THE CITY OF ZAGREB AND CROATIA: A PICTURE OF CAPITAL CITY'S CONTRIBUTION TO NATIONAL ECONOMIC GROWTH

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DOI: https://doi.org/10.31410/EMAN.S.P.2019.171

Abstract: *In today's world the wealth of nations rests predominantly on the wealth creating effect of their cities. Capitals are often economic dynamos of their national economies and in this regard the paper provides insight into the City of Zagreb's importance for Croatia. The importance in the growth of GDP is observed from the perspective of (de)population changes in the country. Starting from the fact that the GDP per capita indicator is often used to point out regional inequality and as key argument for claiming more "fairness" e.g. in fiscal revenue distribution, this paper suggests that "trading" the productive potential of Zagreb for a nation-wide attenuation of resources should be carefully weighted to avoid hampering effects on the nation's GDP.*

Keywords: *City of Zagreb, economic growth, depopulation, decentralization.*

1. INTRODUCTION

This paper provides insight into the economic and demographic strength of the City of Zagreb when compared with national trends. On the one hand, the concentration undoubtedly represents the source and drive of economic power - a platform for innovation, entrepreneurship, and economic growth. On the other hand, national political discussions on (regional) inequality issues, with buzzwords such as: solidarity, fairness e.g. in fiscal revenue, (re)distribution and/or "more balance", result in a decline of generators of growth. GDP and population, i.e. GDP per capita is perhaps the most clichéd term used in these political (and media) debates. Under the circumstances of profound demographic changes that Croatia is facing, political reasoning on decentralization, development, and growth without an all-encompassing and analytical expert basis, the weakness of decision-making that traditionally strives towards status quo, rather than fundamental change, is even more pronounced.

National decision-makers do not address the highly defragmented structure of Croatian local government and self-government, but, under the parole of fairness and a reduction of regional differences, they, in fact, trade development of the capital cities and national growth for financing a suboptimal regional territorial organization.[4] Under this status quo, even the best equalization scheme is, in essence, unfair. This paper does not argue against the process of decentralization but, rather, raises concern about the optimal degree of fiscal decentralization and horizontal equalization – they should not result in budgetary imbalances for bearers of national economic growth. This paper gives insight into the demographic picture of Zagreb compared to that of

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4 See e.g. [1].

the nation, followed by the City's role in Croatian economy. In part three, the aforementioned are discussed in the light of Croatian fiscal decentralization, followed by concluding remarks.

2. DEMOGRAPHIC SNAPSHOT OF CROATIA AND ZAGREB

The long-term population growth trend, in which Croatia reached nearly 4,8 million inhabitants in the late 1980s, was disrupted by the war and the transition of the 1990s. According to the latest census in 2011, 4,28 million people lived in Croatia, roughly the same amount as in the mid-60s of the last century. The next census in Croatia will be held in 2021, meaning that the time line between the censuses is currently deep in the area of statistical estimation. It is highly likely that, during the interim period, the estimated population of Croatia will decline and Croatian demographers have already rated the situation as very alarming.[5] According to data from the Central Bureau of Statistics, the 2017 mid-year population estimate for Croatia was 4.124.531 inhabitants, and for the administrative area of the City of Zagreb – 802.762 inhabitants.[6] The comparison of population trends (Figure 1) points to the Capital's strong resistance against the national trend: while the national snapshot indicates a dramatic depopulation and a drop towards the psychological limit of 4 million inhabitants, for the City of Zagreb, this trend (in overall observation) has a slightly positive curve. However, this snapshot is not a result of a natural increase, but of a positive (internal) migration rate. It is generally accepted, as well as confirmed by European immigration statistics, that a predominantly younger population emigrates from Croatia in search of work, i.e. people in their twenties and thirties.[7]

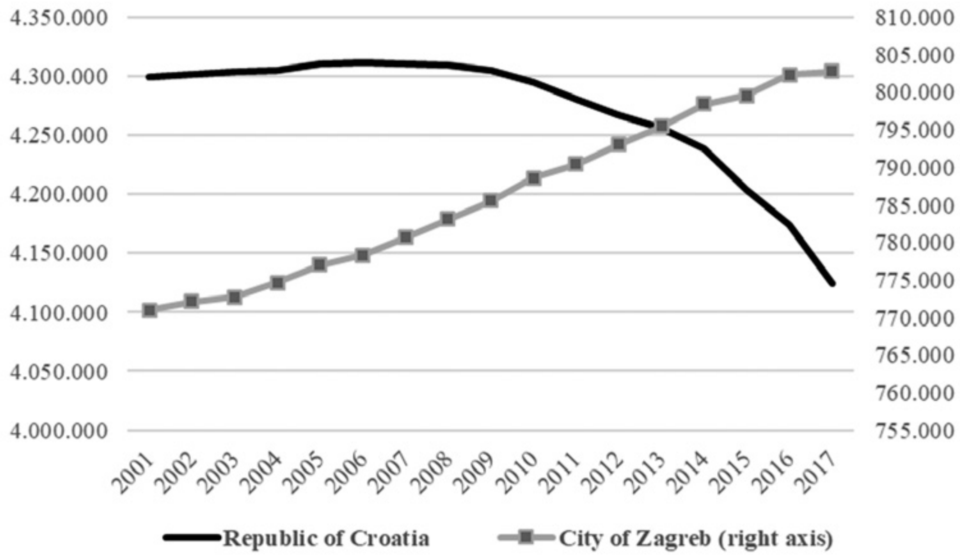


Figure 1: Mid-year estimate of total population from 2001 to 2017 (persons)
Source: Author's work, based on Croatian Bureau of Statistics data.

5 See e.g. [2] - [6].

6 Demographers believe that Croatia had fewer than 4 million inhabitants in the beginning of 2019 [7] and point to the key problem of Croatian official (e)migration statistics, which only include officially unregistered persons and that the dynamic, i.e. that net emigration, for the period 2013-2016 is actually several times higher than official statistics [8].

7 For example, according to German migration monitoring by the Federal Office for Migration and Refugees, there were 50.283 immigrants with Croatian citizenship in 2017, of which 7.509 were juveniles (15%) and 32.243 adults between 18 and 45. They made up almost 80% of the total number of Croatian citizens who moved to Germany in 2017 [9].

Since Croatia's accession to the European Union, the City of Zagreb has evidently not been immune to emigration out of the country, but it has managed to maintain a positive total migration balance. Compared to a large increase in the economic (e)migration of the population at a national level, the opening of the European market to Croatian labour force has defeated Croatia, but (at least for now) has not defeated the City of Zagreb (Table 1).

	2013	2014	2015	2016	2017	2013-2017
REPUBLIC OF CROATIA						
Net migration with foreign countries	-4.884	-10.220	-17.945	-22.451	-31.799	-87.299
○ Immigrants						
-from another county	29.959	33.806	33.418	31.512	30.433	159.128
-from abroad	10.378	10.638	11.706	13.985	15.553	62.260
○ Emigrants						
-into another county	29.959	33.806	33.418	31.512	30.433	159.128
-abroad	15.262	20.858	29.651	36.436	47.352	149.559
CITY OF ZAGREB						
Total net migration	2.871	3.040	2.132	2.706	1.003	11.752
○ Immigrants	11.606	13.116	13.644	13.765	13.758	65.889
-from another county	9.012	10.376	10.886	10.435	10.043	50.752
-from abroad	2.594	2.740	2.758	3.330	3.715	15.137
○ Emigrants	8.735	10.076	11.512	11.059	12.755	54.137
-into another county	6.731	6.955	6.466	6.183	5.941	32.276
-abroad	2.004	3.121	5.046	4.876	6.814	21.861

Note: Mid-year estimates.

Table 1: Immigrant and emigrant population from 2013 to 2017 (persons, in thousands)
Source: Author's work, based on Croatian Bureau of Statistics data.

As with most major European cities, the population of Zagreb does not grow on the basis of natural growth, but primarily due to new migration. The rate of natural increase in 2017 was -0,9‰, while, in Croatia, it was -4,1‰.

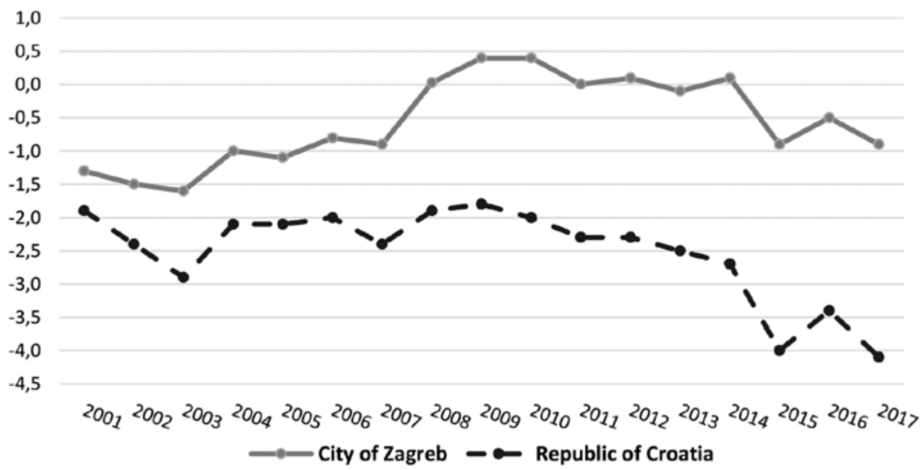


Figure 2: The natural increase rate from 2001 to 2017 (per thousand inhabitants)
Source: Author's work, based on Croatian Bureau of Statistics data.

Figure 2 shows the trend of the rate of natural increase in the City of Zagreb and Croatia since the beginning of the millennium. This City's rate is continuously better than the national rate, and the difference has never been greater than in recent years. Compared to the Republic of Croatia, the indicators of natural movement are more favorable in the City of Zagreb, partly because of a slightly younger population structure and an urban demographic policy (higher birth rate), and partly because of the concentration of top Croatian health care institutions in Zagreb (lower mortality rate). Overall, in recent years, the share of younger people in the total population of the city has decreased, while the share of the older population is constantly increasing, continuing the long-term trend of demographic population aging (Figure 3).

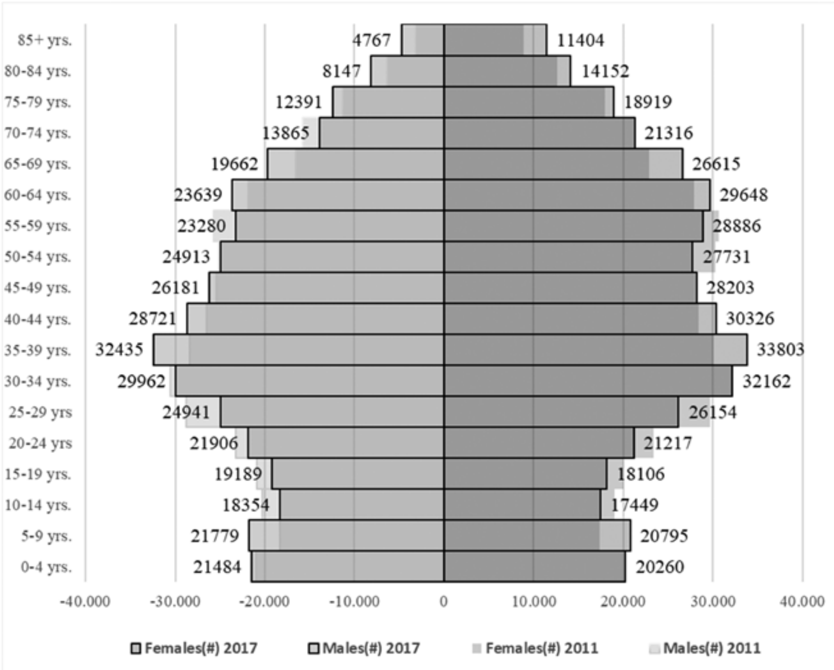


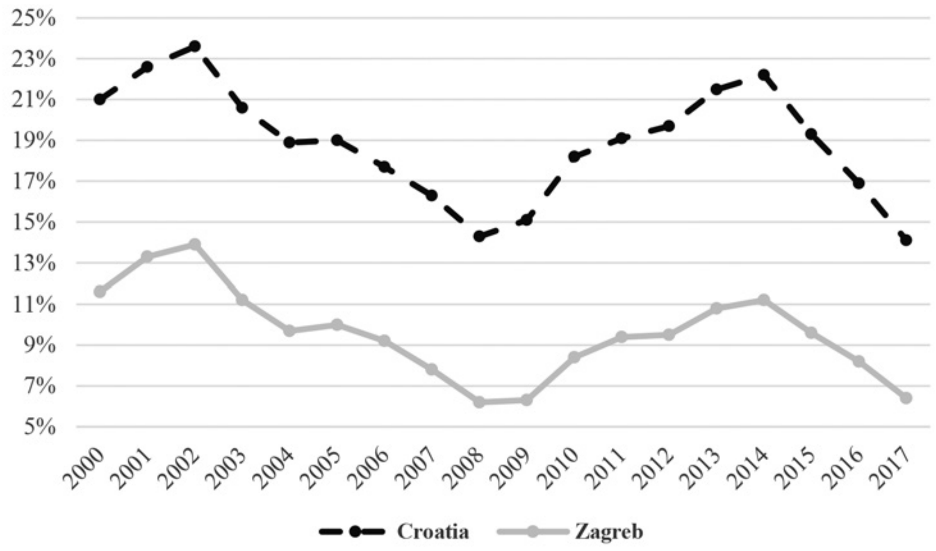
Figure 3: Age/Gender Pyramid of the City of Zagreb according to Population Census 2011 and Mid-Year Assessment of Population 2017
Source: Author's work, based on Croatian Bureau of Statistics data.

3. CROATIA'S CAPITAL CITY ECONOMIC IMPORTANCE

Since 2014, the rate of unemployment in Croatia has been rapidly falling and converging toward the unemployment level in the capital city in the past few years (Figure 4). In 2017, there were around 1,383 million people employed in Croatia, out of which 413 thousand in Zagreb; compared with 2014, employment in Croatia increased by 4,56%, and in the City of Zagreb by two percentage points more. At the same time, Croatia's active population shrunk by 5,4%, while the City's rose by 2,1%. Furthermore, it seems that the country has, in just a few years, moved to the other extreme of labour shortage, which is most prominent before the tourist season.[8] Although the actual proportions and consequences of depopulation and reduction of the working population have yet to be established/assessed, the economic and social challenge will certainly be great.[9] Compared to other major cities, the population of the City of Zagreb is twice as big as all of these cities, or Zagreb is four, six and eight times larger than Split, Rijeka and Osijek respectively.

8 See e.g. [10] - [15].

9 In this context, Croatian urban areas, especially the City of Zagreb, are of particular importance because, apart from the fact that they are the cornerstones of economic development, they are places where good care may be provided for the elderly population.



Note: The rate is calculated as a relation of unemployed persons and total active population.

Figure 4: Registered unemployment rate in the City of Zagreb and Croatia from 2000 to 2017
Source: Author's work, based on Croatian Bureau of Statistics data.

Although almost 60% of the Croatian population lives in towns, every fourth person lives in one of the four largest cities. Pursuant to the Act on Regional Development of the Republic of Croatia, the Cities of Zagreb, Split, Rijeka, and Osijek are the centers of Croatian urban agglomerations (UA), established during 2015 and 2016.

	Urban agglomeration				Croatia
	Osijek	Rijeka	Split	Zagreb	
Entrepreneurs	3.818	6.971	10.075	47.504	120.081
Number of employees	28.529	41.497	61.190	387.134	882.884
Total Revenues (000 EUR)	2.528.570	3.576.542	5.115.369	50.848.443	90.936.477
Total Expenses (000 EUR)	2.522.060	3.387.967	4.859.005	48.351.168	87.099.294
Profit (after tax, 000 EUR)	110.606	211.575	332.991	3.220.888	5.549.154
Loss (after tax, 000 EUR)	116.748	59.436	133.495	1.271.392	2.615.481
Consolidated net result (000 EUR)	-6.142	152.139	199.496	1.949.495	2.933.673
Export (000 EUR)	596.750	811.690	773.865	8.205.869	18.477.372
Import (000 EUR)	344.744	293.630	447.550	10.703.082	15.792.051
New long term invest. (000 EUR)	65.642	109.351	153.612	1.579.095	3.179.940
Average monthly net salary (EUR)	608	693	637	821	720

Note: Recalculated to EUR based on Croatian National Bank average annual (mid) exchange rate.

Table 2: Business Data for Entrepreneurs Headquartered in UA Area in 2017
Source: Author's work, based on [16].

In 2017, of the 120.000 Croatian entrepreneurs who submitted Financial and Statistical Statements to the Financial Agency for 2017[10], almost 57% had headquarters in the UA. By far, the majority of them are in the UA area of Zagreb (47.504), where every fourth entrepreneur had their headquarters, with a share in the total number of UA entrepreneurs in the amount of 69,5% (Table 2). The UA entrepreneurs employed over half a million people (518.350) or 7,6 employees per business enterprise, of which 387.134 in UA Zagreb (on average 8,1 employees). Entrepre-

[10] The Financial agency (FINA) is a public company which collects financial and statistical data from businesses and provides information and analyses for the public.

neurs in UA areas showed a positive consolidated financial result of EUR 2,3 billion, of which 85% was realized in UA Zagreb. In short, entrepreneurs headquartered in UA Zagreb have had the largest share in the Republic of Croatia, with the highest average net wage per employee, 14% above the average calculated monthly net salaries of employees on the level of the Republic of Croatia. Observed in the three-year period, in the area of UA Zagreb, the average salary was 6% higher, the number of employees 3%, and the number of businesses 15%, when compared with 2015 [16], [17]. Work productivity measured by the amount of income per employee in UA Zagreb in 2017 was 27,5% higher than the productivity of entrepreneurs at the level of Croatia, and, measured earnings per employee are also significantly the highest in UA Zagreb. The economy of UA Zagreb's total business was slightly above the Croatian entrepreneurs' economy as a whole. Figure 5 shows the trends of Croatian and the City of Zagreb's GDP, as well as the corresponding GDP per capita from 2000 to 2016. Croatian GDP in 2000 amounted to EUR 23,3 billion, While the GDP of the City of Zagreb was EUR 6,3 billion.

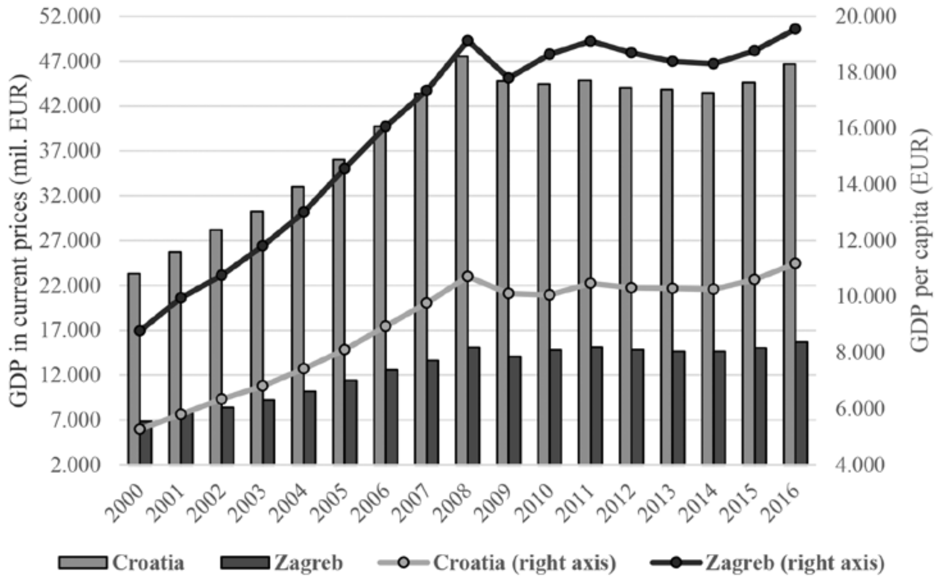


Figure 5: GDP and GDP per capita
Source: Author's work, based on Croatian Bureau of Statistics data.

Year	GDP (mil. EUR)		Share Zagreb in CRO, %	GDP per capita (EUR)		Index (CRO = 100)
	Zagreb	Croatia		Zagreb	Croatia	
2010	15.334	45.173	33,9	19.445	10.514	184,9
2011	15.117	44.854	33,7	19.117	10.473	182,5
2012	14.831	44.008	33,7	18.702	10.309	181,4
2013	14.627	43.808	33,4	18.388	10.297	178,6
2014	14.614	43.456	33,6	18.303	10.259	178,4
2015	15.028	44.630	33,7	18.769	10.606	177,0
2016	15.685	46.664	33,6	19.546	11.184	174,8

Table 3: Comparison of GDP and GDP per capita from 2010 to 2016
Source: Author's work, based on Croatian Bureau of Statistics data.

In 2016, the Croatian GDP was at EUR 46,7 billion, and that of the City of Zagreb was EUR 15,7 billion, and the share of the City of Zagreb in GDP grew from about 30% at the beginning of the millennium to 33,6% in 2016. GDP per capita in Croatia in 2016 increased by 112% in comparison to the GDP of 2000, and GDP per capita of the City of Zagreb increased by 123%. In the observed period, the biggest difference in GDP per capita was recorded in 2010, when GDP per capita in the City of Zagreb was 85% higher than Croatia's GDP, but, since then, this difference has decreased. *Ergo*, the convergence of the GDP per capita indicators is predominantly determined by the decrease of the Croatian denominator, i.e. the number of inhabitants, and not by the growth of the numerator (GDP). This is evident from Table 3, which shows the shares of GDP and GDP per capita of the City of Zagreb relative to that of the Republic of Croatia.

4. DISCUSSION

In professional and political public discussions, it may be heard that the importance of the City of Zagreb is "too big" and implicitly implies "injustice" in the distribution of economic and other benefits in Croatia. The attractiveness of moving into, and doing business in Zagreb is thus placed in the context of the "rent" that Zagreb enjoys as the capital city, further justifying the equalization of the development of the weaker parts of the country in relation to the better developed ones, through the pattern of a distribution of income tax revenue.[11] Income tax is the key tax revenue of Croatian local and regional self-government, as well as of the City of Zagreb, where income taxation constitutes ¾ of the revenue. Over the past 25 years, the financing models, i.e. the (re)allocations have been changed/supplemented more than ten times, and each time in order to be "simpler" and "fairer". The latest model, which has been in use since 2018, is more transparent in calculating the share of local units in the total amount of fiscal equalization funds. However, its key disadvantage is the detachment from Croatia's demographic reality, as the capacity of the per capita income tax revenue and the reference value and the optimal amount of fiscal equalization (per unit) are calculated on the basis of the number and structure of the last census, in 2011.

All policies, measures, programs, projects, and activities of the City of Zagreb are almost exclusively funded from the city budget, in which three quarters of revenue are made up of the income tax and the surtax, and in 2017 it was executed with revenues and receipts of HRK 8.72 billion, while the realized expenditures and expenses were in the amount of HRK 9.17 billion (approximately EUR 1.2 billion). Although this may seem nominally big to the Croatian public and politicians, it is less than 7% of state budget expenditures, and it should be emphasized that these expenditures include all the expenses of state administration jobs transferred to the city, which are neither refunded, nor co-financed from the state budget, by the central government, solely to the City of Zagreb.[12] Instead of Croatia, for example, following the example of Denmark, which has gradually (during fifty years) reduced the number of local government units from 1.300 to 98, Croatia has increased their number from 487 in 1993 to the current 576.[13] Without going into the reasons for maintaining the existing nano-fragmentation of local self-government, we can only point out the financial consequences of these long-term "gymnastics" of national politics on the financing models of the City of Zagreb.

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11 See e.g. the statement of the President of the Association of Cities in [18].

12 For example, approximately twenty state administration offices in other counties were financed from the state budget in 2017 in the amount of HRK 304 million.

13 In the Republic of Croatia, a total of 555 units of local self-government (428 municipalities and 127 cities) and 20 regional self-governments (counties) are established. The City of Zagreb, as the capital of the Republic of Croatia, has a special status of a city and county. Overall, the Republic of Croatia has 576 units of local and regional self-government.

According to the framework calculations of the City of Zagreb's Financial Office, Zagreb's realized tax revenues have, in the period 2015-2018, in comparison to 2014, been continuously lower for HRK 200 to 500 million per year, in a cumulative amount of HRK 1,5 billion (approximately EUR 200 million). While the average income tax revenue growth rate of the City of Zagreb in 2000/2006 was about 14%, for 2007/2016, the average growth rate of tax revenues was about 1%. The City of Zagreb faces the same problem noted by the Mayor of Rijeka, who pointed out that GDP and employment are growing with good result indicators of Rijeka's entrepreneurs, while the city's income tax revenues [19], due to the approach of the national fiscal policy to tax rates and the amount the of non-taxable part, have decreased. Sometimes, for financially self-sufficient cities, providing even relatively small domestic financial components for EU (co) financed projects thus becomes problematic, without even touching the state budget. After exhausting the alternatives of selling property and borrowing, balancing will have to be found in the context of cost reductions, which, for a City which wants and needs to develop, ultimately means extending the time horizon for the realization of development projects and/or increasing social insensitivity to the growing needs of its own citizens.

In social sciences, the rule is that often that which is valid in theory is no longer so unambiguous in practice. This, it seems, is the case with the phenomenon of fiscal decentralization from which, in theory, a higher level of economic efficiency and economic growth is expected, while empirical research in this context provides contradictory results and conclusions.[14] A standardized, conventional approach to the design and implementation does not exist because it is a complex process determined by the available (financial) resources and capacities on the one hand, and on the other, by the national and local territorial, political and administrative arrangements. If a thorough analysis and pragmatic thinking had been done before deciding, we would probably not have read in the Croatian press about the surprise at the Ministry of Finance after preliminary results of financial statements made it clear what the local authorities had spent the equalization funds on [20].

5. CONCLUSION

In the economic and demographic context, the share and "specific weight" of Zagreb are such that it can be said that, if Zagreb has a cold, Croatia has pneumonia. This is solely a consequence of weakness in other parts of the „organism", i.e. the country. Reducing regional differences between "stronger" and "weaker" in most countries is an objective of public interest. It is only ostensibly so if the economic and social convergence is realized at the cost of a lower national output. Changes in national tax policies, together with fiscal equalization, significantly impact Zagreb's tax revenues. While it makes sense to expect certain positive effects on national economic growth from income tax reliefs, Croatian decision-makers should thoroughly rethink the basic question: Does the equalization model serve its proclaimed goal, or does it create asymmetric incentive effects and support economic inefficiency?

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14 See e.g. [21] - [25].

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