

System of Czech local government financing as a framework for local development: 12 years of trial and error approach

JIŘÍ BLAŽEK

Charles University, Department of Social Geography and Regional Development, Prague

Abstract: The paper deals with the problems of setting up a system of local government financing in the Czech Republic. It starts with discussion of reasons for a decade of unsuccessful efforts in reforming local finances, then development of the system of local finances is elaborated, but core of the paper is devoted to analysis of current system of municipal financing. The article concludes that the new model of financing suffers not only from problems of a technical nature (e.g. the issue of coefficients used for distribution of shared taxes among municipalities of different sizes) but of much more conceptual problems. Finally, consequences of existing system of financing for local development are provided.

Key words: local government financing, reforms, municipalities, Czech Republic

1. Introduction

Unfortunately, the Czech Republic is probably keeping a world record as far as the number of reforms of systems of local government financing over the last 12 years is concerned. This creates many problems for local development as the instability of the financial system is hindering not only day to day management, but especially investment projects, not talking about implementation of 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 basic 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 adequate provision of public services on the whole territory of the state. 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 the current situation in the Czech Republic where local governments are primarily preoccupied with solving issues of neglected or even non-existent technical infrastructure.

The article introduces the main specific features of the Czech local government that are closely related to the issues of local government financing. It further outlines reform efforts

of the Czech system of local government financing with main focus on previous system. Then there follows the main part of the article that is devoted to an analysis of the current system of local government financing and also provides its critical examination. Finally, several recommendations and conclusions are drawn.

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). For reasons described above, 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 seized their existence due to their inability to set up even a single ballot list as enthusiasm for running local affairs by themselves faded away. Currently, (in 2001) there are 6251 municipalities in the Czech Republic (MMR, 2001). 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 current districts will be abolished (which is scheduled for 2003) and replaced by approximately 200 (i.e. three times higher number) smaller "districts" or microregions of municipalities empowered by III. 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 stimuli 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 assumed that the instability of the rules of the Czech local government financing will persist also in the future.

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 big 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).

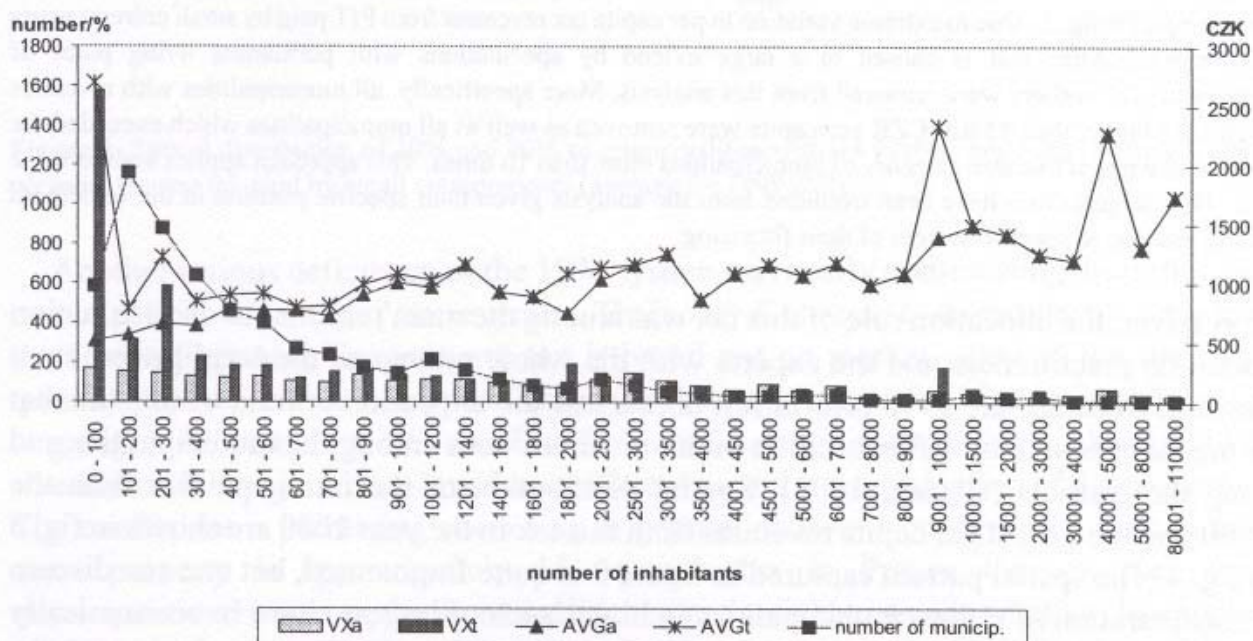


Figure 1. Revenues from PIT paid by small entrepreneurs according to population size categories of municipalities (per capita, average for 1999–2000)

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.

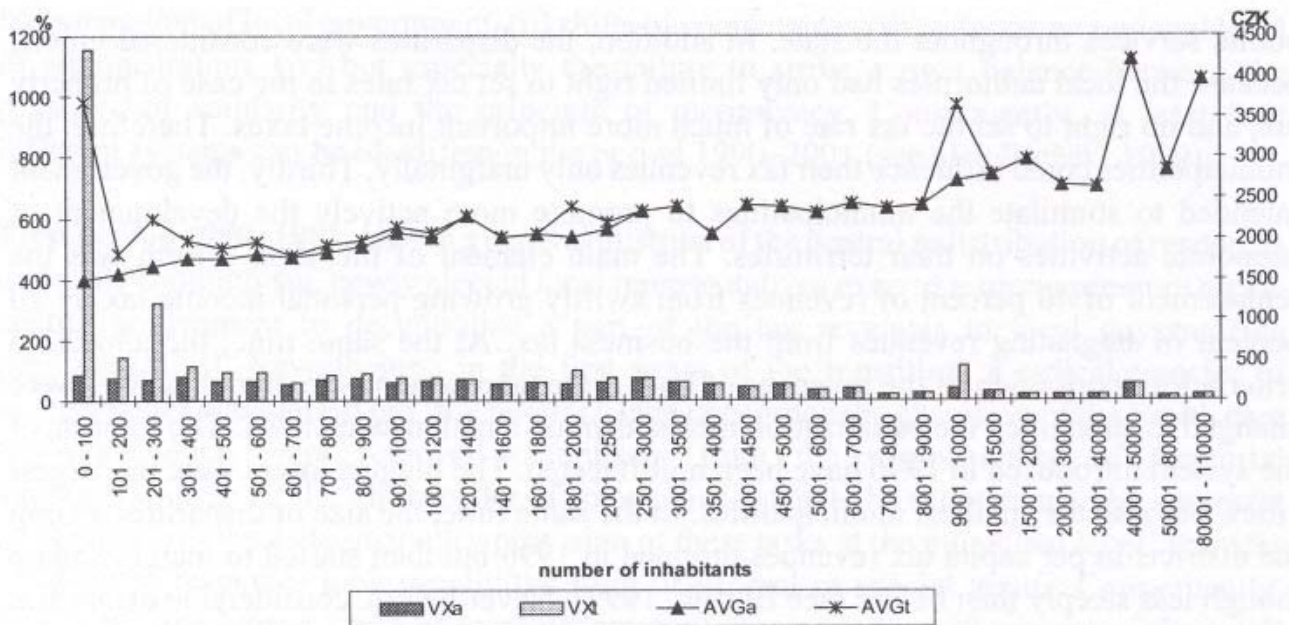


Figure 2. The sum of revenues from both parts of PIT and from property tax according to population size categories of municipalities (per capita, average for 1999–2000)

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

Note: see note for fig. 1. 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.

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. Because, the 1996 reform left untouched the allocation criteria of this tax that was the main source of differentiation in tax revenues both among the municipalities and among the districts (Blažek, 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).

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.

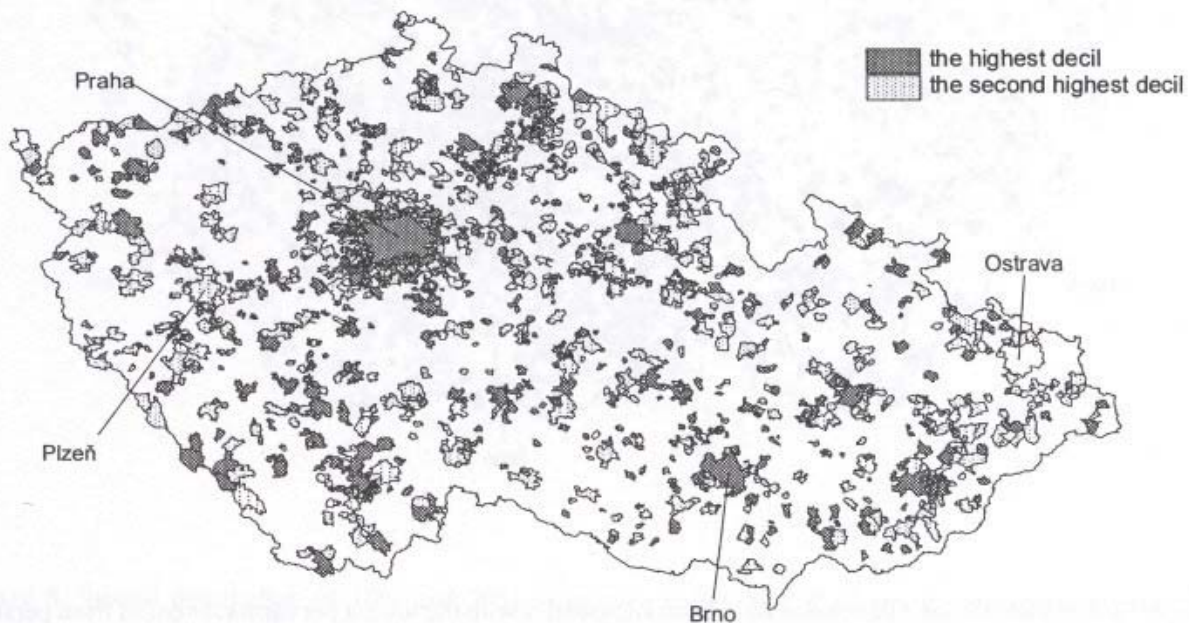


Figure 3. Spatial distribution of 10% and 20% of municipalities with the highest per capita revenues from the personal income tax paid by small entrepreneurs (average for 1999–2000)

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

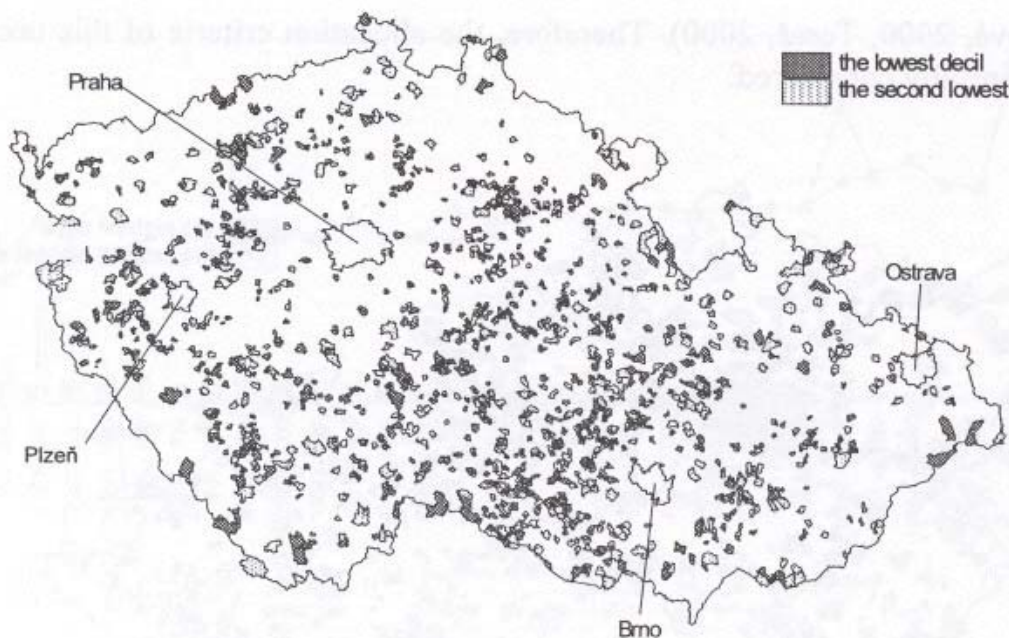


Figure 4. Spatial distribution of 10% and 20% of municipalities with the lowest per capita revenues from personal income tax paid by small entrepreneurs (average for years 1999–2000)

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. 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.

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.

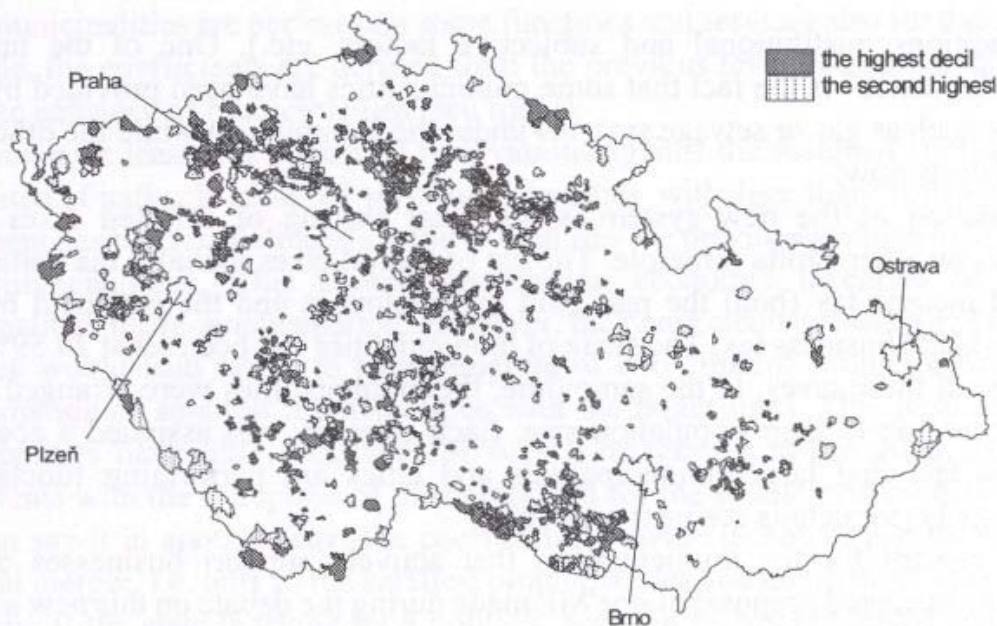


Figure 5. Spatial distribution of 10% and 20% of municipalities with the highest per capita revenues from property tax (average for years 1999–2000)

4. The current system of local government financing (2001 and further)

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

Tax	Share allocated to municipalities
Property tax	100% according to location of the property
VAT	20.59% of national revenues
Personal income tax paid by employees	20.59% of national revenues
Personal income tax paid by small entrepreneurs	20.59% of national revenues
Personal income tax paid by small entrepreneurs	30% of revenues paid by taxpayers who are permanently living in the municipality in question
Business tax	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 there was assigned a coefficient determining the actual volume of tax revenues. 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.

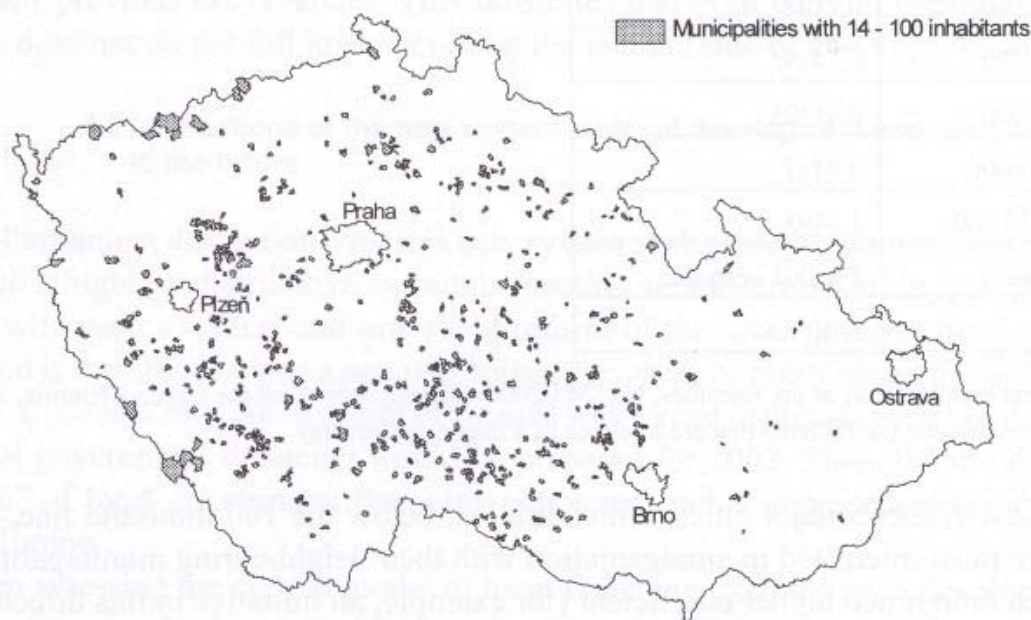


Figure 6. Distribution of small municipalities up to 100 inhabitants in the Czech Republic (year 2000)

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 – 1500	0.5881
1501 – 5000	0.5977
5001 – 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	0.81425
50 001 – 100 000	<u>0.8487</u>
100 001 – 150 000	<u>1.0393</u>
150 001 or more	150 001 or more
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 České 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 population between 50 and 80 ths. 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
Total revenues	92.8	106.8	114.6	123.9	137.9	169.4	162.6
Tax revenues	45.3	58.4	62.8	65.5	72.1	75.7	79.3
Total expenditures	95.5	110.8	123.5	129.2	136.3	150.0	164.0
Capital expenditures	32.1	39.1	43.1	42.1	41.3	45.5	56.8
Debt (loans, bonds, other)	13.8	19.9	28.1	34.4	39.2	40.3	41.4
Rate of inflation	10.0%	9.1%	8.8%	8.5%	10.7%	2.1%	3.9%

Sources: Ministry of Finance (internal materials); Kameníčková, 2000; Czech Statistical Office (inflation).

Note: exchange rate of Czech crown (CZK) has been over the last ten years relatively stable, 1 EUR=approx. 32 CZK in December 2001.

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.

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 conditioned the provision of some of state grants by "healthy" financial management of the municipality concerned. However, in December 2001, the central government submitted to the parliament a proposal of a new law regulating municipal borrowing. The most important point to be mentioned is the suggested provision that a municipality cannot take loan, which would increase its debt service over 15% of its budget.

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 financing 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.

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.

References

- BLAŽEK, J. (1994): Changing Local Government Finances in the Czech Republic - Half Way Over?, *GeoJournal* 32.3, pp. 261–267.
- BLAŽEK, J. (1995): Nový systém financování místní správy v ČR a jeho regionální dopady, CEFRES, Praha, str. 181–194.
- BLAŽEK, J. (1996): Financování místních rozpočtů v České republice od r. 1996: dilema mezi principem solidarity a zásluhovosti, In: Hampl, M.: *Geografická organizace společnosti a transformační procesy v České republice*, Přírodovědecká fakulta UK, Praha, str. 333–342.
- BLAŽEK, J. (1999): Local and Regional Development and Policy in the Czech Republic in the 1990s, In: Hudak, V., Huitfeldt, H., Meegan, E. (eds): *Regional Policy Goes East*, The East West Institute, Praha, str. 44–65.
- BROŽ, P. (2001): Diferenciace a vývoj daňové výtěžnosti obcí libereckého okresu, magisterská práce, Přírodovědecká fakulta UK v Praze, 103 str.
- BUČEK, J. (1996): Mesto, štát, územie, *Acta Facultatis Rerum Naturalium Universitatis Comenianae, Geographica* No. 36, pp. 127–250.

- CZYŻ, T. (1998): The territorial organisation reform and the regional structure of Poland, paper presented at Regional conference of IGU, Lisboa, August 1998, 12 p.
- DOSTÁL, P., KÁRA, J. (1992): Territorial administration in Czechoslovakia: an overview. In: Dostál, P. et al. (eds.): *Changing Territorial Administration in Czechoslovakia: International Viewpoints*, Univ. of Amsterdam, Amsterdam, 17–32 p.
- DOSTÁL, P., HAMPL, M. (1994): Changing economic base of Prague: towards new organizational dominance. In: Barlow, M., Dostál, P., Hampl, M. (eds.): *Development and Administration of Prague*, Univ. of Amsterdam, Amsterdam, str. 29–46.
- HAMPL, M., MÜLLER, J. (1998): Jsou obce v České republice příliš malé? *Geografie – Sborník ČGS*, Vol. 103, No. 1/1998, p. 1–12.
- HOGYE, M.: (ed) (2000): *Local and Regional Tax Administration in Transition Countries*, LGI Studies, Local Government Public Service Reform Initiative, Budapest, p. 490.
- HORWÁTH, T. M. (ed) (2000): *Decentralization: Experiments and Reforms*, LGI Studies, Local Government Public Service Reform Initiative, Budapest, p. 424.
- ILLNER, M. (1996): K otázce reprezentativnosti místních zastupitelstev (The question of representativeness of municipal boards), In: Hampl, M. (ed): *Geografická organizace společnosti a transformační procesy v České republice*, Faculty of Science, Charles University, Prague, p. 343–351.
- ILLNER, M. (1999): Territorial Decentralization: An Obstacle to Democratic Reform in Central and Eastern Europe? In: Kimball, J. D. (ed): *The Transfer of Power: Decentralization in Central and Eastern Europe*, The Local Government and Public Service, Budapest, p. 7–42.
- KAMENÍČKOVÁ, V. (2000): Hospodaření obcí v loňském roce, *Obec a finance*, 3/2000, p. 18–20.
- KÁRA, J. – BLAŽEK, J. (1993): Czechoslovakia: regional and local government reform since 1989, In: Bennett, R. J. (ed): *Local Government in the New Europe*, Belhaven Press, London, pp. 246–258.
- LEEMANS, A. F. (1970): *Changing patterns of local government*, IULA, Den Haag, 512 p.
- MUSGRAVE, R. A., MUSGRAVE, P. B. (1994): *Veřejné finance v teorii a praxi*, Management Press, Praha, 582 p.
- PERLÍN, R. (1996): Problematika organizace státní správy a samosprávy (Problems of state administration and self-government), In: Hampl, M. (ed): *Geografická organizace společnosti a transformační procesy v České republice*, Faculty of Science, Charles University, Prague, p. 315–332.
- SLAVÍK, V. (1998): Územnosprávné usporiadanie Slovenskej republiky v medzinárodných porovnániach, (Territorial administration of Slovakia in international comparison), *Geografia* No. 1/1998, p. 4–7.
- SURAZSKA, W., BLAŽEK, J. (1996): Municipal budgets in Poland and the Czech Republic in the third year of reform, *Environment and Planning C: Government and Policy*, 15, No. 4, p. 437–462.
- TESAŘ, L. (2000): Dnešní rozdělování daní je špatné, *Obec a finance* č. 2/2000, p. 14–15.

Other materials:

- Dexia (2000): *Local finance in 11 countries of Central, eastern and Baltic Europe*, Dexia Public Finance Bank, Paris, 197 p.
- MMR (2000): *Informace o změnách v územních identifikacích*, MMR ČR, 2001 (www.regionservis.cz).
- Předkládací zpráva k novému návrhu rozpočtového určení daní, Ministerstvo financí ČR, Praha, 1995, (interní materiál pro poslance).
- Předběžné výsledky Sčítání lidu 2001, ČSÚ, Praha, 2001.
- Územní rozpočty 1999, 2000, Ministerstvo financí ČR, Praha (database).
- Zákon o rozpočtovém určení daní, č. 243/2000 Sb.
- Založení operativního souboru hranic územního členění ČR v systému ARC/INFO, Terplan, ArcData, Praha, 1993.

Résumé

Příspěvek se zabývá důvody bezprecedentní nestability systému financování místní správy v ČR, přičemž nestabilita pravidel financování je společně s velmi omezeným podílem vlastních příjmů ve smyslu teorie fiskálního federalizmu považována za hlavní nedostatky tohoto systému. Za hlavní příčinu neúspěšných pokusů o vytvoření stabilního systému financování místní správy autor považuje skutečnost, že mezi klíčovými aktéry nebylo dosaženo ani rámcové shody na řešení dilematu mezi principem solidarity a principem zásluhovosti. Teprve pak následují důvody vyplývající z velké horizontální fragmentace místní správy v ČR a důvody související s rušením krajského stupně správy na počátku 90. let a se znovuzřízením tohoto stupně správy o 10 let později.

V první části příspěvku jsou shrnuty hlavní rysy financování místní správy v jednotlivých obdobích (1990–1992, 1993–1995, 1996–2000) a diskutovány důvody, které vedly vždy k dalším radikálním reformám. Na základě údajů z let 1999 a 2000 byly analyzovány regionální rozdíly v daňových příjmech i rozdíly v rámci jednotlivých velikostních kategoriích obcí.

V další části je analyzován současný systém financování místní správy, který je jednostranně založen na principu solidarity. V textu jsou uvedeny argumenty, které zpochybňují nejen oprávněnost takto koncipovaného systému financování, ale i argumenty, které zpochybňují reálnost dosažení stejné úrovně a kvality poskytovaných služeb na území celého státu. Pokud jde o dílčí výhrady k novému systému financování je diskutován zejména způsob stanovení velikostních kategorií a jim přiřazeným koeficientům. Velikostní kategorie byly stanoveny zcela formálně bez ohledu na strukturu osídlení, což se nejvíce projevilo v případě velikostní kategorie 50–100 tis. obyvatel. Právě skupina výrazných regionálních center s počtem obyvatel těsně pod hranicí 100 tis. obyvatel má paradoxně největší zájem na sloučení s jinými obcemi, aby tak dosáhla zvýšení sdílených daňových příjmů o cca 20 %. Naopak stanovení záměrně nižšího koeficientu pro obce do 100 obyvatel, které mělo vytvořit ekonomický tlak na jejich slučování se zatím ukázalo jako neúčinné. Značný počet těchto malých obcí se navíc nachází v relativně chudých periferních oblastech (viz obr. 6), takže nový systém financování je v přímém protikladu k jiným státním programům, jako je např. Program obnovy venkova.

Pokud jde o výhled na budoucí vývoj systému financování v ČR, již několik let je připravován návrh na zvýšení motivační složky v systému místních rozpočtů, neboť současný systém poskytuje obcím zcela minimální podnět pro řešení otázek zaměstnanosti a rozvoje podnikání na jejich území. Další reforma systému financování však dále zvýší nestabilitu systému a obtížnou předvídatelnost příjmů obcí, což bude mít důsledky nejen na investiční aktivitu obcí a na realizaci víceletých rozvojových strategií, ale mohlo by mít i závažné důsledky pro čerpání prostředků ze strukturálních fondů po našem vstupu do EU. V tomto kontextu je také upozorněno na nebezpečí, kterému se vystavují obce, které jsou v současnosti výrazně zadluženy, neboť míra zadlužení bude muset být v blízké době regulována s ohledem na plnění maastrichtských kritérií. Zkušenosti ze stávajících členských států EU přitom ukazují, že obce si velmi často pro zajištění nezbytné míry spolufinancování podpůrných programů EU zajišťují úvěry. Vysoké zadlužení některých obcí v současnosti jim tak může zabránit v přístupu k velmi výhodným podpůrným programům po našem vstupu do EU.

Zásadním problémem, který se v postkomunistickém období nepodařilo vyřešit je velmi malý podíl vlastních příjmů obcí. Je proto nutné, aby připravovaná reforma místních financí rozšířila prostor obcím k ovlivňování výše vlastních příjmů.