financial resources is a significant bottleneck for successful leadership, and uncertainty in the availability of financial resources prevents local managers in the detailed planning and implementation of any of development measures, in line with medium-term programs. In many local government units local revenue base is too weak to allow the local authorities to implement independent development measures.

In the the circumstances of the strong centralization of budgetary resources and low fiscal capacities of local budgets, crucial importance is given to local management with their activities in strategic planning of local economic development, promotion of entrepreneurship, public-private partnerships, creation of positive business climate, attracting of foreign investors, incentives, using modern information technology and the involvement of the public creates the preconditions for economic development.

The question is whether the local government function efficiently in a centralized state, in conditions of the monopoly of central government in the legislative and executive power in the system of bureaucratic relations of the state towards the private and public sectors of the economy, public services and citizens in all spheres of economic, educational, health care and social life¹¹.

In the circumstances of the strong centralization of budgetary resources critical importance is given to local management that with their activities creates the preconditions for economic development. Only the implementation of the measures established by the strategic planning of local economic development with the use of modern information technology and its permanent education of local management can contribute the increase of the fiscal capacity of local government units in order to more effectively manage public funds and efficient fulfillment of public needs of its residents.

¹¹ Hanžek, J: Napomene o lokalnoj i regionalnoj samoupravi u Hrvatskoj, Hrvatska javna uprava, god.9.(2009.), str.999-1010.

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