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## Summary

The aim of the paper is to provide a description and an analysis of the evolution of the Czech regional developmental governance regime throughout the 1990s.

Part I. discusses the outcomes of state reform with a focus on the question what roles were assigned and what rooms were given to subnational actors to pursue developmental goals. A peculiar feature of the country's settlement system is its extreme fragmentation. The local governments are as a rule too small to function properly as political, administrative and economic units. They cannot mobilize sufficient personal, political, economic and organizational resources, cannot launch more ambitious developmental projects or provide sufficient services; they are also too weak as partners in negotiations with state offices. This part of the paper offers an analysis of the coming about of self-governing regions and separate regions of cohesion in the Czech Republic.

Part II. provides a description of the role played by central governments and subnational governments in the development and implementation of economic policies during the 1990's in the Czech Republic. In the process of privatization a minimal role was played by subnational units. In 1998, a special governmental program of the development of industrial zones was launched. The aim of the program was to help municipalities to prepare the conditions to develop investment projects in their territory. The activity of municipalities in the field of attracting the investors, however, was limited. Decisions about the investments into limited number of so called "strategic zones", where the most of state subsidies are spent, are in the hands of the national government. In supporting SMEs Regional Advice and Information Centers (RPIC) or Business and Innovation Centers (BIC) play a minor role. In the field of labour market policies the National Plan of Employment 2002 was the first to involve various partners; not only other ministries but also the representatives of regions.

Part III. provides a descriptive analysis of development of local government financing in the Czech Republic since the collapse of communism in 1989. Unfortunately, the system of local government financing is being constantly reformed or at least adjusted thus creating unpredictable environment for local development. The paper analyses arguments used for justification of particular reforms as well as examines impacts for different categories of municipalities. The paper starts by introduction of the main specific features of the Czech local government that are closely related to the issues of local government financing. Then follows an outline of reform efforts of the Czech system of local government financing. Finally, several policy implications and conclusions are drawn. The analyses performed were constrained by the fact that data on municipal level are available only for 1999-2000 period. Therefore, for remaining years, the only available data are those aggregated on district level.

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**PART I:**  
**The Development of Subnational Government in the Czech Republic**

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## **0 Introduction**

The present system of territorial public administration in the Czech Republic is the outcome of a systemic reform started in 1990 and continuing until the first years of the 21st century. The reform was component part of the country's overall deep political, economic and social restructuring which followed after the 1989 demise of the communist regime. The approaching accession of the Czech Republic to the European Union, particularly expectations of the EC as regards the country's ability to participate in the Union's regional policy, have prompted finalization of the reform. Although the evolution of public administration which has constantly to adapt to new tasks and changing circumstances is a never ending process, after fifteen years of restructuring a situation was reached in the Czech Republic when the system of territorial public administration has been more-or-less stabilised. Its main structures and rules are in place and further changes mostly consist in their fine-tuning.

### **1. The geographic and demographic characteristics and the settlement system of the Czech Republic**

It is never superfluous to recall that space matters in reforms of subnational public administration. Several parameters of a country's settlement geography and demography are of importance for the structuring of public administration: size of the country (both in demographic and spatial terms), population density, number and size distribution of settlements, their spatial distribution and the level and type of urbanization, as well as the size and territorial distribution of ethnic groups. The configuration of these characteristics constitutes an objective matrix with which the system of local government has to cope. As for its size, the Czech Republic with a population of 10.3 million (2001) and surface area of 77 thousand square kilometres ranks among the smaller European countries. Average population density is 132 persons/km<sup>2</sup>, the highest levels are reached in metropolitan areas and the lowest ones in some of the western and south-western border areas of the country. 75 % inhabitants live in urban municipalities, plus further percentage in metropolitan areas outside the largest cities. Capital Prague, with its 1.2 million inhabitants (representing 11.6 % of the country's total population), and the primacy ratio (ratio of the population sizes of the largest and the second largest city within a country) reaching 3:1, is far the largest city in the Czech Republic.

A peculiar feature of the country's settlement system, highly relevant for the structure of municipal government, is its extreme fragmentation. The Czech Republic is covered by a scattered network of settlements – a dense net of villages and small to medium-sized towns, more-or-less evenly distributed over its whole territory. The number of settlements - irrespective of whether they have the status of municipalities - reached almost 16 thousand in 1990s. Although steadily falling due to the depopulation of rural areas outside of urban regions, the large number settlements, many of which are proper territorial communities whose population share a feeling of local identity, poses a challenge when designing the municipal structure. Obviously, a country with a scattered settlement structures is susceptible to fragmentation of local government and the issue is, if and how far, should a public administration reform push for an integration of settlements under joint authorities. Criteria of economic and administrative efficiency often clash here with the need for transparency of local government and its acceptance by local population

On the other hand, there do not exist (with the exception mentioned below) in the Czech Republic any organic, historically anchored sociocultural regions into which the country could be divided and that could become a basis of its political and administrative regionalisation. The only such split could be possibly made on the macro regional level between Bohemia –

the western part of the country, and Moravia (together with a segment of Silesia) – its eastern part.

Size and spatial distribution of ethnic minorities might be another geo-demographic factor relevant in designing territorial administrative structures, particularly at the regional level. Large, spatially concentrated and politically active minorities may demand territorial autonomy or some other form of special administrative and political status. In the Czech decentralization reform this has not been a relevant issue. Nowhere in the ethnically homogeneous country are at present ethnic groups which would demand politico-administrative autonomy. According to the 2001 population census, Czechs represent 90.1 % of the population, the next most numerous groups are Moravians (3.6 %) followed by Slovaks (1.8 %), Poles (0.5 %) and Germans (0.4 %).<sup>1</sup> With the exception of the Moravians (see below) the minorities do not form large spatial concentrations. Beside these groups there is a non-negligible but elusive Roma population, the majority of which did not declare Roma nationality and preferred to indicate the Czech or Slovak one. In the 2001 population census, only 11.7 thousand, i.e. 0.1 % of the population, chose Roma nationality although the real number of Roma living in the Czech Republic is estimated to be about fifteen times larger which would make them the second or third most numerous ethnic minority. In spite of its size, the Roma group is spatially dispersed, constituting only micro-concentrations, mostly in urban settlements.

A special case are the Moravians. Routinely, this term denotes inhabitants of Moravia, the eastern part of the Czech Republic, expressing their regional rather than ethnic identity. In the modern era, Moravians have been considered to be a branch of the Czech nation. Since the 12th century Moravia has been integrated into the Crown Lands of Bohemia, enjoying at the same time considerable political autonomy [Janák and Hledíková 1986]. Since the foundation of Czechoslovakia in 1919, Moravian autonomy was gradually reduced, to be finally abolished altogether in 1949 by the communist regime. It was therefore a surprise when Moravians emerged as a sizeable group in the 1991 population census, where people had the opportunity for the first time after many years to opt freely for whichever nationality they preferred: 13.2 % of the country's total population chose Moravian nationality. In Moravian districts the share of Moravians ranged between 20 and 65 %. However, this phenomenon turned out to be temporary: ten years later, in the 2001 population census, the proportion of „statistical” Moravians shrank to 3.6 % of total population – almost a fourth of the previous number. The volatility of the Moravian phenomenon suggests that its sudden emergence was another manifestation of the identity searching atmosphere which temporarily prevailed after the demise of the communist regime and has mostly faded away during the second half of the 1990s.

## 2. The territorial administrative division of the country

The Czech Republic is a unitary state. Its territory is divided into regions, regions are divided into districts and districts are divided into municipalities and military areas (Act No. 36/1960 Coll., On territorial division of the state, and its later amendments).

*The regions (NUTS III level units)*, of which there are 13 plus capital Prague that too has the status of a region, have been established in 1997 by Constitutional Act. No. 347/1997 Coll., On establishment of the higher-level territorial self-governing units (effective from January 2000). They substituted former eight regions that had existed since 1960. With the exception of Prague and the Central Bohemian regions, the delimitation of the new regions, based on geographic and political criteria, was new and did not copy any more ancient regional admin-

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<sup>1</sup> All data are from the 2001 population census.

istrative structure of the country. As higher level territorial self-governing units, the regions enjoy some degree of autonomy and they have their own elected regional governments. At the same time, they are also seats of the general state administration (see below).

### Chart 1. The regions

Figure 1. Division of the Czech Republic into Regions of Cohesion and Districts



The regions are unequal in terms of both their area and population size. Geographically, the largest is Central Bohemia and the smallest (with the exception of Prague) is the Liberec region in north Bohemia. Most populated is the industrial Moravo-Silesian region in north Moravia, least populated the Karlovy Vary region in west Bohemia. Also municipalities are unevenly distributed over the regions: the largest number of them can be found in Central Bohemia, the smallest in the Karlovy Vary region. Cf. Table 1

Table 1. The main characteristics of regions

Region	Area	Population	Population density	Districts	Municipalities	Urban municipalities	Urban population
	km <sup>2</sup>	2001 in thous.	per km <sup>2</sup>		in 2000	in 2000	% in 2000
<b>Praha</b>	496	1.173	2,414	1	1	1	100
<b>Středočeský R.</b>	11,014	1.132	101	12	1 148	71	56
<b>Jihočeský R.</b>	10,056	630	62	7	623	43	65
<b>Plzeňský R.</b>	7,561	553	73	7	505	45	68
<b>Karlovarský R.</b>	3,314	306	92	3	132	28	82
<b>Ústecký R.</b>	5,335	826	155	7	354	46	81
<b>Liberecký R.</b>	3,163	430	136	4	216	36	79



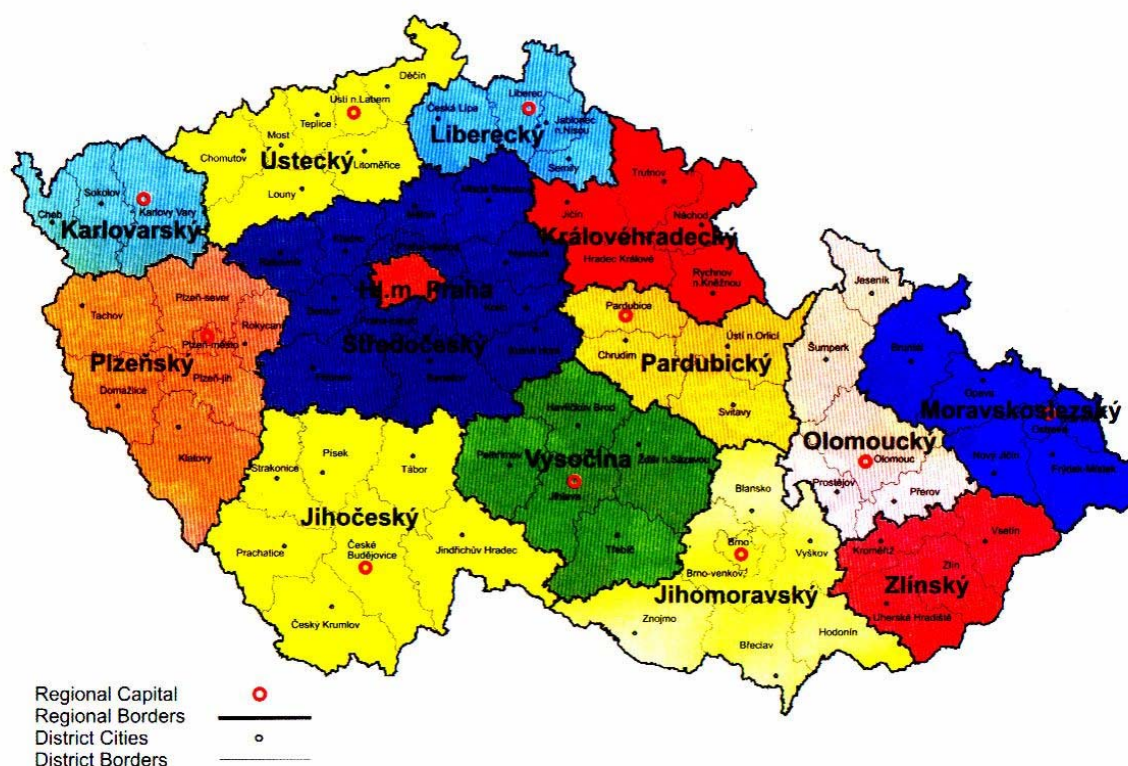
<b>Kralovehradecky R.</b>	4,758	510	116	5	448	42	69
<b>Pardubicky R.</b>	4,518	510	113	4	453	30	62
<b>Vysocina</b>	6,925	521	75	5	730	29	57
<b>Jihomoravsky R.</b>	7,062	1.132	161	7	647	43	63
<b>Olomoucky R.</b>	5,139	642	125	5	393	24	58
<b>Zlinsky R.</b>	3,964	597	151	4	300	28	61
<b>Moravskoslezsky R.</b>	5,554	1.275	231	6	301	39	77
<b>Czech Republic</b>	78,86	10.282	131	77	6 251	505	75

Source: Czech Statistical Office, 2000, 2001

In preparing itself for accession to the EU and for participation in the EU's regional policy, the Czech Republic has divided its territory into NUTS II level statistical regions in 1998 which were declared later (by Act No. 248/2000 Coll., On support to regional development) to be the *Regions of Cohesion* as well. Eight such regions were designated – five of them by grouping together some of the existing administrative regions, while the capital Prague, the Central Bohemian region and the Moravo-Silesian region became alone the NUTS II level units as well as the regions of cohesion. These are non-governmental units which will, however, play an important role in regional development policies.

## Chart 2. Regions of cohesion

Figure 2. Division of the Czech Republic into Regions and Districts



*The districts.* The country is further divided into 77 districts whose territories were delimited, bar later amendments, in 1960. The capital Prague and three other largest cities (Brno, Ostrava and Plzeň) count each as one district (the territories of districts were most recently delimited by the Decree of the Ministry of the Interior No. 564/2002 Coll., On the delimitation

of territories of districts in the Czech Republic and territories of boroughs of the capital Prague). The population size of districts (Prague excluded) is in the order of tens or hundreds of thousands inhabitants, but varies widely. Until 1990, districts had the communist-type elected local governments and they were also seats of the general state administration offices as well as of some deconcentrated offices of ministries and other central administrative bodies. During the transitory period between 1990 and the end of 2002, districts remained to be seats of the general state administrative bodies – the District Offices (Act No. 147/2000 Coll., On District Offices), while organs of the district self-government were abolished. Since 2003, also the District Offices ceased to exist and their responsibilities were transferred partly to Municipal Offices in municipalities with extended powers and partly to Regional Offices – see below. At present, it is only some bodies of the central state that have kept their deconcentrated offices in the districts.

*The municipalities.* There existed 6,249 municipalities, both urban and rural, in the Czech Republic in 2004 and this number has not substantially changed since then. Nearly 80 % were very small places with population below one thousand – see Table 2.

**Table 2. Size distribution of municipalities (as of 2004)**

Population size	number of municipalities		population	
	n	%	n	%
<b>-199</b>	1.642	26,28	201.862	1,98
<b>200 - 499</b>	2.018	32,29	655.426	6,42
<b>500 - 999</b>	1.291	20,66	900.139	8,81
<b>1 000 - 1 999</b>	664	10,63	918.935	9,00
<b>2 000 - 4 999</b>	370	5,92	1.133.479	11,10
<b>5 000 - 9 999</b>	133	2,13	911.787	8,93
<b>10 000 - 19 999</b>	68	1,09	957.807	9,38
<b>20 000 - 49 999</b>	41	0,66	1.205.631	11,81
<b>50 000 - 99 999</b>	17	0,27	1.212.713	11,88
<b>100 000 +</b>	5	0,08	2.113.676	20,70
<b>Total</b>	6.249	100,00	10.211.455	100,00

Source: Malý lexikon obcí (Small Lexicon of Municipalities), Praha: Czech Statistical Office, 2005.

The municipal tier of public administration is itself internally differentiated into three levels, as selected larger municipalities were delegated by the state the execution of certain state administrative powers also in other municipalities in their vicinity (Act. No. 314/2002 Coll., On delimitation of municipalities with commissioned Municipal Offices and of municipalities with extended powers).

Depending on the scope of the delegated powers and size of the territories where these are exercised, there are distinguished

1. *Municipalities where just single functions* are executed for the surrounding territories,
2. *Municipalities with extended powers* (205 municipalities),
3. *Municipalities with commissioned Municipal Offices* (383 municipalities).

Czech public administration does not explicitly distinguish between urban and rural municipalities as regards their responsibilities. 526 municipalities (as of 2002) had the formal status of towns or cities and can be thus considered urban in the administrative sense. However, the urban status does not per se imply any prerogatives beyond merely formal ones. Among the cities in the Czech Republic, capital Prague and other nineteen largest cities – the so-called *statutory cities* – enjoy a special formal position: they can be internally divided into self-administered city districts or city parts.

### **3. The post-1989 reform of territorial public administration**

#### **3.1 The political context of the reform**

As mentioned, the democratizing and decentralizing reform of territorial government was an essential component of the overall political transformation in the Czech Republic after 1989 and its first stage followed closely after the change in regime. Expediency was an important situational factor in the implementation of the reform measures: the need to build a new system of territorial government was viewed as a political task that could not be postponed. A delay would have had a negative impact on other components of the transformation.

The reforms and the democratic local elections were intended to facilitate the displacement of the old local and regional political elites and thus to undermine the remnants of communist power in the provinces. Also, the reform had a strong symbolic meaning, as it was a way in which to legitimize the new power and to demonstrate that things have moved away from the previous circumstances. Political concerns were primary, and administrative and economic rationality was of secondary importance at this stage.<sup>2</sup>

While the overall function that the reform fulfilled in the political transformation was more or less the same in the individual East Central European countries, it was particularly expedient in Czechoslovakia whose hard-line communist regime did not allow the issue of decentralization and democratization of subnational government to be opened until the very end of its existence. Serious steps toward decentralization could be taken only after November 1989. Before that time, discussions among experts and intellectuals took place, critically motivated research of the local administration was undertaken, and some half-hearted ameliorations of the territorial government were made by the authorities, yet no consistent reform policy was either formulated or implemented. Compared with the other two countries of East Central Europe – Hungary and Poland, Czechoslovakia was the least prepared for institutional reform in 1989 and preparation of the reform (of its first stage) had to be compressed into the nine months between the fall of the communist regime and the local elections of November 1990.

The political atmosphere in 1990, when the reform was drafted and its first stage implemented, was full of euphoric plans and expectations concerning democratization, the reparation of earlier injustice and the fulfilment of diverse political and social ideals and ambitions. Localism was among such influential streams. Its roots were different. Localism was an ingredient in the thinking of some groups among the anti-communist opposition who had conceived the future post-communist society as composed of different kinds of self-governing units applying direct democracy and thus escaping bureaucratization as well as the traps of

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<sup>2</sup> Abolition of the provincial tier of government in Czechoslovakia in 1990 (of the eight „regions“ which existed in the Czech part of the Republic) may serve as an example. Its main purpose was political - to uproot the strong communist establishment in the provinces. Viewed retrospectively, this was probably a rash decision: the provincial tier of government was missed thereafter as the proper level for the implementation of several public administration agendas (e.g. protection of the environment, regional planning, the administration of higher-order health, educational and cultural services, and others).

party politics. Localism was also a reaction of the population and of the local elites to the centralism applied by the communist regime, and particularly to its neglect of traditional structures and its effort in the 1970s and early 1980s to streamline the settlement structure through the reckless application of the central place system. Many small rural communities lost their administrative status in that time, as amalgamations were forced upon them from above, antagonizing their inhabitants.<sup>3</sup> Localism and other forms of stressing the territorial dimension of social organization were also a reaction to the tendency of the communist regime to enforce economic organizations as the backbone of social life.

The effects of localism were ambivalent. Localism prompted the decentralization reforms, reinforced the sense of territorial belonging, generated local and regional activism and were manifested by a strong desire for local autonomy and self-government. But sometimes such demands exceeded realistic dimensions, as when they called for regional autarky or required autonomy for odd territorial entities. They also generated many unrealistic expectations toward the potential benefits of decentralization and were co-responsible for the fragmentation of the territorial structure of government. Such atmosphere was characteristic mainly of the early stages of the reforms, whose main thrust was to transform and safely anchor the local tier of subnational government. A somewhat different – irresolute and more conflictual climate prevailed in the later years when the reforms proceeded to their second stage - to the overhaul of intermediary-level government.

The post-1989 reforms in Czech Republic, just as in other ex-communist countries, faced the formidable two-sided task of transforming undemocratic and also mostly inefficient systems into democratic as well as effective ones. The onerous institutional and cultural legacies of the communist past have been complicating the reform process.<sup>4</sup> The heritage of the soviet-type subnational government has had more of an influence on the political and administrative culture accompanying the new local and regional government systems than on their structural aspect. Although new institutional structures were established by the post-1989 reform, old informal relations, patterns of behaviour and stereotypes often persisted and colonized the new system. They were anchored in the values, attitudes and the *modus operandi* of the administrative personnel, which was taken over from the local and regional authorities of the former communist era, and whose administrative culture was often plagued by centralistic instincts, bureaucratic behaviour, arrogance in dealing with the public, clientelism, susceptibility to corruption, and sometimes by professional incompetence.

Yet it was also the general public whose political culture, originating under oppressive authoritarian regimes (first the fascist and later the communist one), was changing only slowly in the new democratic environment. This heritage was characterized [cf. Rose et al. 1995] by a separation of the private and the public spheres in popular thinking, by distrust of institutions, of political representation and of formal procedures, as well as by the unwillingness of citizens to get involved in public matters and to hold public offices. It was marked by a paternalism consisting of the belief that local needs should be taken care of by extra-local actors - the state or the regional bodies, and that the proper strategy for having local needs attended to is to mobilize support of these kinds of external patrons. This set of attitudes and patterns of

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<sup>3</sup> Settlements were categorized in 1971 according to their centrality into five hierarchically arranged categories and for each category a certain level of development was foreseen. Housing construction and the development of infrastructure were regulated to comply with the categorization. In the case of the least preferred category of settlements their development had to be suppressed and depopulation was expected

<sup>4</sup> There was, of course, some difference between the official model of subnational government and its real-life face. Neither was the system entirely static during the forty years of communist rule. Several reform steps were introduced, intended to adapt the system to newly emerging functional needs and partly also shifting political climate. Yet they were never such that they would touch upon the fundamentals of the system.

behaviour, in its time a functional reaction to the pressure of the authoritarian regimes, became a difficult heritage after 1989 which complicated the democratic reforms.

Besides the communist heritage, older traditions of public administration also played a partial role in the post-1989 reform. Territorial government has quite a long history in the Czech lands and the pre-communist system provided some inspiration for the reformers. In the territories which belonged to the former Austro-Hungarian monarchy, a relatively modern territorial administration was founded as early as the 1860s.<sup>5</sup> With modifications, several elements of this system were maintained after 1918 in the Czech part of the new Czechoslovak state and some traces of that distant heritage may be recognized also in the present post-1989 system of Czech local government. They include: its fragmented structure – the existence of large number of small, non-integrated municipalities; adoption of a dual-function model of local government - municipalities are entrusted with the execution of both self-government, i.e. of their own independent competencies, as well as of some administrative responsibilities on behalf of the state, i.e. of the transferred competencies; preference for a collective (instead of individual) executive organ of local government - the executive function is vested with the Municipal Board, while the position of the indirectly elected Mayor is relatively weak.

### 3.2 Three steps of the reform

The reform of territorial public administration in the Czech Republic was implemented in several steps. The aim of *the first step*, approximately between 1990-1993, was to establish a democratic representative local government and to delegate some state administration functions to local government bodies. The Act on Municipalities No. 367/1990 Coll. (since then several times amended) took effect in November 1990 and soon thereafter the municipal elections have installed first Councillors and first Mayors into their functions. Codification of the basic rules of the new system, democratic local elections and the creation of new local bodies were the main accomplishments, followed by legislation dealing mainly with the financial regulations of local government, its property, legal supervision and other issues. The status of territorial self-government was also anchored in the new republican Constitution, adopted in December 1992 and effective since 1993. In 1998, the Czech Republic signed and ratified the European Charter of Local Self-Government.

On the base of a new tax system introduced in 1993, major innovations entered the local government's finances. Financial self-sufficiency of local government was strengthened and the dependency of municipal budgets on the state budget was weakened. Autonomy and responsibility of municipalities as regards their spending was enlarged.

In the *second step* of the reform, extending till 2001, the regional government was re-built. While the part of the public administration's reform which dealt with the municipal government had been implemented relatively smoothly, the situation was different with respect to the intermediary level. After dismantling the former communist-type regional governments and adapting the district administration to the current needs in 1990 (see below), few innovations followed in the subsequent years. It took almost ten years for the second step of the territorial administration's reform to be started.

Among reasons why the reform at the intermediary level was postponed for such a long time, political reasons mattered the most. Relevant political actors were not enthusiastic about the

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<sup>5</sup> Principles stipulated by the General Imperial Communal Code (das Reichsgemeindegesetz) in 1862 for the whole Austro-Hungarian Empire were adopted by way of further legislation in 1864 as regards Bohemia together with Moravia and already one year earlier as regards Silesia [Janák and Hledíková 1989:349-354].

reform. Little interest in the establishment of regions and of regional authorities did also show the general public.

The impasse was broken in 1999. Preceding the breakthrough, a law was already passed in 1997 which divided the country into thirteen regions plus the capital Prague. The law only dealt with the geographic aspect of the new structure, confining itself to delimitation of the number, boundaries and capitals of the new regions and leaving aside such substantive issues as the status of the regions, their organs, powers, elections of the representative bodies, finances etc. Finally, in 2000, further legislation on the regional government followed and on November 12, 2000, the first regional elections were held and regional representative bodies were established in thirteen regions. In the capital city of Prague, which is an independent region, the elections took place in 2002, in the same time as the municipal elections.

The aim of *the third step* of the reform process was to terminate the functioning of the District Offices on December 31, 2002. After the establishment of regions as the seats of the general state administration, the District Offices became superfluous. To fulfil this aim, their functions, powers and the property which they administered were transferred to municipalities and to regions. To this purpose, 205 large municipalities, were selected and endowed with extended powers transferred to them from the abolished District Offices, together with the corresponding property. Such municipalities exercise these powers also in the surrounding territories.<sup>6</sup>

#### **4. Two arms of territorial public administration and the constitutional status of territorial self-government**

Public administration in the Czech Republic has two arms:

- state administration, and
- territorial self-government

*State administration*, characterized by its limited autonomy in decision-making, its vertical hierarchy, its prevalent monocratic way of decision-making and the fact that most positions are taken by appointment, is divided into central state administration and territorial state administration.

*Territorial self-government* is an expression of the right of population living in a territory to independently manage the territorial affairs within the scope defined in the Constitution and legislation. The basic status of territorial self-government has been laid down in Chapter VII of the 1992 Constitution of the Czech Republic (the Constitution was approved by the Czech National Council in December 1992 and became effective on January 1, 1993, the day when the former Czechoslovakia split into two independent successor states - the Czech Republic and the Slovak Republic). The Constitution stipulates that in terms of the territorial self-government the territory of the country is divided into municipalities which are the basic territorial self-governing units, and regions which are the higher level territorial self-governing units.

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<sup>6</sup> Unlike the three steps in the process of reforming the *territorial* public administration which we recognize in this text, the Czech Government's official time-table distinguishes three different stages of the *comprehensive* public administration reform which includes also the central level: during the first one, municipal and regional administration was put in place, the second stage brought about abolition of the District Offices and establishment of municipalities with extended powers, while the third stage, yet to be accomplished, will involve restructuring of the central administration.

The territorial self-governing units are territorial communities of citizens entitled to exercise self-government. They are independently administered by their elected Municipal and Regional Councils, while other self-government bodies are derived from the Councils. The territorial self-governing units are corporations of public law which are entitled to possess their own property and manage financial means according to their own budget. The territorial self-government is not vertically hierarchical and self-government authorities are not subordinated to the state or higher level self-government authorities. The state can intervene in territorial self-government only in cases provided by law and for reasons of upholding the law.

Thus, on the territorial level, tasks are executed pertaining both to the state administration as well as to the territorial self-government. The two sets of responsibilities are separated and they cannot infringe upon one another. Two institutional mechanisms are applied to discharge responsibilities of the territorial state administration:

- some responsibilities are executed by *deconcentrated territorial agencies* of central state's authorities (for example by financial authorities),
- while the exercise of other responsibilities is entrusted by law to *territorial self-governing authorities* – to all regional governments and to municipal governments in larger municipalities - which discharge them on behalf of the state. Each of such self-governing authorities has thus to exercise two distinct sets of responsibilities:
- their *independent powers* in the sphere of self-government, and
- powers of state administration delegated to them by law - *the delegated powers*.

This *integrated* (combined, fused) *model* of the territorial public administration has a long tradition in the Czech lands. Its advantage is that it reduces or helps to avoid the duplication of administrative authorities in the territories.

## 5. Municipal government

The system of municipal government is regulated by Act. No. 128/2000 Coll. On Municipalities.

### 5.1. Responsibilities

Municipalities are legal entities with the right to their own property, own incomes and an independent budget. They execute self-government and can exercise also some functions of state, if entrusted to them by law. This duality of municipalities' responsibilities is manifestation of the above-mentioned integrated model of local government.

With respect to self-government, the powers of municipalities - their *own responsibilities* - include matters which are in the interest of the municipality and its citizens, unless such matters are entrusted by law to regions or belong to the transferred responsibilities of the municipality. Other matters can be entrusted to municipalities by special laws. In general, this means that a municipality cares for the creation of conditions for the development of social welfare and the fulfilment of citizens' needs, particularly in the fields of

- housing,
- protection and improvement of health,
- transport and communications,
- education,
- culture
- protection of public order.

Municipalities act in legal relations in their own name and bear responsibilities resulting from them. Within its independent responsibilities, a municipality is entitled to issue generally binding ordinances and establish legal entities and organizational components of the municipality.

As mentioned above, in matters of their independent responsibilities, municipalities are not subordinated to the state or higher level self-government authorities. The state can intervene in territorial self-government only in cases provided by law and for reasons of upholding the law.

An important prerogative of municipalities is their *right to cooperate with other municipalities*, to conclude agreements on such cooperation, to enter into association of municipalities, both within the Czech Republic and beyond it. The Act on municipalities has foreseen several modes of cooperation between municipalities, ranging from a one-off cooperation to perform a particular task, to cooperation involving the founding of joint legal entities by two or more municipalities. Another widely used form of cooperation are associations of municipalities based on their common interests. Indeed, many municipalities are members of The Union of Towns and Municipalities of the Czech Republic, the largest, most universal and most influential among such associations. Many other associations exist, bringing together municipalities of some specific type, within a particular region or sharing particular interests.

As units of self-government, municipalities are not subordinated in matters of their independent powers to any organs of state administration (such organs only have the authority to supervise the legality of municipalities' decisions and to audit their accounts). Also, no vertical relationship between the municipal and the regional self-governments exists.

Alongside self-government, some state administrative tasks can be delegated to municipalities by legal acts, constituting their *transferred responsibility*. Municipalities are obliged to execute such responsibilities on behalf of the state and are responsible for their execution to the respective state administrative bodies. For the exercise of the transferred responsibilities they receive contributions from the state budget. Municipal Offices in selected municipalities can be entrusted with the exercise of the transferred responsibilities also in other municipalities within their micro-regions.

## 5.2 Structure

Municipal self-government is vested with representative organs - *Municipal Councils* that are elected every four years by local citizens and which are the highest decision-making bodies of local government in the sphere of its independent powers. The Council decides on matters belonging to the independent responsibilities of the municipality. In particular, it

- approves the developmental program of the municipality,
- approves its physical plan,
- approves municipal budget,
- issues generally binding ordinances of the municipality,
- establishes and abolishes organizations founded by the municipality and its organizational component,
- elects from among its own members the Mayor, the Deputy Mayor(s) and other members of the Municipal Board and also removes them from their office and has a number of other responsibilities.

The number of Councillors depends on the population size of the respective municipality, ranging from the minimum of five members in the smallest municipalities and 55 in the largest ones. Meetings of the Councils are public.



The Council elects from among its own members a collective political executive body – the *Municipal Board* – which is responsible for the execution of tasks within the independent responsibility of a municipality and, if entrusted to it by law, as well within the transferred powers. The Board must have at least five, but no more than eleven members. No Boards are elected in very small municipalities.

The Council also elects from among its members a *Mayor* who represents the municipality in external relations, convenes sessions of the Council and usually presides over them, decides on matters of the independent responsibility entrusted to him by the Council, appoints and removes from office (with consent of the Director of Regional Office) Secretary of the Municipal Office and fulfils other responsibilities. In small municipalities, where there is no Municipal Secretary or where of the Municipal Office (see below) has not been appointed, the Mayors exercises their transferred responsibilities. The Mayor reports to the Municipal Council. The Czech Republic is the only country in east-central Europe where all Mayors are elected indirectly.

The Council can as well establish *committees* as its advisory and supervisory organs, and elect their members. Financial and review committees must be always established. Also the Board is authorized to form its consultative bodies – the *commissions* - and appoint their members.

The administrative tasks of a municipality, within the sphere of both the independent and the transferred responsibilities, are taken care of by a *Municipal Office* headed by the Mayor and consisting further of Deputy Mayor(s), a *Secretary* of the Municipal Office and other municipal employees (none may exist in the smallest municipalities).

Municipal Offices in selected municipalities have also been entrusted with the execution of transferred powers in other municipalities within the surrounding region (Act No. 314/2002 Coll., On delimitation of municipalities with a commissioned Municipal Office and of municipalities with extended powers). Three partly overlapping categories of municipalities can be distinguished according to the extent of these functions and the size of the territories where they are discharged: 1. municipalities where just single responsibilities are involved (such as administration of registers of births, marriages and deaths), 2. municipalities with so-called *Commissioned Municipal Offices* executing a whole set of transferred powers in surrounding regions (383 municipalities), and 3. *Municipalities with Extended Powers* whose Municipal Offices enjoy a still larger number of transferred responsibilities and discharge them in larger administrative areas (205 urban municipalities).

### 5.3 Electoral system and results of local elections

The system of local elections is regulated by Act No. 491/2001 Coll., on the elections of Municipal Councils and the amendment of some laws. The members of Municipal Councils are elected for the period of four years in universal, direct, equal elections by secret ballot, using a proportional electoral system. Citizens of the Czech Republic at least 18 years old who are registered as permanent residents of the respective municipality (are local citizens) have the right to vote and to run for membership in Municipal Councils. Under special conditions, also foreign subjects enjoy both the active as well as passive voting right in the local elections. The Act mentions specific situations when a person's voting right is restricted or suspended. This regards, for example, public servants and also some categories of municipal employees.

Electoral parties, which have the right to register candidate lists for local elections, are defined by law as

- registered political parties and political movements
- coalitions of political parties and political movements

- independent candidates
- associations of independent candidates
- associations of political parties or political movements and independent candidates.

A petition signed by a qualified number of voters is required in the case of independent candidates and their unions.

Voters may choose to vote 1. for an electoral party (for a list of candidates), 2. for individual candidates from any of the lists that were submitted, 3. for an electoral party and for individual candidates from any of the other lists.

Since the demise of the communist regime, municipal elections took place in 1990, 1994, 1998 and 2002. The turnout was 74 %, 62 %, 58 % and 43 % respectively. Electoral participation tended to be negatively correlated with the size of the municipalities. In smaller municipalities independent candidates were most successful, while the greater the size of the municipality is, the larger is the role of political parties in the elections.

In the most recent municipal elections that took place in 2002, 62,494 members of 6,344 Municipal Councils (inclusive Councils of City Parts) were elected from 193, 216 candidates of which 53, 528 were women. Independent candidates obtained 54. 5 % mandates, although they received only 14.1 % votes. This disproportion was due to the fact that it was mostly voters in the small municipalities who cast votes for the independents. In urban municipalities, independent candidates received only 18.1 % mandates. Cf. Table 3.

**Table 3. Results of the 2002 municipal elections**

<b>Political party</b>	<b>Votes received (%)</b>	<b>Mandates (%)</b>
<b>Civic Democratic Party</b>	25,4	9,4
<b>Social Democratic Party</b>	15,6	7,5
<b>Communist Party</b>	14,6	9,3
<b>Independent candidates</b>	14,1	54,5
<b>Christian Democratic Party</b>	10,0	9,9
<b>Association of Independent Candidates</b>	5,3	5,0
<b>Freedom Union - Democratic Union</b>	4,1	1,0
<b>European Democrats</b>	1,8	0,1
<b>Independents</b>	1,5	1,1
<b>Green Party</b>	1,4	0,2
<b>Other</b>	6,2	2,0
<b>Total</b>	100,0	100,0

Source: Czech Statistical Office

#### **5.4 Issues of the municipal government system**

Although by and large successful, the reform of the municipal government has left some problems unresolved and has also created several new ones. Those will be mentioned here, which we consider to be particularly relevant.

An unplanned by-product of the reform has been the *fragmentation of local governments*. The post-1989 localism, together with the liberal legislation enabling the easy separation of those

parts of the existing municipalities which have opted for administrative independence, contributed to the far-reaching spontaneous fragmentation of the existing territorial administrative structure. During the period of 1990-1993 the number of municipalities increased by one half, to stabilize later at around 6,250. By far the largest proportion of municipalities (79 %) are now small rural places with less than one thousand inhabitants where, however, less than one fifth (17 %) of the country's total population resides – cf. Table 2 above.

Separation fulfilled local ambitions, made up for perceived injustices caused by the earlier forced amalgamations, enhanced local feelings, and activated, in many cases, local initiatives and civic participation. Sometimes it also brought economic advantages for the separating municipalities. But at the same time, the resulting fragmentation of local government caused serious problems. The tiny local governments are as a rule too small to function properly as political, administrative and economic units. They cannot mobilize sufficient personal, political, economic and organizational resources, cannot launch more ambitious developmental projects or provide sufficient services; they are also too weak as partners in negotiations with state offices. With a fragmented structure, inter-municipal differences in the provision of services increase and equity is difficult to attain.

Any efforts to consolidate the structure of local governments can only be gradual and have to be carefully prepared in a democratic way. A straightforward, externally imposed administrative reform would be politically untenable: for many small municipalities which split away from their larger neighbours after 1989, their reclaimed independence is a valued accomplishment of the post-communist transformation. One of the policies applied to ease down the negative consequences of fragmentation is to support inter-municipal cooperation, which might later lead to the genuine amalgamation of the participating communes. As a bottom-up process, municipalities have established a number of associations in support of mutual cooperation and to pursue their joint interests.<sup>7</sup> Another method is to relieve the small municipalities of some of their administrative tasks and to entrust these obligations to a network of selected towns and cities which would then provide administrative services also for the neighbouring smaller units. The Czech Republic has been moving in this direction.

Closely connected with the fragmentation and, partly, one of its consequences, is *financial plight of local governments*. The share of municipalities plagued by unbalanced budgets and indebtedness was growing until the end of the 1990's. It is more-or-less stabilized now, but at a disturbingly high level: according to the Ministry of Finance 67 % municipalities were in debt in 2001. In June 2002, for the first time in Czech Republic's recent history, a municipality went bust and its assets were sold in a public auction. Indebtedness is most often the result of the insufficient financial discipline of some local authorities, of their lack of experience in dealing with financial matters, of the inadequate qualification of local government personnel and, last but not least, of the economic weakness of many municipalities whose responsibilities and duties are not matched by adequate financial resources. These are problems plaguing typically (but not exclusively) the small municipalities. Lacking sufficient resources for capital investment, municipalities often tend to sell out municipal real estate property or to take bank loans, without being able to repay them. It is generally acknowledged that the tasks which municipalities, mainly the urban ones, face in the modernization of the neglected communal infrastructure are not matched by their revenues. Tightening the rules regulating local debt, introduction of more stringent audits, improving professional competence of local

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<sup>7</sup> The Act on Municipalities has foreseen several modes of cooperation between municipalities, ranging from a one-off cooperation to perform a particular task, to cooperation involving the founding of a joint legal entity by two or more municipalities. Another widely used form of cooperation are associations of municipalities based on their common interests.

government officials and providing assistance to small municipalities in running their financial matters have been acknowledged as the main short-term elements of the cure. Consolidation of the local governments' structure and strengthening of local budgets should be the long term measures.

Democratic legitimacy of local government can be jeopardized by low and declining participation of citizens in local governance. The population's initially favourable acceptance of the new local governments as an opportunity for influencing local development has been limited. While confidence in local governments and satisfaction with their activity have persisted - cf. above, local political participation has been declining. Turn-out in the local elections has been falling over time: 74 % participated in 1990, 62 % in 1994, 58 % in 1998 and 51% in 2002. Scepticism has also widespread as far as the relevance of local politics and the possibility to influence local affairs are concerned. Data from Czech surveys indicate that the percentage of citizens who thought it advisable not to get involved in public affairs and that it is better to mind one's own business grew from 29 % to 42 % between 1992 and 2001 while the proportion of those who disagreed fell from 52 % to 33 %. Within the same interval the percentage of people who thought they had no influence on local affairs reached 62 %, a disquieting level, although a drop from earlier 66 %. The proportion of citizens who felt they were not concerned with the decisions of local councils grew from 33 % to 50 % [the data are from two representative surveys conducted by the Institute of Sociology, ASCR]. The distance people felt toward local governments strangely contrasted with their relatively high confidence in this institution and with their fairly high level of satisfaction with local governments' performance. In April 2004 58 % trusted local councils – almost twice the number of those who did not (32 %) – data from CVVM representative opinion polls.

A systemic issue, whose relevance is yet to be fully appreciated, is the absence or inadequacy of local government structures suitable for emerging new settlement structures. The existing model of local (and, for that matter, also of intermediary) government is not sufficiently versatile to offer a wide and flexible enough variety of administrative forms capable of accommodating settlement systems, such as metropolitan areas, agglomerations and urban regions, although such spaces are clearly gaining in importance. The currently existing nodes-centred administrative territories hardly offer a sufficient menu of options that would deal with structures which exceed territories of individual cities, encompassing also their hinterlands, or such, that by their nature, are more networks than hierarchies. It is questionable if the intrinsically slow process of a bottom-up growth of inter-municipal cooperation can solve this problem.

## 6. Regional government

Two tiers of soviet-type elective intermediary authorities - the „*National Councils*” – existed from 1960 until 1990, when they were abolished: 76 district authorities as the lower tier and 8 regional) authorities as the higher tier of the intermediary public administration. As regards the districts, they were preserved after 1990 as territorial units of deconcentrated general state administration, lacking, however, any self-governmental function. State administration was performed by District Offices whose heads were appointed by the central government. Until the end of 2002 when they were abolished, District Offices were the strongest arm of the state administration at the subnational level.

As distinct from districts, regional authorities ceased to function in 1990 as a tier of general subnational state administration and the communist era provincial authorities were abolished without replacement. Regions survived temporarily as a territorial subdivision of the country,

void of any general governmental function. This situation lasted until 2000 when a new system of regional government came finally in force.

### 6.1. The delayed reform

While, in spite of some remaining problems, that part of the public administration reform which dealt with the municipal government has been implemented relatively early and was a success, the situation was different with respect to the intermediary level government. Few innovations were introduced at this level during the first stage of the subnational government's reform in 1990-1993 as it was assumed that the substantive changes at the intermediary tier will follow soon after. This did not, however, happen and it took almost ten years for the second stage to follow.

Several reasons can be mentioned as to why the reform at the intermediary level was repeatedly questioned, disputed and postponed for such a long time, in spite of the fact that establishment of the "higher self-governing territorial units" had been foreseen by constitution of the Czech Republic as early as 1993.

Political reasons were those that mattered most. With the exception of regional elites in the largest cities and advocates of the Moravian regionalism, none among the relevant political actors was enthusiastic about the reform of intermediary government. The national level politicians justly perceived this reform as more relevant for the distribution of political power in the country than was the local reform and were uneasy about its potential consequences. The ruling Civic Democratic Party which held power in the Czech Republic until 1997 feared that the majority position enjoyed at the national level would be not reproduced in the future regional governments. Its effective resistance to the reform was sometimes supported by doctrinal arguments questioning the very idea of decentralization. Also national level bureaucracies did not support the reform because of fears that they would have to give up some of their competencies and decision-making powers in favour of the new regional authorities. Neither did local politicians show much sympathy for establishing the new regional authorities as they (unjustly) feared that this would reduce their own areas of competence and would diminish financial resources of municipalities. Thus, for example a majority of Czech Mayors (59 % of Mayors in towns and cities) who were questioned in 1997 survey did not consider the absence of intermediary level elected government an important issue (Mayors 1997).

Little interest in the establishment of provinces (regions) and of provincial (regional) authorities did show the general public. In fact, its support for the reform has been steadily falling. The opinion prevailed that while the decentralization of government is in principle desirable, the establishment of provincial authorities would be an excessively costly project, strengthening the already inflated bureaucracy and increasing the distance between citizens and the administrative services. The public did not exert any pressure on legislators to proceed with the reform agenda and the reform did not, figure as an important theme in the 1994 election campaign.<sup>8</sup>

Moreover, aversion towards the former communist intermediary authorities – the *Regional National Councils* abolished in 1990, which were the most discredited element of the com-

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<sup>8</sup> While 72 % citizens interviewed in opinion polls agreed in June 1997 that it is preferable to decentralize decision-making that concerns regional issues (9 % disagreed), 68 % considered the establishment of new provincial („regional“) authorities too expensive (13 % disagreed), and 45 % thought that this level of government is not necessary (33 % disagreed). The opinion concerning the expediency of the new regions for an improved functioning of state administration was split half-and-half, while at the same time about one third of respondents had no opinion at all (data from a June 1997 opinion poll, Institute of Public Opinion Research, Survey Information 97-06).

munist territorial administration and were therefore the target of the fierce criticism after the collapse of the regime, was (unjustly) extended to the project of regional-level government as such.

An important factor underlying the relatively small sympathies for decentralization at the intermediary level has been the *weakness of regionalism* in the Czech Republic. In this ethnically and culturally rather homogeneous country, industrialized and urbanized already more than a hundred years ago, there exists limited potential for formation of strong regional identities. Also frequent changes in the administrative division of the country, the tough centralism practiced by the Nazi occupational authorities as well as by the communist power have limited the space for the formation and institutionalization of regional interests. Unlike other disintegrative tendencies which surfaced after 1989, regionalism, with the exception of the Moravian movement, did not, play an important role in the recent development. Efforts to (re)create political regionalism in Moravia were short-lived. As a vehicle for mobilization of political support, regionalism was not promising.

Also, some well founded *concerns stemming from the specific situation of a transforming country* cautioned, in the early 1990s, against a too radical and swift decentralization at the intermediary level. Central government felt that it needs to maintain control of the economic development in the country during the initial, still volatile situation of the transformation process. Inter-regional economic and social differences had to be controlled and kept within tolerable limits by the central state, using redistributive mechanisms, so as to prevent the marginalization of some regions and the resulting social and political tensions. Also national integration had to be maintained in the general atmosphere of societal fragmentation and vis-à-vis the tangle of conflicting interests, concomitant of the existing district transformation processes. It was also feared that the radical overhauling of the existing district administration, concurrent with the on-going transformation in other spheres of the economic, political and administrative system, could destabilize the country and should be therefore postponed until later.

And there were also reasons arising from the logic of the policy process. The initial momentum of the territorial reform was nearly exhausted after most of the post-revolutionary enthusiasm regarding this reform had been spent on the reconstruction of municipal governments in 1990-1993. Time and energy were missing for overhauling the regional-level government – a task which was more demanding both conceptually, politically and technically than the municipal reform. It called for a larger amount of legislative work and made considerably larger demands on the Parliament whose attention was in that time fully occupied by the economic reform and also by building the new Czech state after the split of Czechoslovakia.

The extending provisional situation was increasingly burdensome. It did not permit the finalizing of the overall architecture of public administration reform and perpetuated the existence of gaps and vague points in the legislation as well as an uncertainty in inter-governmental relations. It left unattended issues which would be properly managed on the regional level and contributed to the proliferation of deconcentrated territorial branches of the central government's agencies in the vacuum. It dissatisfied regional elites and invited criticism from the European bodies after the Czech Republic applied for the EU membership

## **6.2 The difficult birth of the Constitutional Law establishing the higher territorial self-governing units**

The higher territorial self-administrative units (hereafter „regions”) were established by an act of Parliament in 14 regions, including the capital city of Prague. Each region is composed of several existing districts. The vote took place on October 23, 1997 in the Chamber of Deputies, and very shortly thereafter, on December 3, in the Senate. The consensual opinion of the

parliamentary debate regarding the bill, which occurred in the second half of 1997, is that the most controversial issue connected with the bill was not the ultimate number of regions to be established, but the degree of decision-making to be relinquished to the self-administrations in the territories.<sup>9</sup> The vote in fact determined to what degree the government powers and resources should be decentralized, and to what degree there should be a strong central government.<sup>10</sup> The arguments that were voiced in the debate were either in favour of the bill justifying it as a step, towards fulfilment of the Constitution, which presupposes such regional arrangement, or favoured postponement of or withdrawal from the reform. Interestingly, no political party deputies prevailed in one or the other opinion group. Only the heads of districts for the most part argued in favour of the postponement of the Act on Regions.<sup>11</sup> And yet, it took five years since the adoption of the Constitution, which enacted the regions. What was the role of the Parliament, the government, the local administration and the public in that regard?

Admittedly, the Czech Republic's government has for five years shown little or no interest in establishing the regions, despite the fact that such was one of the objectives of the program statement of the government in 1992, and similarly in 1996?<sup>12</sup> The fact that the government showed little interest in establishing the regions can be documented, for instance, by the fact that the number of documents drafted or filed by it in connection with such a matter is limited, or that there are no such documents. The number of documents is smaller in comparison with those produced by other players, such as deputies, the President and all those who may propose bills to the Parliament. Taking a close look at the list of legislative bills, pertaining to the establishment of self-administration in the regions, presented to the Chamber of Deputies between 1993 and 1997,<sup>13</sup> one may conclude that a greater number of such proposals were filed in 1994. These include a total of five proposals by the government and five by individual deputies. The first government bill was submitted in January 1994, and is an outline of underlying principles for the constitutional law on regions, whereas the last two proposals by the government, submitted in September 1994, were a draft of the constitutional law on the jurisdiction of the regions, and the government's plan of the public administration reform. In 1993 and again in 1995, one proposal by a member of the Parliament was submitted. Thereafter, all activities ceased in both the government and the Parliament until June 1997, when the debate on establishment of regions was reopened. Two proposals by deputies to enact the regions preceded a proposal submitted by the government, and were followed by another proposal by deputies in July. The government proposal was eventually approved.

However, regardless of the quality of the government bills, they certainly were not fewer than proposals by the deputies. Of the total number of bills submitted by the government for instance in 1994, the bills on public administration reform represent only a fraction. That is, however, of no significance for the present study. The number of such bills alone does not indicate that the government (i.e. the cabinet of Prime Minister Klaus between 1992 and 1997 when the coalition disintegrated and the cabinet resigned) showed no interest in the issue of regional administration. The program statements of the government implies otherwise. The 1992 program statement of the new government includes as one of its tasks a „reform of the government administration and its decentralization”. The 1996 statement of the Klaus' cabinet

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<sup>9</sup> Michal Prokop in the Chamber of Deputies during the second reading of the bill.

<sup>10</sup> Martin Hampl during the expert seminar on the Act on Regions, November 20, 1997 in the Senate.

<sup>11</sup> Heads of the district offices during the expert seminar in the Senate.

<sup>12</sup> According to Josef Ježek, deputy until 1996.

<sup>13</sup> Background study for National Forum on Regional Self-Administration in the Czech Republic, 31.3.–1.4. 1999, published by EWI, Prague.

lists among its priorities „optimization of the public administration” by way of establishing regional self-administration „based on proportionate decentralization of decision-making, on respect to natural regional ties within the Czech state and on substantial reduction of red tape.”

Another indication of the lack of interest in the regional arrangement on the part of the government may be seen in the fact that the government’s Office for Legislation and Public Administration was abolished in October 1996. The mission of the above Office was to propose a concept of the public administration reform and to carry it out. Since 1993, the Office produced 26 drafts of reform concept and proposed legislation. According to Olga Vidláková<sup>14</sup>, many of these documents were never reviewed by the cabinet. However, during those same years, the cabinet submitted five documents to the Parliament regarding the reform of the administration. Vidláková considers the abolishment of the Office to be unwise and justified by false arguments (although Olga Vidláková was the deputy director of the Office, her interpretation should not be regarded as biased). It was the Ministry of Justice which took over the legislative responsibility from the Office upon its abolishment. The responsibility for public administration was not passed upon any single ministry in view of the fact that the agenda was considered cross-ministerial. It was not until 1998 that the Ministry of Interior was charged with the responsibility over the public administration reform.

After the 1996 elections, the government headed by Václav Klaus was a coalition government. A member of the coalition was the Civic Democratic Alliance (ODA), a political party whose program was to reform the public administration and whose leader was former head of the now defunct Office for Legislation and Public Administration. Perhaps, it was just some members of the cabinet who demonstrated little or no interest in the public administration reform.

Given the above facts and circumstances, we may conclude that until 1997 there were no persuasive reasons for the government to pursue the reform. Moreover, with the 1996 general elections approaching, discussions and debates over controversial issues in both the cabinet and the Parliament were suspended, in particular where differences in opinions did not follow the borderline between parties. In mid-1997, the debate on regional governments resulted in a solution, whereby the powers and jurisdictions to be vested in the regional governments were no longer subject of the proposed constitutional law. All four bills provided merely for the establishment of the regions, whereas the powers and systems at the regional level remained open. In this way the government and the Parliament circumvented the key problem: what type of public administration system should function on the regional level, and which powers should be vested in the regional governments.

The opinions voiced in the Parliament regarding the establishment of regions continued to be very diverse since the adoption of the Czech Constitution by way of Act No.1/1993 Coll.: some parliamentarians opted for the highest possible number of regions to be created, some favoured postponement of the whole process, and some even argued that the respective provisions of the Constitution should be revoked. This diversity of views is apparent when we look at the minutes from debates held in the Parliament prior to the adoption of the Act on Regions in 1997. It seems that for quite a long time there was no single force on the Czech political scene, which would unify the Parliament and lead it to a consensus. The only political party, which prioritized the public administration reform and the establishment of the regions, was the Civic Democratic Alliance (ODA). However, in the course of time and due to some com-

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<sup>14</sup> Olga Vidláková. Public Administration Reform in the Czech Republic, 1990-1998.



promising events, ODA disappeared from the political scene and later lost the support of the voters in the 1998 general elections.

Interest in the issue of regions was renewed in mid-1997. What new political agents came to play resulting in the consensus needed for the passage of the law? The answer may be found in the explanatory reports attached to the bills on establishment of regions (hereafter „bill” or „Act”) in 1994, 1995 and 1997.

The first such document is the explanatory report to the government bill submitted to the Parliament in July of 1994. The report states as the main reason for the Act to be adopted the fact that it would become the chief legal instrument upon which *the continuation of the territorial administration reform* in the Czech Republic is conditional. According to the report, the reform had been launched in November 1989 by abolishing the system of so-called „national committees”, by introducing local self-administration and by establishing the district offices, as government bodies with general jurisdiction located in the districts of the Czech Republic. The reform is referred to in a similar manner in other government documents, and is deemed necessary due to the fact that the government committed itself to *the reform and decentralization of the administration* in its Program statement from 1992, and wishes to *endorse the fundamental principle of democracy* by „placing the decision-making rights and responsibilities close to the citizen”, which should be done through an appropriate system of territorial bodies of administration. No reference is made to the fact that the Constitution should be satisfied. The second document is the explanatory report attached to the bill submitted by deputy Josef Ježek and others in October 1995. This report states as the chief reason for the adoption of the Act the fact, that such Act is „essential for further progress in *the territorial administration reform*”. In addition, references are made to the fact that the Act would be a fulfilment of the *Constitution of the Czech Republic*.

It was thanks to the proposal of deputy Dušan Kulka and others that the government reopened the issue of regions in June 1997. It may be assumed that the proposal was in fact initiated by the Civic Democratic Alliance (ODA). At the first sight, it seems that the explanatory report did not offer anything new, same reasons were reiterated as in the two preceding proposals. The Act is an important precondition for the continuation of the *public administration reform*, which should allow for *decentralization of decision-making* in regional matters and for *restructuring of the system of administrative bodies*. As a result, red tape should be largely eliminated or limited. In addition, the *respective provisions of the Constitution of the Czech Republic would be thus implemented*. There seems to be no change in the rationale or in the content of the reform, the only change is that of the term of reference. Instead of the „*territorial administration reform*” mentioned in the explanatory reports of 1994 and 1995, we now hear about the „*public administration reform*”. This is an evidence to the fact that only during the course of time the parliamentarians, but not only they, began to understand what the notion of public administration means, what processes are involved when public administration reform and decentralization are referred to. Accustomed to the rule of the communist „national committees”, many forgot or never understood what self-administration means. The abolishment of the system of „national committees” and establishment of the local administration, endowed with exclusive and transferred powers, was not only the first step towards the public administration reform, but also the first step towards the recognition what state administration is as opposed to local self-administration, and what these two components of the public administration represent and how they relate to one another. Mayors and local councilmembers elected in local elections in the autumn of 1990 were among the first to go through this recognition process. In their day-to-day practical experience they had to learn to distinguish between responsibilities for specific decisions: in case of their exclusive powers, they

were only accountable to law, in case of assumed powers, they were accountable to the district office.

The next proposal was submitted in June of 1997 by deputy Václav Grulich and others. The explanatory report states that the proposal was initiated by the deputies of the Social Democratic Party. The main reason is the *political necessity to carry out the Constitution*. The proponents further state that no other reasons needed to be mentioned as they are contained in the program statement of the government. The reference made to the „*political necessity*” may be construed as a legitimate feeling of responsibility for the Constitution and a reminder of the same to the others. The purpose of the proposal is to „initiate practical legislative and other activities of the respective government bodies to carry out the overall reform of the public administration.” It is to be noted that the proposal was submitted by then opposition Social Democratic Party, and that the term *public administration reform* already became commonplace.

All the explanatory reports have used the same rationale and language over the course of several years. This is why one has to conclude that neither the government nor the deputies felt urged to move forward in the matter of establishment of the regions. Reasons underlying the necessity to adopt the Act, and derived from the core of the matter, were not strong enough to instigate activity. Fulfilment of the Constitution, creation of the conditions to facilitate the public administration reform and to decentralize the government power did not present strong enough incentive for the representatives of the central power to move to action and arrive at a consensus on the issue of the regions. It may be speculated that the legislators and the government felt bound by the Constitution only mildly, and that the paternalistic attitude prevailed which resulted in a lack of willingness to limit their powers on the central level. It was only the Social Democratic Party, which has demonstrated more respect for the Constitution and less paternalistic attitudes.

The last proposal to be discussed herein is a government bill submitted also in 1997. In addition to repeated references made to the Constitution, this proposal presents new justification, one that lies not in the actual substance of the matter, but is derived from the Czech Republic's relation to other countries: „In most European countries” exists a multiple-tier system of „administrative, territorial self-governing bodies”. Though not explicitly said so, it is implied that the Czech Republic should adopt a similar system. To build such a system is conditional upon adoption of the Act on Regions. Which is “of key importance *for our functioning in the Council of Europe, and in particular vis-à-vis the Czech Republic's accession to the European Charter of Local Self-Administration*. Equally important is *cooperation with self-governing bodies of the neighbouring countries.....*”, which do not have their counterparts in the Czech Republic. Such language seems to indicate that the new activity has something to do with the process of accession to the European Union. It seems that it was the „external” reasons that made the government act. It also appears that the very same reasons made the parliamentarians debate the bill and pass it as a constitutional act. Pragmatic approach prevailed.

Beside the central government and the parliamentarians also local governments and the public had a stake in this long process. In the spring of 1997, only one-third of Mayors considered the absence of directly-elected, self-administrative bodies standing in-between the central government and the local administration a problem<sup>15</sup>, whereas 59 % did not see that as a problem, and the remaining number did not know. On closer scrutiny, it turned out that some

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<sup>15</sup> According to the survey conducted among mayors from municipalities with over 2000 inhabitants in the spring of 1997. Vajdová, Z., 1999. Mayors in Cities and Municipalities in the 7th Year of Existence. Cahiers du CEFRES, No. 16, Prague, pp. 3146.

common attitudes prevailed in the group of mayors who considered that absence of regional government problematic. These Mayors would welcome potential mergers of smaller municipalities, would favour higher number of elected representatives in their municipality, and did not consider political partisanship and right contacts at the central level important. In other words, they were prepared to cooperate in a larger group, preferred broader democratic control, and did not consider favouritism and partisanship desirable for the effective functioning of the local administration. Interestingly, such attitudes did not seem to be different by region, by size of the municipality or by size of the budget.

The Union of Cities and Municipalities has always acted as progressive force with respect to the issue of public administration reform. During the ten years of its existence, it won respect as a legitimate advocate of municipal interests and as a counterpart to the government administration. Its opinion was often sought when proposals were debated regarding the public administration reform. In the summer of 1997 when the activities towards the public administration reform revived, the Union took a very matter-of-fact position. Its recommendation was to set a deadline by which the District Offices would cease to exist, and a proper transfer of powers and responsibilities with underlying funds would be affected.

It is our belief that the public was inadequately informed about the public administration reform, and that the communication between the government and the Parliament on the one hand and the public on the other was insufficient to win the support for the public administration reform. The general public's view may be only grasped through public opinion polls. There was a lively public debate, i.e. debate in the media, on the issue of public administration, which took place shortly after 1989. The key issue was the arrangement on the central level (union, federation, confederation, Moravian land), but also autonomy of municipalities on the local level. Various representative studies conducted at that time indicated that people had little or no knowledge of the issue, and often supported mutually contradictory opinions. The issue of the regional government still continued to be important for 56 % of citizens.<sup>16</sup> Unfortunately, 1993 was the last year in which such question was asked in research surveys. Thereafter, respondents were only asked their opinion regarding the importance of regions, for the most part in public opinion polls rather than in scientific surveys. The fact, that the public administration reform's objective is to decentralize decision-making process and establish self-governing regions as a third tier between the central and the local administration, became lost on most of the public. The reduced interest in territorial and administrative division was apparent. Prior to the split of the country in 1992, the issue of the division of Czechoslovakia into the Czech and Slovak Republics personally affected each and every citizen though all consequences might not have been quite clear at the first sight. Therefore, the related issue of public administration arrangement was considered pressing by about 45 % of the Czech citizens.<sup>17</sup> Until February 1997, this number dropped to 20 %. In 1995, most respondents stated as a reason for the urgency of the problem the fact that „it needs to be taken care of, so that we are not kept from dealing with other issues”. After the Act on Regions was passed at the end of 1997, the Public Opinion Research Institute (IVVM) included in its regular poll the question, whether the new regions will be to the advantage or disadvantage of the average citizen. 62 % of respondents were undecided on the issue. This indifferent attitude did not change: in the fall of 2000, an average of 33,6 % voters took part in the elections to the regional governments.

The first condition for the continuation of the public administration reform was met – the territories of the regions were determined. What followed were negotiations about fiscal issues,

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<sup>16</sup> Attitudes to Environment and Local Politics, 1993 survey, Sociological Institute.

<sup>17</sup> This, as well as other facts, are taken over from the IVVM press releases from 1992-1997.

jurisdictions and powers, staffing and buildings, but also about what offices and bodies will be elected and how they will be elected. Regions were not welcome with great enthusiasm, neither in the Parliament, nor by the local governments. Self-administration is not an automatic guarantee of democratic management of public affairs but is an essential precondition thereof. The higher territorial self-administrative units represent a hope that the democratic development in the country will be sustained and that the political elites will be cultivated to demonstrate democratic virtues.

### 6.3 Completion of the regional reform in 1998-2000

As early as in March of 1998, the public administration reform agenda was moved to the Ministry of Interior by the then „administrative” government headed by Josef Tošovský. After the emergency elections in the spring of 1998, the Czech Social Democratic Party (ČSSD) formed the new cabinet. In view of the fact that ČSSD deputies (Grulich and others) submitted to the Parliament one of the above mentioned bill on the regional reform in the summer of 1997, the expectations were great. The program statement of the government once again listed the public administration reform among its priorities, which was, however, the case with all preceding cabinets. The concrete impulse came in the fall of 1998 with the creation of an institutional framework for the reform, i.e. with the appointment of deputy Minister of Interior responsible for the public administration reform.<sup>18</sup> Headed by Yvonna Strecková in the office of deputy minister, the Ministry of Interior produced a document called Proposal of the Public Administration Reform<sup>19</sup>. The document offered several scenarios for the relation between the central government and the regional self-administration, as well as a time-table. The scenario recommended for final adoption was the one based on separation of the state government and the self-administration, i.e. the so-called dual system of public administration.<sup>20</sup> The Proposal was put up for discussion and review, which in itself was seen as a new mode of behaviour on the part of the Ministry of Interior.<sup>21</sup>

The documents were discussed in the respective committees of the Parliament, particularly by the Committee for Public Administration, Regional Development and Environment. In February of 1999, the government organized an expert seminar on the public administration reform. The Union of Cities and Municipalities met with the authors of the Proposal also in February 1999, and consequently discussed the Proposal within its Presidium and during its Congress held in April 1999. The issue most frequently discussed was the relation between the central government and the self-administration in the regions, i.e. what system of public administration the Czech Republic will opt for, to what degree the central government and the self-administration will be separate or connected in terms of organization. The East West Institute became involved in the discussion by organizing a series of workshops on regional self-

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<sup>18</sup> Olga Vidláková, as quoted above.

<sup>19</sup> Proposal of the Public Administration Reform. Ministry of Interior, Public Administration Reform Division, January 1999.

<sup>20</sup> Each existing public administration scheme follows one of the three existing models based on the relation between the central government and the self-administration: 1. dual or separate model, whereby the administration is carried out by government offices and institutions which operate parallel to self-administration bodies in a given territory; this model exists for instance in Slovakia, 2. combined model, in which the self-administrative bodies carry out the functions of the central government in a given territory such as the cities and municipalities in the Czech lands, and 3. mixed model, whereby there are only government bodies on one level, and self-administration bodies on another level, or one of the two above mentioned patterns is used at one level and the other on another level. Leemans, A.F., 1970. Changing Patterns of Local Government. The Hague, the Netherlands.

<sup>21</sup> Y. Strecková, Municipality and Finance 1/1999, or in Public Administration'99 No. 12.

administration at various places throughout the Czech Republic. The Center for Community Work, as a non-profit and non-government organization helped organize these workshops.<sup>22</sup> Attended by the representatives of local or municipal governments, business community and by non-government organization of various kinds, the workshops mostly focused on the issue of powers and jurisdiction the regions should be endowed with. A parallel discussion appeared in the press, namely in the specialized journals *Public Administration* and *Modern Municipality*, and included explanatory comments by the government officials, discussion pieces on behalf of the District Offices,<sup>23</sup> municipalities and other involved parties. All this resulted in an unprecedented public discussion over a document produced by the government. Deputy Minister of Interior Strecková responsible for the public administration reform was determined to adhere to the deadline included in the proposed time-table irrespective of the outcome of the discussion: i.e. to establish regions by 1 January 2001.<sup>24</sup>

Additionally, the Phare project funded some of the public administration reform work. Carried out by the National Institute for Education, many of the analytical studies resulted in the *Proposed Strategy for Public Administration Reform in the Czech Republic*,<sup>25</sup> published in November 1998.

The outcome of the 1999 public debate was a recommendation to the Ministry of Interior to develop the combined model for the Czech Republic, and to submit respective legislative bills to the Parliament. This was a whole package of laws related to the establishment of regions. Some of the bills were entirely new, some were just amendments to existing legislation. Various pieces of legislation covered either organizational or jurisdictional issues under the auspices of the Ministry of Interior, or financial and property issues under the auspices of the Ministry of Finance.<sup>26</sup> The relevant bills were submitted to the Parliament for review in the fall of 1999. In November, they went through the first reading, and on March 8 and 9, 2000, they were enacted.

#### **6.4 Responsibilities of the regional government**

Responsibilities and structure of regional government have been stipulated by Act. No. 129/2002 Coll., On regions. The Region is a territorial community of citizens with the right of self-government and, it is a legal entity with the right to its own property, own income and an independent budget. The integrated model of public administration applied on the regional tier implies that a region executes on its territory both self-government, as expressed by its independent powers, as well as state administration, as manifested by the responsibilities transferred to it by law. In the exercise of the independent powers, the region is bound solely

<sup>22</sup> This NGO was mentioned earlier. Established in 1996 with the objective to enhance transparent decision-making and access to information, this NGO has local offices in Western Bohemia, Central Moravia, Southern Bohemia and the Moravian-Silesian Region.

<sup>23</sup> Press analysis by Lenka Bušíková in: Background study for National Forum on Regional Self-Administration in the Czech Republic, 31.3 –1.4. 1999, published by EWI, Prague.

<sup>24</sup> Y. Strecková, in *Public Administration* '99 No. 12, p. 7.

<sup>25</sup> *Proposed Strategy for Public Administration Reform in the Czech Republic. "Improving Czech Republic's Public Administration"*, Phare Project. NVF, October 1998.

<sup>26</sup> Act No. 128/2000 Coll., On municipalities

Act No. 129/2000 Coll., On regions

Act No. 130/2000 Coll., On elections to regional councils

Act No. 131/2000 Coll., On the capital city of Prague

Act No. 147/2000 Coll., On district offices

Act No. 157/2000 Coll., On the transfer of some property, rights and liabilities from the holding of the Czech Republic to the holding of regions.

by law. State authorities can interfere only for reasons of upholding the law and in a manner delimited by law.

The general task of regional government within its *independent powers* is to care about interests and development of the region and about interests of its citizens. It cooperates with municipalities on its territory, must not, however, encroach on their independent powers. Within its own independent responsibilities regions are obliged to consult aims of the region's development with the concerned municipalities.

The tasks of regions within their independent powers include complex territorial development of the region in the fields of

- spatial planning and regional development,
- education,
- culture,
- transport and communications,
- healthcare,
- social welfare,
- environment,
- protection of public order.

The region is further entitled to establish legal entities and organizational components of the region and to issue binding ordinances. Regions can cooperate with each other as well as with foreign territorial self-governing units and to enter into regional groupings with domestic and foreign partners.

Regions cooperate with municipalities on their territory, but they must not encroach on the independent powers of these municipalities. They have the right to cooperate with other regions and with municipalities and to enter into association of regions, both within the Czech Republic and beyond it. All regions and the Capital City Prague are members of The Association of Regions of the Czech Republic.

## **6.5 Structure of the regional government**

A region is administered independently by a *Regional Council*. Further bodies of the regional government are the *Regional Board*, the *President* of the region and the *Regional Office*.

*Regional Council* is the highest decision-making body of regional government in the sphere of its independent responsibility. The Council consists of the members of the Council – the Councillors elected for a four year period by citizens of the region aged 18 and more. The number of Councillors is 45, 55 or 65, depending on the population size of the region. The Council establishes and abolishes Committees as its initiative and advisory bodies and elects and dismisses their chairpersons and members; it shall always establish a financial committee, a monitoring committee and a committee for education and employment; in regions, where at least 5 % of inhabitants consider themselves not to be of a Czech nationality, a committee for national minorities must be established. The Council elects representatives of the region to Regional Councils of the Regions of Cohesion (NUTS 2).

*Regional Board* is a collective political executive body of the region in the area of the independent responsibilities. It may also take decisions on matters within the transferred powers, but only if stipulated by law. The Board is elected by the Councillors from among themselves and consists of the President, one or more Deputy Presidents and other members of the Board. It has 9 or 11 members, depending on size of the region's population. The Board reports to the Council. It prepares proposals and suggestions for consideration by the Council and fulfils

resolutions approved by it. The Board establishes Commissions as its initiative and advisory bodies, appoints and dismisses their chairpersons and members,

*The President of region*, elected by Regional Council from among its members, represents the region on its behalf and is responsible to the Council. Among other duties of the President there is to appoint or dismiss the Director of the Regional Office after prior approval from the Minister of the Interior, and to set his salary. He is also responsible for informing the public on the activities of the region.

*Regional Office* as an administrative executive body of the region fulfils administrative tasks of the region, within the spheres of both the independent and the transferred responsibilities. The Office is headed by the Director and is divided into departments and other organisational units. The Director reports to the President for the fulfilment of tasks assigned to the Office in the area of independent and transferred responsibilities.

*Supervision*. The performance of both the independent and transferred responsibilities is subject to state supervision by the relevant ministries and other central administrative authorities. In the area of independent powers, the supervision consists exclusively of a follow-up assessment of compliance with the law and must not encroach on the region's independent responsibilities and jurisdiction.

## **6.6 Electoral system and the elections to Regional Councils**

On November 12, 2000, the first regional elections were held in the Czech Republic, thus completing the second phase of the territorial reform of the public administration – the establishment of regional representative bodies. In thirteen regions, whose territories and capital cities were set forth by the Constitutional Act No. 347/1997 Coll., the citizens elected Regional Councils. In the capital city of Prague, which is an independent region, the City Council functions as the council for the region of Prague. The next elections will take place in Prague in 2002.

In the proportionate election system, 45, 55, or 65 Council-members were elected depending on the size of the electorate in a given region. The mandates were distributed in a single scrutiny. Only political parties, movements and coalitions thereof could run in the elections. Like in the general elections and unlike in the local elections, the voters would choose a ballot of the political party and within that ballot give four preferential votes. Those parties, which gained a minimum of 5 % of the valid votes, were included in the single scrutiny. Each mandate was defined for each candidate by the number of votes won by his or her party, by the place the candidate appeared on the ballot, and by the number of preferential votes the candidate obtained; the preferential votes could change the place of the candidate on the ballot, provided the number of such votes was higher than 10 % of the total of votes the candidate's party received.

A total of 41 parties ran in the elections (in average 11 – 14 in a region): 28 political parties or movements and 13 coalitions with a total of 7 760 candidates. 33, 64 % of voters took part in the elections. In the outcome, the mandates were divided among 9 political parties and movements and 1 coalition. A total of 675 Council-members in 13 regions were elected. Preferential votes made a change for only 8 candidates. The composition of Regional Councils may be interpreted from various points of view:

- a) from the point of view of social representativeness,
- b) from the point of view of previous experience in public administration,
- c) from the point of view of association with the given regions.

Ad a) Among the candidates, there were 78 % of men and 22 % of women; in the Councils, there are 86 % men and 14 % women, making the ratio between men and women among the Council-members less proportionate than that among the candidates. There are, however, significant regional differences. In the region of České Budějovice, there were 25 % of female candidates, whereas in the Karlovy Vary region, there were only 17 % of female candidates. Differences occur also in the percentage of women on the ballots and with actual mandates – mostly there is a drop between 50 % and 65 %; however, in Ostrava region the percentage remained the same: 20 % of women among candidates and Council-members. Representation of women ranges from 29 % in the Pilsen region to 7 % in the Zlín region. The average age of candidates was 46.9, ranging from 18 to 86 years of age. The average age of Council-members is 47.1 = ranging from 24 to 73 years of age. Again, regional differences may be observed.

As far as education or professions of Council-members are concerned, the most successful were candidates with higher professional education, which may involve both secondary and college degrees. 85 % of Council-members fall into this category and are people in employment. 11 % are business-owners and self-employed individuals. Regional differences occur in this regard as well, in particular in how the elections changed the representation of various occupations and educational levels among Council-members as opposed to among candidates.

However, it has to be noted that the success of a particular subgroup in the elections – whether men or women, age groups or professions – was largely predetermined by the political parties, which formed the list of candidates on the ballots and their order.

Ad b) Those who had previous experience in government administration were largely successful in the regional elections. 22 % of candidates, who were Mayors or heads of District Offices and other functionaries, were elected, which means that 34 % of new council-members have previous experience with public administration.

An interesting perspective may be gained by looking at the number of such experienced candidates on the ballots of those parties, which succeeded in the elections, and how many of those candidates appeared on the first few places on the lists. The Coalition of Four and the Civic Democratic Party (ODS) had on their ballots 52 % of candidates with previous public administration experience, the Communist party (KSČM) had 33 % and the Czech Social Democratic Party (ČSSD) had 16 % of such candidates. The Coalition of Four ran a candidate with previous public administration experience as a number one in 11 regions, ODS in 7 regions, ČSSD in 6 regions. The Communists ran no such candidates as number one, only in 3 regions they had such candidates in the third position on the ballot. The Independent political movement ran in six regions with 38 % of candidates from public administration, out of which they were number one in 3 regions; and the Independent Association, which ran in 3 regions, had 60 % of candidates with previous public administration experience as number one in all three regions.

Ad c) Out of the 41 entities, which ran candidates in the regional elections, 8 were regional parties. There is a striking difference between the Moravian and the Bohemian regions: there were more regional parties in Moravia. In all Moravian regions, the coalition of Moravian Democratic Party and the Movement for Self-Administration of Moravia and Silesia – Moravian National Unification (MDS a HSMS-MNS) put up their candidates, though they registered under different names: in the Jihlava region as Prosperity of the Highlands, in central Moravian regions as Moravian Coalition and in Ostrava region as Moravian-Silesian Coalition. However, the coalition won no seats in either of the regions. In addition to that, there was a political movement known as Non-Partisans for Moravia, which ran in the Brno region and gained one seat, the Independent Movement of Zlín, which ran in the Zlín region and



gained a seat, and the New Chance of Olomouc movement, which ran in the Olomouc region and won no mandate.

The situation in Bohemia was quite different. There are only two regions in which regional entities ran: the Alliance for Pardubice in Pardubice regions, which gained two seats, and three regional entities – Liberec Union for Sport and Health, Regional Democratic Party and Party of the Free North – in the Liberec region, which gained no mandates.

The second regional elections were held in 2004. Altogether, 55 electoral parties took part in the elections, with a total of 8 309 candidates. The turn-out was 29,6 %. In the outcome, the mandates were divided among 12 political subjects: 43.1 % for ODS, 23,3 % for KSCM, 16,6 % for CSSD, 12,4 % for KDU-CSL and 5,6 for others. Among a total of 675 Council members there were 85 % men and 15 % women. The average age of Councillors was almost 49 years; the youngest was 23 years old, and the oldest one's age was 75 years.

## 6.7 Issues of the regional reform

The experiences with the implementation of the reform during the first three years of existence of the new regional government, however still brief a period, have indicated several problems, three of which will be mentioned here.

*The weak political legitimacy of the new provincial governments.* A major part of the general public and also some influential political actors – those who had resisted the reform (cf. above) - have been watching first steps of the new provincial authorities with sceptical eyes. Among the general public there has existed uncertainty as regards benefits of the reform. It will depend on performance of the new provincial authorities during the first years of their existence if citizens will eventually accept them as viable and useful institutions. Their ability to stimulate the economic and social development of the provinces and to promote participation of citizens in dealing with regional issues will decide about the political fate of the new provincial system. As of late, some facts suggest that the development in this respect has been encouraging. Since fall 2002 the share of citizens who trust the regional councils (about 40 % in 2004) has repeatedly outweighed the percentage of those mistrusting them (about 30 %) and also the number of people unable to make a judgment has been falling (about 25 % in 2004) [CVVM opinion polls]. The re-election of many the regional presidents in 2004 can be understood as vindication of their performance.

*Limited spending discretion of the regional governments.* While the volume of public finances channelled into regional budgets has been radically increasing since 2001, the regional governments have had only very narrow space to decide about their spending. The largest part of the revenues has been targeted subsidies from the central state aimed to finance facilities entrusted to regions (schools, hospitals, social care facilities etc.) which the regional authorities are obliged to run. It has been estimated that the return on the shared taxes - the main revenue item about whose use the regional authorities can freely decide – amounted to just 12 % of their total revenue. Most of these „free” resources” were spent on operation of the Regional Offices [Kameníčková 2004].

*Preservation of the deconcentrated territorial agencies of state administration (the “decos”).* Although offices of general state administration came into existence at the provincial level, and it would be rational to incorporate within them most of the so far separately existing *decos*, there is resistance from some central state authorities toward such measures. Many of the *decos* tend to survive outside of the general provincial administrations (tax and customs administration, Labour Offices, social welfare administration, school administration, environmental protection, hygiene authority, veterinary administration and some other agendas), weakening thus their authority and complicating inter-governmental relations.

Experience with the new system of intermediary government is still relatively brief and it would be premature to make any far-reaching conclusions about its successes and failures.

## **7. Resources of the territorial government**

### **7.1 Finances**

Both municipalities and regions, as territorial self-governing units, have their own budgets and are liable for their financial obligations. According to the Act. No. 243/2000 Coll., on the budgetary allocation of taxes, approximately 76 % of all tax revenues are delimited to the state budget, while the remaining 24 % are divided between municipal and regional budgets at the ratio of approximately 21:3.

#### Municipal finances

Each municipality approves its own budget. After its approval, the budget is sent to the Ministry of Finance and also any changes occurring in the budget during the year must be reported to the Ministry. However, the Ministry is not authorized to make by itself any changes in the budget whose approval is the sole responsibility of the municipality as a self-governing unit. Each municipality must have its final account audited. All budgets are public documents.

Municipal government revenues are structured in the following way:

1. own revenues
  - 1.1. tax revenues
    - a) shared tax revenue
    - b) exclusive tax revenues
  - 1.2. non-tax revenues
  - 1.3. capital revenues
2. external resource
  - 2.1. subsidies
    - a) capital subsidies
    - b) non-capital subsidies.

The largest part of municipal government revenues (56 %) are drawn from taxes – those which proceed exclusively to municipal coffers (at present only the real estate tax) and those shared with the state (income taxes and VAT). All taxes, tax rates included, are decided by the Parliament and have the form of a law. Local governments may influence only the rate of the real estate tax and that of local fees, but only within certain limits given by the law. They have no say in determining the rates of other taxes, nor can they impose any locally specific taxes. The local governments' share of tax returns is determined in the laws on state budget. All taxes (with the exception of local fees) are collected by state territorial Financial Offices and tax yields assigned to municipalities are then transferred to them once or twice within a month. Beyond taxes, other revenues can be drawn by municipalities from independent local sources – local fees, proceeds from municipal property, transfers from organizations established by municipalities, profits from municipal activities, loans, donations etc. and also from state grants (subsidies).

Municipalities exercising the transferred powers of state administration are entitled to a state contribution towards the execution of such powers.

In contrast to their rather strictly regulated revenues, municipalities enjoy considerable freedom as regards their spending. Among local government expenditures, education (mostly elementary schools) is usually the largest item in smaller municipalities. Municipalities are obliged to finance buildings and operational costs of schools, while teachers' salaries are paid by the Ministry of Education through its deconcentrated field offices.

### Regional finances

Since 2002, the financing of regions as the territorial self-governing units has followed similar principles as that of municipalities.

Incomes of regions consist of:

- revenues from own property and property rights
- revenues from own economic activity
- revenues from economic activity of organizations established or founded by the region
- incomes from administrative operations, in particular administrative fees
- tax revenues and shared tax revenues:
  - o income tax of juridical persons (if the region is itself the tax-payer)
  - o share of revenues collected on the national level from state taxes, namely:
    - VAT (3,1 % of total revenue)
    - income tax from dependent activities of physical persons (3,1 % of total revenue).
- subsidies from the state budget and state funds
- financial donations and contributions
- other incomes.

According to *Law on budgetary rules of the territorial self-government*, regions are permitted to finance from their budgets the following main items:

- activity of regional authorities
- execution of state administration
- obligations following from contracts
- subsidies to municipal budgets
- obligations issuing from cooperation with other territorial units
- debt service of loans and credits
- support of private businesses which are beneficial for the region
- support of public benefit corporations
- donations and contributions to social and humanitarian purposes
- obligations following from specific legal provisions.

Unlike the case of municipalities where the weight of own revenues is much higher, state subsidies represent a large and increasing part of all incomes collected by the regions which makes them highly dependent on the state budget – see Table 4.

**Table 4. Budgets of regions 2001 – 2003 (bn. CZK)**

	2001	2002	2003
<b>Total revenues</b>	<b>14,5</b>	<b>37,6</b>	<b>62,1</b>
Tax revenues	0,0	10,2	11,4
Non-tax revenues	0,1	0,7	1,4
Subsidies	14,4	26,7	49,1
Capital revenues	0,0	0,0	0,2
<b>Total expenditures</b>	<b>14,4</b>	<b>35,8</b>	<b>60,6</b>
Current expenditures	13,2	32,1	51,6
Capital expenditures	1,2	3,7	9,0
<b>Balance</b>	<b>0,1</b>	<b>1,8</b>	<b>1,5</b>

Source: State final accounts, Kameníčková, V. 2004. Regional finances. Note: budgets of capital Prague are not included due to its specific regime.

While the size of regional budgets has been increasing throughout 2001 – 2003, the spending freedom of the regions has been severely restricted by their obligation to finance a number of activities transferred to them from the central state.

## 7.2 Personnel

An issue that has implications for the internal structure and functioning of territorial government and is highly relevant for its effectiveness, is personnel policy of local and regional authorities. A demanding task is the recruitment and stabilization of qualified personnel in territorial administrations. The frequently stressful jobs, not too high social prestige and modest salaries do not make local government service particularly attractive for young, educated and ambitious people. The status of local and regional government employees is regulated by the *Labour Code*, i.e. by general rules applying to all employees. Local and regional administrators do not enjoy the special, favourable conditions and the protection that will be enjoyed by public servants under the civil service act (Act No.218/2002 Coll., on service of state employees in state administrative offices) that does not apply to them (this Act is not yet effective).

A special law on officers of the self-administered territorial units has recently been adopted and partly makes up for this handicap (Act No. 312/2002 Coll., on officers of territorial self-governing units, effective on January 1st, 2003). In addition to the general rights and responsibilities of any employees as stipulated by the *Labour Code*, it guarantees officers of self-governing territorial units an extended legal protection and some additional advantages. It defines their specific responsibilities and rights, regulates the hiring procedure and adopts measures preventing conflict of interest. The largest part of the law deals with the qualification of officers and the system of its upgrading and periodical verification. The Act is supported by the *Code of Ethics of public administration employees*, a non-binding document approved by the Czech government (The Code of ethics of public administration employees approved by resolution of the Czech Republic's government No. 270 from May 21st, 2001).

## 8. Institutional guarantees of civic participation

Several measures, apart from the right to take part in local and regional elections, guarantee citizens an opportunity to participate in the territorial government:

- *Local referenda* may be held on the municipal level as a form of direct democracy to decide issues within the independent responsibilities of municipalities (Act No. 22/2004 Coll., On local referendum and amendment of some laws). Any local citizen may propose a referendum if supported by a petition signed by a qualified proportion of local voters. The referendum's decision is valid if at least one half of the registered electorate participated and it is binding for the respective Municipal Council and other organs of the municipality if approved by more than one half of those taking part. A qualified majority is required in special cases. A referendum must always be held on a proposal to merge municipalities or to establish a new municipality by splitting away a part of the existing one. But there are also issues where a referendum is excluded.

No regulation exists as regards referenda on the regional level.

Local and regional citizens can be members of municipal and regional governments' *Committees* and advisory *Commissions* established respectively by the Municipal or Regional Councils and Municipal or Regional Boards. A *Committee for Ethnic Minorities* must always be established in municipalities and in regions where at least 10 % or 5 % of population respectively opts for other than the Czech nationality. Citizens have the right to be present at *sessions of the Municipal and Regional Councils* and to express there their opinion on the agenda. Local citizens may also demand that certain issue falling within the independent responsibilities of the municipality be considered by the Municipal Council or by the Board. Citizens may submit proposals, comments and initiatives to local and regional authorities which are obliged to process them within a certain time.

Further measures guarantee *public accountability* of local and regional governments. Sessions of Municipal and Regional Councils are open and their date, venue and program must be made public in advance. Citizens have the right to inspect the municipal budget and the annual final account and to express their views on these documents. They have as well the right to inspect minutes and resolutions of sessions of the Municipal Council and resolutions of the Municipal Board, of its specialized Councils and committees and to make excerpts from them. These documents must be made available to citizens for inspection.

Territorial governments are obliged to inform local citizens about their activities, this being a personal responsibility of Mayors and Regional Presidents. More specifically, according to the Act No. 106/1999 Coll., *On free access to information*, which obliges not just organs of the state, but also territorial government and any other public institution which uses public money, territorial governments must maintain a service informing the public about principles and conditions of their operation, their organizational structure, *modus operandi*, administrative rules, regulations etc. They are obliged to provide information related to the field of their responsibilities to any physical or legal person who may apply for it.

## 9. The European context of the subnational government's reform

One facet of the reform was its "European" context. As the country is endeavouring towards integration in West European international and supranational institutions – chiefly the European Union - adaptation to West European standards and expectations is one of the most important prerequisites to successful integration. The relevance of the European dimension for the reform of subnational government was recognized only gradually - mostly during the later stage of the reform process, i.e. in the second half of the 1990s. Also the European bodies asserted their influence on the reform only gradually. The "European" factor has been particularly relevant with respect to the intermediary-level government.

Although the decentralization reform and regionalization in the Czech Republic were influenced and speeded up by expectations of the EU and of other European institutions, this proc-

ess has been driven *above all internally* and cannot be viewed as just an adaptive effort intended to satisfy external requirements. The political intention to decentralize government and to regionalize the country was part of the democratisation programme of the early 1990s, long before the country applied for EU membership.

The influence of the European institutions on the process of decentralization has materialized in multiple ways. On different occasions, both explicitly, as well as more indirectly, the expectation was expressed that regionalization should be implemented in the East Central European candidate countries. Such expectations have been mentioned in its documents not only of the *European Commission* itself, but also by other European bodies which made use of the pre-accession situation to express their opinion and ideas about the desirable institutional restructuring in the candidate countries. The EU's *Committee of the Regions* and the *Congress of Local and Regional Authorities of Europe* have been outspoken in this respect. It has been the application of certain principles and the creation of certain capacities rather than the adoption of concrete models of territorial government that were the core of these expectations. In fact, systems of subnational government are so widely different in the EU countries that there is no single "European model" which could be recommended to the candidate countries.

With regard to the European Commission, its expectations concerning the role which regional policies and, consequently, regions and regional authorities should play in the candidate countries, have been expressed in *Agenda 2000*, its chapter concerning the ability of the applicant countries to assume the obligations of membership - that is, the EU's legal and institutional framework as defined by the *acquis* [European Commission 1997]. As for regional development, the fundamental requirement of the *acquis* was the candidate countries' ability to adopt the EU's cohesion policy and to participate in its *Structural and Cohesion Funds* [European Commission, *ibid*]. This, in turn, implied that a subdivision of their national territories into regions should exist in the candidate countries which could function as a territorial matrix of regional analyses and policies. Such regions must be of sufficient size to be able to fulfil this function (the NUTS II level size was considered as appropriate) and there must exist developmental programmes towards the implementation of which the funds would be used. Applicant countries should adopt the rules governing EU regional policies in their own regional policy and must establish such a policy if it is not yet in existence. Capacities had to be developed capable of providing and analysing data on regional development as well as of preparing, implementing and monitoring regional development programmes.

Agenda 2000 tackled the administrative capacity of the candidate countries to apply the *acquis*. The situation in 1997 was described and assessed, and concrete targets, measures and standards were mentioned which the accession countries should adopt.<sup>27</sup> The existence of a democratic and efficient public administration system and, consequently, the implementation of thorough administrative reform was envisaged, which would involve all tiers of public administration, including the establishment of regional (intermediary) level authorities. Although no concrete institutional model of this tier was suggested by the EU, it was obvious that the adjustment to the *acquis* would surely contribute to decentralization and the strength-

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<sup>27</sup> With respect to the Czech Republic, the Agenda 2000 stated critically in 1997 that the country lacked intermediary elected authorities standing between the central government and the municipalities, although the existence of self-administering regions was required by the Republic's Constitution, and further that it lacked any independent regional policy and that the volume of financial means assigned for regional development was not satisfactory. Appropriate legal, administrative and financial framework of a comprehensive regional policy had to be created and substantive reform had to be implemented to comply with the EU's structural policy. The European Commission complained that the Czech Republic, along with other applicant countries, did not have suitable infrastructure for regional policies, due to small or non-existent budgets, poorly developed instruments, skeletal administration, etc. [Kirchner 1999: 216-218].

ening of the autonomy, competence and resources of local and intermediary authorities [Kirchner 1999b:210-211]. The EU's notorious *principle of subsidiarity* also implied decentralization and the existence of decentralized local and regional authorities.

In its annual *Regular Reports on Progress Towards Accession* the European Commission evaluates the progress of the Czech Republic with respect to the fulfilment of the accession criteria, pointing to steps and tasks to be implemented. The Reports are widely publicized and discussed in the country. Their positive as well as critical opinions which are used as ammunition in the internal political discourse are certainly an effective instrument facilitating the implementation of the *acquis*. In its 2001 Regular Report the EU stated that the overall legislative alignment as regards regional policy and co-ordination of structural instruments is well advanced. However, additional efforts regarding the Structural and Cohesion Funds are still needed. According to the Report is necessary to establish operational bodies, to develop or extend administrative and project development capacities, capacities for monitoring and evaluation of needs as well as systems and procedures for financial management and controls. Other recommendations concerned pending decisions on the implementation of Structural Funds Programmes, improvement and completion of the National Development Programme and ensuring representation from economic and social partners. The Report recalled that financial arrangements for the provincial („regional”) governments will have to be defined to cover the situation when, since 2003, the district authorities will cease to exist and their responsibilities will be divided among provinces and municipalities [European Commission 2001: 84-86].

An outspoken and influential EU-based actor promoting regionalization in the candidate countries was the EU's *Committee of the Regions*. It has the power to issue opinions on its own initiative, which have a political weight that is difficult to ignore [Bernard 1999: 41-42]. The Committee supported the radical devolution of government to the local and regional levels and extensive autonomy of the regions. Outside the EU, the Council of Europe, through the *Congress of Local and Regional Authorities of Europe*, also acted as an effective pro-regionalization and pro-decentralization force. With reference to the obligations which the Czech Republic accepted by signing and ratifying the *European Charter of Local Self-Government*, the Congress monitored and evaluated the state of local and regional democracy in the country, made an assessment of the progress made in reforming public administration, pointed to existing problems and gave recommendations concerning steps to be taken.

In preparing itself for participation in the EU's regional policy, Czech Republic has divided its territory into NUTS II level *statistical regions*.<sup>28</sup> Eight such regions were designated through the aggregation of some of the existing provinces. The process of establishing a national implementation structure for the European Social Fund was supported by adopting in 2000 the *Act on Support to Regional Development*.<sup>29</sup> The Act defined conditions under which support to regional development can be provided by the state, determined targets of this support and distinguished categories of regions entitled to such support. The need to control regional disparities is an important component of the underlying philosophy of the Czech regional policy. The Act also established *regions of cohesion* and made them identical with the above-mentioned eight NUTS II level statistical regional units. The cohesion regions constitute a territorial matrix for determining areas entitled to support from EU structural funds, and possibly also from the pre-accession funds. *Regional coordination groups* were organized and

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<sup>28</sup> Cf. Resolution of the government of Czech Republic on delimitation of the territorial units NUTS (La Nomenclature des Unités Territoriales Statistiques) on the territory of Czech Republic for the statistical and analytical purposes and for needs of the European Union.

<sup>29</sup> Act No. 248/2000 CoL on support to regional development.

charged with managing the preparation of regional development programmes to be later substituted, in accordance with the above Act, by *Regional Councils* and *Regional Development Committees*. Such bodies were established in each of the eight cohesion regions. A *National Development Plan*, eight *Regional Operation Programmes* and six *Sectoral Operation Programmes* were approved and presented to the European Commission.

## 10 Conclusion

The reform of subnational public administration in the Czech Republic belongs to the family of the post-communist public administration reforms in the east-central European countries. It had to solve many tasks common to all these reforms, encountered analogical problems and adopted similar institutional solutions. However, at the same time, it also differs even from its closest relatives – the Slovak, Hungarian and Polish reforms. It shared – for example – the problem of fragmentation of local government with Slovakia and Hungary and the delay of the intermediary government's reform with Poland and Slovakia. Regarding the solutions adopted, the Czech reform shared elements of the integrated model with all these three countries at the municipal level, but is the only one among them to have preferred such a model also at the regional level. Solely in the Czech Republic indirect elections of Mayors are consistently used; in Hungary as well as Slovakia, and since recently also Poland, and all Mayors are elected directly by local citizens.



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**Part II:**  
**The role of central government and sub-national governments in development and implementation of economic policies in the Czech Republic after the 1989**

Tomáš Kostecký, Daniel Čermák and Jana Vobecká

## **1. Economic restructuring and development policies**

There are plenty of policies that directly or indirectly affect the economic restructuring and development of any country. Many of them are intrinsically of the national-wide scope like fiscal and monetary policies of the national governments or the respective national banks. Therefore we will leave them away at the moment. We will concentrate here on the analysis of the institutional arrangement of on the privatization policy, policy aimed to attract investment and the policies aimed at the support and development of small and medium enterprises (SME).

### **1.1 Privatization**

The Czech economy was one of the most nationalized economies in the world before the breakdown of the Communism. Mertlík (1995) mentioned that over the 98 % of production has been produced by either state owned companies or the cooperative sector in the beginning of nineties. As the state ownership proved to be ineffective in terms of economic productivity, the pace of modernization and innovativeness, new post-Communist government started to prepare the privatization program designed to transfer about 70 to 80 % of the state owned into the private hands (Mertlík, 1995). The debate over both the scope of the privatization and the main methods to be used became, naturally, hot political issue. The actual privatization policies were thus very often the result of political compromises and deals between the different parties, pressure groups and institutions within the Czech Republic. Mládek (1993) distinguishes several different forms of privatization that were implemented in the beginning of nineties. These are: re-privatization (restitution), small-scale privatization and large-scale privatization of entrepreneurial properties (namely companies in services and industry), restitution and privatization in agriculture, transformation of consumer, housing and production co-operatives, restitution and privatization of housing stock. The key institutions in most of the privatization methods became the “Ministry for Administration of the National Property and its Privatization” (Ministry of Privatization) that was established as a part of new government soon after the first free parliamentary election in summer 1990. The above mentioned forms of privatization, however, were organized under a different legislature and by different institutions. Consequently, the ways privatizations tended to vary, so we will describe the role of national government and sub-national governments separately in each case.

#### **1.1.1 Restitution of entrepreneurial properties**

It has been relatively limited in scope as the mainstream reformers were afraid of possible legislative complications, too costly and lengthy process consisting of thousands of court processes over the competing property claims. Later, however, was decided that at least some for of restitution is necessary for at least partial compensation of some property injustices caused by the Communist regime. The types and numbers of eligible restitution claimants were gradually increasing and so the types of properties that could be claimed back from the state. The final version of the restitution law was adopted in 1991 as the Law No. 87/1991. The law declared that physical property that was nationalized or expropriated from Czechoslovak citizens (physical persons) between 25<sup>th</sup> February 1948 (the date of the Communist coup d'état) and 1<sup>st</sup> January 1990 can be claimed back from the state. It does not mention the properties of religious orders and congregations (that has already been covered by some of the preceding laws) and it does not included the properties of juridical persons. The adopted time limits excluded from the restitution process the German population that was expelled from Czechoslovakia after the WWII. The organization of the whole process was very much decentralized. The law stated that only property that was at November 1<sup>st</sup> in the possession of juridical persons (organizations) could be claimed by eligible claimants. The organizations which hold

such claimed possession had to transfer the property rights to the claimant “without delay” after signing a protocol that had been registered by notary. In case of doubts over the of the property claim the final decision was on the court. If property could not be returned to claimants physically, they could ask the Ministry of Privatization for financial compensation.

### **1.1.2 Small-scale privatization**

So called small scale privatization was allowed by the law No. 427/1990. The law was designed by the proponents of “standard methods” of privatization. It was based on the idea of selling smaller properties, mostly in sectors of trade and services, to private persons in auctions. The original idea was to sell about 100000 to 120000 items through auctions, but later the number of sold properties was reduced substantially. The small-scale privatization permits only selling property without obligations and was based on the transfer of real estate, equipment, machinery and inventory. Only Czechoslovak citizens as physical persons could participate in auctions. In case when the property did not found any buyer in the auction, the foreign physical persons were allowed to take a place in a second auction. The most important fight was about which property should be included in the small-scale privatization. The Ministry of Privatization established a network of specialized institutions called Districts Privatizations Committees. In each of the 75 districts (plus separately in the city of Prague) the respective twenty-member privatization commission was appointed by the Ministry of Privatization. The District Privatization Commissions created their own local branches in cities. The local privatization commissions collected information about the properties that could potentially be privatized within the framework of small privatization, but only District Privatization Commission had exclusive right to propose the inclusion of the property on the list of the privatized properties. The list prepared by the District Privatization Commissions had to be approved by the Ministry of Privatization, but in practice, the approval was formal in majority of cases.

### **1.1.3 Large-scale privatization**

Large-scale privatization has been designed for the privatization of the large enterprises. It was believed that after forty years of Communism there is not enough domestic capital available (apart of capital from criminal and black market activities and capital possessed by nomenclature cadres). There was a widespread fear among the reformers that the organization of auctions of large properties in such a situation could result in transferring properties either in hands of proponents of former regime, domestic criminals or to cheap sell-out of the national property to foreigners. The resolution of the dilemma was the law No. 92/1991 which was a compromise between the supporters and opponents of the standard methods of privatization through auctions and tenders and non-standard methods of privatization, namely the voucher privatization. The law allowed different form of privatizations of large enterprises. The management of each privatized company was obliged to prepare the privatization project. The all other physical and legal bodies (both domestic and foreign) were allowed to submit the competing privatization project, so usually several competing privatization projects for each enterprise came into existence. The following method of privatization could be proposed in the privatization project: direct sale to assigned owner without tender, a tender, an auction, a free transfer of shares to a local authority, to a pension fund or a health insurance funds, the sale of shares on the capital market, and the voucher privatization<sup>30</sup>. All privatization projects were first evaluated by the founder of the privatized enterprise – which was mostly respective

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<sup>30</sup> In voucher privatization, the privatization vouchers could be used for buying the shares from the state. Vouchers were distributed to interested Czechoslovak citizens only for a minimal fee of 1000 CZK (about 30 USD). For more details about voucher privatization Frydman , Rapaczynski, Earle et al (1993).

branch ministry or respective local authority. Then the projects were sent, together with recommendations of founder and the opinion of the company management, to the Ministry of Privatization or to a Federal Ministry of Finance for final decision. If the privatization project concerned the privatization of company with more than 3000 employees the final decision was made by the whole government. If direct sale was chosen as the method of privatization, the whole government had to endorse such a decision of the respective ministry. As Frydman et al (1993) pointed out; the criteria for evaluation of the projects were never clearly spelled out. The process of voucher privatization was organized in two huge waves in which the prices of shares were simulated on a virtual quasi capital market. People could buy shares for vouchers individually or they could buy them through Investment Privatization Funds (IPF). Although IPFs were intended to be a help for a limited number of people who would not be able and willing to invest their vouchers individually, IPFs turned to be the most important institutions in the voucher privatization as almost three of four voucher holders allocated their vouchers into IPFs (Mertlik, 1995). From the twelve largest IPFs only three were controlled by the Czech private individuals, two were controlled by foreign banks, but all the rest by the Czech banks and the largest Czech insurance company. As the Czech banks and the insurance company were still in the hands of state, the paradoxical result of voucher privatization was the situation when the state retained indirect control over the large part of the enterprises through banks and their respective Investment Privatization Funds. This situation remained basically unchanged till the late nineties where large banks were privatized by the Social Democratic government.

#### **1.1.4 Other forms of privatization**

The privatization in agriculture has been a topic of many political debates as during the Communist time most of agriculture production was not directly in the hands of state but in the hands of agricultural cooperatives. Some transformation of the rules which cooperatives had to follow was implemented but it did not basically change the existing form of cooperatives. Only a very few farmers decided to go private after 1989. The similar development can be observed in case of consumer and production cooperatives which were struggling to survive in the new more competitive economic environment. Its position within the economy and society was successfully defended by the housing cooperatives which had even pre-Communist tradition and which survived post-Communist economic transformation without much change<sup>31</sup>.

The sector of housing, however, generally underwent large changes during the transformation. The housing stock that was nationalized by the Communists (about 40 % of total housing stock, practically all except single family houses and cooperative houses) have been either transferred to the previous owners during the restitution process or transferred for free to the municipalities. Thus, municipalities happen to possess the large amount of multi-storey rental houses. The decision about what to do with the now municipal houses was left solely on the municipal governments themselves. As a consequence, some municipalities decided to privatize most of their housing stock, while the others retained most of rental houses in their possession. The law demanded that when rental housing is privatized, tenants who lived in the flats have to be the first who is given a chance to buy a flat. In practice, the conditions of privatization of municipal housing stock varied substantially from one municipality to the other.

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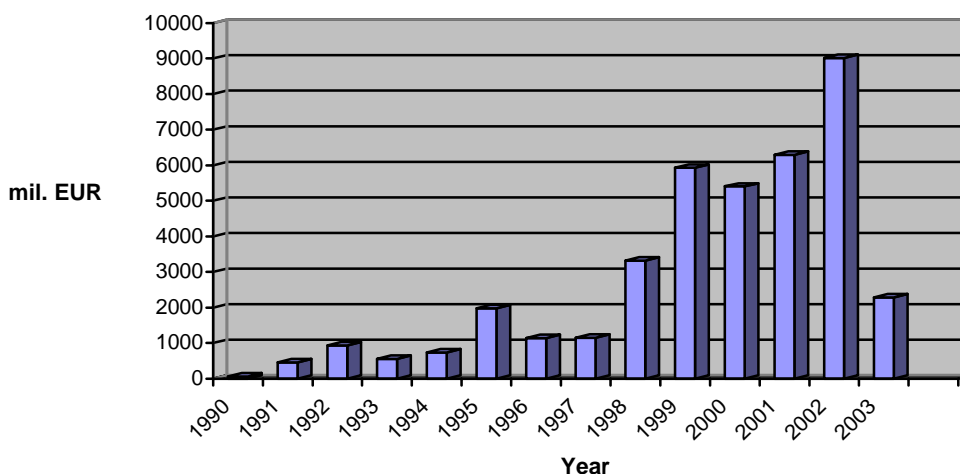
<sup>31</sup> About 20 % of housing stock, mainly in cities, is held by the housing cooperatives of different forms (Census 2001).

## **1.2 Promoting and attracting investment**

The discussion about the necessity to promote and attract investment began just after the breakdown of the Communist government in the fall 1989. Although the discussion was not necessarily about the investment of foreign companies only, as the usefulness of investments from domestic sources of capital have been sometimes mentioned (Pavlínek, 1998), in practice, the foreign investment was the core of the debate. From the very beginning the issue became highly politicized one. On the one side, it has been clear that the Czech economy badly deserves the modernization and that the foreign investment had been perceived as the best tool for achieving the modernization goal, on the other side, there was a widespread fear even among the leading politicians that domestic economy should somewhat be protected from the potential destruction by the financially strong foreign companies. In the beginning of nineties the issue of foreign investment also to a great extent intermingled with the process of privatization. The first phases of the privatization process (that is the restitution of nationalized properties and the small privatization) did not promote foreign investment at all – they were intentionally designed the way which prevented the Czech non-resident nationals and foreigners respectively from effectively participating in the process. The protective measures against the participation of non-residents and foreigners were usually justified by the necessity to create the indigenous domestic business class through restitution and privatization.

The second phase of privatization, the large privatization, already opened the door for the participation of foreign companies in the privatization of large domestic enterprises. It has been argued that it is necessary for keeping large Czech factories competitive on the world market. The inflow of the foreign capital into the Czech Republic remained rather low in the year 1990 as both the political situation and the position of the foreign investors was not very clear yet. The first sign of the fact that the government is seriously welcoming foreign investors was the adoption of the new Commercial Act in 1991. According to this law, foreign investors may invest in any of the following form: sole proprietorship, partnership, branch, Limited Liability Company, joint-stock company and new joint ventures. The law declared the purchase of portion of an existing entity or an acquisition of the ownership through the privatization process authorized. Most of former restrictions on capital movements have been eliminated and full convertibility of the local currency have been authorized. The capital outflow have no longer impeded by any law, although a tax 25 per cent on repatriated earnings has been imposed. The government also started actively attracted the foreign investors and the inflow of foreign investment increased substantively in 1991 (see the Chart).

**Chart 1: Inflow of foreign direct investment into the Czech Republic between 1990 and 2003**



Source: Czech National Bank, September 2004

The biggest FDI deal of the Czech government in 1991 became the Volkswagen investment into the Czech car maker Škoda Mladá Boleslav. In November 1992, the Ministry of Industry and Trade established a special agency for the promotion of the foreign direct investment in the Czech Republic – Czechinvest. At the beginning, Czechinvest have been operating mostly as a sort of marketing agency that advertised the Czech Republic as the ideal place for FDI and to help potential investors implement their projects. The Czechinvest was fully subjected to the Ministry of Industry and Trade and followed its general policy guidelines. The conservative coalition governments led by Prime Minister Václav Klaus between 1992 and 1997 were generally not willing to provide any special incentives for the foreign investors, especially not the tax breaks and other fiscal ones. Klaus himself became a well known opponent of any investment incentives considering them both ineffective and unfair in relation to smaller and domestic investors (Klaus, 2002). From 1992 to 1997, FDI inflow was higher than in the beginning of nineties, but it was mostly due to participation of foreign investors in the large-scale privatization process.

The situation dramatically changed after the breakdown of the Klaus coalition government in fall 1997 and the installation of the provisional government led by the former chief of the Czech National Bank Josef Tošovský. In April 1998, Tošovský's government passed a resolution No. 298/1998 which introduced the package of investment incentives available for both foreign and domestic firms that make at least 25 million USD worth investment through a newly registered company into a manufacturing sector. The package included a 10-year corporate tax break, duty- and VAT-free imports of machinery, training and job-creation grants and possibility to obtain the low-cost land. The government argued that investment incentives are offered in all neighboring countries and emphasized the positive effects of the FDI on the modernization of Czech economy. New Social Democratic government that was installed in summer 1998 after the victory of Social Democrats in the early parliamentary election continued this policy of actively attracting the FDI. The governmental resolution No. 844/1998 from December 1998 increased the eligibility for investment incentives by the decreasing of the minimum amount invested from 25 million to 10 million USD. In 1998, a special governmental program of the development of industrial zones was launched. The aim of the program is to help municipalities to prepare the conditions to develop investment projects in their territory.



By the changes in legislation Czechinvest obtained more powerful tools for its active policy of attracting the FDI into the Czech Republic. The introduction of incentives package proved to be very effective and it is considered as one of the most important reasons<sup>32</sup> why influx of foreign capital into the Czech Republic increased rapidly after 1997 (see Chart). The country became the leader in the region as far as the FDI influx per capita. The generally positive experience with the system of investment incentives led to the adoption of the Law No. 72/2000 on the investment incentives. The law, which was prepared by experts from both Czechinvest and the Ministry of Industry and Trade, basically codified the system that was so far regulated by the governmental resolutions. It declared the fourth basic types of incentives as: the tax breaks, the subsidies to municipalities for the preparation of land at which the construction of new plant is planned, grants for both creation of new jobs and the re-training of employees. The law maintained the limitation of the possibility to obtain the investment incentive only to companies investing over 10 million USD into “a high-tech” manufacturing (e.g. aviation and space industries, transport means, computers, information technologies, electronics, radio communications, telecommunications and pharmaceutical industry) or to the other branches of manufacturing industry provided that the investment into “high-tech” machinery (as declared by the list prepared by the Ministry of Industry and Trade) exceeds 50 % of total investment. The law also declared that investment into mining, the production and the distribution of electricity, gas and water, construction, repairs of motor vehicles, trade and other services are not eligible for the incentives. The investors that plan to invest in the district where the unemployment level exceeds over 25 % the national average could get extra benefits.

The law also clarified and described in detail the procedures which companies interested in obtaining incentives had to undergo. The procedure of obtaining the investment incentive consists of two phases. In the first phase interested investor submits the information about the intention to obtain the investment incentive with all the details over the planned investment to “organization established by the Ministry of Industry and Trade” (which is Czechinvest in practice). Czechinvest studies the materials provided by a company, check the general eligibility of the project for the program of incentives and prepares a report for the Ministry of Industry and Trade. The Ministry has the final say over the decision whether to continue in the process. If the decision is affirmative, the Ministry sends to applicant an offer of investment incentives. The company which is still interested then sends the official application for the tax incentives to the Ministry of Finance and the municipalities in which territory the investment is planned apply for the subsidy for the construction land preparation to the Ministry of Industry and Trade. Territorial branches of the Financial Offices (similar to Internal Revenue Service in the USA) in the respective district where the investment is prepared and made are in charge of checking the tax matters (including tax-breaks) and also the observing the other general rules under which the investment incentives were provided by the recipient.

In sum, the policies of promoting investment were generally very centralized in the Czech Republic after 1989. Practically all important decisions have to be made by the central government itself, the respective ministries or the Czechinvest. The sub-national governments have very little space for influencing this type of economic policy. Even if some features of promoting investment policies were intentionally aimed to have effects on sub-national level – like the provision of the Law on Investment Incentives that gave extra benefits for investors investing in the regions with higher unemployment – the sub-national governments were not participated at all in the formulation of the policies. The strongest sub-national institutions in relation to the attracting of investments are clearly municipalities because these have the

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<sup>32</sup> Together with generally improved economic situation in the Czech Republic and the approaching date of accession of the Czech Republic into a European Union.

highest level of freedom to set up priorities in their respective budgets and, namely the large municipalities, which have more money at their disposal than the regional governments. The activity of municipalities in the field of attracting the investors, however, is almost strictly limited to program of the development of the industrial zones, in which the municipalities or their associations can become eligible applicant for a subsidy from the state. But the decisions about the investments into limited number of so called “strategic zones”, where the most of state subsidies are spent, are anyway in the hands of the national government. On the other side, many smaller industrial zones that were built upon the initiative of the individual municipalities did not attract any investor despite of the subsidy (Dotace, 2002).

### **1.3 Support of Small and Medium-sized Enterprises in the Czech Republic**

First Act about Support of Small and Medium-sized Enterprises was adopted in 1991. New Act about Support of Small and Medium-sized Enterprises was passed by the parliament in 2002 to follow the provision of the European Commission Regulation 70/2001.

The Act determines three types of Small and Medium-sized Enterprises according to number of employees, assets in balance sheet and net turnover:

1. A minor, small or medium-sized enterprise shall be considered any enterprise which:
  - a) employs fewer than 250 employees,
  - b) its assets, stated in the balance sheet, do not exceed 980 million CZK, or its net turnover during the last complete accounting period does not exceed 1450 million CZK.
2. A small enterprise shall be considered any enterprise which:
  - a) employs fewer than 50 employees,
  - b) its assets, stated in the balance sheet, do not exceed 180 million CZK, or its net turnover during the last complete accounting period does not exceed 250 million CZK.
3. A minor enterprise shall be considered any enterprise which:
  - a) employs fewer than 10 employees,
  - b) its assets, stated in the balance sheet, do not exceed 180 million CZK, or its net turnover during the last complete accounting period does not exceed 250 million CZK.

Ministry of Industry and Trade has in its jurisdiction implementation of Programs of Support of SME. But the actual providers of support programs are following institutions: Bohemian-Moravian Guarantee and Development Bank, Agency for the support of business and investments (Czechinvest), Czech agency for the promotion of trade (Czech Trade) and the Czech Design Centre.

Eight from eleven support programs are administered by Bohemian-Moravian Guarantee and Development Bank. Some of these programs are intended only for selected types of SME. The objectives of these programs are to provide subsidized guarantees for bank loans or lease contracts, guarantees for capital investments, bonds for bids in commercial public tenders, subsidized loans, interest free loans etc. Application for support can be submitted to one of six bank branches. Exception is the case when small or minor enterpriser asks for loan lower than 1 million Czech crowns. In this case enterprisers can apply directly in Regional Advice and Information Centres (RPIC) or Business and Innovation Centre (BIC). There are 40 of these centers in the Czech Republic. Cooperation with enterprisers is important part of centers work. They help applicants with preparation of the application. The centers give recommendations to Bohemian-Moravian Guarantee and Development Bank about submitted applications.

Another administrator of support for SMEs is Czech Trade that may support conduction of a marketing study in case when some SME plan to export to a specific foreign market. Czech

Trade also helps to produce the marketing materials in foreign languages and help organize the presentation at trade fairs and exhibitions. Support is provided in the form of a subsidy covering a maximum of 50% of a project's eligible costs. The maximum amount of a subsidy is CZK 1 million.

Czechinvest administers another program of SMEs support. The objective of the program is to enable persons preparing to enter into business and small and medium-sized enterprises in the Czech Republic to receive subsidized general training and consulting services from external consultants. External consultants can be Czechtrade, RPIC and BIC. Czech Design Centre provides subsidized support for product design, internet presentation design etc.

## **2. Labour market and social dislocation policies**

### **2.1 Policy of employment in the Czech Republic**

The regulation of policy of employment was laid down primarily in the law of employment. Tools of policy of employment were defined by the Ministry of Labour and Social Affairs (MLSA) between 1990 and 1992. These included creation of net of Labour Offices and defining its competencies, and the formulation of active and passive policy of employment (under a supervision of minister Milan Horálek (OH)). Labour Offices which execute the main part of active and passive employment policy until the present time are set up and financed by MLSA and their competencies are defined in the law of employment.

Between 1992 and 1999 there were no special guidelines of policy of employment on the national and governmental level in the Czech Republic. The main reason of that situation could be found in political circumstances in that period. The conservative government led by Václav Klaus considered larger involvement of the state in the labour market neither necessary nor healthy. The situation has changed in 1998 when new social democratic government was created. The experts of MLSA inspired by European Employment Guidelines created first Czech National Plan of Employment 1999.

#### **National Plan of Employment 1999**

The main reason for creation of National Plan of Employment 1999 was the internal need. The governments of Prime Minister Klaus (1992-1998) considered social dialog and active employment policy is not inherent to market economy. Mr. Klaus considered the Labour Offices as expensive but necessary part of social net for people who were not successful on the labour market. Starting in 1993, government have had reduced competencies of Council for Economic and Social Consensus following to the idea that market will create "the market" wage relations. Since 1995 there were no more general agreements made between the social partners and the government. Government launched dialog just occasionally under the pressure of the strikes.

Because of a low level of unemployment between 1993 and 1997 (especially due to the postponed transformation of Czech economy) the government was reducing the expenses to the active policy of employment (APE), which was felt as undesirable intervention on the labour market. In 1992 the APE expenditure was 1,72 bn. CZK on APE and 1,42 bn. CZK on passive policy of employment (PPE). In 1998 the expenditures decreased to just 0,9 bn. CZK on APE and 4,2 bn. CZK on PPE. The reason was not the lack of financial sources. In 1998 combined

contributions of employers and employees to the policy of employment was 18 bn. CZK, but the budget expenses for that policy were just a bit more than 5 bn. CZK.<sup>33</sup>

The creation of National Plan of Employment was a reaction of MLSA (under the new social democratic government created in 1998) to the impact of economical crisis after 1997 and to the policy of precedent Klaus governments that did not fit to the real state of labour market. National Plan of Employment was calling for new conception where the economical, regional, social and educational policies would be interrelated according to the structurally changed conditions on the labour market. Here was founded an inspiration in the European Employment Guidelines.

#### Preparation, implementation and evaluation of the National Plan of Employment

All the process of preparation, implementation and evaluation the National Plan of Employment was (and still is) lead by MLSA. National Plan of Employment was created in collaboration with other ministries. First, MLSA made a proposal, which was commented by the other ministries. This process was quite complicated because, very often, the problem of employment policy was perceived as an internal problem of MLSA and an object of its responsibility. At the end of 90's, other ministries didn't know about the existence and content of European Employment Guidelines and it was difficult to spread the knowledge about this material to the representatives of other resorts. Measures were in a competence of diverse state institutions, especially the central ones (the ministries).

The proposal of National Plan of Employment was then also consulted with Council for Economic and Social Consensus. The representatives of employers and employees didn't participate on the creation of the document because they were not prepared to the active role on that field. Consequently, they could not participate in the discussion as equal partners. The government approved the National Plan of Employment (as an information, without any discussion) and established a "Committee for Employment" where were present the representatives of ministries, social partners and of The Union of Towns and Municipalities. The Committee had only two sessions in which its members were not even able to make an agreement on the responsibility of the ministries of the measures received. The Plans of 2000 and 2001 were prepared, implemented and evaluated by approximately the same way as the National Plan of Employment 1999.

The National Plan of Employment 2002 was created in collaboration with British experts under the twining program organized by European Commission. Advises and experiences of British experts were particularly helpful for the experts of MLSA mainly on the field of active employment policy and its forms in different phases of economic cycle. The emphasis was especially on the involvement of various partners; not only other ministries but also the representatives of regions, social partners, representatives of handicapped people, minorities and NGO's. The partners received the basic theses of the document (European Employment Guidelines included). The proposal was put on the web sides of MLSA and was open to public discussion. There were organized two meetings in regions for regional partners with the aim to involve them in the discussion around the document. The results of these activities weren't adequate to the expectations and to the efforts. Just a dozen of proposals were received. The partners (social partners included) were not able to take any responsibility for fulfilling a measure or to arrive with a constructive activity or comment. The general opinion was that all the responsibility should repose on MLSA. Therefore, the plan was prepared again by central institutions - ministries.

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<sup>33</sup> Source: A study „Národní politika zaměstnanosti“ of Dr. Vaclav Kužel (Head of Department of employment policy making on the Ministry of Labour and Social Affairs).

New law of employment was approved in 2004. It stresses more than before the structural problem of labour market and a need of complex reform and therefore a collaboration of various actors. There was created a new National Action Plan of Employment 2004-2006 by a commission with the representatives of ministries and social partners. The responsibility of the measure lies again mainly on the ministries, two of them will be executed by social partners for the first time. There is approved that regional structures should have more responsibilities to respond more effectively to the individual needs and problems of employment in each region. In the Plan 2004-2006 is spoken about the need of future partial territorial jurisdiction.

The regional political structures or other institutions are not involved directly in realization of any measure in this Plan. They are involved indirectly. Their role is in the effective use of their tools to support a healthy economical development, educational system, development of infrastructure in the region. It is important to understand that the priorities of regional governments influence also the situation of labour market, although these institutions have no direct tools. Good knowledge of the problematic of policy of employment, its goals, tools and possibilities, together with acceptance of responsibility are the main challenges for sub-national government and other non-governmental institutions.

## **2.2 Retraining**

The Law of Employment defines retraining as a part of Active Employment Policy. Retraining could be made in the special centers that receive an accreditation for retraining. An unemployed person passes through a retraining program after an agreement with a Labour Office. Labour Office pays the expenses of the retraining. Retraining could be organized by the employer for the employees. A Labour Office can pay a part of the expenses of employer. Retraining is supported by the national policy but it didn't impose exact guidelines of its content.

## **2.3 Social exclusion, poverty**

The social security system has been developed in the Czech Republic as the main tool which should protect people from poverty and social exclusion. Revenues and expenditures associated with social security system are part of budget of the Czech Republic. Social security consists of old age pension scheme, social services and health insurance. Social services are composed of child allowance, welfare benefits, parental allowance, housing allowance, foster care benefits, birth grant and death grant.

The Act about organization and implementation of social security system was passed by Czech National Council in the year 1991 and this Act is in force with small modifications up to the present day. The Act defines national institutions that implements social security, position of institutions and their responsibilities. These institutions are Ministry of Labour and Social Affairs, Czech Social Security Administration and its district branches, Ministry of the Interior, Ministry of Justice, Ministry of Defense and municipalities.

Ministry of Labour and Social Affairs directs and takes control of implementation of public administration, it also prepares new laws. This Ministry takes control of Czech Social Security Administration. The Ministry is responsible for further development of social security system and for observance of the covenants resulting from international treaties.

Czech Social Security Administration (CSSA) arbitrates about quantity of social benefits and ensures payment of the benefits. CSSA collects social insurance payments from citizens and organizations. CSSA directs and take control of district branches. CSSA also adjudicates about appeals against decisions of its district branches.

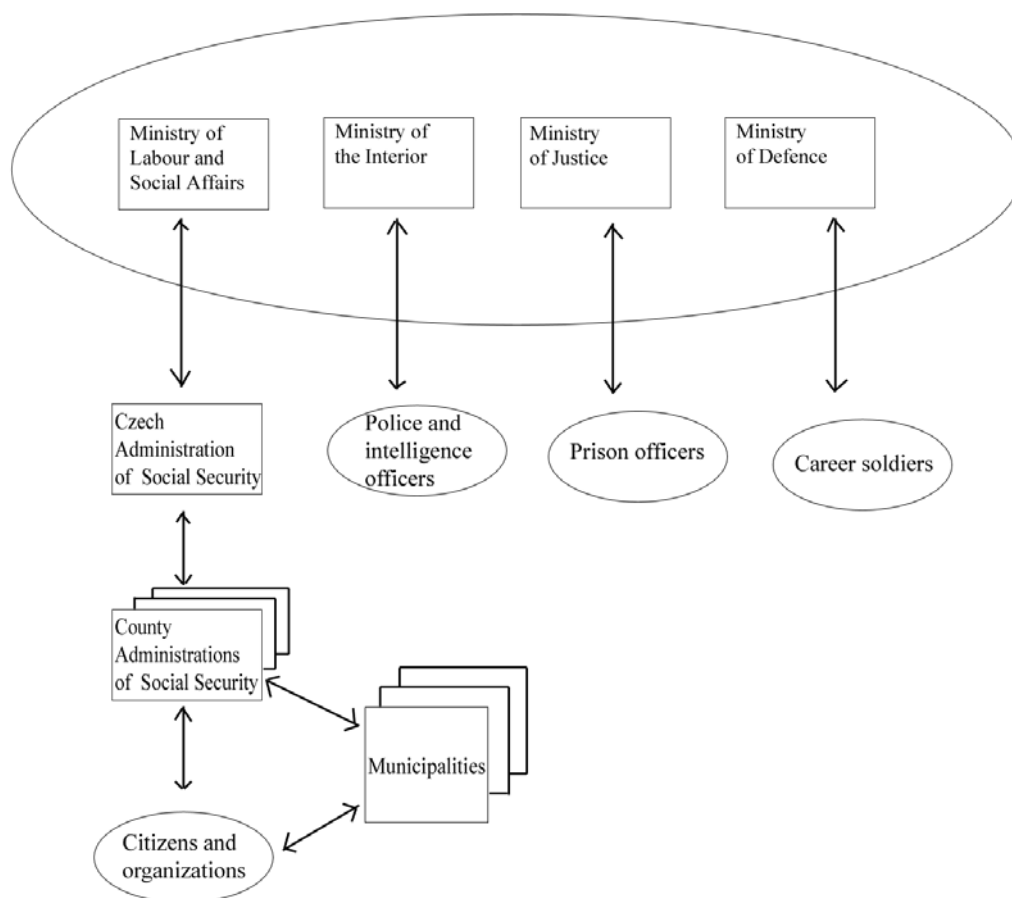
District branch of Social Security Administrations ensure social security in particular districts of the Czech Republic. They decide on beginning and end of health and social insurance. They decide about provision of particular social benefits. They take control on adherence of duties of citizens and organizations. They administer accountancy and statistics concerning the social security system. So they do all routine work on the lowest territorial level and they ensure everyday communication with citizens and the representatives of organizations. In case, when the district capitals are not easily accessible District Social Security Administration can set up its detached posts in other municipalities within the district. Municipalities may help to its citizens to communicate with the District Social Security Administrations, if it is needed.

Slightly aside from this bureaucratic system is Ministry of the Interior, Ministry of Justice and Ministry of Defense that direct and take control of and carry on pension insurance of special units of civil servants, which belongs under their authority: police and intelligence officers, prison officers and career soldiers.

Outside of the above described institutional system, municipalities also often manage rest homes for pensioners and regional governments manage of some Institutes of social services e.g.: for mentally disturbed and handicapped people.

You can see relations of particular institutions on the following diagram:

**Figure 1: Institutional Relations**



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**Part III:**  
**Financing of local government in the Czech Republic: a never ending re-**  
**form process?**

Jiří Blažek



## 1. Introduction

The Czech Republic is probably keeping an unwelcome world record as far as the number of reforms of systems of local government financing since the collapse of communism in 1989 is concerned. Unprecedented instability of the “system” of local government financing creates many problems for local development as it hinders not only day to day management, but especially implementation of investment projects, not talking about multi-annual development strategies. The instability of the system of local government financing also impedes co-operation with other subjects (other municipalities, private firms, development agencies, etc.) and does not contribute towards formation of a pro-active atmosphere.

There are several reasons for this instability, however, perhaps the most important reason is a failure to discuss openly the fundamental dilemma of a design of the system of local government financing, i.e. the dilemma between the principle of solidarity and the principle of meritocracy (or motivation) - see Musgrave and Musgrave, (1994). A proper system of local government financing should provide on the one hand sufficient solidarity in order to guarantee provision of such a level of public services on the whole territory of the state that would be considered as adequate by population and by its political representation. On the other hand, the system should also provide stimuli for efficient management and mobilising local resources. Especially relevant is the need for a suitable financial framework that would encourage activity and initiatives of municipalities in the sphere of business promotion and employment support. This is in contrast with current situation in the Czech Republic where local government elites are primarily preoccupied with solving issues of neglected or even non-existent technical infrastructure.

## 2. Specific features of local government system in the Czech Republic

Firstly, the Czech local government is typical by its large horizontal fragmentation (see Dostál, Kára 1992). Despite the fact that several important positive assets of such highly fragmented structure of local government can be listed (notably the opportunity for democratic participation in local affairs after the decades of communism and closeness and accountability to local citizens), the prevailing perception would be more sceptical. This scepticism of both public sector experts and practitioners about the merits of large horizontal fragmentation relates not only to economic arguments (i.e. limited resources of tiny municipalities and diseconomies of scale) but also to poor quality of public services provided by the smallest municipalities. They argue that small municipalities cannot fulfil the tasks of modern self-government especially under the transition which is typical with frequent changes and growing body of legislation (not talking about the gradual approximation to the *acquis communautaire*) – see Hampl, Müller, 1998 or Illner, 1996. Human resources of such tiny villages are insufficient for fulfilling of all the obligations of current local governments.

However, first of all, it should be stressed that similarly to the western democratic countries also the former communist Czechoslovakia responded in the post-WWII period to the huge horizontal fragmentation of the settlement system and of local government by a policy of amalgamation of municipalities (see e.g. Leemans, 1970). However, due to the fact that the amalgamation under the centralised communist regime endangered the very existence of amalgamated municipalities, the process of amalgamation was extremely unpopular. Nevertheless, in the Czech Republic, as a result of amalgamation policy, the number of municipalities decreased from 11, 000 in 1948 (year of the communist coup) only to 4,100 in 1989 (time of velvet revolution - see Blažek, 1999).

Due to above given reasons, when democracy was reintroduced on the local level after 1989, many amalgamated municipalities decided, on the basis of local referenda, to re-constitute

themselves again and to re-establish the local self-government in their villages. This movement, mirroring the revival of local communities, was quite overwhelming, as more than 2,000 municipalities were re-established within the first 2-3 years of transition, thus increasing the number of municipalities by about 50 percent to more than 6,200 (Blažek, 1996). The number of municipalities appears to be now practically stabilised as a decisive majority of villages that wanted to become independent, have managed to do so already in the beginning of the 1990s. Since the mid of 1990s there appeared several cases of small municipalities which have ceased to perform their self-governing functions due to their inability to set up even a single ballot list as enthusiasm for running local affairs by themselves faded away. Currently, (year 2004) there are 6249 municipalities in the Czech Republic which means that process of re-amalgamation started but up till now it is still rather unique phenomena as over the last 2 years (2002-2003) only 9 municipalities have amalgamated. In the large majority of municipalities (79,6%) live less than 1000 inhabitants which is in contrast, for example to Poland, where such small municipalities do not exist (Surazska, Blažek, 1996).

Secondly, several important implications for local development, and especially for design of local government finances, have been stemming from the reform process of the regional level of administration. The regional reform started in 1990 by the decision to abolish 8 existing regions. This measure was taken mostly for political reasons, especially to limit the bureaucracy and to destroy the communist hierarchical system (Kára, Blažek, 1993). At the same time, it was decided to maintain only functions of the state administration at the district level.

Consequently, a significant shift of competencies took place. Some responsibilities (especially from the former regions) were transferred to bodies of the central administration while some others were given to the districts or some even to municipalities. The system of financing had to accommodate to all these changes of competencies. This was mostly done in the form of special grants. Nevertheless, the absence of intermediate self-government bodies between the municipal and the state level had been causing many practical problems, predominately in financing and managing services on above-municipal level (see Perlín, 1996).

Moreover, the central ministries faced difficulties in executing all their competence from the capital, and therefore, they set up a network of regional branches. The establishment of these regional branches was uncoordinated, thus nearly all ministries designed their own network of regional branches (Terplan, ArcData, 1993). Consequently, after a long period of hesitation and of sharp political disputes, 14 new self-governing regions finally came into existence in January 2001. However, the creation of a new regional level of public administration provided yet another impetus for instability of the local government finances. The need to provide financial resources for the new regions led the government to reconsider the whole structure of public finances in the Czech Republic.

Therefore, the introduction of 14 regions in the year 2001 induced a new reform of local government finances. On the top of it, as a result of the creation of the regions, the districts that existed since reform performed in 1960 were abolished by the end of 2003 and replaced by approximately 200 (i.e. three times higher number) of smaller “districts” or microregions of municipalities empowered by third level of administrative service.

It is likely that this proposed new phase of reform of public administration will cause yet another reform or at least adjustment of local finances. However, much more significant stimulus for a new reform in the near future represents the current model of local finances itself. Because the current model (2001) is based on an extreme type of solving of the basic dilemma of a local financing - i.e. the tension between the principle of solidarity and meritocracy - by almost exclusive adherence to the principle of solidarity (see below). Therefore, it can be as-

sumed that the instability of the rules of the Czech local government financing will persist also in the future.

Currently (end of December 2004) a new Act on allocation of revenues from shared taxes passed the legislative process, which means that since January 2005 the share of regions in on shared taxes will be increased and grants will be cut correspondingly. In the same time, a discussion on a new financial mechanism that would stimulate inter-municipal cooperation and later perhaps even their amalgamation has been started.

Nevertheless, despite these latest developments it is clear that the reform of local and regional government financing is still far from its stabilization. In addition, the foreseen change in political colour of the government (according to opinion polls right wing opposition party “Civic Democratic Party” is clearly dominating the political scene in the Czech Republic) would most likely provide a new impetus for reconsidering the current highly redistributive model.

### 3. Trial and error approach in design of local government financing

After the collapse of communism in 1989, the re-establishment of local financial autonomy was an important component of re-building of a democratic system at the local level. However, the problem of granting at least some financial autonomy to the municipalities proved to be especially difficult to solve. The design of the system of financing of Czech local governments can be described as a „trial and error” approach. The main reasons for the instability of the rules of local financing are (i) large horizontal fragmentation of local government, (ii) shifts of competence, (iii) reforms on regional level of administration, (iv) but especially the failure to strike a right balance between the principle of solidarity and the principle of meritocracy. Consequently, at least four different systems can be identified in the period 1990-2001 (see also Blažek, 1999).

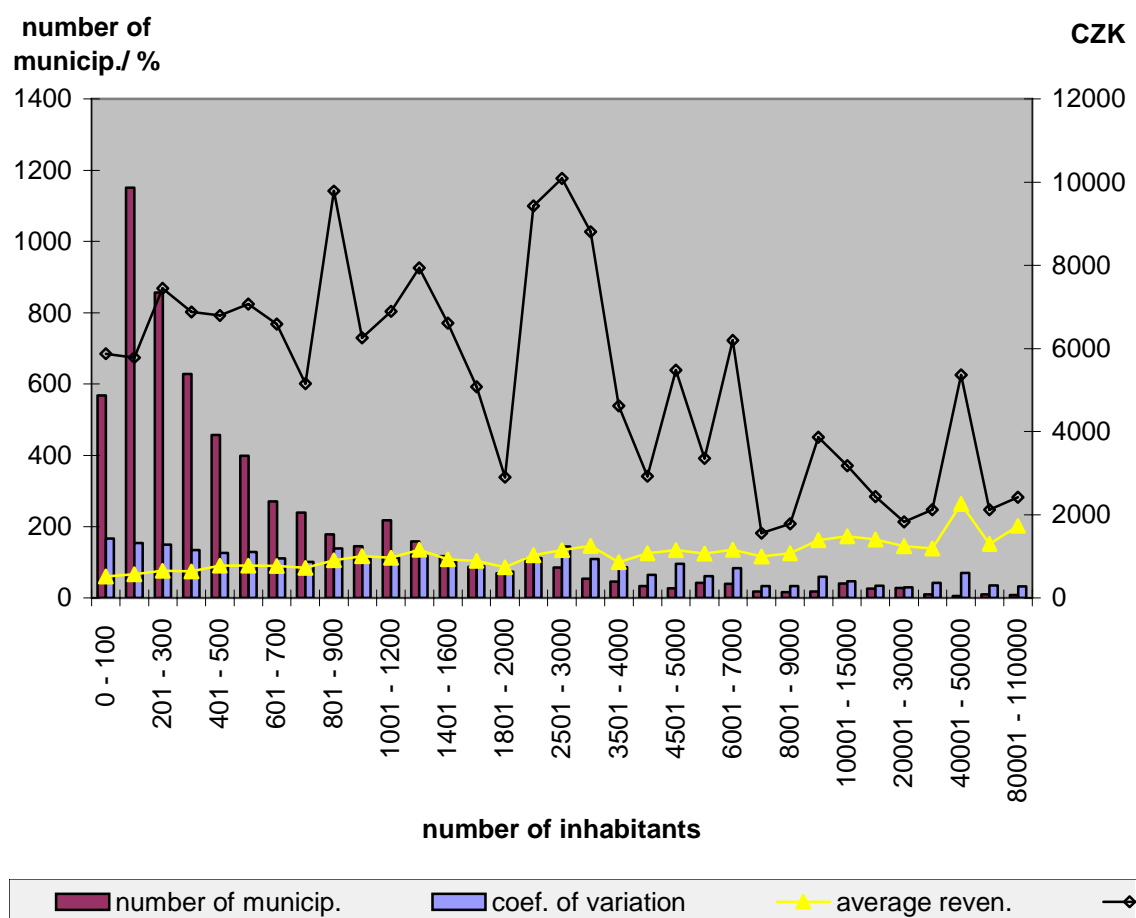
**First period 1990-1992.** Due to a general mistrust of the central redistribution of resources under the communism, newly elected local representatives exerted a strong pressure on the central government to decentralize a part of the tax revenues to local governments (municipalities). Nevertheless, in the first years of the transition, a radical transfer of competencies was carried out (the major change concerned the provision of the health care services, which were removed completely from the responsibility of territorial administration in 1991). The transfer of competencies had to be accompanied by a transfer of financial resources to guarantee provision of these tasks at the municipal level. Transfer of financial resources took usually the form of general or special grants. Consequently, until 1992, the largest share of local government income (about 70 percent of the total) represented grants from the state. However, due to the large number of Czech municipalities and due to the lack of objective criteria, it was decided that state grants would be distributed only to the level of districts where the representatives of municipalities had to agree upon the allocation rule for the distribution of the general grant among the municipalities within the particular district, and this procedure was often accompanied by controversies (for more see Blažek, 1994).

**Second period 1993-1995.** In 1993, as a part of overall tax reform (including introduction of VAT), a radical reform of the local government financing was carried out in order to increase the share of revenues that local governments might generate from their own jurisdictions. The core of the reform was the decentralization of revenues from the personal income tax to local governments. At the same time the state grants were cut correspondingly. This reform resulted in the emergence of considerable disparities among the districts and especially among municipalities in per capita tax revenues due to considerable differences in their tax base (Blažek, 1995). The system was rather complex, important feature being a strong equalization

mechanism operating among the municipalities within the districts. The system provided also for financing of the state administration at a district level. On the other hand, there was rather modest equalization mechanism among the districts represented by relatively small „territorial equalization grant”, corresponding only to about 2 percent of local government total incomes.

**Third period 1996–2000.** This period started with the 1996 reform and lasted until December 2000. The rationale for this reform was according to the Ministry of Finance threefold (Předkládací zpráva, 1995). Firstly, the revenues allocated to local governments were growing more swiftly than the revenues allocated to the state budget. In consequence, the share of the state in public budgets has been shrinking while the competencies remained unchanged. Secondly, there were considerable disparities among the districts and even larger disparities in per capita tax revenues among the municipalities caused by the differences in productivity of local economies (see fig. 1 and 2). The central government saw the disparities incompatible with its aim to guarantee provision of a similar level of public services throughout the state. In addition, the disparities were considered unjust, because the local authorities had only limited right to set tax rates in the case of property tax, and no right to set the tax rate of much more important income taxes. Therefore, the municipalities could influence their tax revenues only marginally. Thirdly, the government intended to stimulate the municipalities to promote more actively the development of economic activities on their territories. The main element of the 1996 reform was the replacement of 40 percent of revenues from swiftly growing personal income tax by 20 percent of stagnating revenues from the business tax. At the same time, the allocation criteria for distribution of the revenues of both these taxes among the municipalities were changed to strengthen the equalization mechanism on a nation-wide level. The impacts of the system introduced in 1996 have been multifaceted. The biggest losers were the largest cities, but also the smallest municipalities. In the same time, the size of disparities among the districts in per capita tax revenues dropped in 1996 but then started to increase again though less steeply than before (see Blažek, 1999). Nevertheless, considerable disparities in per capita revenues persisted especially among the municipalities due to the allocation of entire tax revenues from personal income tax (PIT) paid by small entrepreneurs to the municipality according to entrepreneur's permanent living place (see fig. 1).

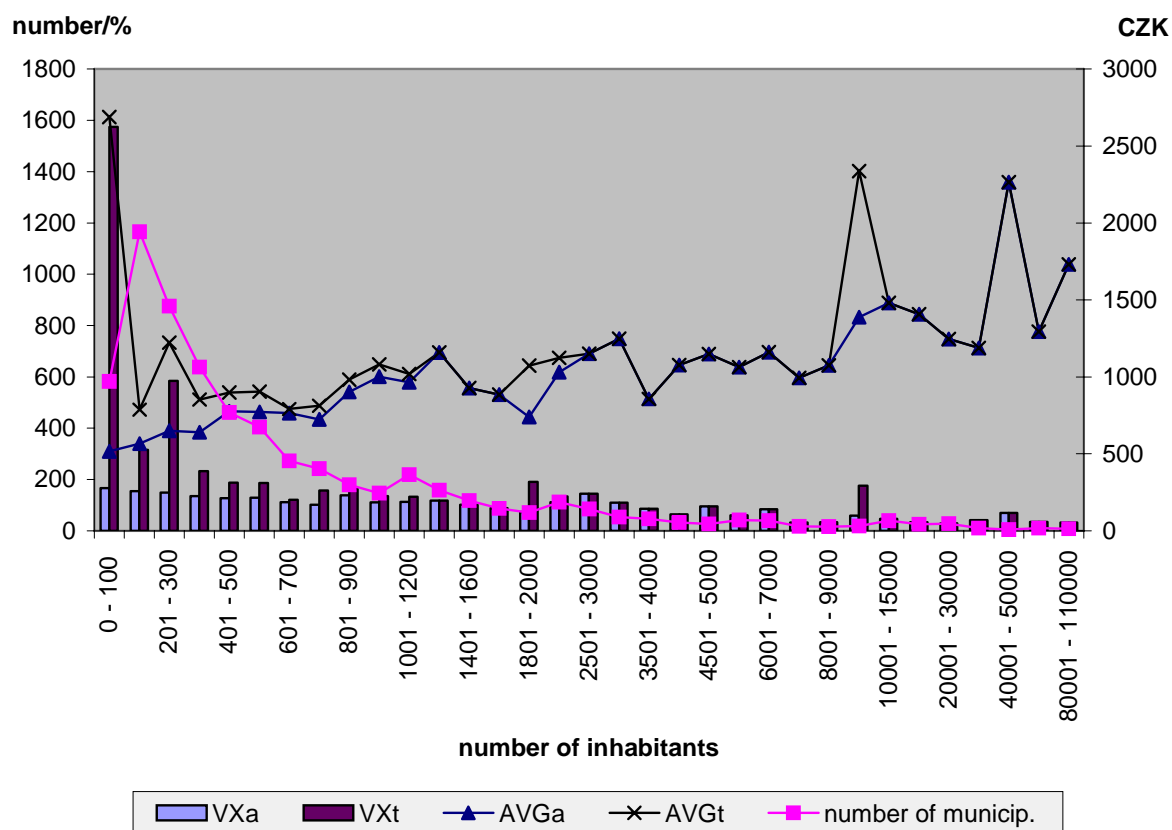
**Figure 1: Revenues from PIT paid by small entrepreneurs according to population size categories of municipalities (per capita, average for 1999-2000)**



Sources: financial data - database of the Ministry of Finance, population - Czech Statistical Office.

Note: Due to existence of outlier municipalities, caused mainly by speculations with permanent living place of natural persons – entrepreneurs (see text below), the coefficients of variation and averages were calculated both for the complete dataset and for dataset adjusted by elimination of the municipalities with extreme values. Coefficients of variation within each population size category of municipalities, resp. averages for total database are marked VXt, resp. AVGt, while for adjusted database VXa and AVGa. For methodology used to eliminate outliers see part 4.1 below.

**Figure 2: The sum of revenues<sup>34</sup> from both parts of PIT and from property tax according to population size categories of municipalities (per capita, average for 1999-2000)**



Sources: financial data - database of the Ministry of Finance, population - Czech Statistical Office.

Note: see note for fig. 1.

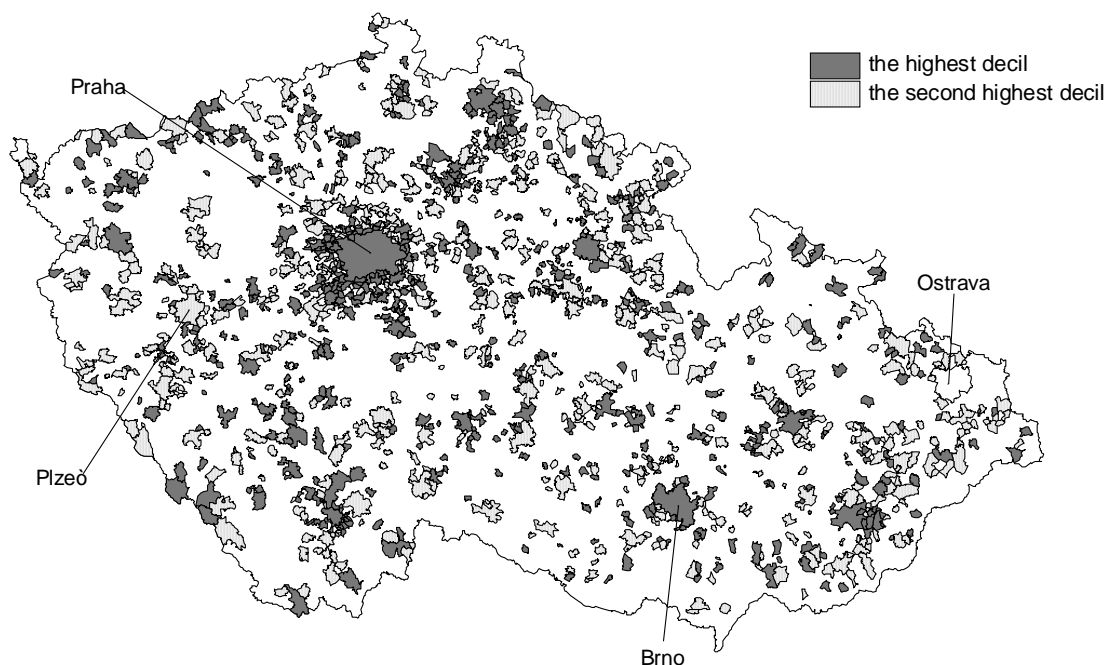
Moreover, the allocation rule of this tax was among the main reasons for dissatisfaction of both the practitioners and the experts with the whole system of the local government financing. The most important reason for dissatisfaction was that the 1996 reform has left untouched the allocation criteria of this tax that was the main source of differences in the size of revenues both among the municipalities and among the districts (Blazek, 1996)

Spatial distribution of the municipalities with the highest and the lowest per capita revenues from this tax in the year 2000 are shown in fig. 3 and fig. 4. The spatial pattern captured in figure 3 is quite fragmented, but one can discern the concentration of richest municipalities in hinterlands of largest cities, in economically strong areas (see municipalities surrounding M. Boleslav) and in areas attractive for tourists. In contrast, the municipalities with the lowest revenues from personal income tax paid by small entrepreneurs are predominately concentrated into Czech-Moravian Highlands and along the border of the Central Bohemia region (fig. 4).

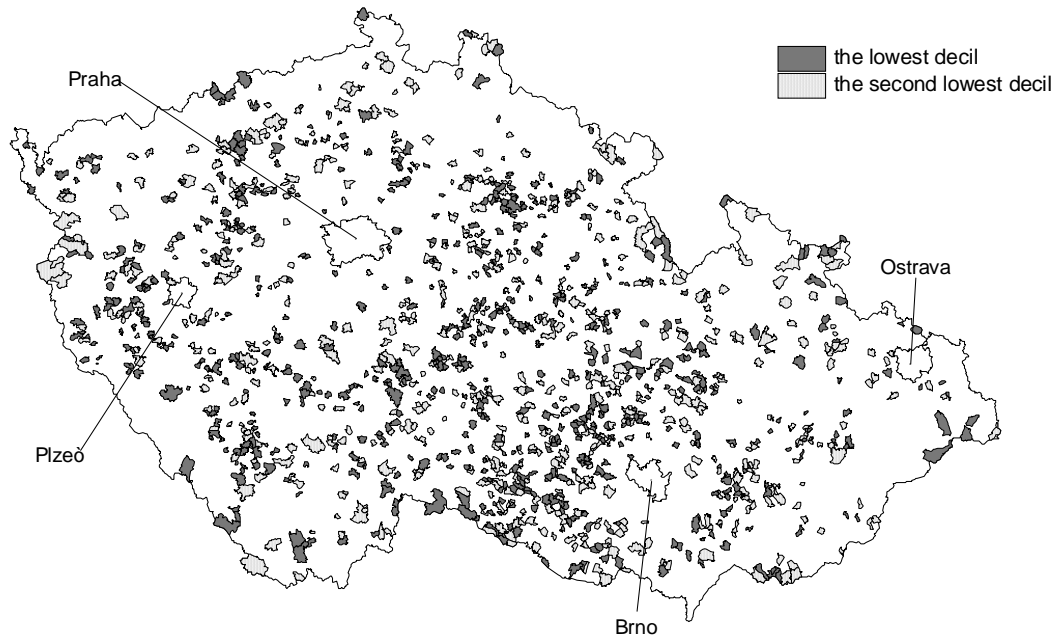
<sup>34</sup> Due to extreme variation in per capita tax revenues from PIT paid by small entrepreneurs among municipalities that is caused to a large extent by speculations with permanent living place of entrepreneurs, 77 outliers were removed from this analysis. More specifically, all municipalities with revenues from this tax higher than 15 ths. CZK per capita were removed as well as all municipalities which exceeded the average of the respective size category of municipalities more than 10 times. This approach applies both to fig. 1 and 2. Four largest cities have been excluded from the analysis given their specific position in the settlement structure and due to specific system of their financing.

In addition, there emerged a whole array of improper features accompanying allocation of revenues of this tax. Namely, some municipalities have been offering a „tax discount” in the form of a grant to those entrepreneurs who formally “moved” to their municipality (see Brož, 2001), some of municipalities became too dependent on a few local entrepreneurs, quite often the living place of entrepreneur and the place of entrepreneurial activity differed. The offering of „bribes” to entrepreneurs by some municipalities was considered to be particularly unfair and was seriously criticized by many local representatives. Such luring of entrepreneurs was also causing an erosion of overall local government revenues (Kameníčková, 2000, Tesař, 2000). Therefore, the allocation criteria of this tax should have been carefully considered.

**Figure 3: Spatial distribution of 10% and 20% of municipalities with the highest per capita revenues from the personal income tax paid by small entrepreneurs (average for 1999-2000).**



**Figure 4: Spatial distribution of 10% and 20% of municipalities with the lowest per capita revenues from personal income tax paid by small entrepreneurs (average for years 1999-2000).**



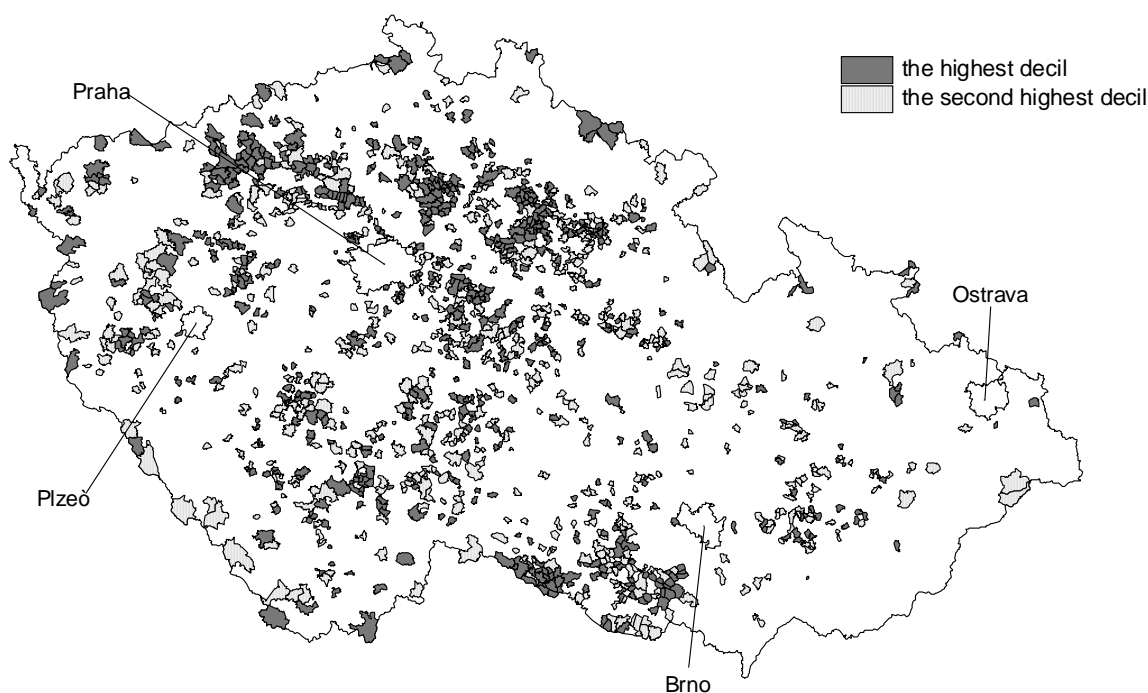
Another serious deficiency of the 1996 system was nearly non-existing discretion of the municipalities over “their” tax revenues. Their only discretion concerns the property tax. In the Czech Republic, the property tax is based not on market value of the property in question, but on its size and type of usage (i.e. housing, recreation, entrepreneurial activity or garage). All municipalities are classified into 6 categories according to their population size and each category is assigned a coefficient used for determination of the property tax. The coefficient is increasing according to population size. Consequently, the tax for the same property is approximately 15 times higher in Prague than in the smallest municipalities. However, the municipalities have the right to decide whether they apply the coefficient from higher or lower population size category. In addition, they can differentiate the size of coefficient in various parts of their territory (for example town centre versus outskirts).

Moreover, the municipalities can also influence the revenues from property tax by giving support to businesses on their territory - either directly or indirectly. For example, direct way of support might take the form of building an industrial zone; the indirect support can especially consist of creation of favourable climate for local businesses (provision of adequate “soft” and “hard” infrastructure, drawing master and strategic plans, setting of moderate level of local fees, care for attractive municipal environment, municipal marketing etc.). Nevertheless, the discretion over the property tax has to be considered in connection with the volume of revenues from this tax in comparison with other tax revenues or even the total revenues. In 2000, the revenues from property tax amounted only to 4.4 bln. CZK (Ministry of Finance, 2001), which represents 5,5% of tax revenues of the municipalities and only 2,7% of their total incomes. The revenues from this tax grew to 4,8 bln. CZK in 2003 but their share on total incomes dropped to mere 1,98%. Generally, in the case of towns, this revenue is only of a marginal significance, while for small municipalities in environments attractive for tourists,



but especially in cases of small municipalities with large cadastre located in lowlands, the revenues from the property tax represent even more than 20-30 percent of their total revenues (Brož, 2001). Spatial distribution of the municipalities with the highest per capita revenues from this tax is shown in figure 5.

**Figure 5: Spatial distribution of 10% and 20% of municipalities with the highest per capita revenues from property tax (average for years 1999-2000).**



Therefore, the basic shortcomings of the 1996 – 2000 system can be summarized according to Blažek (1999) in the following points:

1. there was limited discretion of municipalities over tax revenues;
2. there were considerable disparities in per capita revenues among municipalities;
3. there was unsatisfactory and misused rule of allocation of revenues from personal income tax paid by small entrepreneurs;
4. frequent and radical changes of system of local government financing.

#### **4. The current system of local government financing (2001 +)**

The current system of local government finances represents the fourth main period of ongoing reform of local government finances after the 1989 collapse of communism. Due to general dissatisfaction with the previous model, the government prepared again another financial reform that came into effect in January 2001. The reform had originally also reflected the fact that the new 14 regions would begin functioning, but later the government decided to postpone the definition of regional revenues by one year and to finance them in 2001 provisionally by special grants. According to the government, the main rationale of the new system is

to eliminate sharp and unjustified disparities in per capita tax revenues that in addition, the municipalities are not allowed to influence (Tesař, 2000). In consequence, the new system is fully adhering to the principle of solidarity and rests on equal sharing of revenues of selected taxes based on per capita principle (see below).

However, even the basic premise, i.e. the achievement of equal position of municipalities by elimination of disparities in tax revenues, can be challenged. For example, the number of municipalities with really extremely high revenues was rather limited and also the problem of luring of entrepreneurs by “tax discounts” could have been solved differently. With the exception of the municipalities attracting entrepreneurs by such ways, the significantly above-average revenues have been recorded in hinterlands of largest cities and esp. in the municipalities that are prime destinations for tourists (see also fig. 2). These municipalities were receiving relatively high tax revenues, but at the same time they had quite specific „above-standard” requirements and needs. Moreover, it is important to note that even the full equalization of tax revenues would guarantee neither full “justice” nor provision of the same level of services because the conditions of individual municipality differ (e.g. differences in economic structure, geographic position, climatic conditions, institutional and subjective factors, etc.). One of the important instances of „injustice” is the fact that some municipalities have been provided by costly infrastructure such as gas or sewage systems under the communism while the others have to bear these costs now.

The foundation of the new system is an equal sharing of selected taxes among municipalities on a per capita principle. The list of shared taxes includes the value added tax, personal income tax (both the part paid by employees and the part paid by small entrepreneurs), and business tax. The share of municipalities has been set at 20,59% of the total revenues of these taxes. In the same time, the municipalities were arranged into 14 categories according to their population size. Each category was assigned a coefficient reflecting the fact that larger municipalities and cities are performing functions for surrounding areas (for details see next section).

The only reward for the municipalities that actively support businesses on their territories is an accepted proposal of one MP made during the debate on this new act in the Parliament. It determines that municipalities receive 30% share of revenues from personal income tax paid by entrepreneurs who are permanently living in the municipality. Consequently, “only” 70% of revenues from this tax are subject to redistribution on the central level where the share allocated for local governments (i.e. 20,59%) is redistributed among the municipalities. This measure is obviously not a systemic solution but only a temporary stipulation providing at least some concession to the meritocracy principle and some incentive to encourage local governments in creating favourable conditions for local employment and local businesses. Table 1 provides an overview of the current system of the local government financing.

**Table 1: Tax revenues of local government in the Czech Republic**

<b>Tax</b>	<b>Share allocated to municipalities</b>
<b>Property tax</b>	100% according to location of the property
<b>VAT</b>	20,59% of national revenues
<b>Personal income tax paid by employees</b>	20,59% of national revenues
<b>Personal income tax paid by small entrepreneurs</b>	20,59% of national revenues
<b>Personal income tax paid by small entrepreneurs</b>	30% of revenues paid by taxpayers who are permanently living in the municipality in question
<b>Business tax</b>	20,59% of national revenues

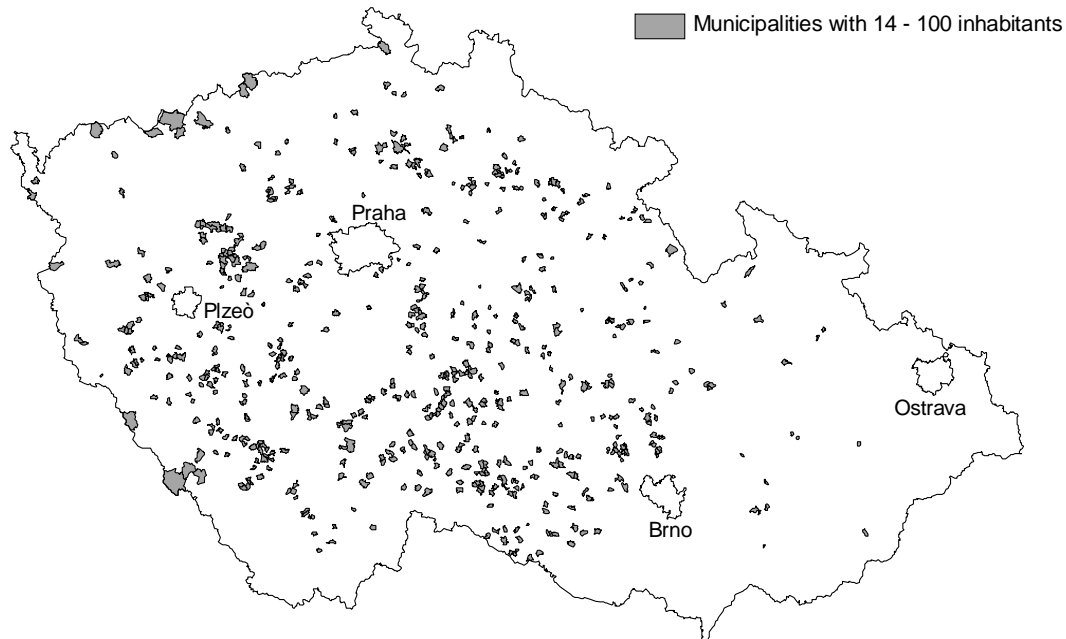
Source: The Act on allocation of tax revenues, No. 243/2000. Official Journal of the Czech Republic, 2000, Prague.

#### 4.1 The issue of coefficients

As explained above, the municipalities were divided into 14 categories according to their population size and to each category a coefficient determining the actual volume of tax revenues was assigned. The coefficients assigned for particular size categories represent obvious bone of contest. These coefficients are designed to reflect the fact that larger municipalities are performing some functions and services also for their hinterlands. As a rule, the coefficients are derived from the previous level of average tax revenues in each size category of municipalities (see fig. 2).

However, at least two important reservations against the assigned coefficients can be formulated. Firstly, in case of tiny municipalities with less than 100 inhabitants, the coefficient has been set deliberately lower than was the previous average of tax revenues of these municipalities. This should provide an economic incentive to these small municipalities for re-amalgamation. However, the coefficients are designed in such a way that they would lead rather to amalgamation of two “micro” municipalities and not to amalgamation of smallest municipalities with the larger ones. This is so because larger municipalities have little incentive for such a merger given the quite flat increase in coefficients with the exception of the coefficient for the smallest municipalities (table 2). One can say it in another way: the coefficients provide incentive just to one side of the potential merger, i.e. only to the smallest municipalities and not to their larger neighbours. Similarly, if the state is trying by a political decision to enforce amalgamation of small municipalities, there arises the question, why the critical size was determined at 100 inhabitants and not at a different (higher, for example 300, 500 or even 1000 inhabitants) figure. In addition, when one is looking at the geographical distribution of the small municipalities up to 100 inhabitants in the Czech Republic (see fig. 6), then it appears that these municipalities are predominately located in rural areas located in so called internal peripheries, especially in South Bohemia and in the Czech-Moravian Highlands. These areas are among the poorest ones in the country and the new model tends to worsen this situation.

**Figure 6: Distribution of small municipalities up to 100 inhabitants in the Czech Republic (year 2000)**



Secondly, a principal objection should be raised against the division of municipalities into the categories and against the coefficients assigned to the towns with population size between 50 – 99 and 100-149 thousand inhabitants. In the Czech Republic, there is a group of major cities with important regional functions of approximately equal size (around 100 thousand inhabitants). However, the intervals between the population size categories were set entirely in a mechanical way without any regard to the settlement structure of the Czech Republic. Thus, the majority of these important cities are put just below the critical line, while similar cities with a few hundred or thousand more inhabitants are already given a higher coefficient. This issue is particularly pressing because of a large gap between the coefficients for these successive categories, i.e. 0,849 vs. 1,039. This implies that similar cities are having their tax revenues by about 20% lower without any possibility to influence the volume of shared revenues.

**Table 2: Coefficients for redistribution of tax revenues among municipalities in 2001**

Number of population	Coefficient
- 100	<u>0,4213</u>
101 – 200	0,5370
201 – 300	0,5630
301 - 1 500	0,5881
1501 - 5 000	0,5977
5 001 – 10 000	0,6150
10 001 – 20 000	0,7016
20 001 – 30 000	0,7102
30 001 – 40 000	0,7449
40 001 – 50 000	<u>0,8142</u>
50 001 – 100 000	<u>0,8487</u>
100 001 – 150 000	<u>1,0393</u>
150 001 or more	1,6715
Prague	2,7611

Source: The Act on allocation of tax revenues, No. 243/2000. Official Journal of the Czech Republic, 2000.

Note: Underlined are the coefficients that are a source of a major controversy.

Paradoxically, these major cities, which are just below the 100 thousand line, are the ones that are most interested in amalgamation with their neighbouring municipalities and thus to reach onto much higher coefficient (for example, an initiative in this direction has been carried out by the city of Č. Budějovice). The solution would be relatively easy one - a change of the bottom limit of the higher population category to 90 thousand or even better to 80 thousand inhabitants and to adjust the coefficients for both categories accordingly.

Moreover, as follows from comparison of tab. 1 with fig. 1 and 2, the coefficients were derived from a highly smoothed curve and, therefore, in several other cases are undermining the very principle on which these coefficients were based (i.e. the previous average tax revenues of the respective population size category). The figures 1 and 2 compare variation and averages of particular size categories in case all municipalities are included with variation and averages after elimination of outliers. The existence of outliers is caused mainly by speculations with permanent living place of natural persons – entrepreneurs (see text below). These outliers were eliminated by a two-steps procedure. Firstly, municipalities with per capita revenues from the tax paid by physical persons-entrepreneurs higher than 15 ths. CZK were excluded. Secondly, the municipalities, which exceeded average of the respective population size category more than 10 times, were also excluded. Consequently, 77 municipalities were excluded from the adjusted database. Extreme discrepancies between average and adjusted

average (and between both measures of variation) were found especially in case of the smallest municipalities up to 100 inhabitants and in category of municipalities with 9 001 to 10 000 inhabitants. In both cases, this discrepancy was predominately caused by an excessive speculation with permanent living place of natural persons—entrepreneurs performed by one municipality in each category. Nevertheless, even after elimination of outliers, significant differences between average tax revenues even among sequential categories were identified.

This is especially the case of category of municipalities with population between 40 and 50 ths. Coefficient assigned to this category is significantly lower than would correspond to previous tax revenues of these towns. On the contrary, the towns with a population between 50 and 80 thousand inhabitants were assigned considerably higher coefficient than would follow from their previous tax revenues. This illustrates that even current, highly redistributive system, does not do the full justice even on the income side of municipal budgets.

#### **4.2 Implications of the new system for local development and outlook to the future**

The Parliament discussion over this new system took place in autumn 2000 and showed that such a highly redistributive system is meeting serious criticism. In fact, the principal reason why such a radical and one-sided reform of the local government financing was approved is that this law was a part of a legislative package establishing the self-governing regions. Consequently, the minister of finance was forced to promise that another model of the local government financing would be prepared for 2002. Thus, the instability of the “system” of local government financing continues, and is unprecedented most likely in entire Europe.

When assessing the current model of local financing from the local development point of view, it should be stressed that the incentive for municipalities to encourage employment creation and business support on their territories is currently much weaker than under the previous system. The municipalities actively promoting such activities are either forced into by acute local needs or they are hoping that their efforts would be reflected in the future also by the system of the local financing and that money they invested into these projects would come back.

Moreover, the new system will also most likely negatively affect the overall level of investment activity – at least in the short- and medium-term. This is a quite pressing issue because in comparison with many other countries – both in central and eastern Europe and western Europe, the Czech municipalities succeeded in allocating significant part of their revenues to capital investments – 3,3% of Czech GDP in 1998 (see tab. 3). For comparison, in the same year the share of capital expenditure in national GDP made by local government on national GDP was 0,5% in Bulgaria, 1,8% in Estonia, 3,3% in Hungary, 1,9% in Poland, 0,9% in Romania, 1,7% in Slovakia and 1,5% in Slovenia (Dexia, 2000). The high rate of investment activity is a very positive feature as the local governments are actively overcoming the large internal debt inherited from the communist period especially in the form of neglected or even non-existent technical infrastructure. These data indicate that Czech local representatives devote a lot of their energy to organizing and guaranteeing finance for this sort of quite demanding projects. Unfortunately, as already indicated above, the chronic instability of the system of financing and especially the current model, are seriously hindering the implementation of investment projects. Moreover, the frequent and radical changes of the local government financing are also impeding the financing of investment projects by external resources; there are cases of municipalities that which run into troubles with their debt service as their revenues have suddenly significantly dropped.

**Table 3: Selected financial indicators of municipal governments (in bln. CZK)**

Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>Total revenues</b>	92,8	106,8	114,6	123,9	137,9	169,4	162,6	184,2	208,2	244,0
<b>Tax revenues</b>	45,3	58,4	62,8	65,5	72,1	75,7	79,3	82,0	90,1	107,5
<b>Total expenditures</b>	95,5	110,8	123,5	129,2	136,3	150,0	164,0	195,5	214,3	248,5
<b>Capital expenditures</b>	32,1	39,1	43,1	42,1	41,3	45,5	56,8	65,3	68,9	71,5
<b>Share of capital expenditure on total exp.</b>	33,6	35,3	34,9	32,6	30,3	30,3	34,6	33,4	32,2	28,8
<b>Debt (loans, bonds, other)</b>	14,3	20,3	28,3	34,4	39,0	40,0	41,0	48,3	55,8	.

Sources: Ministry of Finance (internal materials); Kameníčková, 2000.

Note: exchange rate of Czech crown (CZK) has been over the last ten years relatively stable, 1 EUR=approx. 30,5 CZK in December 2004.

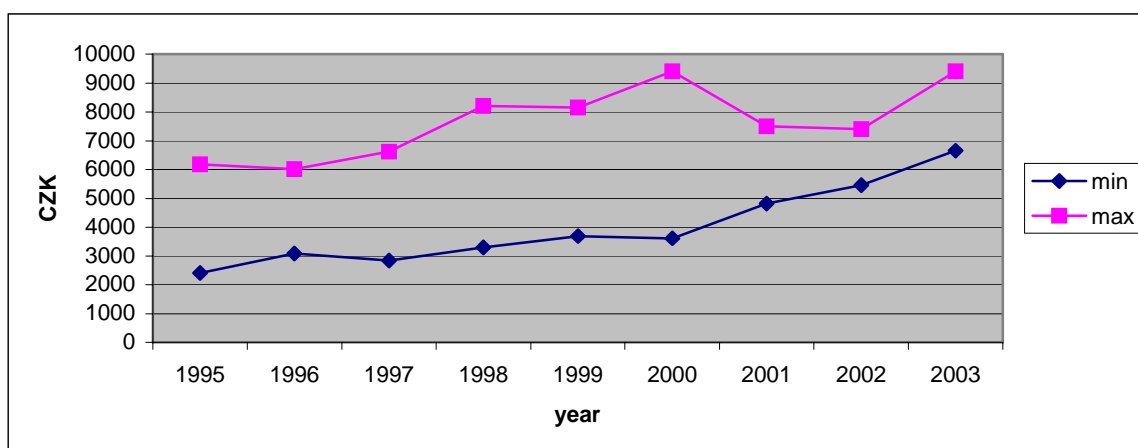
The high investment activity of the Czech local governments has been encouraged along with the acutely perceived need for developing of infrastructure also by three other factors. Firstly, the central government used to declare certain priorities in the sphere of local government investment (e.g. wastewater treatment plants or houses for elderly) and offered significant capital grants as an incentive to municipalities. Secondly, after few years of turbulent economic situation at the beginning of the transition, banks started to consider local governments as relatively stable and credible and, therefore, as low risk subjects. Consequently, the banks developed favourable lending conditions for municipalities (i.e. softer conditions for loans provision, more favourable interest rates etc.). Thirdly, in the first half of 1990s, municipalities got used to annual significant increases of their revenues in real terms (approx. 10% a year), and this contributed to the formation of pro-investment attitudes.

Finally, it should be stressed that over the last several years the sum of investment of local governments equals or even exceeds (it depends on a particular year) the capital expenditures of the central government in the state budget. This is rather a surprising observation that contrasts with frequent opinion claiming that the Czech Republic is a highly centralized country. For example in 1999, the capital expenditures of the central government (after exclusion of investment grants to local governments) amounted to 42 bln. while capital expenditures of the local governments reached 45 bln. CZK. In 2003, the capital expenditures of municipalities exceeded 71 bln. CZK, but for the first time slipped under 30% of total expenditures. Nevertheless, the investment activity of Czech municipalities remains quite high.

The negative side of the high rate of investment activity is a growing municipal debt. The municipalities have been generally considered as trustworthy creditors by the banks. Therefore, the “temptation” of the local representatives to use favourable lending conditions offered to them by the banks has been growing. Until 1997, the discussions about the possibilities to impose some barriers to further growth of the municipal debt had been mostly academic. However, in 1997, due to economic crisis and instability of financial markets, the Czech government decided to discourage municipalities from taking new loans. This was done in the form of a governmental resolution that conditions the provision of some of state grants by “healthy” financial management of the municipality concerned. Currently (2004), the central government investigates the question of possibilities to regulate municipal borrowing by a Law. Therefore, the contemporary practice is that the government does not provide grants to heavily indebted municipalities and is issuing warnings to such municipalities.

Basic comparison of disparities of per capita tax revenues of municipalities aggregated on the district level under different models of local government financing in the Czech Republic offer figure 7 and 8. Both figures illustrate clearly the radical decrease of inter-district variation spread in per capita tax revenues as a result of a new financial model implemented since year 2001. Sharp drop of maximum values (and less significant though still discernible drop of minimum values) recorded since 2001 captured in Figure 8 is a direct consequence of the reform leaving to municipalities only 30% instead of previous 100% of revenues of personal income tax paid by physical persons – entrepreneurs by which decision were severely affected municipalities with high concentration of entrepreneurs. Typical examples of such badly affected municipalities are those located in suburbs of Prague. It is necessary to stress that figures 7 and 8 show only data aggregated on district level. Therefore, the scale of disparities as well as the impact of particular financial reforms was much more profound on municipal level.

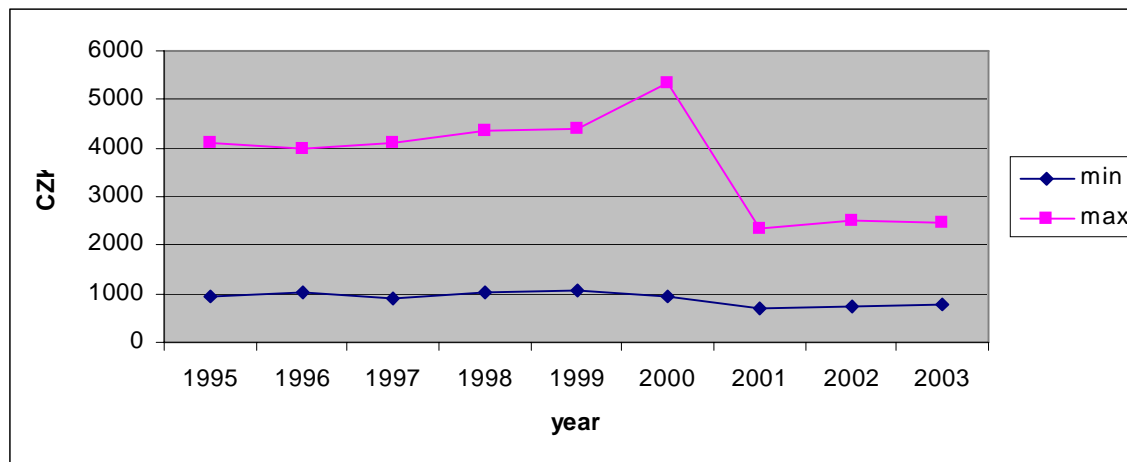
**Figure 7: The variation spread of per capita tax revenues according to districts<sup>35</sup> (the values for the district with highest and lowest per capita tax revenues).**



<sup>35</sup> The four city-districts with specific system of allocation of tax revenues were excluded from the analysis.



**Figure 8: The variation spread of per capita revenues of taxes that can be at least partially or indirectly influenced by particular municipalities<sup>36</sup> according to districts (the values for the district with highest and lowest per capita tax revenues).**



## 5. Concluding remarks

Since the beginning of the post-communist transition, the development of the system of financing for the Czech local government has been far from straightforward. The main reason for the frequent reforms of the system is the lack of a necessary broad agreement between the central government and representatives of the local government on the basic principles of the system's design. Paradoxically, the introduction of a new system of local financing in January 2001 with its extreme stress on the principle of solidarity is a reason for yet another reform of the local finances in the near future. The chronic instability of the Czech system of local government financing can be seen as one of its principle deficiencies. Therefore, it would be highly desirable to keep the system of local financing unchanged at least for one election term.

The problem created by the instability of the financial formula is made even more pressing by the fact that the main development priority of the Czech municipalities is investment in neglected or even non-existent infrastructure. Frequent and unanticipated changes of the system of municipal financing seriously hinder necessary multi-annual investment planning and financing of these large projects, and even cause difficulties in the municipal debt servicing. In contrast, the activities of municipalities in advanced western European countries are concentrated much more on „softer” measures such as development of human resources, including job creation and support to businesses. These spheres are still to be discovered by the Czech cities and municipalities and a system of local financing should provide stimuli for such a shift of priorities. The instability of the financial framework hampers not only investment activities, but it has also other, less tangible aspects. Firstly, the system should have to be considered by the majority of local representatives as fair, otherwise it would lead to dissatisfaction that undermines local participation and initiative. Secondly, the highly equalising system actually shifts the final responsibility for local development away from local people closer (or even back) to the state.

<sup>36</sup> Among these taxes were included property tax and part of personal income tax that is paid by physical persons-entrepreneurs which was until year 2000 allocated fully to municipality of permanent residence of particular entrepreneur.

Another major shortcoming of the Czech system of local government finances is a highly constrained discretion of the municipalities over their tax revenues. In fact, the new model replaces the majority of own resources only by a variant of a general grant. Looking further at the future, it is unlikely that the municipalities will be given some discretion over major taxes. However, the municipalities have already some space to manoeuvre as regards the property tax and there are also realistic proposals to increase the significance of this tax for the local government financing. This might be done by an increase of a relative size of revenues from the property tax within the whole taxation system, for example by changing the tax base from the size of property (as it is in present) to its market value. However, this would require costly large-scale evaluation procedure, which would be moreover hindered by insufficiently developed real estate market in some of the Czech regions.

The new system represents an extensive redistribution of sources and it serves as a good illustration of how the Czech Republic is still unable to strike a right balance between the principles of solidarity and the principle of meritocracy within the entire system of local government financing. Moreover, with the exception of the property tax (the revenues of which are moreover only marginal), the revenues allocated to the municipalities according to the new sharing system represent only a variant of a general grant. The introduction of this model shifts the Czech Republic back to the beginning of the post-communist transition in 1990 when local representatives were arguing that without a clear fiscal autonomy there could hardly be a real democracy at the local level.

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