

# THE ROLE OF ECONOMIC AND POLITICAL MEASURES ON THE PALLIATION OF POVERTY IN CROATIA

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## *Abstract*

*The paper considers measures for palliating poverty in Croatia. After an introductory account, poverty is defined, and a very brief description of the situation in Croatia is given. In the sequel, attention is devoted to the encouragement of economic growth, the creation of greater opportunities for employment, the enhancement of human capital, an effective welfare system and well-oriented targeting of benefits to groups that need assistance, decentralization, the restraining of corruption and the development of institutions. The paper concludes with some final considerations and proposals.*

*Key words: poverty, economic development, welfare, employment*

## **1. Introduction**

It is almost unnecessary to recall that poverty is multidimensional. It is complex, institutionally embedded, and also a gender- and location-specific phenomenon. Usually, in households, children and women suffer more than men. Poverty outcomes are the result of a complex interaction between policies and institutions in the economic and the political spheres. Poverty outcomes depend not only on what happens with the national income, but more fundamentally on how these changes in the national income translate into changes in household measures, and on what happens to the distribution of this consumption.

Although there has been relatively little written about the incidence and scope of poverty in Croatia (true, there are some high quality surveys like World Bank (2001);

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Šućur (2001); Šošić (2003) here we will not discuss the measurement of poverty, survey the causes of its creation and its traits. We will instead direct our attention to measures – mostly economic and political in nature – that are required for poverty reduction or at least to keep poverty at its current level. In discussion of these topics it is necessary to have in mind the activities undertaken, the accepted government documents and the measures for its reduction (The Government of Croatia, 2002).

After the introduction, we briefly outline the situation in Croatia, and according to the Recommendation by the World Bank (2004), we assess the importance of and opportunities in different measures in poverty reduction. This means economic development and growth -especially the role of the state in economic change, the creation of greater opportunities for employment, the enhancement of human capital, an effective welfare system and well-oriented targeting of benefits to groups that need assistance, decentralisation, reducing corruption and the development of institutions.

## **2. Definition, causes and meaning of poverty**

Although at first it looks easy unambiguously to define poverty, its inherent complexity makes this not at all easy. Poverty is usually defined as the incapacity to satisfy material needs, especially food but also ensuring adequate dwelling, working tools and other assets. In other words, poverty is a lack of sufficient resources that leads to inadequate nutrition and the inability to satisfy basic needs. Many poor persons also stress the psychological aspect of poverty (Narayan, 2000) because they are fully aware of their weakness and exposure to exploitation. Poverty creates vulnerability, and that enables many representatives of state power to humiliate the poor among their citizens and treat them as less than human. It creates a sense of loneliness, and due to the limited possibilities of maintaining social links with friends and relatives creates a feeling of social isolation among the poor. For poor persons it is important to preserve cultural and social norms, particularly because for many poor people social solidarity is one of the most important benefits available. Although poor people often stress their economic problems, they mainly complain of social exclusion or limited capacities to break out of the vicious circle of impoverishment. If individuals or families fall into poverty, they face a very hard time finding their way out of it: often their social connections, links with family and friends, sunder, their opportunities to work in the unofficial economy are reduced or very limited, and due to their limited or non-existing social binding it is difficult for them to find employment. (World Bank, 2001).

## **3. The situation in Croatia**

Knowledge about the incidence and scope of poverty in Croatia was very limited until the analytical work on poverty and vulnerability carried out by the World Bank (2001) in collaboration with the Government became available. The analysis was based on the first post-war household expenditure survey in Croatia, carried out by the Croatian Bureau of Statistics in 1998. Results showed that poverty in Croatia is relatively low, i.e., lower than in most transition economies in the region (except for

Slovenia). Only four percent of the population lived on less than US\$4.30 a day at PPP (*internationally comparable* standard across transition economies), and about 10 percent lived on less than US\$ 5.30 a day, which the study suggested as an appropriate absolute poverty line for Croatia.

Absolute poverty in Croatia is low, but this diagnosis is only deceptively consolatory. However, poverty in Croatia is characterized by stagnancy - those who become poor take a great deal of time to escape from indigence (World Bank, 2001). There are several dominant groups of poor: the unemployed and inactive persons, the poorly educated and the elderly. Although the unemployed and inactive represent a small share of the poor population in the Croatia (2.9% and 5.4%), they are exposed to the biggest threat from poverty, while employment is a fairly reliable protection against poverty. Almost three-quarters of the poor live in families whose head has finished at most primary education. These individuals are likely to have little prospect of finding work if they are not employed, or to have low earnings if they are employed. The risk of poverty is particularly high when poor education is combined with unemployment. Those living in households with unemployed or inactive household heads are around 3 times more likely to be poor than the population as a whole. Thus, poverty in Croatia - having become much more like poverty in Western Europe - is highly correlated with the situation in the formal labour market and the skills of individuals (Grootaert and Braithwaite, 1998). Also, important parts of the poor population are older persons, especially those without pensions.

However, despite the high percentage of social transfers in GDP (around 25%) Croatia has achieved little redistribution. This is because most social spending programmes are relatively poorly targeted, while the relatively well-targeted social assistance programmes are fragmented and account for a small portion of total social spending. The benefits in programmes where the majority of social expenditures is spent (primary pensions and health insurance) are relatively badly targeted, while programmes that use just a smaller part of social expenditures (like rights in the welfare system and unemployment benefit) are better directed towards the poor.

Succinctly, we might recall that the characteristics of the poor in the Croatia are very similar to those of the deprived population in other transitional countries in Central and South East Europe, and are mostly determined by education, number of income earners, and employment status. There are several dominant groups of the poor, primarily the unemployed and inactive persons. The type of economic growth in Croatia has failed to generate enough economic opportunities for the poor, and they are at a disadvantage with respect to benefiting from these opportunities.

#### **4. Economic policy, growth and poverty**

It is almost impossible unanimously to determine what enables economic development because it is the result of numerous components or constituents that mutually interact, and the absence of some can prevent any or all from having a positive effect on development. To achieve development is very difficult, while it is easy to make it thorny

or completely unattainable, and the state has an important role. Because of this, economic literature has often analysed the relation between governmental rule and the role of the state for economic development, especially in poverty reducing. Modern economic development theory has passed through three stages in its attitude towards state involvement. In the first, there was an optimistic belief that the state is a benevolent and omniscient leader that will pull an undeveloped society out of its backwardness. The second phase was characterized by the opinion that the state is the most important obstacle to development and that it acts only for the welfare of narrow interest groups or for benefit of politicians and the bureaucracy, or in other words, for its own interests instead for the common interest. In the third phase, huge differences were found in state activities, and economists tried to explain them by directing attention towards the institutional factor of "state capability". This encompasses the aptness of the state to determine policy independent of narrow interests and to implement it effectively. Today, almost no one believes in a benevolent and omniscient state, but no one doubts that it is necessary to find out what the state should do in the realisation of the maximum potential social welfare. Usually, state intervention in an economy is justified by market failures (like externalities, non-existence of a market, importance of public goods), rights of citizens to particular goods and services (like education, health protection and care, and similar), paternalism (the belief that the state can perform some activities better than individuals - for example, organise education, pension insurance, reduce drug addiction) and the rights of future generations (including care for the environment). Furthermore, the role of the state is important in improving the functioning of the market and private sector through building and maintaining the infrastructure, development of and respect for the legal framework that enables market competition (primarily by reducing monopolistic positions), ensuring stable macroeconomic conditions, providing public security, and in some particular circumstances aiding particular economic sectors.

Economic theory in the last 30 years has established a *new orthodoxy of development policy*, which stresses the role and importance of the state in these duties, only its emphasis is on the approval, needs and ways of active state incentives for particular economic sectors. Successful elements of such active policies exist in many countries: helping exports and incentives for the development of marketing, distribution of information, technology and know-how. However, there are some completely opposite opinions, which claim that state planning and directing all individuals in the same direction can cause more damage than the market, and that state planning tends to be inflexible. The state might be incapable of governing the economy and providing the details of a particular programme. State control might inhibit or stifle private initiative. Activities of different levels of state governance might be badly coordinated, thus in the absence of market directions unsatisfactory effects are realised. Privileged and powerful groups could misuse state planning and governing for their own selfish interest. State planning contains a *structural* defect in that it is overambitious, established on inadequate macroeconomic models or data, neglects important non-economic factors, has institutional weaknesses (mostly in lacking communication between planners, administrative bodies and executors), is not inclined to new ideas and the necessary risks, and can easily be

transformed in the bureaucratic process in such a way as to completely lose any reasons for its existence.

Probably, the state can not guarantee economic development, but certainly can be an important obstacle to its realisation. Lack of willingness or capability to reduce huge inflation, unrealistic exchange rate fixing, a permanent budget deficit that generates public debt, a non-independent central bank that does not control commercial banks but functions according to political pressures and interests, are pretty secure determinants of lost economic development and a guaranty of captivity in poverty. Abundant and unnecessary interferences of the state into the economy as well as selective state aid to particular economic entities are additional factors that hamper economic development. Limiting free trade, complicating bureaucratic procedures for establishing and shutting down firms, making inadequate provisions for public services and/or reckless public spending are some of the circumstances and conditions that the state can produce so as to make economic development an unattainable goal.

Analysing the influence of government consumption, Barro (1998) concludes that increased governmental spending has a significant negative influence on GDP. A bigger amount of non-productive governmental expenditures (and the associated higher tax burden) have adverse influence on economic growth. Especially interesting is the importance of the rule of law, which includes the quality of state administration, political corruption, the probability that state will not respect contracts, the risk of state expropriation and the general respect for the rule of law. These factors contribute to the attractiveness of a country for foreign investors. In a survey of the situation in a number of countries, Kaufmann (2004) stresses that increased transparency in the public decision-making process, reduction of corruption, an efficient legal system and the quality of state institution related to respect for the rule of law by one standard deviation, enables approximately a three- or four-fold increase of income *per capita* and analogous poverty reduction.

What is the role of the state in Croatia? The state in Croatia is active in undertaking incentives for economic development, but it performs these incentives through state subsidies or co-financing employment. In Croatia there is still a very high level of state subsidies, so state subsidies in 2001 were 5.25% of GDP, while they were 1.01% of GDP in the EU (Kesner-Škreb, Pleše and Mikić, 2003). A noteworthy amount of public resources is directed to active labour market policies (Babić, 2003) but their effects are rarely evaluated and contain significant *dead weight* – which means that the employment-financing programmes helped persons who would have found jobs anyhow. Finally, one should not neglect the amount of resources spent on education, research and development. Bajo (2003) unambiguously shows the fallacy of the belief that science and tertiary education are under-funded. Also, in the system of education and research there is a serious lack of verification of the quality of results, the accountability of institutions or careful economising with expenditures.

What can be concluded about the role of the state in economic development? The state should be active in reducing economic inequalities, developing stable and expert institutions that contribute to political stability, and respect for the rule of law and rights

of property: these are pretty obvious preconditions for achieving economic development and poverty reduction. Barro (1998) believes that a significant direct influence on economic development (and so upon poverty palliation) is exerted by the rule of law, while de Soto (2000) underlines property rights. Easterly (2002) reminds that prosperity happens when citizens have adequate incentives. By investing in the future – for example by starting a small business or sending kids to school – people believe in the future benefit from today's activities. If the incentives are adequate and directed towards growth, people will recognise them and increase their working efforts and frugality and their dedication towards development and welfare. If this is not the case, people will squander, they will not improve their knowledge and skills, but will direct their activities towards plundering, cheating or taking from those who have assets or are believed to be rich. Governmental welfare programmes should stimulate but not punish the possibilities of earning, and the tax system should be as simple, predictable and stable as possible. Succinctly: the government should be oriented towards creating the opportunities for people to work and earn, and minimally engaged with the redistribution of existing assets and incomes. In palliating poverty – not only in Croatia – economic development is a necessary but not sufficient precondition of success<sup>1</sup>. However, economic development is crucial because it increases the demand for labour, and labour is the capital that the poor most depend on (Chu, 2003). Along with adequate economic and social policy, it is necessary to ensure that the poor also benefit from economic development and growth. First of all, it is necessary to empower poor citizens so they also have an active role in exiting from poverty. Empowerment encompasses viewing poor citizens as the key determinant and partners in the alleviation of poverty, helping them to obtain knowledge and skills, improving their employability, and increasing their influence and motivation for leaving poverty. Nobody derives more benefit from their emerging from penury than they do.

## **5. Greater opportunities for employment**

There is clearly a strong association between poverty, education, employability and long-term unemployment. Employment is the best protection against poverty and social exclusion. Also, paid jobs out of the house enable social integration and realisation of full citizenship. People who earn participate more easily in social, political, even sporting activities. There is not enough work for all, to a certain extent because a part of the population does not have the knowledge and skills sought by employers.

Most of the time the labour market is not perfect, so unemployment and unfilled demand co-exist. This implies that, particularly in countries like Croatia with high current unemployment, there is room for improved functioning of the labour market by bringing unemployment nearer to the minimum of labour demand and labour supply, thus reducing both unemployment and vacancy. Research on unemployment around the

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<sup>1</sup> Here we will not perform a detailed analysis of complex questions of interrelation between economic growth and poverty. The author intends to write more about it in some future paper. We are aware that it is necessary to investigate which conditions do and which do not enable economic growth, poverty reduction and palliation. Furthermore, economic growth is possible without any increase in employment.

world has identified a number of plausible determinants of unemployment situations and rates. Among others these factors include: unemployment insurance, active labour-market policy, product market competition, taxes, systems of wage bargaining, employment protection regulation, working time, etc. A particular problem is long-term unemployment, because after an unsuccessful job search, long-term unemployed persons really tend to lose any possibility of finding a job. Partially, they lose the skills and knowledge gained through their education; other skills and knowledge become obsolete, and their self-esteem as well as their hope for the future disappears. Some of the young turn to crime, while older persons become discouraged and apparently withdraw from the labour market.

Active labour market policy (ALMP) could redistribute job opportunities so that fewer people become long-term unemployment benefit and/or welfare assistance recipients. When total employment and total labour supply are given, this would imply distributing the unemployment burden among more people (assuming that not the same people are experiencing more unemployment spells as a result of the policy intervention). Clearly, an increase in total employment as a result of ALMP would be preferable to a redistribution of unemployment amount a greater number of people. Economic theory states that ALMP hardly affects total employment directly. But if ALMP succeeds in reintegrating long-term unemployed persons or welfare recipients, the effective labour supply increases. Therefore, reintegrating the long-term unemployed and preventing long-term unemployment are certainly worthwhile. There are other meaningful activities in addition to paid employment which can be a source of social integration and individual fulfilment. Nevertheless, the prevention of long-term and recurring unemployment would be a major contribution towards combating poverty and social exclusion and/or large numbers of social welfare recipients. This is especially important when the employability of the long-time unemployed is increased, or they become attractive to potential employers.

Although there is no qualitative research to call on for the particular Croatian circumstances, international experience, Ministry data and the Šućur report (2001) point towards the following four main causes of long term joblessness for some people.

- Low levels of employability brought about by poor education and work experience; this results in such people being uncompetitive in the labour market;
- Employer recruitment practices that tend to discriminate against long term unemployed people; long unemployment is often seen by employers as an indicator of a lack of motivation and other undesirable personal traits;
- Passivity in seeking work and reluctance to accept those jobs (mostly low paid) that do become available; the long term unemployed frequently blame others for their predicament and absolve themselves of any responsibility to find work. They see no worthwhile financial benefit in accepting low-paid work, sometimes with good reason, but sometimes incorrectly.
- Unwillingness to risk disturbing their current 'life style arrangements' because they fear change and ending up in a worse position. They may be poor but their



circumstances are predictable and manageable. In some cases they have supplementary forms of undeclared income (grey economy and subsistence farming).

Missing from the above list of causes is the “aggregate deficiency of jobs” on the demand side of the labour market. It would of course be helpful to all unemployed people if there were more jobs. However, there is clear international evidence and examples in Croatia, that labour supply shortages can exist alongside high levels of long term unemployment. Further, each business cycle creates additional long term unemployment that is not extinguished by the following business cycle. Till recently, long-term unemployment was ratcheted upwards and more and more unemployed people were dropping out of the effective labour supply. That has negative influences on the efficiency of the labour market, and on the material position of exposed persons. It also increases the costs of welfare system.

The task is to reduce both the flows into long-term unemployment and the stock of people already out of work for more than a year. The problems faced by many of the long-term jobless are often multi-dimensional and frequently include low levels of education and of motivation. Croatia has a range of active and passive measures to assist the unemployed. The employability of the long-term unemployed should be enhanced and social exclusion reduced through participation in work-related activities. There is the lack of timely evaluation to assess the true effectiveness of policy measures on the labour market. This could be addressed through the introduction of new techniques (tracking studies) for collecting up-to-date data about their impact. It is important to enhance the employability of these people – especially increasing their human capital, or improving their knowledge and skills, and to enhance work attractiveness for them by realisation of measures that make *work pay* (see Guidelines 8, of the Proposal of National Employment Action Plans for the Republic of Croatia for 2004).

Also crucial is the creation of an adequate entrepreneur and investment climate. This means improved governance, incentives for economic openness to foreign direct investment and foreign trade exchange, and creation of an adequate organisational infrastructure that enables investments. Improved human capital, better availability of public services and employment enable social inclusion of the poor citizen, which is so important for full participation in society.

## **6. The enhancement of human capital**

Most researchers agree that human capital is an essential component of competitiveness and economic development (return on investment in education is greater than that of any other investment), but this is no *guarantee* of development because countries with the finest human capital do not necessarily achieve the best developmental results. The concept of human capital is broader than just the formal education of a population and its employees, because it should encompass all knowledge and skills acquired informally and, under the broadest definition, investments in health. The level of human capital need not be the same as the average level of formal education, because attention should be dedicated to the health situation of population.



### 6. 1 Education, improved knowledge and skills

Education is the most important determinant of employability – in Croatia more highly educated persons find jobs more easily and faster – but also doubtlessly carries ancillary non-market effects (for example, easier access to information, greater care for personal health, more active participation in social life which encourages responsible democratic civic behaviour, election of democratic authorities and actualization of the rule of law). Non-participation in education is especially dangerous for the children of poor citizens. According to the World Bank (2001), the children of the poor in Croatia are very likely to drop out of the schooling system early, and differences in access to higher education are now very stark. The lack of access to levels of education that are highly valued on the market tends to lower their employability and increase the danger of staying in poverty. These factors perpetuate existing inequalities in earning prospects between the poor and non-poor and create the potential for the intergenerational persistence of poverty. A considerable number of youths in Croatia drop out of secondary and higher educational institutions. This is, among other reasons, caused by a serious lack of a network of “second chance” schools, aimed at young people who have either been excluded from education or are on the verge of exclusion. High drop-out rates drive up the costs per graduate. The school drop-out rate should be reduced, and an apprenticeship system should be created or the existing system improved.

Systematic prevention of youth exclusion from education could be realized by optimal *flexibility* and the *passability* of the education system at all levels. Flexibility implies sensitivity of the educational system to the changes in the needs of the environment and the needs of pupils and adult learners. Flexibility of education can be accomplished by recertification of the existing competences of an individual and by recognition of the results of non-formal education and self-education, i.e. by introducing a system of non-formally and formally acquired qualifications (introducing *identity cards* of acquired knowledge and skills). *Passability* implies avoiding “dead ends”. Dead ends in education are those educational streams (types of programmes) which do not allow for the transfer to a higher degree of education or to a different programme of the same educational degree. *Dead ends* decrease the availability (democracy) of education and utilization of human resources. *Passability* is being achieved by establishing a sufficient number of vertical and horizontal links between various directions of the system, which decreases its selectivity and avoids “averaging” of pupils’ achievements. *Passability* of the system particularly depends on the pathways that make possible transfers between general education and vocational education at the level of higher secondary education, higher secondary vocational education and tertiary education, in order to enable the continuation of education at a higher education level; and non-university and university tertiary education, in order to enable easier transfer from one type of higher education to another.

With the goal of lessening the number of drop-outs from the educational system and preventing low employability and poverty, it is necessary to establish counsellors and the employment of the young drop-out and provide measures for the ongoing training of the counsellors. Counsellors should assist in preparing the young drop-out for entering the labour market. To solve employment problems of the young drop-out, an additional

collaboration network should be established comprising various state institutions, private and non-profit organisations involved in employment issues.

Regarding youth education and employment, measures that increase the return and participation in secondary and particularly in tertiary education could enhance employability, reduce unemployment, prevent (or reduce) long-term unemployment, poverty and social exclusion. In all EU members and developed European countries, participation in education has increased in the last 25 years, but there are huge differences among countries, among particular parts in countries, and among particular socio-economic and ethnic groups. On the one hand, in Norway almost the whole youth population finishes secondary education - 60% vocational programs and education, while in Spain only 68% of the youth finishes secondary education - 23% vocational programme and education (OECD, 1996). Although the situation and causes of unemployment in Croatia differ from those in the EU, similarly, the unemployment rates are lower for persons with higher education and qualification levels. Because of this, it could be assumed that, like France and Finland, Croatia would also profit from motivating the youth to further education, while, like in Spain and Italy, there would also be benefits from increasing the possibilities and programs of vocational education, and participation of youth in it. This is an aspect of increasing their employability, which is the most important determinant in evading the fall into poverty and incentives for exit from it

In the absence of domestic research and data and according to the situation in many countries (Wolf, 2002), we can be relatively certain that educational programs in fact increase existing social differences, because poor citizens profit relatively little from participation in education, while children from richer social strata finish better and higher quality schools that introduce them to advantageous possibilities of further education, employment and professional promotion. In most transition countries, existing educational systems are expensive and ineffectual with regard to their results. Students are forced to learn more data, but are weaker in implementation and use of available knowledge and skills in unusual circumstances. Thus, at all levels of education, it is necessary to emphasize active participation of students, improve efficiency and modernization and enhance teaching methods.

Undoubtedly, many long-term unemployed people have finished at most a low level of education and/or have knowledge and skills that are not sought on the labour market. It would be reasonable to assume that many do not have basic skills of literacy and numeracy; some have had no formal education whatsoever. There are many indicators and reports that stress the insufficient incentives for lower paid workers to find jobs and leave the system of protection during unemployment or welfare. Employers complain of the difficulty of finding an adequate work-force even in regions with high unemployment. Long-term unemployed people are in a further adverse position due to the depreciation of knowledge and skills during the period of their unemployment, as well as negative attitudes by employers in providing them with jobs. Therefore, it is necessary in a coordinated way to improve the basic knowledge and skills of long-term unemployed people, develop new programs so that these people will acquire working experience, and expand the programs (courses) of reorientation.

In improving formal education, attention should be directed towards the palliation of widespread *functional illiteracy* and the increase of *the threshold of minimal competencies*. The consequences of functional illiteracy are long-term unemployment and a serious reduction of employability. Even in Sweden, the country with the highest percentage of literate people, 8% of the adult population has a severe literacy deficit. In some other countries the percentage even rises to 25%, so a huge part of the population is incapable of understanding and using the information contained in brochures, information bulletins and simple instructions for tools at the workplace (UNESCO, 2000). The minimum competence threshold is a certain extent of knowledge without which it is not possible to survive on the labour market. This usually implies minimum computer literacy and minimum foreign language knowledge, but also personal traits and capabilities like willingness to cooperate and participate in team work, providing services to users, learning ability, and motivation.

## 6.2 *Improvement of health situation*

As a part of human capital, an important cause of poverty, next to insufficient or inadequate education, is the health situation of the individual and his family members. Bad health or serious illness in a family imperil employment possibilities, professional promotion and an exit from poverty. Furthermore, in these circumstances, it is necessary to spend a significant part of limited financial resources for health protection. Croatia spends considerable financial resources on health expenditures, so in 2001, 9% of GDP was spent for this purpose, while in the EU the equivalent figure was 8.9%, and in Slovenia 8.2%. Also in Croatia the share of public expenditures in total expenditures for health was above the EU average. In Croatia this was 81.8% compared to 74.9% in EU and Slovenia. The amount of expenditure is not *per se* a guarantee of efficient and affordable health protection. According to the surveys by the World Health Organization, the country that spends the biggest amount on health protection – USA, with almost \$4500 yearly per capita at the end of last decade – can not be used as a positive example because an important part of citizens do not have any form of health insurance and/or receive low quality of health protection and care.

In Croatia there is a huge concentration of medical institutions in the bigger cities, especially Zagreb, while some regions have health organisation that are poorly staffed and provided with the required medical instruments. Even so, indicators of development of health protection in Croatia (such as infant mortality or percentage of vaccinated) are usually more like those of developed European states than those of transitional countries of Central and Eastern Europe. The biggest problem of Croatian health protection is the low and unequal affordability and accessibility of health services. There is a widespread practice of informal payments and use of private health services, and this very likely worsens the position of the poor social strata. There is no reliable data about this problem in Croatia, but such a conclusion can be made from the known organization of the Croatian health system as well as experiences from other countries. Those clearly show the problem of lower affordability of quality health protection for poor groups of population, and confirm the existence of a whole scope of diseases linked with risk behav-

iour (especially unhealthy nutrition, smoking, alcohol consumption, drug addictions, obesity, insufficient physical activity and similar lifestyle factors). In Croatia, among the whole of the population, but especially among poor people, there is a generally reckless attitude towards one's own health.

Many factors have made obvious a need for change: Inefficient provisions of service provision, increased costs and expenditures for health purposes, dissatisfaction of users with the quality, accessibility, affordability and speed of the services provided. Croatia has for some time been making changes in its system of health protection. The last reform began in 2000, with the intention of improving the health of the population, restoring financial sustainability to the health institutions, privatizing part of the capacities of health institutions, empowering primary health protection and the health system in general, and reducing differences in access to and affordability of health services. The reform encompasses the enhancement of institutional capacities by the health system, realisation of the pilot programs for providing health services, and the improvement, development and integration of a health information system.

Efforts in the health system now are directed towards better integration and co-ordination of local bodies of government and self-government and health institutions. Emphasis has been put on better regional adjustment and planning of health capacities, the resolution of existing problems of overlapping and/or sufficient processes in service provision. Also, it is hoped that organizational changes that will determine hospital priorities will reduce long waiting lists. The development and use of adequate cost-benefit analysis is required, as well as the strengthening of links between hospitals and primary and secondary health care. With better organisation and stronger binding of the three levels of health care a higher reliance on primary health care should be obtained, as well as a reduction of the use of specialist and hospital services. Reform activities are grouped into three parts: providing services including primary health care and protection; acquiring equipment; and the development of information technology. Through better provision of health services in the home of the patient, the ties with local communities are strengthened, patients are released sooner from hospitals, and more general practitioners are involved in the post-hospital recovery of patients. Also examined are the possibilities of daily inpatient treatment with the aim of processing a larger number of patients.

Croatia has started to develop its system of health care that consists of private and public health care service provisions, and a mixed - public and private - system of insurance and financing. To fully develop this system, at least one decade will be needed before information is acquired about its advantages and disadvantages. In the future, it will be necessary to empower family doctors and train doctors in primary care. In the system of care it is essentially to increase the number of employed nurses, and bring their knowledge and skills up to date. The doctors and staff in primary practice are in the place of first encounter with patients, and they are the most important factor in creating an impression of quality in the health system and health services. It is vital to enhance managerial skills in health protection and care, and systematically educate a new generation of leading health institution persons. It is important to create incentives

for medical staff to work in less developed and poorer regions of the country. It is necessary to ensure long-term financial sustainability of the total health care system. It is essential clearly and in detail to define minimal financial standards in health protection and care, and ensure their constant adjustment and modernisation. Finally, it is indispensable to adjust the authorities and responsibilities of health facility owners (mostly the bodies of local government) and sources of financing (Croatian Institute for Health Insurance).

## 7. Welfare system

Scientific and political discussions in the world often quarrel about the efficiency of welfare programs because it is stated *that the welfare system – like many other expressions of human intention – contains a seed of corruption*. Often, it is stated – but only partly justified – that excessive and long-term unemployment benefits or significant rights in the welfare system (which is not the case in Croatia) encourage the unemployed and poor to a longer and more selective job search, as well as to lower work efforts and earlier withdrawal from employment. Formally huge expenditures for welfare purposes are not a guarantee of efficient targeting and use. The situation with welfare program efficiency is particularly unfavourable in transitional countries where the (limited available) resources are mostly not very well targeted towards the most vulnerable groups in society. Also, some programs that are at first glance costly or luxurious maybe really help poor people, while some others – less expensive or generous – actually do not have any effect (or the effect is very weak is very weak) on reducing and palliating poverty. Thus it, is necessary constantly to monitor and survey the implementation of particular programs.

Market forces alone can never be relied on to produce a fair or equitable society. The state must be committed to the reduction of poverty and inequality, and in order to do so, it must maintain a transparent and equitable system of social protection that relies on a foundation of universal coverage and non-discrimination. It is necessary to strengthen the social safety net through improved targeting and monitoring of social welfare programmes, empowering civil society in the provision of social services, decentralisation of some social services, improving the targeting of social assistance, and better design of employment policy measures. A primary aim of policy must be to get people into work - or back into work. For most people most of the time, dependency on state assistance cannot provide a satisfactory alternative to employment - in terms of either psychological satisfaction or material well-being. The opportunity of paid employment is among the simplest ways of escaping poverty and dependency. It is desirable, wherever possible, that people are found (or find themselves) jobs in the formal sector. Not only are such jobs more secure, in general, they also offer more opportunities for training and the acquisition of skills. Further more, they will increase the tax base and, in some measure allow a reduction in indirect labour costs. Increased attention should be directed towards improving the situation and employment possibilities of the person from the *hard-core of poverty*, who needs the aid the most.

According to experience from many countries (World Bank, 2004), it is completely obvious that successful poverty palliation requires close cooperation between public

and private sectors, neither alone being sufficient. Also important are a clear division of authority and responsibility and improvements in the system of reporting, monitoring and incentives. A successful program realisation requires a strong national commitment, a broad consensus, and a general realisation that this process is not short term and that it entails the persistence and patience of all participants.

There is a need for two types of activities in order to improve public awareness of and access to social programs. First, to support the reform of the whole social and welfare system, the Ministry of Health and Welfare should create a plan for a public education campaign to inform members of the public about all changes in the legislation, procedures and new nation-wide social programmes. Then, social programmes available to the citizens under the reformed system and provided through the welfare centres by national, regional and local self-governments should be well publicized through the different systems of on-going publicity for the potential beneficiary. This system should include the dissemination of information through various means about the different benefits available through the particular welfare centre.

Substantial poverty reduction could thus be achieved in Croatia by careful reallocation of expenditures and improvement of coordination among existing social programmes. The Government reviewed the policy and public expenditure implications, and accepted a National Poverty Reduction Strategy in early 2002 (Government of Croatia, 2002). Two key recommendations emerged: (a) adopt a scheme to prompt a more comprehensive role for NGOs in providing services to the poor through outsourcing, and (b) ensure closer integration between social assistance programmes and education and employment services, in order to enhance the chances of the poor and unemployed returning to work. Initiatives in these areas should improve the effectiveness of social spending over time. To achieve more efficient allocation of resources, free market mechanisms are vital, but so are mechanisms concerning social equity. Reforms to build thriving, sustainable market economies will only succeed if premised on successful investment in people. Unfortunately, speaking about the *National Poverty Reduction Strategy*, it is necessary to recall that there have been no monitoring activities or estimation of its effects.

Collection of poverty indicators and an accompanying poverty analysis are important for the sake of acquiring a compact and detailed insight into the social situation in Croatia. One of the goals should be to establish the official poverty rate. Objective poverty analysis can help to put poverty issues in an adequate place on the political priority list, at both a national and a local level. Poverty indicators can be a good base for defining and shaping different measures of social policy. Monitoring the effects of a social programme is also one of the purposes of these indicators.

Many positive activities have been performed, but one should recommend that further effort be invested in improving the quality, range and frequency of collecting data, information and social statistics as well as in enhancing research about poverty, economic inequality and social exclusion. Such information and research are required for social planning and for the formulation of appropriate policies. If the objective is for safety nets to reach the poor, information is required on who the poor are and where they



are located, and how much of the benefits from the programme are reaching this target group. In most cases, (especially transitional) countries spend significant resources on safety nets but fail to collect data and monitor who receives the benefits and how they were affected by them. Such information should also be made available to the research community and general public. These two steps will help to make government at all levels more accountable to the electorate, by providing voters with more information about the impact of government policies, which should also raise the quality of public debate and increase the participation of citizens in the political decision-making process. This could maybe contribute to better determination of the governmental goals in poverty reduction, improved targeting in implementation of measures and active participation of bodies and individuals on different levels of government.

## 8. Corruption and poverty

Many surveys (Rose-Ackerman, 1999; Transparency International, 2003; OECD, 2003) have conclusively shown that countries with higher and more widespread corruption tend to have slower economic development and lower growth in income per capita. Corruption is the most important obstacle to exiting the vicious circle of poverty, economic inequality, illiteracy and ineffective investment. Countries with much corruption badly use or altogether neglect their available human and natural resources. Corruption is a serious threat to foreign direct investments, and significantly contributes to political instability and widespread disbelief in governmental institutions and state bodies. Corruption jeopardises public revenues and endangers existing social belief or enables its creation. Corruption activities divert the resources of all citizens into the hands of a select few, and mostly from poor to rich. The lack of financial resources causes low quality of public services or thwarts the provision of them. This causes higher infant and child mortality rates, a lower quality of child nutrition and higher school drop-out rates.

Unclear and often changing laws that provide public officials with huge discretionary powers are fertile preconditions for widespread corruption. This causes insecurity in business activities, encourages suboptimal decisions and makes impossible, or at least hinders, the realisation of economic development and poverty reduction. Widespread corruption and the intermingling of government and organised crime are especially dangerous in transitional countries, where the privatising process includes huge assets that are the result of the work of many previous generations. If through corruption, criminal and political activities become interwoven, it is almost impossible to separate them. Thus, many transitional countries are falling into the trap of corruption because the highest government representatives are the ones least interested in the eradication of corruption, while ordinary citizens are powerless.

Generally, it is believed that increased economic control by governmental bodies is the main cause of higher corruption. Theories of public choice and the rent-seeking literature stress that government is nothing else but a huge machine for the redistribution of existing income that contributes nothing positive to growth and development. In this, it is often forgotten that the government is not *neutral* and it should have an important role in respecting property rights, reducing transitional costs and similar. Governmental



programs probably are benevolent at the beginning, but if they do not take into account the existing relations and powers in society, they can produce not only weak, but also negative effects (for example, that the rich receive credits and subsidies intended for the poor – as was the case in the financial program of improving the situation in underdeveloped villages and farming in India). Governmental policy should create incentives, and not limit the possibilities for economic development; thus the problem is obviously not in *too much* government, but that government often *does the wrong things*.

What could be done to reduce corruption? It is necessary to go ahead consistently with structural reforms because transitional countries that have made more progress on structural reform and realised decentralisation tend to be less corrupt. It is also important to work hard on achieving a skilful and independent judiciary, creating acceptance of unambiguous and lasting laws, clearly delineating the authorities and responsibilities of governmental bodies, and reducing the discretionary powers of public officials. It is necessary to respect existing laws, and to improve the co-ordination of state bodies. State bodies and the highest public functionaries should serve as a positive example. Finally, it is important to draw attention to what is perhaps the most important step – sensitising the domestic public to the existence of the problem. This would be greatly helped by a high-quality media campaign, which should include incentives for skilful, independent and relentless journalism. Surely this is not an easy and simple task, nor one that can be done overnight; nevertheless, experience from many countries, some much poorer and less developed than Croatia, show that it is possible.

## **9. Decentralization of resources and services**

Successful poverty alleviation is directly linked to a consistent increase in decentralization of resources and services, which should improve the quality of services provided by this system with minimized administrative costs and overall expenditure. Decentralization should not be seen as the main goal of reform, but, rather, as a means to improving local service delivery. The structure of intergovernmental relations affects the efficiency and equity of service delivery, the social safety net, and poverty alleviation programs. Croatia already has taken the first steps in the decentralization process. A further, more practical problem with central government failure is that often, because of the poor performance at the local level, everyone who can afford it avoids governmental services. Instead of going to the public school or public hospital, citizens begin to look for private schools, private hospitals, and even private security firms. This not only weakens the role of the state but it leaves the government with the weakest and most needy part of the population which increases the burdens on governmental services and often affects quality adversely.

Across the world, countries are increasingly focusing on decentralizing decision-making authority to lower levels of government. Yet effective decentralization presupposes a broad set of conditions that should be met prior to and during decentralization. This raises a fundamental question: Why decentralize? While in any given situation the reasons vary, in transition countries there appear to be three key imperatives driving decentralization: a political imperative, an economic imperative and a service delivery

imperative. These factors are mutually overlapping and supplemented, so they should not be seen independently. The fundamental notion underlying theoretical discussions about decentralization is that local governments, closer to citizens, are likely to be better informed about citizens' needs and/or demands and therefore able to provide services more efficiently than the central government. Underpinning this general idea are ranges of assumptions concerning local government accountability, the extent and type of information flow, and the mobility of individuals. From the economic point of view in many countries – including Croatia – the necessity to reduce the role of the state in the economy in general and in welfare in particular is recognized. The inability of the Budget to finance all expenses in welfare, education, health care and similar is obvious. From the service delivery point of view, decentralization allows regional and local governments to determine the types and characteristics of social services that best meet local needs at all levels.

Next to the direct influence on poverty reduction and better service delivery, one should not forget the auxiliary decentralization effects that also indirectly affect the welfare picture of society. Many surveys from around the world (von Braun and Grote, 2000; Bird and Smart, 2001; Ebel and Yilmaz, 2001) show that fiscal and organisational decentralisation are a quite successful protection against corruption, that they enable higher equity and accessibility of services, mean more careful and frugal spending of public money, and contribute to economic growth. Decentralisation motivates a more active approach and participation by citizens, and it improves transparency in decision making and responsibility of governmental bodies and functionaries. However, there are also some possible negative effects, like increased costs because of duplicated capacities, deterioration of the quality of provided services, and impairment of responsibility and transparency – which mostly happens when duties are not clearly defined or there is an overlapping of the responsibilities of different levels of government. In many transitional countries, local governmental bodies have a relatively high level of independence but have limited possibilities for financing their activities. For example, in the Czech Republic, local governmental units have huge autonomy in budget expenditures, and almost none on the revenue side (Hogye, 2000). Often, local governmental bodies are not capable or knowledgeable enough for efficient, timely, and adequate service delivery. Very small governmental bodies are in danger of finding their service delivery becoming fragmented and inefficient, because they are not capable of satisfying all the responsibilities that they have been charged with.

What is the key prerequisite for successful fiscal and organisational decentralisation? It is essential that the central government respect a defined approach to allocating resources, so that *ad hoc* mechanisms of giving additional resources that disrupt the system can be avoided. A prerequisite for predictability and stability is that the system be transparent. It should be absolutely clear how and why resources are allocated to different jurisdictions. If the government is serious about poverty reduction and improving service delivery through decentralisation of the welfare system, it should link services that are delivered at the regional and local level with the required financial resources.

A key element of developing a formula-based system is to provide local governments with the predictability and stability that using such a system provides. Often the

lack of transparency comes in the form of excessively complicated formulas, but it also may result from the difficulties localities may have in obtaining formulas and the information used in calculating them.

Finally, we would stress that though fiscal and organisational decentralization can be an effective means to poverty reduction and the better provision of services to the poor citizens, it is no guarantee. Local government maybe knows better how to fulfil the needs of its citizens, but if clear divisions of authority and responsibility are not realised, if there are no incentives for implementing efficient procedures of decision making and mobilising financial resources, there is a meagre possibility that local government will be successful in delivering better services and being more effective in helping poor citizens.

## **10. Institution establishment and empowering**

The quality of economic institutions is closely linked with the quality of political institutions, the extent of political reform and the level of the democratization of society attained. Free political competition, free media, a network of NGOs and effective protection of human rights generally have an important role in improving economic institutions and limiting socially adverse and harmful phenomena like corruption and arbitrary rule. It is necessary to set up a good legal framework that enables the required political and social changes and ensures the willingness of those in charge of activities - institutions and individuals – to adjust to changed circumstances, to be innovative and to use positive experiences.

In improving the position of poor citizens it is particularly important to solve the existing senseless administrative limitations upon business activities and reduce civil servants' discretionary powers, which create huge possibilities for rent-seeking and bribes. In fostering entrepreneurship, further simplifications and equal treatment for business start-ups are necessary. Furthermore, in alleviating poverty and social exclusion, it is indispensable to increase public goods like security and respect for the rule of law, and to enhance access to technical infrastructure, education and public healthcare. Often cited factors that directly exacerbate the situation of the poor are the non-existence of the rule of law – especially labour law – so that citizens do not feel the equality of everyone before the law and the judiciary (which is under the influence of politically powerful persons) and a legal framework that is too complex for even better educated persons. As a possible important force for improving the position of poor citizens in Croatia, we direct more attention to improvement the judicial system and public administration.

### *10.1 Poverty and the judicial system*

Making and (still more importantly) keeping the judiciary independent, effective and honest is not a privilege; it is the obligation of the state. The main legal values on which the judiciary in a state of law and order should be founded, with all its various aspects (organisational, material, procedural and competence-related) are the protection of human rights and the public good, fair and correct procedures vis-à-vis the citizen, the legal responsibility of the judiciary, impartiality and equality, and other, similar val-

ues. But alas, the situation in Croatia is fairly distant from that desirable, or rather, requirement for the successful functioning of the judiciary and the attainment of its ultimate aim: of being the ultimate guarantor of the constitutional and other rights and liberties of citizens. During more than a decade, the justice system in Croatia has been in a state of permanent crisis. The causes of this crisis are numerous and diverse: from changes in the political and legal system, the collapse of the federal community, and the foundation of an independent state, all the way up to the war and the state of emergency brought about by the general instability in the region. The duration of judicial processes is one of the most important problems of the judiciary in Croatia (Uzelac, 2001). Croatia is very unfavourably assessed in judicial independence and legal efficiency (18.2% of interviewed persons were satisfied with the situation in the judiciary, the quality of the legal framework, corruption in the judiciary and protection of property rights), which was even lower than in other countries (for example, 51.1% in Slovenia, 47.1% in Hungary and 19.4% in Macedonia) (Kaufmann, 2004). The insufficient efficiency and excessive duration of judicial processes are especially dangerous for poor people because they do not have enough money for covering high judicial costs and paying huge legal fees. Thus, the realisation of the constitutional right of accessibility to the courts is questionable. According to internationally comparative indices of the results of judiciary reform, Austermiller et al. (2002) assess as the most important problems in the Croatian judiciary system the judges' working conditions, inadequate information and office equipment, and insufficient numbers of administrative auxiliary staff.

Certain measures have already been taken towards judicial reform, but it is necessary to increase efforts in improving efficiency of the system. Better territorial distribution of courts (big courts need to be split up and turned into several smaller courts), the redistribution of judicial powers (mostly by giving priority to cases that are urgent "in the letter of the law", and are also socially important and sensitive), better equipment (with more rapid computerisation), clear criteria for assessing judges, independence of the bodies that make these assessments, specialisation and better cooperation with experts from other professions in the fight against sophisticated crime, legislative encouragement of pre-trial proceedings in which attorneys and public notaries would be more involved, and some other institutions working towards conciliation between the opposing parties are all needed. At the same time it would be necessary to consider the possibility of letting officers in the land registers rule on cases themselves, and take over a certain degree of responsibility. This would allow judicial advisers to work on certain cases more independently. Also, over a certain period, the state should hire more judges who would be selected from experienced lawyers, or perhaps retired judges. According to the experiences from many countries (World Bank, 2004) the state can with adequate reforms significantly increase the efficiency of the judiciary system and improve its accessibility to poor citizens.

The Judiciary, like a business entity, should be accessible, efficient and user-oriented. It should implement modern managerial instruments and practices (like strict respect for a time schedule, simplification of procedural rules, and wider implementation of modern information technology) as a means of speeding up and facilitating judiciary processes. Keeping in mind the differences between Roman and Common Law, and tak-

ing into account the many specifics of national judicial systems, it is hard to propose some general measures for judiciary system reform and its increased efficiency. However, the following lessons emerge from successful judicial reform strategy.

*Strong political support for improvements in the judiciary system* – this encompasses political bodies and a general consensus; the good intentions and readiness for change of the highest state functionaries should be made obvious.

*Strong leadership is essential to creating and achieving a vision of change* - while inclusiveness and teamwork are hallmarks of a successful strategy, any initiative requires a leader to motivate and direct the reform course.

*Strategic thinking and business planning are central to institutional success* - any strategy to reform an organization must be holistic and participatory, fostering initiative for the reform process at all levels. Experience has showed that there is no general strategy that can be applied for all countries and all conditions, but it is important to determine reform priorities.

*Systematic programs for training judicial personnel are important* - as a means for obtaining strong cohesive unity of skilful people dedicated to changes and enhancements in the judicial system.

*Institutional reform must be tailored for and targeted at those the institution serves* - successful judicial reform efforts should largely focus on meeting the specific needs of local users, businesses and foreign investors.

## 10.2 Public administration and poverty reduction

Undeveloped and insufficiently effective public administration is surely an important hindrance to economic development and successful poverty reduction. The public administration in Croatia has not reached the level of institutional development required for effective implementation of many newly accepted laws and regulations. In Croatia there are serious limitations on wages and salaries and new employment in public administration. Thus, due to the relatively lower income (with the aim of reducing the huge public expenditures in Croatia) and weaker possibilities of professional promotion (mostly based on *seniority* – the duration of employment in administration, and not according individual results; real and not formal knowledge, skills and efficiency) in public administration there is an austere negative selection. The employees who remain in the public administration are those who are not competitive enough for the private sector. If fast change is not possible (by organising adequate undergraduate and post-graduate studies, and creating serious improvements in working conditions) it is important systematically to begin monitoring, analysing and determining the wages and salaries in public administration (and afterwards, in the whole public sector). More attention needs to be directed towards the performance of workers and not simply to the duration of an individual's employment. An employee's pay rise cannot be expected to be a guarantee of increased efficiency, if it is not accompanied by systematic and objective output monitoring and measuring.

Although the needed organizational and technical aid could be relatively easily obtained from foreign experts, successful reform of the public administration requires a

certain "critical mass" of domestic experts who are better acquainted with the domestic situation. By using help from foreign experts, especially from different sources, one has to keep in mind the possibility that inconsistent systems and procedures may result, because a particular advisor might not be aware of the proposals and measures suggested by another foreign advisor. The inconsistency of two opposite approaches will ultimately become obvious, but this might take some time. Also, there is an unfounded belief that modern information technology will solve *per se* the issue of effective performance of public administration. Many countries have invested enormous sums in contemporary technologies without necessarily having raised the efficiency of their public administration. The computerised collection and processing of data is not a panacea for the problems of public administration, but in conditions of good organisation it can certainly increase performance, accuracy, and speed, which is increasingly important in alleviating the position of poor citizens.

## Conclusion

Approaches to poverty reduction could be categorized into two alternatives: technocratic or institutional. The former emphasizes targeting and explores programme designs that try to direct limited resources to the people with the greatest need. The latter approach notes that the poor lack political power, and that administrative incompetence and corruption hinder government delivery of services. Poverty reduction therefore requires institutional development, and changed political structures, improved governance, and changed attitudes towards the poor.

However, there is no single model for the eradication of poverty, economic inequality and social exclusion that is optimal for all societies. Like every other country, Croatia has to find and develop constitutional and legal arrangements that best suit its own historical, social, cultural and economic situations, conditions and possibilities. From the abundant economic and social literature as well as from everyday practice it is quite obvious that government (not only Croatian) is incapable of solving the issues addressed. Although in Croatia there is mostly a general consensus about the necessity of institutional reform, there is no unanimity on how to obtain it. While the building of tangible infrastructure (like highways or bridges) is a complicated and demanding but still attainable goal, the reform of government that will assure an effective and inexpensive public sector, and the empowering of the private sector that will lead the economy, is in the present conditions, almost an unreachable aim. The Government should provide a stable legal framework, social infrastructure, and, with the co-operation of its citizens, establish the rule of law. Otherwise, the poor and socially excluded will suffer most from the lack of clear laws and the unwillingness of society to respect those laws that do exist. It is not so important to produce new laws and changes in the organizational structure, rather to enhance respect for the current laws. However, in order to make the laws work, political will and leadership commitment is vital. Equally important is the empowerment of citizens and their full participation in the political process.



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