

**ECONOMICS DEPARTMENT**

**ENHANCING ADMINISTRATIVE AND FISCAL DECENTRALISATION IN THE CZECH REPUBLIC**

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## Abstract/Résumé

### Enhancing administrative and fiscal decentralisation in the Czech Republic

There is considerable regional variation in incomes and poverty in the Czech Republic and gaps have grown over time. With the highest number of municipalities per head in the OECD, subnational government is very fragmented and the resulting lack of capacity at the local level reduces the quality of public services and impedes the uptake of effective development projects. This paper discusses various policy options to address the challenges faced by Czech subnational governments and proposes reforms to enhance their effectiveness. Mergers of municipalities would be an obvious way towards greater integration, but this may be politically difficult. Mandating inter-municipal co-operation over a legally defined set of public services can be an alternative way of improving efficiency and the quality of service delivery. Tweaking the tax sharing system to disincentivise small size of municipalities and to make subnational governments more autonomous could be steps towards higher efficiency. Improving and consolidating the delivery of education and health services at the local level is also needed in the context of demographic change.

This Working Paper relates to the 2020 OECD Economic Survey of Czech Republic (<http://www.oecd.org/economy/czech-republic-economic-snapshot/>)

JEL classification: E62, H70, H71, H72, H77, I18, I28, R1

Keywords: local government, decentralisation, administrative fragmentation, municipal mergers, municipal cooperation, public services

### Renforcer la décentralisation administrative et fiscale en République tchèque

Des différences régionales importantes de revenus et de pauvreté existent en République tchèque et les écarts se sont creusés avec le temps. L'administration infranationale est très fragmentée et le pays enregistre le plus grand nombre de municipalités par habitant dans l'OCDE. Le manque de capacités qui en résulte au niveau local réduit la qualité des services publics et empêche l'adoption de projets de développement efficaces. Ce document examine diverses options politiques pour relever les défis auxquels sont confrontés les gouvernements infranationaux tchèques et propose des réformes pour améliorer leur efficacité. Les fusions de municipalités constitueraient une voie évidente vers une plus grande intégration, mais cette option peut s'avérer politiquement difficile à mettre en oeuvre. Mandater la coopération intercommunale pour un ensemble de services publics légalement défini représente un autre moyen d'améliorer l'efficacité et la qualité de la prestation des services. Ajuster le système de partage des impôts pour décourager les municipalités de petite taille et rendre les administrations infranationales plus autonomes pourrait être un pas vers une plus grande efficacité. Il est aussi nécessaire d'améliorer et de consolider la prestation des services d'éducation et de santé au niveau local dans le contexte du changement démographique.

Ce Document de travail a trait à l'Étude économique de l'OCDE de la République Tchèque 2020 (<http://www.oecd.org/fr/economie/republique-tcheque-en-un-coup-d-oeil/>)

Classification JEL : E62, H70, H71, H72, H77, I18, I28, R1

Mots clés : gouvernement local, décentralisation, fragmentation administrative, fusions municipales, coopération municipale, services publics

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# Enhancing administrative and fiscal decentralisation in the Czech Republic

By Urban Sila and Christine de la Maisonneuve<sup>1</sup>

## Introduction

Incomes and poverty vary significantly across regions in the Czech Republic and inter-regional gaps have grown over time. The population is ageing and declining in many rural areas, reducing the school-aged population and increasing the demand for public services such as health and long-term care, while at the same time putting pressures on resources to deliver them. The highly fragmented territorial administration of the Czech Republic does not help in this regard. There is a very high number of municipalities, which makes coordination difficult. In addition, the small size of many municipalities results in low capacity at the local level and a lack of economies of scale that compromise service quality and raise costs.

After the COVID-19 crisis, the need to ensure long-term fiscal sustainability will put the efficient use of resources more strongly to the fore. Subnational governments showed healthy fiscal balances for many years, but a drop in revenues during the crisis puts pressures on local budgets. In this context, enhancing access to high-quality services across regions and municipalities is needed to address economic and social challenges in the wake of the COVID-19 pandemic and to ensure that vulnerable people and areas are not left behind. In this regard, a well-resourced local administration can help to accelerate economic recovery, notably by effectively undertaking productive investment projects.

This paper addresses the challenges faced by Czech subnational governments and proposes reforms to enhance their effectiveness. The first section describes the basic features of the territorial division and distribution of responsibilities among different levels of government. The second section discusses challenges that arise from the fragmented territorial division. The section that follows reviews inter-municipal co-operation and suggests ways to improve the system. Section four discusses the impact of the COVID-19 crisis on fiscal balances, fiscal arrangements and the level of fiscal autonomy of Czech subnational governments. The last two sections discuss the delivery of education and health and long-term care services at the local level, under demographic pressures.

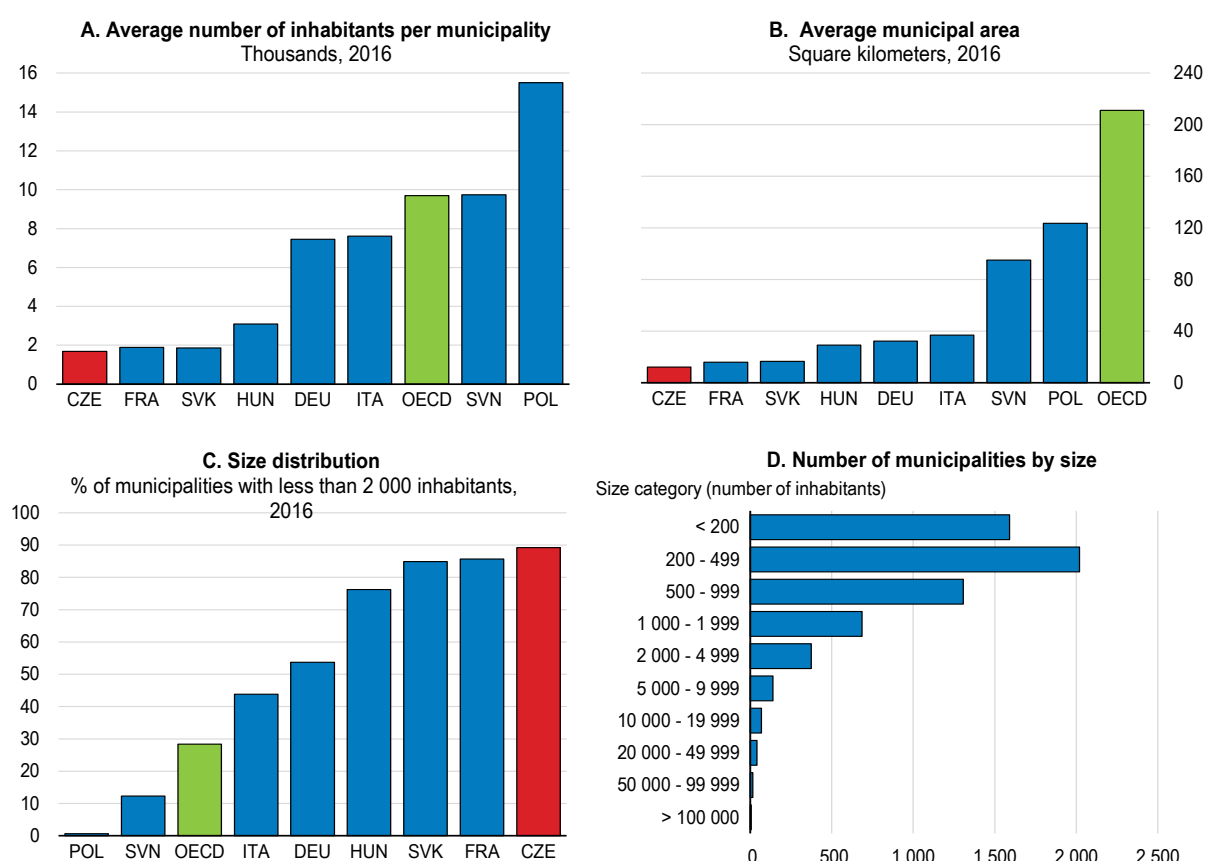
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## A fragmented and complex territorial division

The Czech Republic's administrative organisation is fragmented with a high number of very small municipalities, potentially reducing economies of scale and compromising service quality. With 6 254 municipalities (not counting military districts), the average municipality size is the lowest among OECD countries in terms of both population and area (Figure 1, panels A and B). Almost 90% of municipalities have fewer than 2 000 inhabitants and close to one quarter of municipalities have a population below 200 (Figure 1, panel B and C). The median size of a municipality is 426 inhabitants (Ministry of the Interior, 2018).

Figure 1. Municipalities are very small



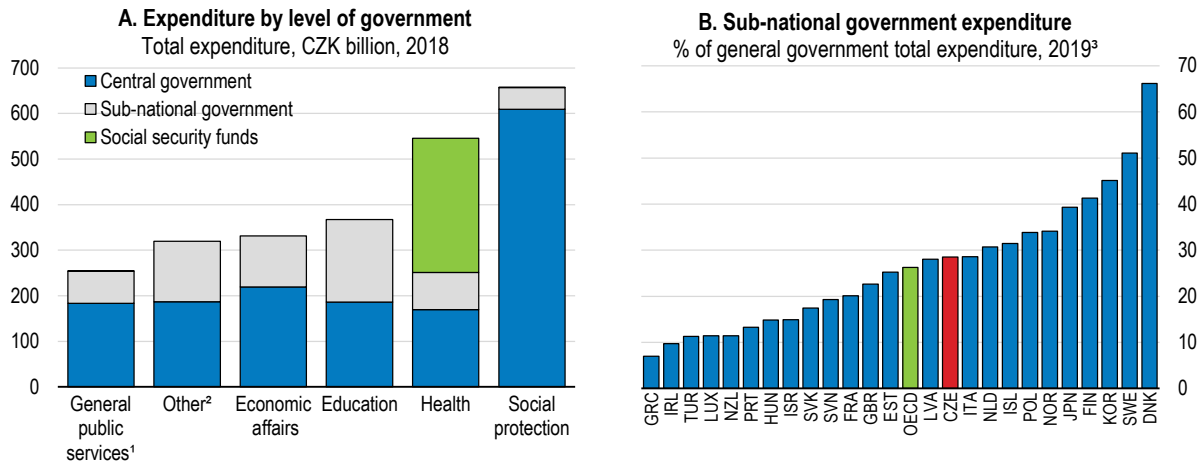
Source: OECD Subnational Government Structure and Finance database; Ministry of the Interior of the Czech Republic.

Contrary to experience in many other OECD countries, fragmentation has increased over the past decades, partly due to historical reasons. After the 1989 “Velvet Revolution”, the centralised system was abolished and municipal self-government was restored. This resulted in a steep rise in the number of municipalities: there were 4 100 municipalities in 1990, 6 097 in 1992 and 6 230 in 1994. Growth in the number of municipalities eventually stopped in 2000, after a requirement of at least 1 000 inhabitants for the creation of a new municipality was introduced.

There are fourteen administrative regions in the Czech Republic (including the capital city of Prague, which has a special status as a region and municipality), which are also small by international standards. Most of the regions are not big enough to qualify as NUTS2 regions for EU-regional funding purposes. Only three regions are stand-alone EU-funding units. Consequently, combinations of regions have been formed for this purpose, adding a layer of complexity to regional administration and policymaking.

Overall, sub-national spending accounts for about one-quarter of general government expenditure, close to the average for OECD unitary countries (Figure 2, panel B). However, even in cases where much of the funding is covered by the state or social funds, local governments are often responsible for setting up, investing and managing the delivery of services. Autonomy and discretion in service delivery of local governments varies across sectors in terms of responsibilities and autonomy over revenues (Table 1).

**Figure 2. Subnational governments spending is comparable to the OECD average**



Note: OECD refers to an unweighted average of available OECD unitary countries.

1. Executive and legislative organs, financial, fiscal, external affairs, foreign economic aid, general services, basic research, R&D related to general public services, public debt transactions and transfers of a general character between different levels of government.

2. Public order and safety, defence, environment protection, housing and community amenities, recreation, culture and religion.

3. Or latest available year.

Source: OECD National Accounts database.

Czech local governments are responsible for the delivery of many key services. Key spending items at the local level include education, economic affairs (transport), and other spending such as waste and wastewater treatment (Figure 2, panel A). Municipalities have greater spending responsibilities than regions. They are responsible for education up to lower secondary school, social services including housing, energy, water infrastructure and waste services. In health care, spending is largely covered by social security funds, but regions are responsible for hospitals and municipalities for health centres and small hospitals.

Municipalities and regions also perform public administration functions delegated to them by the state (Figure 3). The varying degrees to which state administration is delegated to different types of municipalities adds complexity. All municipalities perform a basic scope of delegated competencies on the area of the municipality (type I), but there are two more categories of municipalities, depending on the degree of transfer of state administration: type II – “Municipalities with authorized office” (338) and type III – “Municipalities with extended powers (MEPs)” (205). The latter form the so-called micro-regions and carry out a selected list of delegated competencies also for other municipalities in their respective micro-region (Box 1).



**Table 1. Main responsibilities at the municipal, regional and central levels**

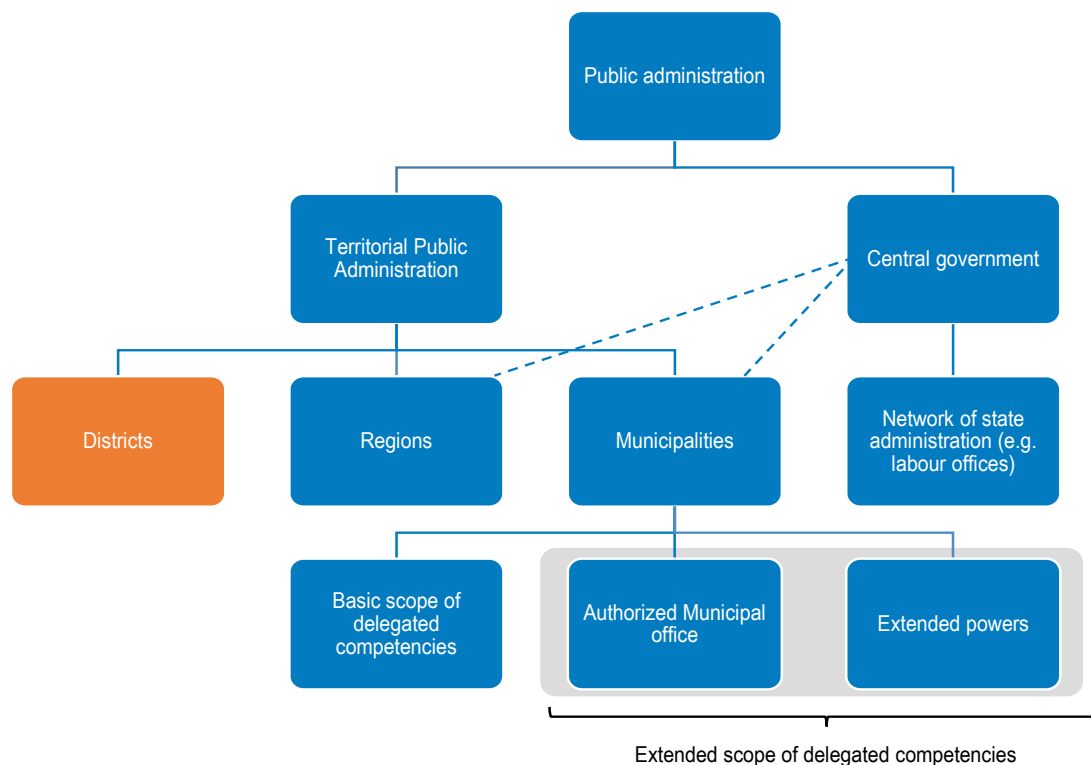
Own responsibilities	Central government responsibilities	Autonomy over revenues
<b>Education</b>		
Provision of early childhood education (municipalities) Primary schools (municipalities) Secondary schools (regions). Some aspects of human resources but most is delegated to schools	Sets national education strategy, per capita financing and standardised tests Provides building grants	School financing is based mainly on the number of lessons taught. Tax revenue of municipalities received via the tax sharing formula includes the number of pupils in kindergartens and primary schools with a weight of 9%. There are no user charges.
<b>Health</b>		
Opening and closing of hospitals (regions) Opening health centres (municipalities) Staffing levels	Determines treatment covered and the cost to insurance funds Provides investment grants Sets nation-wide pay	Funding is from the health insurance scheme and earmarked investment grants There are some small user charges.
<b>Economic affairs</b>		
Secondary (regions) and local roads (municipalities). Public transport	Sets technical standards for roads and prices for public transport	Funding comes from the sub-national government (SNG) resources and from tax revenues via the tax sharing formula. State provides some earmarked investment grants. Control over public transport fares is constrained by centrally set ranges.
<b>Social protection</b>		
Administration of social benefits on behalf of central government (municipalities) Level and quality of public housing (municipalities)	Sets parameters for social benefits There is no national definition of social housing but a national policy is planned	Transfers are received for costs of administering benefits and not earmarked. There are limited user charges. Housing investment grants are earmarked.
<b>Utilities</b>		
Water and waste management (municipalities with extended powers)	Sets standards following EU requirements Sets part of water price	User charges are an important source of revenue.

Source: Updated version of table 4 in OECD (2016a).

An efficient allocation of delegated power is impeded by the excessive fragmentation of municipalities in the Czech Republic. The allocation of delegated powers could be changed so that they are exercised only by municipalities of the second and third types, which have sufficient personnel and financial capacity to perform those functions. The new government strategic document, “Client’s oriented public administration 2030” (Government Resolution no. 562/2020), includes a plan to transfer some of the competencies of delegated powers to the type II municipalities, which would be a step in the right direction.

State administration tasks that were previously performed by district offices were mostly transferred to the municipalities with extended powers after the 2002 decentralisation reform. However, districts have not been fully abolished, adding to the overlaying and complicated territorial structure. In 2020, an Act on Territorial Division of the State was passed by the parliament to complete the transition from districts to municipalities in order to streamline the system and raise efficiency, effective from January 1<sup>st</sup>, 2021.

Figure 3. The structure of public administration is complex



Note: Dotted lines are for delegated competencies. Districts have been replaced by municipalities with extended power but in practice remain. Municipalities with an Authorized Municipal Office carry out fewer delegated competencies.  
Source: Ministry of the Interior of the Czech Republic (Ministry of the Interior, 2018).

### Box 1. Delegated and independent competencies of municipalities

Municipalities' delegated competencies depend on the size and capacities of municipalities. They form 3 types of municipalities. In parentheses, the number of municipalities concerned.

#### Delegated competencies

##### **Type I : Basic delegated power (6254)**

- Dealing with offenses (e.g.: minor disorderly conduct, traffic);
- Ensuring elections;
- Population records;
- Water management;
- Road authority.

##### **Type II : Municipalities with authorized office (388)**

###### **Type I competencies plus**

- Building authority (e.g.: delivery of building permits) (some are also located in Type I municipalities);
- Registry office (some are also located in Type I municipalities);
- Selected agenda on environment and agriculture;

- Social work/assistance;
- Administering war graves.

### **Type III : Municipalities with extended powers (205)**

#### **Type I + II competencies plus**

- Issuance of ID cards, travel documents, driving licenses, trade licenses;
- Management of the register of motor vehicles and the population register;
- Coordination of the provision of social services.

#### **Independent competencies (6254)**

- Management of the municipality and the municipal office;
- Issuance of generally binding decrees;
- Territorial and regulatory plan of the municipality;
- Setting local fees;
- Establishment and management of nursery, elementary and basic art schools;
- Inter-municipal co-operation.

Source: Ministry of the Interior, 2018.

## **Administrative fragmentation increases costs, constrains the quality of services and reduces capacity at the local level**

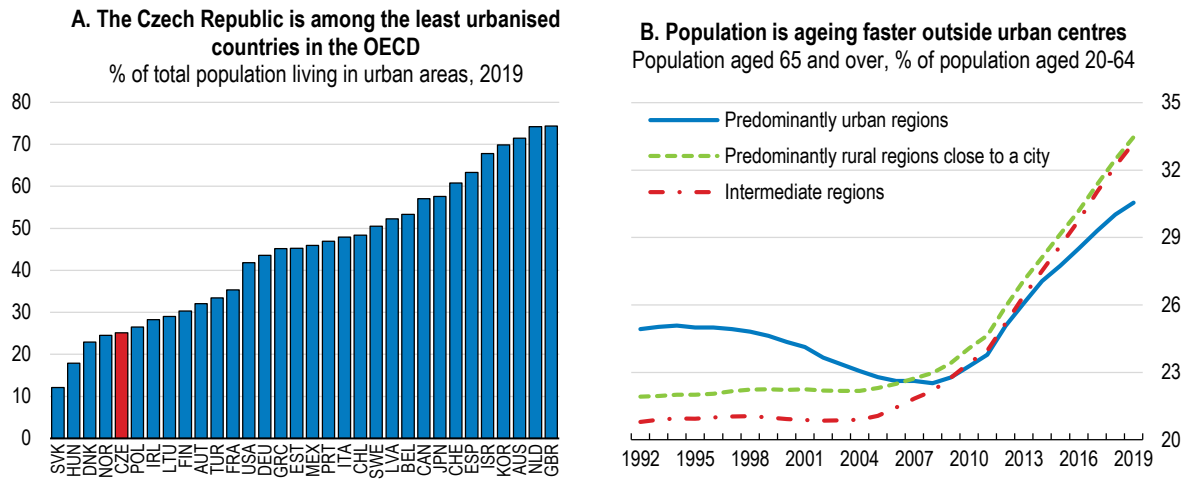
Small units of government make it more difficult to exploit economies of scale in public administration and service provision. A high number of territorial units and overlaying administrative structures make coordination of policies more difficult. It is also difficult for small municipalities to attract and pay sufficiently skilled staff to undertake more complex procurement and investment projects. These factors contribute to the overall below average public spending efficiency in the Czech Republic, in particular in the domain of general public services (Dutu and Sicari, 2016).

International evidence suggests a U-shaped relationship between the costs of service provision and the size of municipalities. Municipalities with more than 250 000 inhabitants or with fewer than 20 000 – 25 000 (well beyond the size of most Czech municipalities) appear less efficient (Holzer et al., 2009; McKinlay Douglas Limited, 2006). Very small size brings additional costs. In Spain, per capita total expenditure has been estimated to be 20% higher in municipalities with 1000 inhabitants compared to those with 5000 inhabitants (Solé-Ollé and Bosch, 2003). In Switzerland, costs have been found higher and service quality lower in municipalities with less than 500 residents (Ladner and Steiner, 2003).

The nature of economies of scale differs for different services. Small municipalities face a loss of economies of scale especially in capital-intensive services. Labour-intensive services such as police, fire and education, on the other hand, can be efficient also in smaller governments (Holzer et al., 2009).

The cost of public service provision also increases in remote and more sparsely populated areas (OECD, 2017a; OECD, 2018a). Sparsity was found to be associated with higher service delivery costs in rural areas in the United Kingdom (Ranasinghe, 2014). The Czech Republic is among the least urbanised of OECD countries (Figure 4, panel A), and many Czech municipalities with a small number of residents are remote and sparsely populated, raising costs. In addition, population tends to be older in rural areas compared to cities (Figure 4, panel B), requiring different and potentially more expensive public services. This is set to worsen over time as remote and rural areas will experience further depopulation and ageing.

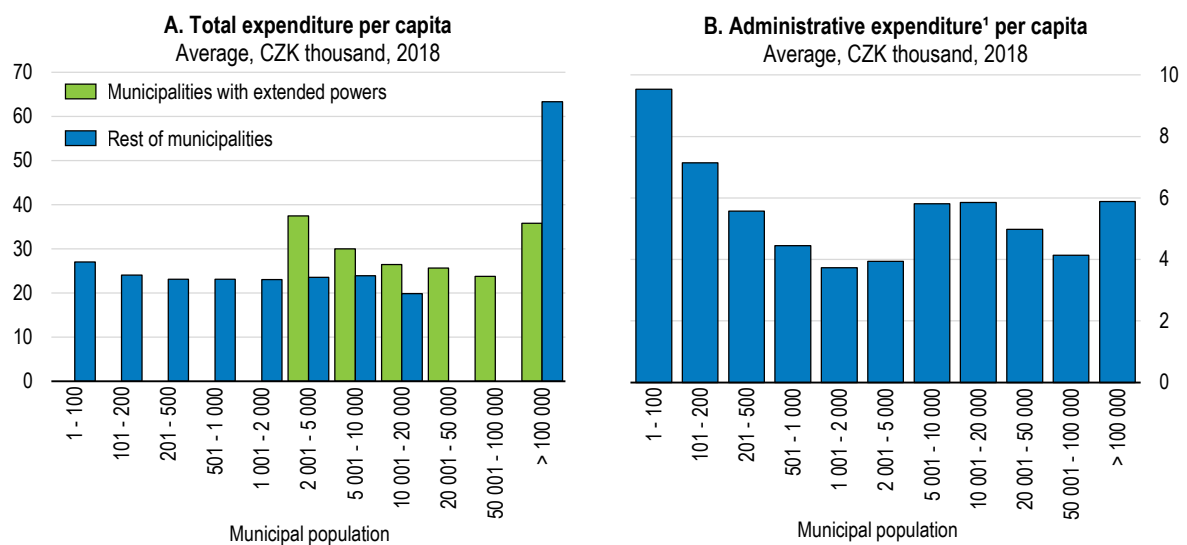
Figure 4. Share of urbanisation is low and population is ageing faster in rural areas



Source: OECD Regional Statistics database.

In the Czech Republic, total municipal expenditure per capita shows a slight U-shape pattern (Figure 5, panel A). However, making comparisons is difficult, as big cities tend to provide a full range of services, while very small municipalities simply do not provide some services. Comparisons of total expenditure are further complicated by the fact that different types of municipalities cover different ranges of delegated public administration functions. In this regard, it is telling that municipalities with extended powers, which in the domain of delegated state functions provide the same basket of services, also show a U-pattern in expenditure per capita. Narrowing the focus on administrative expenditures only, the U-shape pattern described above becomes more pronounced (Figure 5, panel B), with a decline in the cost per capita up to the population of 1000 – 2000. Overhead costs therefore affect the efficiency of very small municipalities and leave them with smaller financial resources for other services.

Figure 5. Expenditure per capita is higher in small municipalities

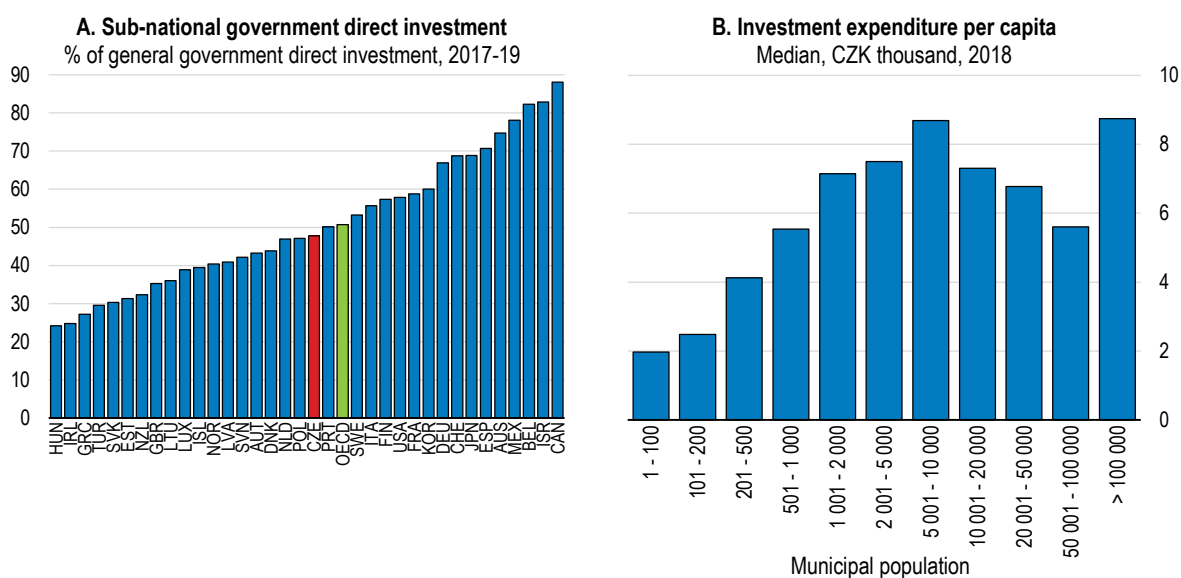


1. Data refer to sectorial expenditure in state power, state administration, local government and political parties.  
 Source: Ministry of Finance.

The small size of municipalities also brings problems of low capacity. The lack of adequate skills and low administrative capacity in small municipalities is particularly acute when dealing with specialised areas such as investment projects and procurement, contributing to the lower number and lower quality of projects. Sub-national governments in the OECD on average perform about half of all public investment (figure 6, panel A). They invest in roads, energy supply, water management, schools and hospitals, among others. Yet, evidence shows that in the Czech Republic, investment per capita in small municipalities (with less than 500 inhabitants) is less than half of investment per capita in mid-size (5 000 – 10 000 inhabitants) or large municipalities (over 100 000 inhabitants) (Figure 6, panel B).

There are no indicators about the cost and quality of public service provision across Czech municipalities and regions. Such indicators would contribute to enhancing the efficiency and effectiveness of local service delivery by helping the central government to assess performance, allow benchmarking and identify potential for efficiency improvements across the country. Some OECD countries such as Australia, Denmark, Italy and Norway compile and publish such indicators (Mizell, 2008 and Fadic et al., 2019). For example, in Norway, the KOSTRA system has brought several benefits to Norwegian municipalities. It has provided municipalities with a tool for internal planning, budgeting, and benchmarking. It has also helped the central government to assess if municipalities are complying with national standards and regulations (OECD, 2010a). In Italy, an online portal, OpenCivitas, has been set up to collect public administration efficiency indicators, and it provides a large number of detailed data on the performance of local governments (municipalities, provinces and regions) based on actual expenditures and public services provided. The collection of this data is legally mandated at regular intervals (Fadic et al., 2019).

**Figure 6. SNGs are important investors, but small municipalities invest comparatively less per capita**



Note: Direct investment includes gross capital formation and acquisitions, less disposals of non-financial non-produced assets. OECD refers to an unweighted average for available OECD countries.

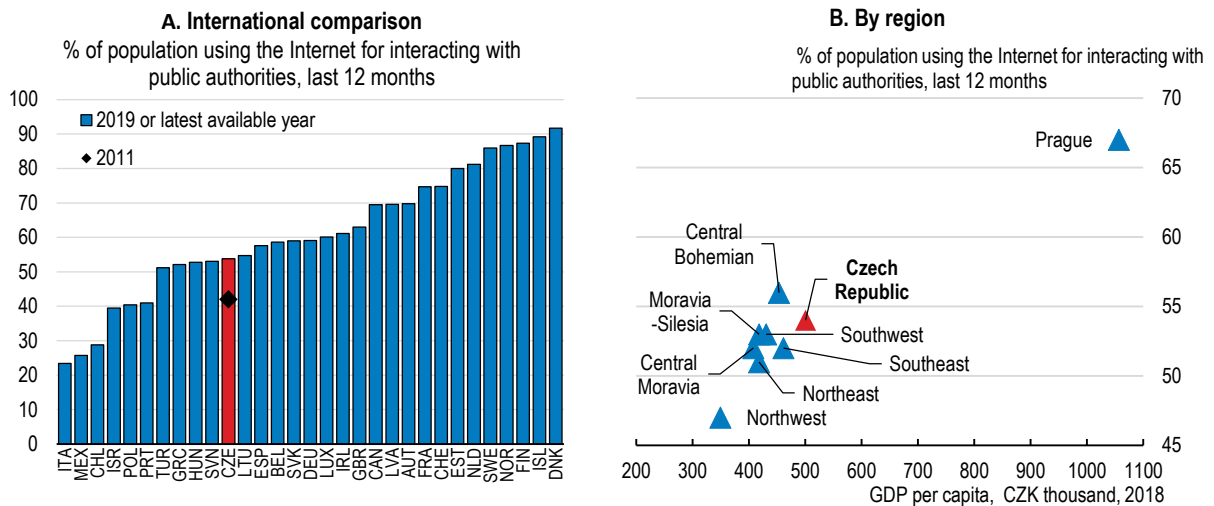
Source: Ministry of Finance; OECD National Accounts database.

The Ministry of the Interior has supported various pilot projects on collecting detailed cost and output data on state administration and other public services at the sub-national level, as reported in previous Surveys (OECD, 2006 and 2011). However, these benchmarking projects have had limited participation and the indicator database has not been made public. The government should introduce further

incentives for participation and step up efforts to make the systematic collection of cost and output data of public service delivery at sub-national level a comprehensive nationwide system. Yet, this could be a high burden for very small municipalities, and difficult to manage due to the very high number of municipalities. It is nevertheless important to improve transparency, enhance data collection and strengthen performance monitoring. More systematic benchmarking could therefore be done at the level of regions and municipalities with extended powers.

Capacity at the local level and quality of public administration can be strengthened by higher skills-building among local employees, and greater use of digital technologies and e-government, which can be especially beneficial for sparsely populated areas. In recent years, the government launched two initiatives to promote the development of e-government: the Strategic Framework of the Development of Public Administration in the Czech Republic followed by Digital Czechia. The latter aims to provide user-friendly and efficient online services for citizens and businesses, increase staff capacities and competencies in public administration and provide an efficient and centrally coordinated Information and Communication Technology (ICT) system for public administration (European Commission, 2019). However, the use of the internet to communicate with public authorities has room for improvement, especially in certain regions (Figure 7). Access to internet broadband connection is unequal across regions and cities, impeding the use of e-government by a higher number of residents.

Figure 7. The use of e-government could be increased



Source: OECD ICT Access and Usage by Households and Individuals database; Eurostat database [isoc\_r\_gov\_i]; OECD Regional database.

Administrative capacity can be raised also through lifelong training and higher professionalism of local administrative staff. Reinforcing the expertise of public officials and institutions has been shown to foster public investment at the local level (OECD, 2014a). A recent OECD review on Making decentralisation work (OECD, 2019a), lists a number of measures through which the central government can support capacity building at the subnational level. The central government should assess capacity challenges in different regions on a regular basis, adapting policies to the needs of various territories. The aim should be to reinforce the capacities of public officials and institutions in a systemic and sustainable way, rather than offering technical assistance on a case-by-case basis. Open, competitive hiring and merit-based promotion, as well as offering competitive salaries, could also help raise professionalism of local staff.

## Encouraging mergers and mandating inter-municipal co-operation to tackle fragmentation

Merging small municipalities is an obvious solution to administrative fragmentation, but can be politically challenging. Inter-municipal co-operation is another way of overcoming fragmentation and is common in the Czech Republic. However, inter-municipal co-operation is unstable, relies on external funding and mostly focuses on one-time investment projects rather than effective delivery of recurring public services. Mandating inter-municipal co-operation over a legally defined set of public services - in the area of micro-regions - can be an effective way of improving efficiency and the quality of service delivery. Eventually, this can be accomplished more durably by transferring competencies for service delivery to a higher level of territorial administration (municipalities of extended powers and their micro-regions), effectively introducing an intermediate layer of subnational government.

### ***Mergers of municipalities should be encouraged***

Many OECD countries have reformed their fragmented territorial administration, by successfully merging municipalities, despite initial political resistance (Box 2). Mergers can be politically difficult as they are seen as weakening local democracy and accountability and potentially threatening public jobs. In Nordic countries, especially Denmark, Norway and Sweden, successive waves of mergers have drastically reduced the number of municipalities (OECD, 2014b). In the Netherlands and Switzerland, municipal mergers have been more of a gradual process. Mergers can be made mandatory as in Denmark, Greece, Japan and New Zealand or voluntary as they were in France and Norway. Some countries encouraged mergers by keeping the former municipal administration with a sub-municipal status, like in Korea, the United Kingdom, New Zealand, Ireland and Portugal or in France with the delegate mayors (OECD, 2017b).

### **Box 2. Experience of municipalities' mergers in selected OECD countries**

Municipal mergers have been considered or implemented in most OECD countries over the past 15 years to, inter alia, generate economies of scale and scope, generate cost savings and internalise spillovers in the provision of local public services; to adapt to demographic change and to increase municipal administrative capacities.

#### **Compulsory approach:**

Mergers were made mandatory in Japan (1953-1999), New Zealand (1989), Denmark (2007), Greece (2011) and Turkey (2008 and 2012). Forced mergers were implemented either through strict pre-determined plans and targets (for instance, a determined targeted number of municipalities after the reform) or with more flexible objectives.

**Japan (up to 1999):** Strict pre-determined targets were used. Several waves of mergers drastically reduced the number of municipalities, from 9 868 in 1953 to 1 741 in 2017-2018 (OECD, 2018b).

**New-Zealand:** Strict pre-determined targets were used. Before the consolidation process, the local government sector was characterised by high fragmentation and wide disparities in size and activities, both at regional and local levels. An independent commission, the Local Government Commission, had the responsibility to supervise the reform process.

**Denmark:** The approach was characterised by some level of flexibility. Realigned responsibilities and financing changes drove a bottom-up process of amalgamation. A lower size limit of 20 000 was imposed. Local authorities were free to choose the neighbouring municipalities with which to merge. The central government gave municipalities six months to prepare their merger plans, with the implicit



threat of intervening and imposing mergers in cases of non compliance. The number of municipalities fell from 271 to 98 in 2007. At the same time, 13 counties were replaced by 5 regions.

**Greece:** More competencies and resources were given to the new municipalities. The number of municipalities was reduced from 1 033 to 325. Also, 54 departments were replaced by 13 regions, including two metropolitan regions.

#### **Voluntary approach:**

Norway, Iceland, Luxembourg, Netherlands, Finland ("PARAS" reform) and Japan (after 1999) chose the voluntary approach, relying on various incentives. However, in Japan and Finland, mergers based on voluntary approaches did not achieve their objectives.

**Japan (after 1999):** Mergers were pursued to raise cost-efficiency and address the weak fiscal situation of many small towns and villages. Many rural municipalities were also still considered below the critical size to provide public goods efficiently. The government used different financial incentives (grants and tax advantages) available until 2006. Moreover, "special amalgamation bonds" were introduced to fund projects related to amalgamations. Measures to mitigate the resistance to mergers were also taken, such as the guarantee to maintain the seats of local assembly members, a local tax "freeze" and the use of new organisational structures to enhance local representation. While the aim of the reform was to reduce the number of municipalities to around 1 000 (from 3 232), the goal has not yet been reached. In 2017-2018, the number of municipalities was 1 741 (OECD, 2018b).

**Finland:** Enacted in 2005 and 2007, the PARAS reform aimed to strengthen municipal and service structures, improve productivity, slow down the growth of local government spending and create a sound basis for local service provision. Municipalities were free to choose whether to merge or not and to select their merging partners. Financial incentives were implemented to promote mergers, in particular, grants were offered to merging municipalities. Other incentives were proposed (organisation and consultations tools, including local referendums). Only 67 mergers took place between 2007 and 2013, most mergers involving two municipalities. The number of municipalities declined from 431 in 2006 to 320 in 2013. A large-scale merger plan was introduced in 2011 and abandoned in 2015 because of strong resistance and the risk of being unconstitutional.

**France:** A voluntary process started in 2010. Financial incentives were provided for municipal mergers (cut in transfers for non-merging municipalities, see Box 4) and for transferring powers to "communities of municipalities". Since 2016, the number of municipalities has been reduced from 36 700 to 34 970.

Source: OECD (2017b), OECD (2016a) and OECD (2014b).

Czech municipalities are the smallest in the OECD, and mergers of small municipalities should be strongly encouraged, in particular as in many areas population's decline is set to continue. This was discussed at length in previous Surveys (OECD, 2016a and 2006). To make municipal mergers mandatory, a law would need to be passed by parliament, but political support for such legislation seems currently limited. Alternatively, mergers can be encouraged on a voluntary basis, using financial and non-financial incentives as has been done in other countries.

### ***Municipal co-operation is common but it lacks stability***

Inter-municipal co-operation is common in the Czech Republic and has a long history. Ninety per cent of municipalities are involved in some form of co-operation (Swiandiwicz, 2010). Different types of co-operation exist and there is some overlap in the functions carried out by each association as no overarching legislative rules and recommendations are in place (Ministry of the Interior, 2020). This can create inefficiencies and makes monitoring difficult. Furthermore, many associations lack stability. They depend on the willingness to cooperate by the current municipal administrations. In fact, in most cases



inter-municipal co-operation is not aimed at the exercise of recurrent public services (e.g. strategic planning, education, social care), but at optional independent tasks (e.g. promotion of tourism, support for the construction of cycle paths, etc.). Inter-municipal co-operations also often importantly rely on external, temporary sources of financing, such as from the state budget or EU funds, rather than funding provided by member municipalities or own revenues from service provision.

The most common way of inter-municipal co-operation is via the Voluntary association of municipalities (VAM). As reported in the previous OECD Survey (OECD, 2016a), VAMs vary in nature, purpose and membership. As regards the scope of the activities, VAMs can be divided into single-purpose and multi-purpose VAMs. While the multi-purpose VAMs cover several functions, mostly in order to help with strategic development of its members, the activities of single-purpose VAMs are most often related to infrastructure and transportation (OECD, 2016a; Sedmihradská, 2010). They can have a one-time single purpose (e.g. an investment project) or ongoing provision of a service (e.g. waste removal). They can be established as joint stock companies (which can invest in another body alongside private companies) or public bodies.

Examples of such co-operation include a transfer of water infrastructure to a VAM (by a large number of municipalities) that also became the main shareholder in the water management company. Another example was a more modest VAM that was formed for connection of three small municipalities to the gas supply network. This VAM had no employees and individual municipalities carried out most of the functions for the project while the largest municipality managed accounting (OECD, 2016a).

Inter-municipal co-operation can also take the form of contracts for performing certain functions (Sedmihradská, 2010). In such cases, contracts are used to delegate some services that municipalities are required to provide, typically to the municipality with extended powers. Responsibilities transferred include administration, but also services such as education.

Co-operation is also taking place at the regional level. Groupings of regions were created with the main purpose of receiving EU structural funds, as most of the administrative regions are too small to be eligible for EU funds alone. The Association of Regions was established in 2001, a year after the creation of regions, and has gradually developed into a formal institutional structure comprising representatives from all regions. It facilitates co-operation, accumulation of expertise and trust, and dialogue with the national government.

The funding of VAMs can come from membership fees, user charges, or grants and subsidies from EU funds, regional authorities and selected state funds (e.g. state fund for transport infrastructure). Funds received from the EU and the state budget represent roughly 1/5 of total revenues of VAMs (Table 2). In fact, attracting grants or subsidies from the EU and state budget often requires co-operation, which has been an important driver of VAMs. Main expenditure items are capital expenditure, purchase of goods and services and salaries. Yet, VAMs can even be established without funding, as seen in the example above.

High reliance on external sources of funding can be a problem. External grants are project-based, hence temporary in nature. The lack of own funds and the reliance on external sources often drives the thematic focus of inter-municipal associations, which are not always aligned with local and regional priorities (Ministry of the Interior, 2020). Furthermore, receiving EU or state budget grants requires financing participation, for which inter-municipal associations lack own revenue-raising powers. With the expected relative trend decline in the inflow of EU funds to the Czech Republic, these sources of financing will gradually decrease over time. To ensure continued operations, member municipalities as well as the two associations of municipalities and the state should think of alternative sources of funding in the short term. Over time, municipalities should boost their own financing participation in inter-municipal associations to sustain stability. In the past, many municipalities accumulated budget surpluses that could be directed for these purposes.

**Table 2. Revenue and expenditure of Voluntary Associations of Municipalities**

	2019
<b>Revenues (millions CZK)</b>	
<b>Tax revenues</b>	..
<b>Non-tax revenues</b>	<b>1429.2</b>
Of which:	
Income from own activities	321.4
Proceeds from letting property	892
<b>Capital revenues</b>	<b>18.5</b>
<b>Transfers</b>	<b>2678.0</b>
<b>Current transfers</b>	<b>1193.3</b>
Of which:	
From municipalities	478.2
From regions	66.9
From central government and the EU	200.5
<b>Capital transfers</b>	<b>1484.6</b>
Of which:	
From municipalities	702.4
From regions	152.3
From central government and the EU	622.5
<b>Total revenues</b>	<b>4125.7</b>
<b>Expenditures (millions CZK)</b>	
<b>Current expenditure</b>	<b>1445.2</b>
Of which:	
Salaries	368.9
Purchase of goods and services	838.3
<b>Capital expenditure</b>	<b>2303.4</b>
<b>Total expenditure</b>	<b>3748.7</b>
As a percentage of total public spending	0.2

Source: Ministry of Finance.

Co-operation is common and flexible, but it can be associated with drawbacks and does not solve all the problems of fragmented governance that can result in lower quality or lack of certain services at the local level. There are costs associated with the formation of associations. While the voluntary basis of co-operation can result in such co-operation being well-targeted to the needs of participating municipalities, it may be costly to search for partner municipalities across a range of needs. This can be especially significant for small municipalities, which are the most in need of co-operation. Moreover, where VAMs involve participation of a large number of small municipalities, coordination costs can be high. Some VAMs do not include adjacent municipalities, likely leaving out places where the benefits of co-operation could be large (OECD, 2016a and Sedmihradská, 2010). There may be political costs linked to co-operation and the sustainability of an association or agreement usually depends on the current mayor or local administration. Finally, inter-municipal co-operation may suffer from a degree of democratic deficit as representatives of inter-municipal co-operation structures are not directly elected, potentially leading to accountability problems (OECD, 2019a and 2017b).

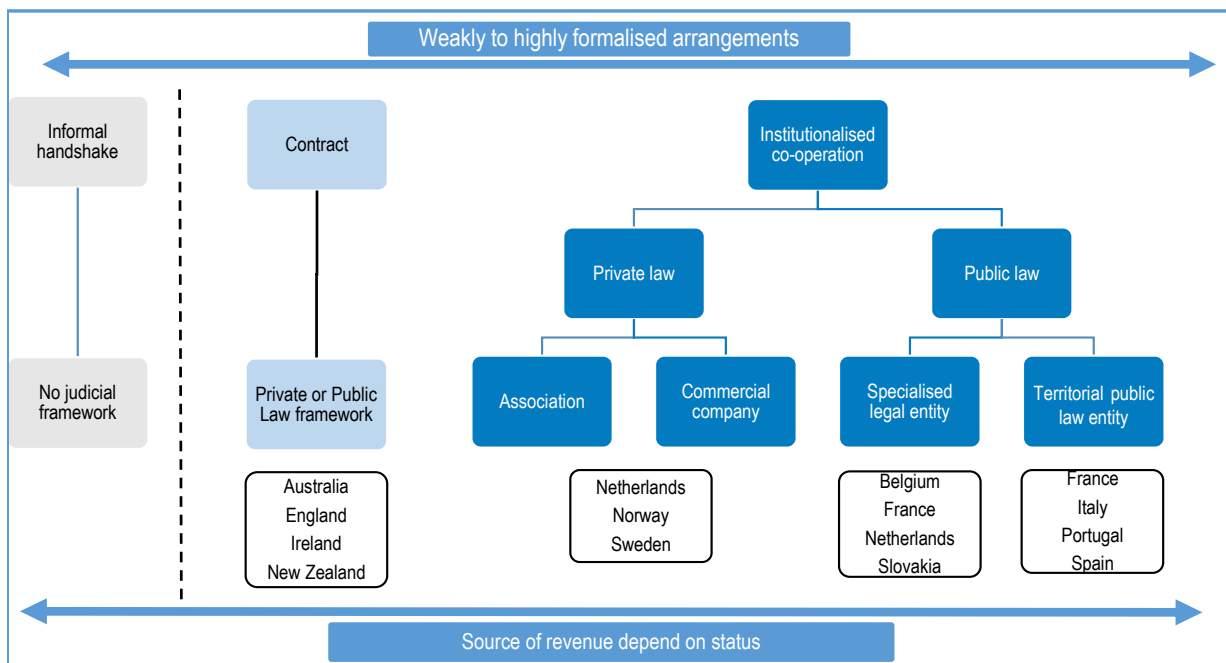
### ***Mandating inter-municipal co-operation and increasing the role of municipalities with extended powers***

Municipal co-operation exists in many OECD countries. It is particularly popular in Nordic countries (Finland, Sweden, Norway and Denmark) but also in Italy, Spain, Poland and France, where it is mandatory for all municipalities (OECD, 2019b and OECD, 2014b). Inter-municipal co-operation

arrangements are very diverse, varying in the degree of co-operation (Figure 8), from the loosest (single or multi-purpose cooperative agreements) to the strongest form of integration (supra-municipal authorities with delegated functions and even taxing powers). The financing varies considerably by country, over time and even by service sector. While, for instance, the Nordic countries have mostly relied on the member municipalities to fund the associations, other countries such as France have relied more on direct central government financing of subnational co-operation. In addition, the French public establishments for inter-communal co-operation (EPCI or établissement public de coopération intercommunale) have their own sources of tax revenue (OECD, 2019b, 2017b).

There is a number of “multi-purpose VAMs” in the Czech Republic that include most of the municipalities from their functional micro-region (administrative unit of the municipality with extended powers). They facilitate coordination among municipalities across a wide range of different activities, many of which are known to benefit from economies of scale. These include: strategic planning and development; co-operation in provision of selected services (education, social services, telecommunications, waste management, care for public greenery); support for the development of social, cultural and leisure activities, and for tourism development; landscape management and prevention of the consequences of climate change; and administrative support for member municipalities (e.g. public procurement assistance, and sharing experiences and best practices). In their function, these multipurpose VAMs within micro-regions come closer to the strong forms of sub-governmental integration mentioned above - the supra-municipal authorities with delegated functions stipulated by law. The Ministry of the Interior sees the multipurpose VAMs as role models on which to base progress towards greater integration (Ministry of the Interior, 2020). However, as with other VAMs, their set up does not guarantee stability and their sources of funding are highly uncertain. They receive funds from their members, but mayors are reluctant to raise membership fees sufficiently to ensure adequate financing (Ministry of the Interior, 2020).

Figure 8. From soft agreements to more formalised forms of co-operation in the OECD



Source: OECD (2019), Making decentralisation work: a handbook for policy-makers.

In order to support a wider use of multi-purpose associations in the Czech Republic, it would be necessary to enshrine in law the selected mandatory tasks that municipalities must perform either independently (if they are large enough) or through inter-municipal co-operation. A clear definition by law of mandatory tasks to be performed by local self-government is missing in the Czech Republic. Exercising independent competencies and joining inter-municipal associations are all on voluntary basis. The case of multipurpose inter-municipal co-operations in Germany with clear co-operation structure and well-defined tasks supported by law (Box 3) is a good example for raising the stability of co-operation.

Inter-municipal co-operation could be made mandatory at the level of micro-regions. Like the Czech Republic, France has a high degree of administrative fragmentation, and also a long history of inter-municipal co-operation that developed to counter fragmentation. Since 1992, France promoted inter-municipal co-operation as integrated territorial projects - “communities of municipalities” - with own taxation powers. Due to the high complexity of inter-municipal organisation, this was further streamlined in 2014, by setting a minimum threshold for inter-municipal co-operation structures (15 000 inhabitants instead of 5 000), as experience showed that a sufficiently large population threshold was needed to form effective “communities of municipalities”. The reform resulted in a decrease in the number of inter-municipal co-operation (IMC) structures with own-source tax, from 2 456 in 2013 to 1 258 in January 2019. Today, all French municipalities are part of an IMC with own-source tax, ranging in size from 21 metropolises (greater than 400 000 inhabitants), 13 “urban communities”, 223 “agglomeration communities” and 1 001 “communities of municipalities” in rural areas (as of January 2019). With their own taxing powers, these structures form another quasi-layer of subnational level of government (Box 4, OECD/UCLG, 2019). Creating communities of municipalities around MEPs in the Czech Republic can be a way to boost efficiency and quality of local public services, without undermining the sense of local independence.

### Box 3. Multipurpose (mandatory) associations of municipalities – example of Germany

There are four basic models of inter-municipal co-operation around large cities in Germany. The highest degree are unions of municipalities that are legally equal to territorial self-governing units. The second model are multi-purpose associations of municipalities (“Zweckverband”), while the third model are single-purpose associations (dealing with, for example, regional planning). The fourth type are inter-municipal co-operations using forms of co-operation based on private law, such as the joint creation of companies by several territorial units.

The second model - multi-purpose associations of municipalities – is interesting from the perspective of making inter-municipal co-operation more stable in the Czech Republic. The second model in Germany has three typical foundations: 1) on the basis of an agreement of its members to perform optional tasks, 2) on the basis of an agreement of its members to perform mandatory tasks established by law and 3) by special law, which directly determines the scope of obligatory, or alternatively voluntary tasks of the co-operation (e.g. Regional association for the greater Braunschweig area 2017).

Source: Schliesky, Utz: Stadt-Umland-Verbände, pages. 874 - 899, in: Handbuch der kommunalen Wissenschaft und Praxis.

A longer-term solution to stabilise funding and improve efficiency, but currently not constitutionally feasible, would be to increase the role of MEPs as an intermediate level of subnational government, with independent competencies over their respective micro-regions. Certain municipal competencies could thus be moved to the level of MEPs - those especially prone to economies of scale or those that are effectively done over larger areas and populations, such as public transport, spatial planning and environment, to name a few. MEPs already provide delegated public administration functions for other municipalities and in some cases smaller municipalities outsource to them the provision of other services, so this will be a natural step. The staff and functions of the existing inter-municipal co-operation

structures could eventually be integrated with the MEP administration. To ensure stability and effective provision of services this would also require changing the division of competencies among different layers of government, and should involve greater revenue-raising capacities (taxing powers) of MEPs.

#### Box 4. Inter-municipal co-operation and mergers: the experience of France

France is a unitary country with three tiers of local government: regions, "departments" (départements) and municipalities (communes). In January 2019, there were 18 regions, 101 departments, and 34 970 municipalities. France also has a fourth subnational quasi-level composed of 1 258 inter-municipal co-operation structures, having their own sources of tax revenues. This complex structure is the result of different waves of decentralisation.

##### Objectives of the municipal and inter-municipal reforms

France is a country with one of the highest number of municipalities in the OECD. The objective of the different reforms has been to reduce municipal fragmentation in order to reach economies of scale and greater efficiency.

In the past, as reforms encouraging mergers failed to generate a substantial reduction in the number of municipalities, policies have encouraged inter-municipal co-operation. However, despite the numerous positive outcomes of inter-municipal co-operation, the way it was implemented resulted in the creation of a dual municipal layer, generating an unnecessary proliferation of inter-municipal structures and duplication of services and staff.

Since 2010, and even more since 2015, the perception of municipal mergers has evolved and thus the objective of the government has been: i) to reduce the number of inter-municipal co-operation structures while reinforcing their responsibilities; ii) to favour municipal mergers by improving the *Commune Nouvelle* legislative framework adopted in 2010.

##### Characteristics of the municipal and inter-municipal reforms

In March 2015, a law was passed which aimed at promoting voluntary municipal mergers. Under this framework, the status of "associated municipalities" allows merged municipalities to remain and retain some particularities such as a delegate mayor, a town hall, an advisory council, etc. The rules for the creation of new (merged) municipalities have been relaxed and strong financial incentives for small municipalities creating communes nouvelles were introduced. Financial incentives took the form of the safeguarding of transfers from the central government in a context of large cuts in transfers to non-merging municipalities. Associated municipalities were also guaranteed to receive the sum of the main transfer from the central government (Dotation Globale de Fonctionnement, DGF) of all former municipalities. Moreover, for merged municipalities of greater sizes, the DGF has been enhanced over three years ("Financial Pact").

Simultaneously, the government aimed at strengthening the powers of inter-municipal co-operations (IMCs) while decreasing their number. The minimum population threshold for IMCs was lifted from 5 000 to 15 000 inhabitants, to be attained before 1 January 2017. All municipalities had to integrate an inter-municipal co-operation structure, on a compulsory basis. The number of inter-municipal syndicates (single or multi-purpose and without taxing power) had to be reduced. Inter-municipal co-operation was strengthened, as municipalities have the obligation to transfer some additional responsibilities to their IMC structure - community of municipalities. These responsibilities include water provision and sanitation, waste, tourism, commercial activities, and other optional responsibilities (e.g. creation of public services centres). In addition, provisions for pooling services and personnel were improved by law to avoid duplication.

The reform has had some success as the number of municipalities decreased from around 36 700 in 2015 to 34 970 in 2019 (Ministère de la cohésion des territoires et des relations avec les collectivités territoriales, 2019). The number of communities of municipalities decreased by almost 1 200.

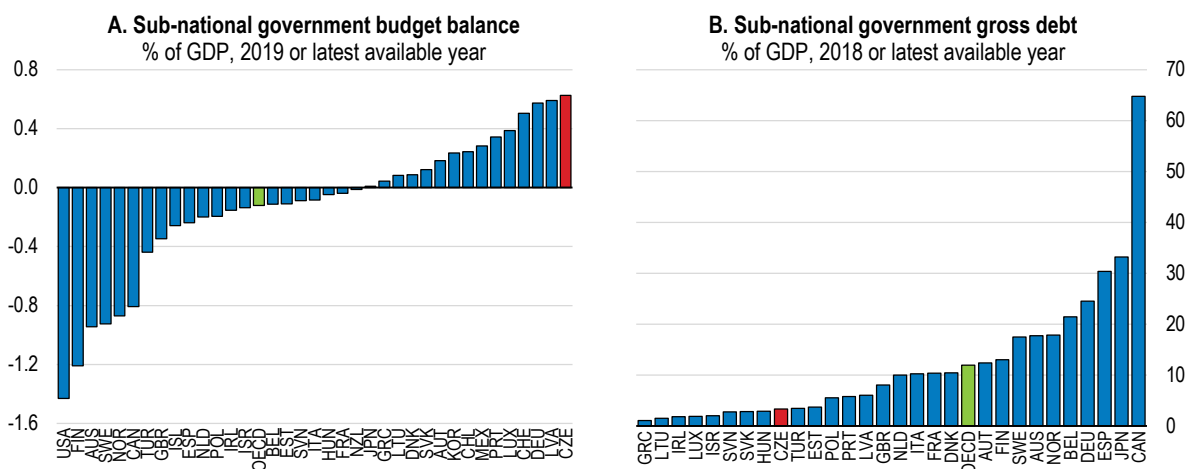
Source: OECD (2017b), *Multi-level Governance Reforms: Overview of OECD Country Experiences*, OECD Multi-level Governance Studies, OECD Publishing, Paris.

### Fiscal arrangements to improve efficiency

#### **Overall, the fiscal position of local governments is sound but the COVID-19 shock will pose challenges**

Overall, the budgetary situation of subnational governments (SNGs) before the crisis was sound. Debt as a share of GDP was among the lowest in OECD countries while their fiscal balance was positive (Figure 9). But the large drop in economic activity and the reduction in fiscal revenues during the crisis will have a significant impact on subnational government fiscal balances. It is common in crises that subnational governments struggle with a “scissors effect”, of decreasing tax revenues and rising expenditure (Bloechliger et al., 2010). Czech SNG fiscal balances appear quite sensitive to the economic cycle (Figure 10, panel A). Notably, through a tax sharing formula (more on this below), Czech regions and municipalities are exposed to cyclical variation in tax revenues. During the 2009 global financial crisis, fiscal balances of Czech subnational governments quickly deteriorated from surpluses to deficits (Figure 10, panel B), before returning to surpluses in the following years. The effect in the current situation can be expected to be similar.

Figure 9. Local government finances were sound before the COVID-19 crisis

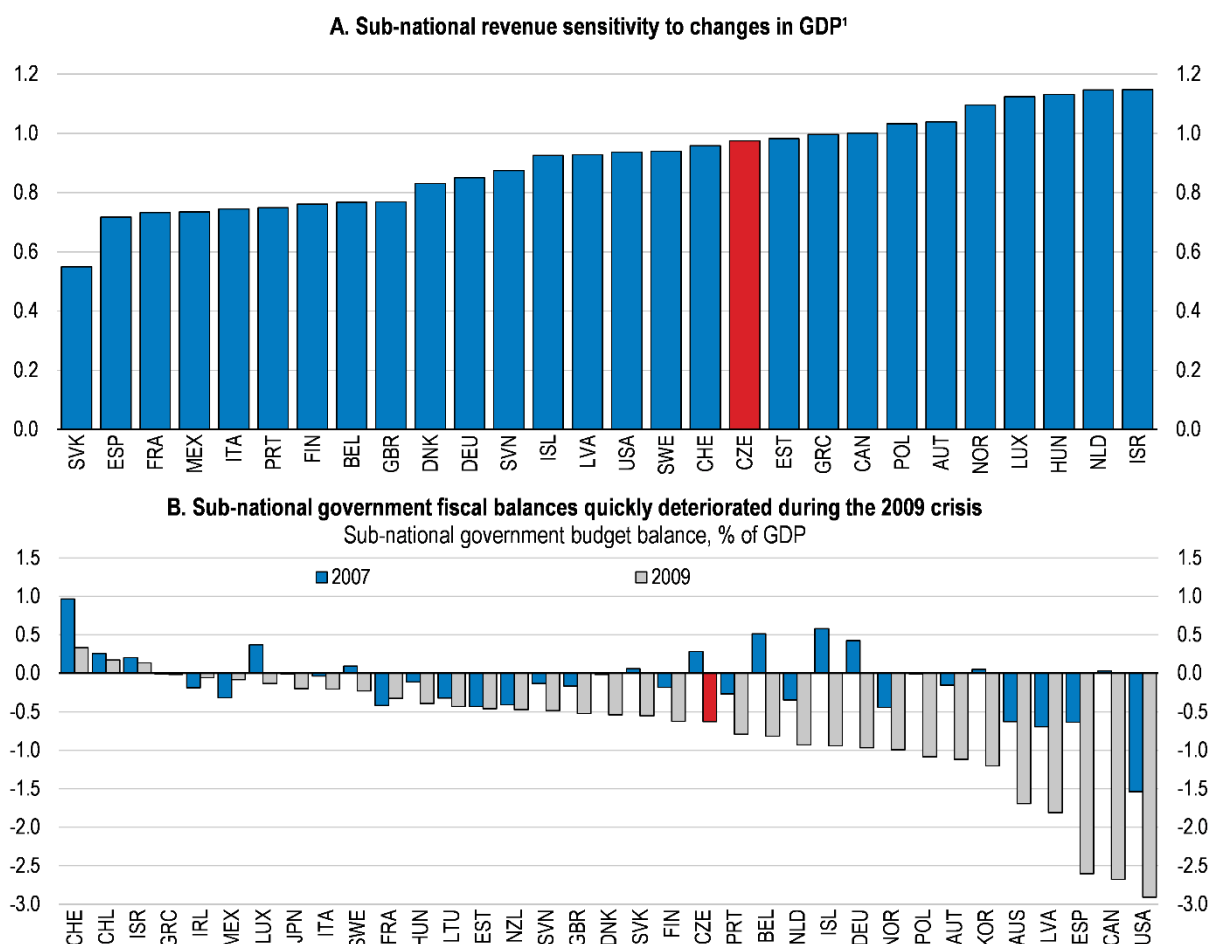


Note: OECD refers to a simple average of available OECD countries. Gross debt is based on the SNA 2008 and includes the following liabilities: currency and deposits, debt securities, loans, insurance pension and standardised guarantees and other accounts payable. Source: OECD National Accounts database.

Municipalities’ limited ability to raise their own taxes and, for small municipalities, to borrow money, result in only limited room for discretion. This can lead to large pro-cyclical cuts to local expenditures, notably investment, that could be important for post-crisis recovery. It is generally accepted good practice to assign less pro-cyclical tax sources to sub-central governments, such as property taxes, in order to avoid large sub-central government budget fluctuations and pro-cyclical effects (Kim and Vammalle, 2012). The central government – with its strong fiscal position and ability to borrow - is better

able to bear the burden of economic fluctuations and emergency fiscal measures, without causing strong pro-cyclical contraction in other expenditures.

**Figure 10. Sub-national fiscal balances in the Czech Republic are highly sensitive to changes in GDP**



1. The responsiveness elasticity is calculated as the coefficient of a log-log regression that regresses overall SNG revenue on GDP (including different types of own-source taxes and intergovernmental transfers). Years considered: from 1995 to latest available year (varies among countries). Only countries with regression R2 higher than 75% are presented.

Source: OECD National Accounts database; OECD (2020), COVID-19 and fiscal relations across levels of government, [https://read.oecd-ilibrary.org/view/?ref=129\\_129940-bar72laqm&title=COVID-19-and-Fiscal-Relations-across-Levels-of-Government](https://read.oecd-ilibrary.org/view/?ref=129_129940-bar72laqm&title=COVID-19-and-Fiscal-Relations-across-Levels-of-Government)

To help the economy during the COVID-19 contraction, a number of emergency fiscal measures were instituted through the tax system, putting additional pressures on budget revenues of the Czech subnational governments through the tax sharing formula. In particular, the support to the self-employed (compensatory bonus) was introduced through the personal income tax, and deferrals were introduced on personal income tax advances and corporate income tax advances by companies. Sharing the additional burden of the emergency measures with Czech municipalities makes their revenues even more pro-cyclical in a time of crisis. This was indeed controversial at the time, and the Czech National Budget Council (2020) argued against it. In the end, the central government compensated the municipalities, by allocating them non-earmarked grants, and by allocating more funding for repairs to local schools and kindergartens and other buildings owned by municipalities. Moreover, due to concerns



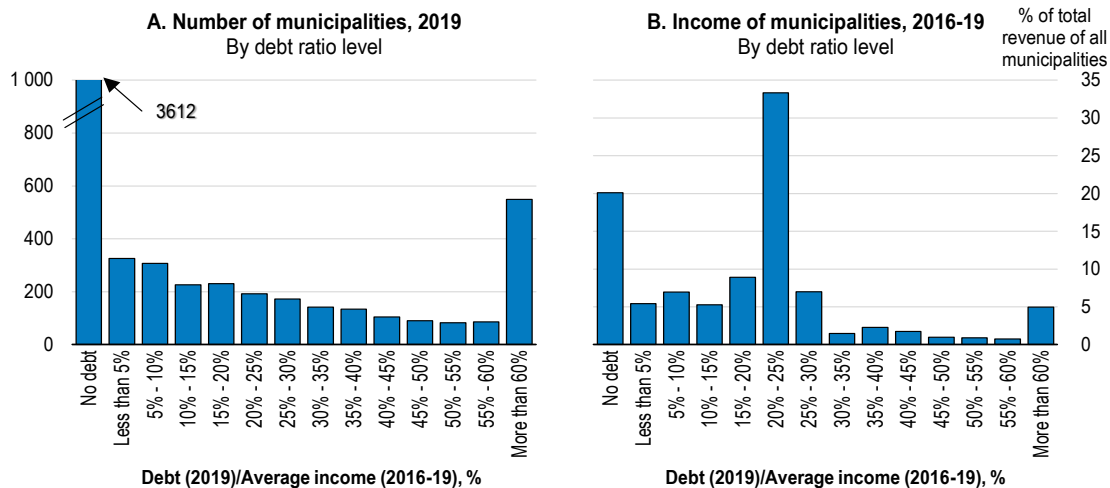
about the impact of the COVID-19 crisis and the additional burden of emergency measures on the municipal investment projects, the central government also invited the Union of Towns and Municipalities of the Czech Republic to review the status of various investment projects. The central government committed to support those for which funding was missing (Ministry of Finance, 2020).

To counteract the pro-cyclical impact of deteriorating SNG budgets on local public expenditures during the COVID-19 crisis, many other central governments across the OECD – Finland, Italy, Norway, Spain and the United States - stepped in to extend support to local budgets with discretionary grants. This has been done with a view that SNGs expenditures, notably investment expenditures, will be important for the recovery. SNGs form an important part of public investment, including in the Czech Republic. As said earlier, budget positions of Czech SNGs were strong before the crisis, and many of them had built substantial cash reserves. It is therefore difficult to assess from the outset how much support – if any – is warranted.

To avoid pro-cyclical effects, it is also possible to relax fiscal rules, as has been temporarily done for the general government sector. In the wake of the COVID-19 crisis, Spain, France and Germany, for example, relaxed fiscal rules for their SNGs (OECD, 2020a and 2020b). This said, there are no strict fiscal rules pertaining to municipal expenditure in the Czech Republic, as long as they can finance them from reserves or by borrowing money. The latter might be a constraint for small municipalities. But, due to low debt in most municipalities, the debt rule (maximum 60% of the average revenue over the past four years, beyond which municipalities need to gradually repay the debt) is binding only for a minority of municipalities (Figure 11).

Once the crisis subsides, the SNGs will nevertheless need to contribute to the consolidation efforts to restore fiscal space and to get on the path of sustainable public finances of the general government. To effectively support the economic recovery and credibly commit to fiscal consolidation, efficient provision of public services at the local level and increased capacity to undertake productive investment projects will become even more important.

**Figure 11. Not many municipalities would reach the 60% debt limit**



Source: Ministry of Finance.

***Distribution of tax revenues favours small municipalities***

In the Czech Republic, SNGs’ revenue comes mostly from shared taxes and from grants and transfers from the central government (Tables 3 and 4). The mix of revenue categories is in fact close to the OECD average (Figure 12). However, as already discussed in a previous Survey (OECD, 2016a),



Czech SNGs have comparatively very little autonomy over revenues. They raise a very small proportion of total taxes (Figure 13) and a large part of tax revenue is distributed via a tax sharing formula. Moreover, grants from the central government are generally earmarked and often do not require cofinancing (matched funding) by the SNG receiving the grant possibly reducing efficiency (Bergvall et al., 2006).

**Table 3. Revenue and expenditure of regions and municipalities**

As a % of total, 2019

	State	Regions	Municipalities <sup>1</sup>
<b>Revenues (% of total revenue)</b>			
<b>Tax revenues</b>	<b>86.4</b>	<b>31.4</b>	<b>67.3</b>
Of which:			
PIT (person income tax)	10.8	8.8	16.8
CIT (corporate income tax)	8.1	7.0	14.6
VAT (value added tax)	19.1	15.6	28.1
Social security contributions	36.2	0.0	0.0
Other tax revenues	12.1	0.1	7.7
<b>Non-tax revenues</b>	<b>1.4</b>	<b>2.8</b>	<b>9.8</b>
<b>Capital revenues</b>	<b>1.2</b>	<b>0.2</b>	<b>1.9</b>
<b>Transfers (consolidated)</b>	<b>11.0</b>	<b>65.6</b>	<b>21.1</b>
Current transfers	6.6	60.7	14.7
Capital transfers	4.4	4.9	6.4
<b>Total revenues</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Expenditures (% of total expenditures)</b>			
<b>Current expenditures (consolidated)</b>	<b>91.0</b>	<b>86.1</b>	<b>72.1</b>
<b>Capital expenditures</b>	<b>9.0</b>	<b>13.9</b>	<b>27.9</b>
<b>Total expenditures (consolidated)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

1. Including capital city Prague and Voluntary associations of municipalities.

Source: Ministry of Finance, "Monitor Státní pokladna – Analytical part of portal Monitor".

**Table 4. Revenue and expenditure of regions and municipalities**

In billions CZK, 2019

	State	Regions	Municipalities <sup>1</sup>
<b>Revenues</b>			
<b>Tax revenues</b>	<b>1 315.7</b>	<b>75.0</b>	<b>245.2</b>
Of which:			
PIT (person income tax)	164.5	21.0	61.2
CIT (corporate income tax)	123.5	16.8	53.2
VAT (value added tax)	291.3	37.1	102.5
Social security contributions	551.7	0.0	0.0
Other tax revenues	184.7	0.1	17.3
<b>Non-tax revenues</b>	<b>21.5</b>	<b>6.7</b>	<b>35.6</b>
<b>Capital revenues</b>	<b>18.7</b>	<b>0.4</b>	<b>6.8</b>
<b>Transfers (consolidated)</b>	<b>167.3</b>	<b>156.5</b>	<b>77.0</b>
Current transfers	101.0	144.8	53.8
Capital transfers	66.3	11.7	23.3
<b>Total revenues</b>	<b>1 523.2</b>	<b>238.5</b>	<b>364.6</b>
<b>Expenditures</b>			
<b>Current expenditures (consolidated)</b>	<b>1 412.6</b>	<b>200.4</b>	<b>244.2</b>
<b>Capital expenditures</b>	<b>139.1</b>	<b>32.3</b>	<b>94.5</b>
<b>Total expenditures (consolidated)</b>	<b>1 551.7</b>	<b>232.7</b>	<b>338.7</b>

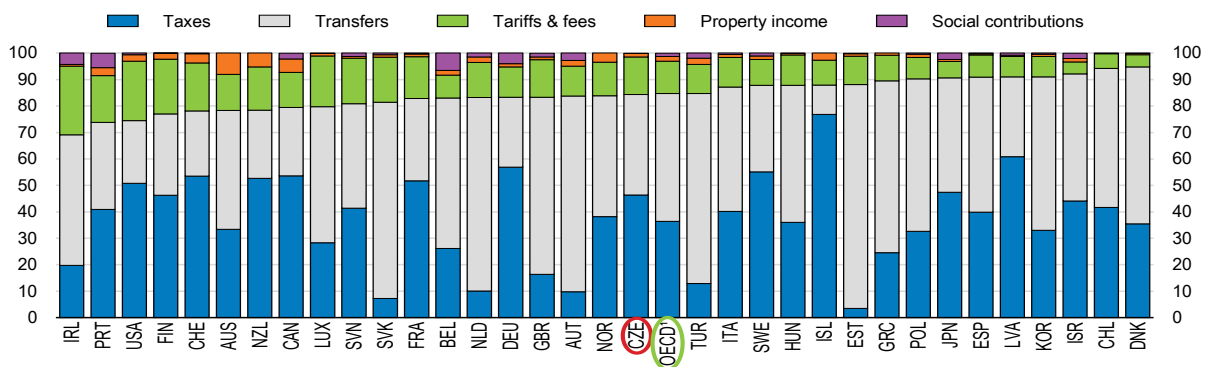
1. Including capital city Prague and Voluntary associations of municipalities.

Source: Ministry of Finance, "Monitor Státní pokladna – Analytical part of portal Monitor".

Total tax revenue is shared among different levels of governments (state, regions, municipalities, and the state fund for traffic infrastructure) according to coefficients stipulated by law (Table 5). Recently, the share of SNGs has been increased for several taxes, including VAT. These revenues are then further distributed between regions and municipalities. For regions, the coefficients for redistribution were set in 2005 and roughly followed the estimated level of costs associated with delivering delegated services and functions. As the situation has evolved since then, including diverging population trends, there is growing pressure for a change to a horizontal distribution of revenues among regions.

**Figure 12. Sub-national governments' revenues come mainly from shared taxes and transfers**

Subnational government revenue by type, % of total revenue, 2016

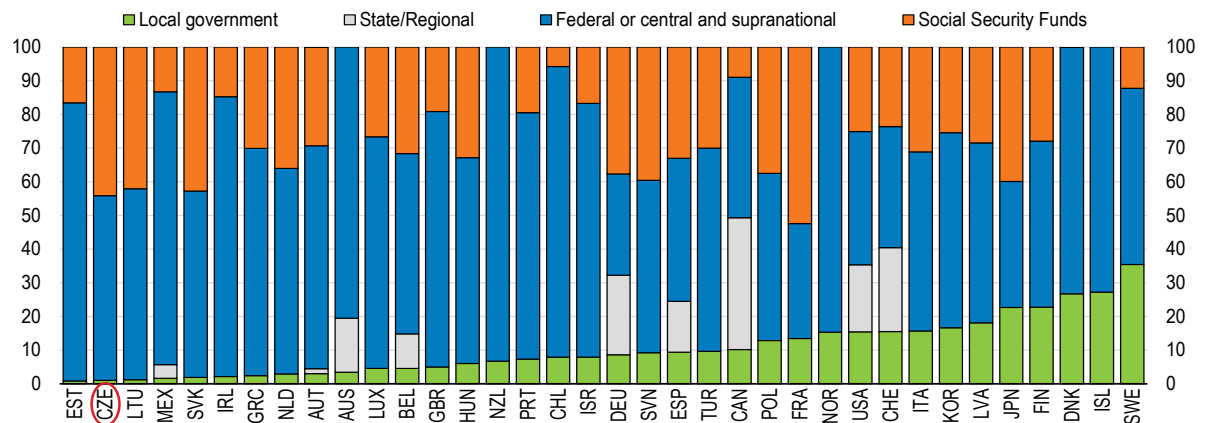


1. Unweighted average.

Source: OECD Subnational Government Structure and Finance database.

**Figure 13. Tax revenue levied at the local level is very low**

Tax revenues of sub-sectors of general government as % of total tax revenues, 2018 or latest available year



Note: Compulsory social security contributions paid to general government are also treated as taxes.

Source: OECD Revenue Statistics.

**Table 5. Tax sharing arrangement in the Czech Republic, 2018**

	State	Regions	Municipalities	State fund <sup>1</sup>
<b>Tax revenue distributed via tax sharing formula</b>				
Value added tax	67.5	8.92	23.58	0
Corporate income tax	67.5	8.92	23.58	0
Personal income tax				
Tax on interest and dividends	67.5	8.92	23.58	0
Tax of unincorporated individuals	80.5	5.352	14.148	0
Tax on wages and salaries	66.0	8.92	25.08 (1.5 % is redistributed according to the location of employees)	0
Gambling tax				
Technical games <sup>2</sup>	35.0	0	65.0	0
Other games	70.0	0	30.0	0
Real property transfer tax	100.0	0	0	0
Excise duty on mineral oils	90.9	0	0	9.1
Other excise duties	100.0	0	0	0
<b>Tax revenue distributed directly to sub-national governments or state fund<sup>3</sup></b>				
Income tax paid by municipalities <sup>4</sup>	0	0	100.0	0
Income tax paid by regions <sup>4</sup>	0	100.0	0	0
Real estate tax <sup>5</sup>	0	0	100.0	0
Road tax	0	0	0	100.0

1. State fund of traffic infrastructure.

2. Tax revenue is shared according to the information on permits issued for the placement of gaming space.

3. The real property transfer tax is state budget income.

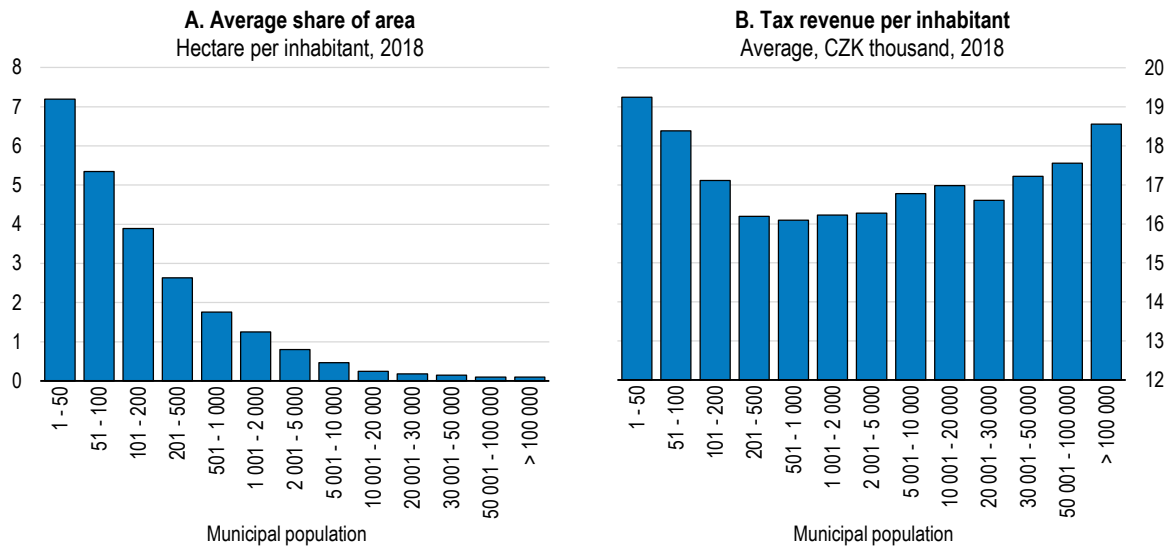
4. Income tax paid by municipalities or regions is the income of the same municipalities or regions.

5. Tax is redistributed according to the location of the estate.

Source: Act No. 243/2000 Coll. on Budgetary Tax Determination.

For municipalities, the tax sharing formula is more complex, and it implicitly encourages very small municipalities to remain small. The formula takes into account population size (88%, following a formula), number of children in nursery schools and primary schools (9%) and the size of the cadastral area (3%). On top of this, a small share of PIT that is levied on wages, is distributed according to the number of employees across municipalities. Over the past years, the tax sharing system was changed in favour of larger municipalities by introducing a cap on the cadastral area component and increasing the weight of the component on the number of children in kindergartens and primary schools. However, as the density of population increases with the population size of a municipality, the cadastral area component matters especially for small municipalities (Figure 14, panel A). Hence, the average tax revenue per inhabitant follows a U-shape curve (Figure 14, panel B and Table A.1) and very small municipalities on average receive significantly more tax revenue per inhabitant. It is understandable that the tax sharing system compensates for higher costs of service delivery in scarcely populated areas. However, in the Czech case where the number of municipalities is taken to the extreme, the tax sharing formula should be made more neutral for small municipalities, say for municipalities with population of fewer than 1 000 inhabitants.

Figure 14. The tax sharing system favours small municipalities



Note: Brno, Ostrava, Plzeň and Prague are not included.  
Source: Ministry of Finance.

The tax sharing formula also results in strong implicit redistributive flows between municipalities, as the amount of tax revenue received is little related to the tax base in each municipality. However, the formula-based system does not make clear how much a municipality receives from its own tax base, and how much it receives through redistribution.

A model with two parts of revenues, one from own tax base and another for fiscal equalisation (as in many OECD countries) could make redistribution flows more transparent, while at the same time incentivising SNGs to develop their tax base. Explicit fiscal equalisation has an important role in various OECD countries, notably in those with high fiscal autonomy of SNGs, as higher autonomy can raise equity concerns due to uneven distribution of tax raising capacity (Blöchliger and Petzold, 2009). In the Czech Republic, it would be however important to design the equalisation system in a way that promotes tax and development efforts of subnational governments (Blöchliger et al., 2007).

Apart from the implicit redistribution through the tax sharing formula, the Czech Republic attempts to resolve imbalances at the level of municipalities or regions also through transfers dedicated to special programs for structurally affected areas (such as RE:START to support the coal mining regions). Explicit fiscal equalisation would make it easier to pursue explicit politically agreed goals in terms of closing persistent gaps in living standards across regions.

### ***Giving local governments more tax autonomy***

Tax revenue directly levied at the local level represents only 1% of total tax revenue, which is among the lowest levels across OECD countries. Apart from income taxes paid by municipalities and regions, the property tax is the only tax that belongs directly to municipalities. Municipalities thus directly raise only 8.3% of their own tax revenue, whereas for regions this is as low as 0.4%. Municipalities (and regions to a lesser degree) additionally receive some revenue from their own sources such as user charges and property income (Table 4 and 5).

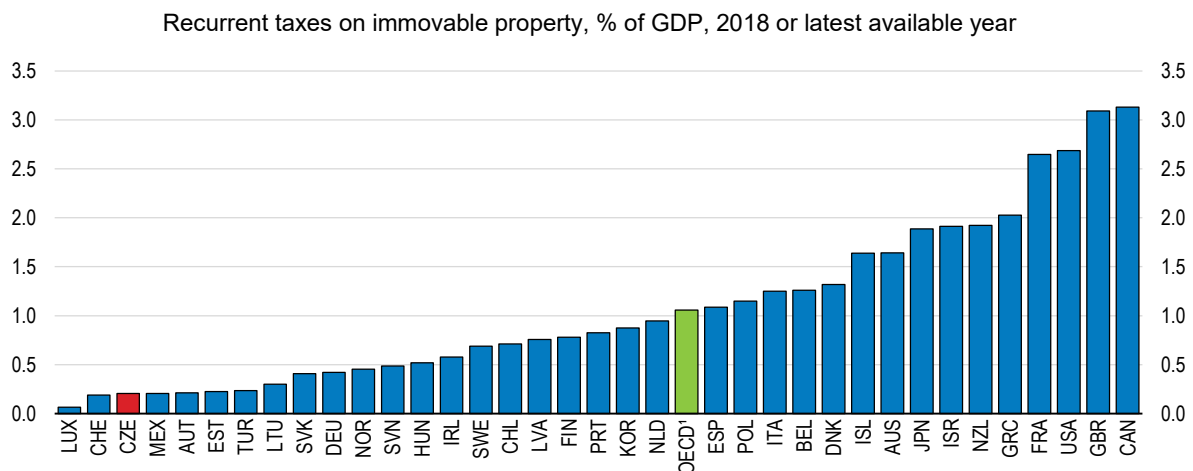
Czech regions and municipalities are quite heavily reliant on shared taxes and revenue from the central government, through grants and transfers. The system has its strengths. The advantages come from lower uncertainty and higher stability, especially for small municipalities. Taxes are determined centrally,

and the Ministry of Finance regularly provides projections of expected tax revenues, making budgeting at the local level easier. However, this also reduces the efficiency and accountability benefits of decentralisation (Dougherty et al, 2019). Indeed, international evidence shows that subnational governments are more efficient when local residents self-finance local services through local taxes and charges (Geys, Heinemann and Kalb, 2010; Blöchliger and Kim, 2016). This encourages local residents to assess the costs and benefits of local service provision, and compare them with neighbouring jurisdictions (OECD, 2019b). It also increases the accountability of SNGs.

However, from a practical point of view, it can be difficult to achieve a meaningful level of self-financing and corresponding accountability in the Czech case. Most Czech municipalities due to their small size are not optimal taxing units. Encouraging mergers or moving to a system where larger subnational units (such as micro-regions) play a bigger role should therefore be undertaken in combination with financing reforms to promote greater fiscal autonomy at the subnational level. In fact, giving municipalities greater tax autonomy once merged could be used as an incentive for administrative consolidation.

A first step towards increasing the fiscal autonomy of Czech municipalities would be to encourage SNG to raise more revenue from the property tax. Total revenue from the property tax in terms of GDP is one of the lowest in the OECD (Figure 15), and represents only 5% of municipalities' tax revenue, despite the fact that this tax is among the least distortive for growth. In addition, property tax provides relatively stable revenues, which is good for local governments that have largely non-cyclical spending (Blöchliger, 2015).

**Figure 15. Revenue from property tax is low**



1. Unweighted average.

Source: OECD Revenue Statistics.

In the Czech Republic, the property tax comprises a land tax and a tax on buildings, and the calculation of the tax is based on the size of property rather than its value. The base rate is set centrally, but municipalities can raise the rate up to five times the minimum threshold amount. Yet, most municipalities tend to set their local property tax rate at the low level, and only 7% of municipalities have made use of the possibility to increase tax rates. Moreover, municipalities can set exemptions and the number of exemptions and of properties excluded from taxation is high (Radvan, 2019). The tax evaluation should be based on regularly updated estimates of property value, such as in Denmark, Estonia, Spain, United Kingdom among others, rather than size as is currently the case. To avoid resistance to the tax and unintended consequences for vulnerable households, targeted means-tested exemptions could be introduced (Blöchliger, 2015).

The local tax autonomy could be raised also by encouraging local governments to develop their tax base. The tax sharing formula could be tweaked to raise the weight of factors linked to economic activity (number of employees) and income. Alternatively, additional taxes could be designated as own-source taxes, such as the municipal income tax as in Finland and Sweden. In case of a transition towards “communities of municipalities” within micro-regions, they could be given their own tax source to finance the new responsibilities (in a tax neutral way, not to raise the overall tax burden).

### ***Using grants and transfers to boost efficiency***

In addition to their own competencies, municipalities and regions are also responsible for the performance of delegated state administration functions. Those competencies are mainly financed by transfers from the central government (and also by administration fees and partly shared tax revenue). In principle, the distribution of transfers is based on a formula set by the Ministry of the Interior taking into account the population of the municipality and the scope of delegated competencies of state administration. Municipalities with extended powers receive an additional transfer that corresponds to their extended responsibilities. However, the link between the cost of service provision and the transfers made for the provisions of these services is small. A past Survey (OECD, 2016a) reported that there was no allowance for economies of scope even in services such as a population register.

Reducing earmarking is needed to encourage spending efficiency. Grants and transfers received by municipalities and regions are predominantly earmarked (91% of total grants were non-matching earmarked grants in 2010 (OECD fiscal decentralisation database), both current and capital. These are for example used to finance education, specific development programmes or infrastructure maintenance. Municipalities may also receive subsidies from regions, both within the independent competence of the region (e.g. programs announced by individual regions) and by redistribution of some types of subsidies received from the state budget (e.g. salaries of teachers). Still, earmarked grants are associated with lower efficiency, in particular when they do not require matched funding (cofinancing by the SNG receiving the grant) (Bergvall et al, 2006). The Czech Republic could therefore make more use of non-earmarked grants that require matched funding or to move to block grants, which are less constraining, as in Denmark and Norway. This could boost innovation and efficiency.

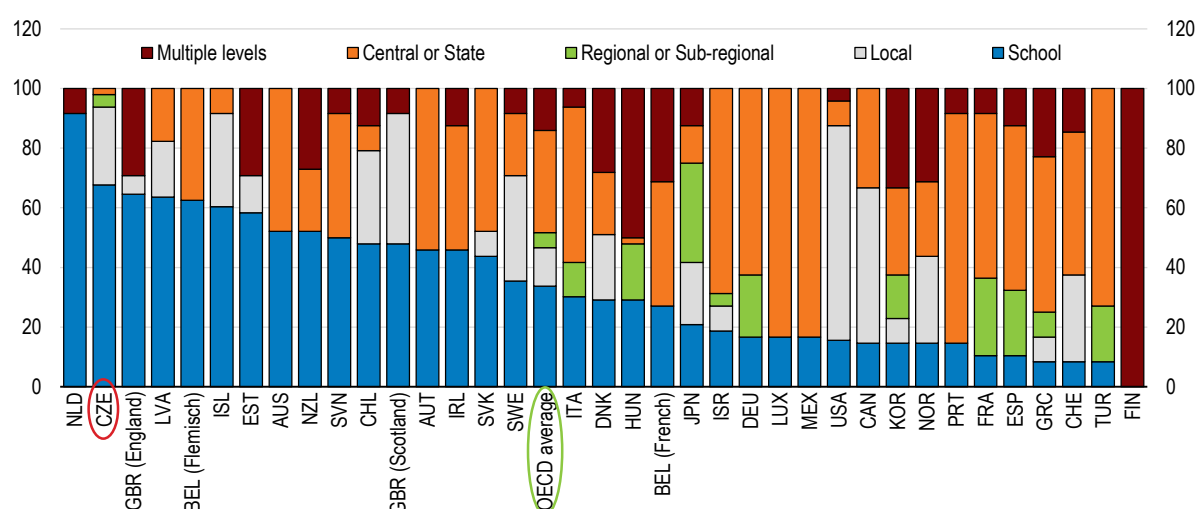
### **Making delivery of education more equitable across the country**

In the Czech Republic, the education system is highly decentralised (Figure 16). Roughly, two thirds of the decisions are taken at the school level. Schools can tailor their educational programmes and other activities to the needs of their students and community. Schools are also responsible for the professional development and performance of their staff. This said, the majority of school-level decisions are taken within a framework set by the Ministry of Education, Youth and Sports (Table 6). For example, for curricular issues, schools have substantial autonomy through the development of School Educational Programmes (SEP) as long as they are in line with national Framework Education Programmes (OECD, 2018c and Shewbridge et al, 2016a).

Responsibilities are also split between different levels of government. While the Ministry of Education, Youth and Sports (the Ministry) establishes the legal framework for the school system, municipalities are responsible for the delivery of pre-primary, primary and the majority of lower secondary education and regions for organising upper secondary education. The founders of schools (regions, municipalities or associations of municipalities) finance the operating costs and capital expenditure. The state budget, via the Ministry, on the other hand covers wages and social security contributions of teaching staff, expenditure on teaching aids, the training of teachers, and special-interest activities.

**Figure 16. The education system is highly decentralised**

Percentage of decisions taken at each level of government in public lower secondary education, 2017



Source: OECD (2018), Education at a Glance 2018: OECD Indicators.

**Table 6. Decisions taken at the school level in public lower secondary education, %, 2018**

	Czech Republic		OECD average		
	In full autonomy	Within framework set by a higher authority	In full autonomy	Within framework set by a higher authority	Other
Organisation of instruction	33.3	66.7	19.4	38.7	7.2
Personnel management	33.3	58.3	13.3	22.3	7.4
Planning and structures	0.0	83.3	0.5	37.4	1.8
Resource management	50.0	50.0	26.7	18.2	6.8

Source: Education at a glance, 2018.

There are advantages to the Czech system of decentralised responsibility, but there are risks of regional disparities in service quality. A previous OECD Review (Shewbridge et al., 2016a) noted that such a high level of decentralisation should be combined with a more adequate system of checks and balances. Monitoring of the quality of teaching and learning could be improved and a persistent lack of relevant information makes it difficult to conduct policy based on evidence. Furthermore, there are important gaps in information to monitor equity, including comparative information across regions and basic indicators of socio-economic factors, despite this being a strategic priority. In recognition of these problems, the Czech authorities plan to address the issue of information gaps and lack of monitoring in the future as stipulated in the 2030+ Education Strategy, and some progress has already been made. Notably also, the Czech School Inspectorate launched the Complex System of Evaluation project (2017-22) for the evaluation of the quality of education services and facilities with the aim to support the monitoring of the school system and help identify, among others, the impact of socio-economic and territorial factors in education outcomes (OECD, 2019c). The analysis in this section draws on the

findings in previous OECD Reviews of the Czech education system, most notably the OECD Reviews of School Resources: Czech Republic (Shewbridge et al., 2016a).

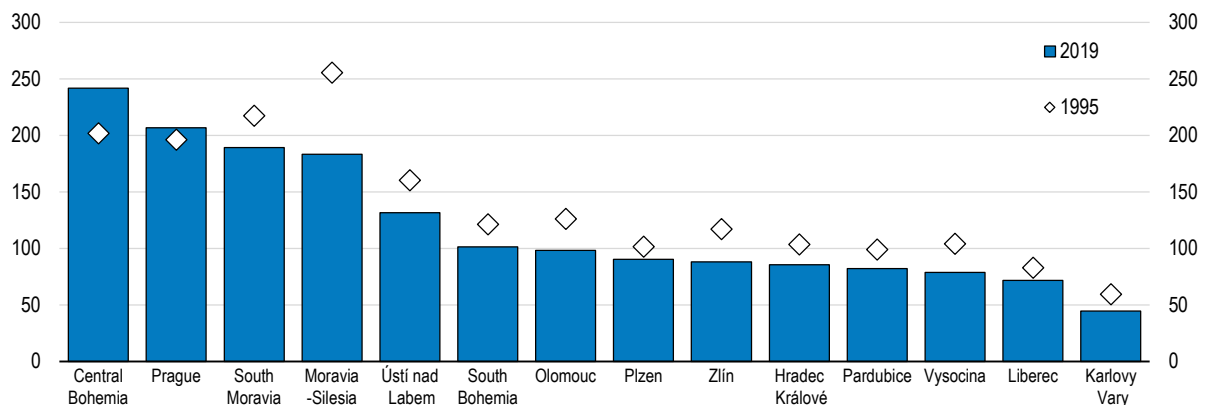
### Consolidating the school network would raise quality and efficiency

While education is a basic and essential service at the local level, territorial fragmentation can heighten organisational challenges as well as affect the quality of education provided. Many municipalities are too small to effectively operate schools. At the same time, municipalities tend to be highly attached to the schools in their area – even if small and of low quality - making closing or merging schools unacceptable from a political point of view. Previous OECD Reviews (Santiago, 2012) found that widespread opposition to consolidate the school network in the Czech Republic reduces the willingness to monitor education quality and can hinder improvements, even in schools identified by the system itself as underperforming. In recognising this, the National education strategy of the Czech Republic for the period 2030+ goes some way towards supporting consolidation of school network.

Many rural areas face severe demographic pressures and declines in school-age population (Figures 17 and 18), making it increasingly difficult to keep schools of appropriate “size efficiency” (Shewbridge et al., 2016a). The number of schools in basic education is now lower than it was in 2005, but recently the number has started rising again (CZSO database). The proportion of small schools (with less than 200 students) has been on the rise. The per-student funding system helped to initiate some school consolidation in basic education (Shewbridge et al, 2016a), as the declining number of students translated into lower grants from the state for local schools, exacerbating resource constraints in local schools that did not consolidate. At the same time, however, it resulted in major regional differences in the amount of funding received for similar activities (Ministry of Finance, 2020) and thus intensified equity concerns.

Figure 17. Declines in school-age population put pressures on the school system

Number of children under the age of 15, thousands



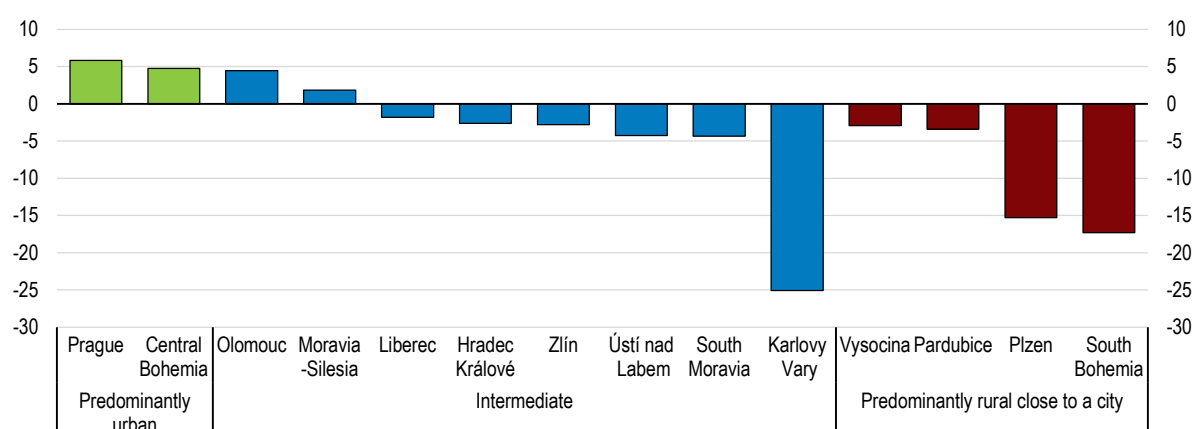
Source: OECD Regional database.

The 2020 reform to school funding (primary and secondary) goes some way towards addressing the problem of declining resources in small schools. The system of per-student funding that implicitly favoured schools in urban areas has been replaced by funding for the actual number of lessons taught in a school, loosening the link with the number of students. Funding for direct costs will now be more closely linked to the real financial needs of schools (i.e. for salaries of the required teaching staff and costs of teaching aids) to effectively deliver their teaching load, adjusted for other aspects, such as the class size and the number of students with special needs.



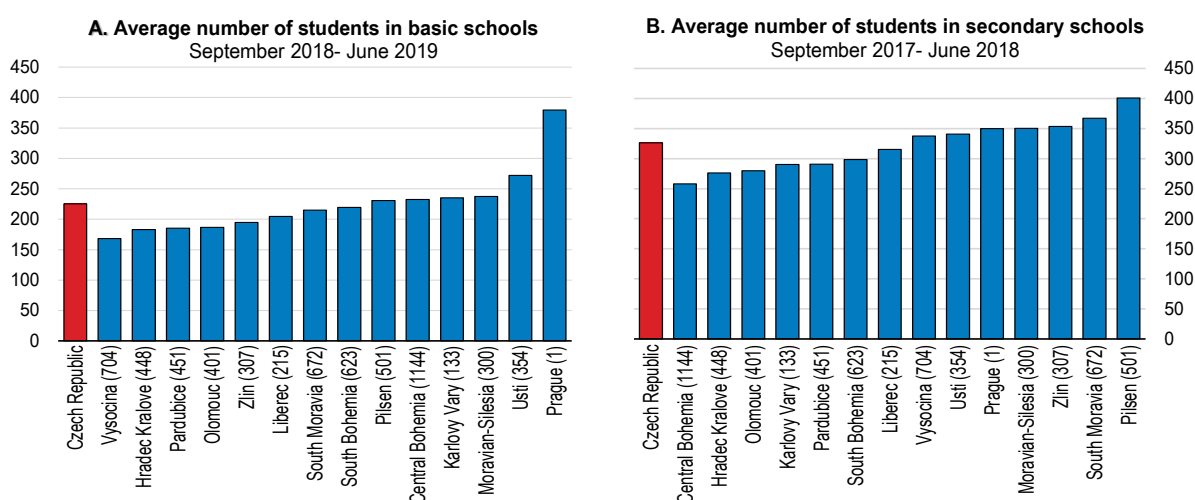
**Figure 18. The population in rural areas will decrease further**

Projected population growth, 2015-2060, % change



Source: Batista e Silva et al. (2016) Regionalisation of demographic and economic projections. Joint Research Centre, European Commission.

Further consolidation of the school network should be pursued to raise efficiency and quality. Many small schools could benefit from merging with schools in neighbouring areas and in regions with a low average size of basic schools there is room to further reduce the number of municipalities with schools (Figure 19).

**Figure 19. Some regions have many small schools**

Note: The numbers in parentheses refer to the total number of municipalities by region.  
Source: Czech Statistical Office.

Although consolidation of the school network is a sensitive national and local issue, international experience suggests that national frameworks and assistance can spur school network consolidation through municipality co-operation or mergers. For instance, in England, during the 1980s and 1990s, many rural schools were closed because of demographic changes and a strong push from the government for reform. Some smaller schools started collaborating and sharing resources, by, for

example, using common ICT and catering services, and common provision of specialised teaching. Other schools chose to merge, which in some cases proved to help recruit and retain qualified teachers and even helped raise the total number of pupils (OECD, 2010a). In Finland, the project to restructure local government and services (PARAS), launched by the government in 2005, set minimum population targets for a number of activities (e.g. 50 000 for vocational basic education) and it was then up to municipalities whether they would reach the goals by mergers or co-operation (OECD, 2017b). In Lithuania, a large drop in school-aged population triggered a large reorganisation of the school network, with the number of municipal schools reduced by almost one fourth, between 2005 and 2015. The government introduced initiatives to assist municipalities with school consolidation, including expansion of transport for students (Shewbridge et al., 2016b and OECD, 2017c).

To consolidate the school network the Czech government should establish a set of guiding principles, rules and even target quotas for capacity (minimum school size) at different stages of schooling (Shewbridge et al., 2016a). As in other countries, small schools could be encouraged to cooperate by sharing resources and common services. Clusters of schools could be formed, that would come under the umbrella of common school leadership and a shared pool of administrative staff. Finally, good demographic data and projections at the regional level and a strong school registry with comprehensive information on educational fields and capacity across the country are needed so that policy is built on objective and reliable information.

Collaboration between central, regional and municipal levels is important to build trust and steer policy but this is challenging given the fragmentation. Incidentally, the recent funding reform made a move towards greater centralisation. Before the reform, regions were tasked with reallocating the national funding for direct costs to municipalities, which impaired efficiency and created a systemic conflict of interest where regions had a tendency to provide preferential treatment to schools under their direct operating responsibility (secondary and special education). The reform has separated the funds for schools founded by municipalities from those for schools founded by the region and funding goes from the Ministry directly to municipalities.

More direct links between the Ministry and municipalities can act as a useful policy tool that enables the Ministry to better understand the challenges of the education system at the school level (Shewbridge et al., 2016a). In turn, it can help steer policy more effectively towards strategic objectives, including on the consolidation of the school network. However, for this to work well municipalities need to have sufficient capacity to run schools effectively and to engage in a policy dialogue with the Ministry, which is a challenge with the current fragmented local government. For instance, many municipalities only have one school or no school at all. Setting minimum population targets for different levels of education could therefore go hand in hand with shifting the competency for primary and lower secondary education - and the flow of education grants - from municipalities to municipalities with extended powers (MEP). This would also simplify policy coordination between the Ministry and a high number of municipalities.

Nevertheless, moving towards a consolidated network of schools has to be accompanied by reforms in other policy domains. To address economic and other disadvantages, more explicit and objective criteria in the funding formula for schools could further help address the inequities in education. In Australia, for example, after a recent reform, funding is based on a base funding amount for every student plus six additional loadings that provide extra funding for disadvantaged groups (loadings for disability, low English proficiency, Aboriginal and Torres Strait Islanders, socio-educational disadvantage, school location and school size). The criteria and specific loadings can then evolve in step with strategic priorities of the government.

Greater distances to schools in remote areas would also require integrated policy that would include infrastructure and transportation. For the moment, there are no legal requirements for schools or local governments to provide free transportation to students when the distance between school and their residence goes beyond a certain threshold (although in 2018 transport discounts for pupils and students

were introduced). This partly stems from the fact that currently the school network is quite dense. However, without adequate provision of transportation of pupils to schools, consolidation of the school network could result in raising barriers to attend schools, which can have detrimental effect on disadvantaged groups. Comprehensive investment and provision of transportation services can significantly reduce the cost savings of school network consolidation (OECD, 2010b). However, it is important to preserve access while improving the quality of schooling in remote areas.

### ***Improving the quality of teaching by expanding incentives for teachers to work in remote areas***

In the Czech Republic, the attractiveness of the teaching profession is low with relatively low salaries (OECD, 2019d; OECD, 2020c) and limited career progression. This results in low diversity, with teachers being quite old on average and predominantly female. The OECD Review (Shewbridge et al., 2016a) found that the Ministry's capacity to monitor and plan teacher supply according to needs is lacking. One key issue in the planning and distribution of teachers is whether the best teachers are working where they are needed most, especially in disadvantaged schools. International evidence shows that disadvantaged schools are more likely to have staff shortages and they more often employ the least experienced teachers, intensifying the disadvantage. This is often even more pronounced in remote and rural settings (OECD, 2012).

The uneven distribution of qualified teachers across schools is a concern in the Czech Republic. Disadvantaged schools are more likely than advantaged schools to report shortages of qualified or competent teachers (Shewbridge et al., 2016a; Schleicher, 2014). The Czech Republic does not have targeted programmes or incentives to motivate teachers to work in remote or regional areas (Shewbridge et al., 2016a).

The Ministry should increase incentives for highly qualified teachers to work in remote areas to help reduce disparities in the quality of schooling. Both financial and non-financial factors are important in motivating teachers. Professional factors matter, such as opportunities to take on extra responsibilities and positions of influence, reforms and innovation, and developing strong leadership and collegiality in professional development (Mourshed, Chijioke and Barber, 2010; OECD, 2012; Rice, 2010). The Ministry should help create an environment where disadvantaged schools are in position to attract the best teachers by offering meaningful careers, good working conditions and opportunities for rewards. The overall reform to the career system of teachers would be helpful and consistent with this approach. It is actually also part of the government education strategy 2020 and has been recommended by the OECD on previous occasions (Shewbridge et al., 2016a; OECD, 2014c, Santiago et al., 2012).

## **Improving the delivery of health and long-term care for an ageing population**

Addressing ageing-related challenges will require efficiency gains at all government levels. Together with ensuring the adequacy and sustainability of the pension system, expanding access to health and long-term care services are key challenges. Meeting increased demand for these services while improving value-for-money to manage fiscal costs and ensuring quality will require better coordination between levels of government and healthcare and long-term care providers. The COVID-19 crisis also highlighted the key role of local governments and regional providers of health care services.

### ***Healthcare outcomes are unequal across the country***

Regions and municipalities are to a large extent responsible for the management of health and long-term care. Funding of health care and social services is predominantly by the central government and social security funds. The Central government (Ministry of Health) has a supervisory role and the direct administration of some care institutions and bodies. It owns and runs university hospitals. Within their

independent authorities, regions are responsible for the establishment of regional health facilities, monitoring the quality of care of private health care providers and the preparation and implementation of subsidy programmes, such as capital investments or operational costs (Table 7). In addition, the regions are responsible for a set of delegated authorities from the state administration, such as authorisation and registration of health services, inspection and quality control as well as the provision of emergency services. The regional authorities own emergency units, long-term care institutions, some primary care facilities and medical spa facilities. Provision of health services through smaller hospitals are often under the responsibility of municipalities, which also manage services provided by private doctors.

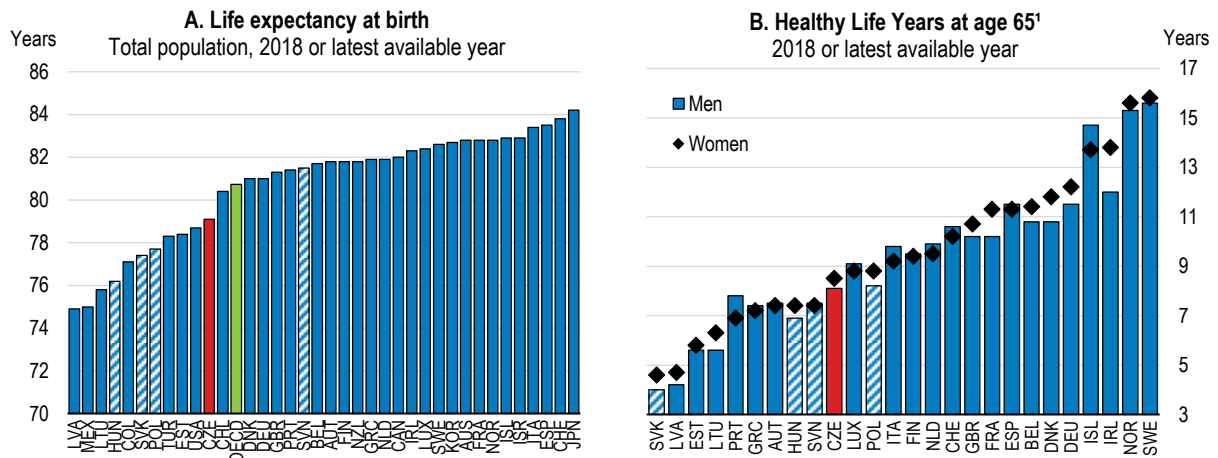
**Table 7. Responsibility for health care by level of government in the Czech Republic**

National responsibility (Ministry of Health)	Regional responsibility	Municipal responsibility
<ul style="list-style-type: none"> <li>– Health care</li> <li>– Management of large hospitals</li> </ul>	<ul style="list-style-type: none"> <li>– Establishment and management of hospitals</li> </ul>	<ul style="list-style-type: none"> <li>– Health services, through both municipal hospitals and private doctors</li> </ul>
<ul style="list-style-type: none"> <li>– Public health protection, health research activities and directly controlled health facilities</li> </ul>	<ul style="list-style-type: none"> <li>– Nursing homes</li> </ul>	
<ul style="list-style-type: none"> <li>– Ensuring the safety, quality and rational use of pharmaceutical and medicinal products, precursors and additives; approving, licensing and monitoring pharmaceuticals and medical aids</li> </ul>	<ul style="list-style-type: none"> <li>– Facilities for physically and mentally disabled adults and children</li> </ul>	
<ul style="list-style-type: none"> <li>– The search for, protection and use of natural medicinal sources, natural spas and mineral water resources, medicinal products and technical equipment for prevention, diagnostics and treating people</li> </ul>	<ul style="list-style-type: none"> <li>– Monitoring the quality of health care delivery of private providers, jointly with professional medical chambers; monitoring refers to a minimum set of criteria for material and technical equipment, as well as qualification of medical staff which are set by the Ministry of Health</li> </ul>	
<ul style="list-style-type: none"> <li>– Health insurance and health information systems</li> </ul>	<ul style="list-style-type: none"> <li>– Ensuring that non-state providers comply with a variety of laws and directives that define the technical, staffing and hygienic requirements before registering and thereby allowing them to offer health services</li> </ul>	
<ul style="list-style-type: none"> <li>– The use of biocide preparations and introduction of biocide preparations and agents to the market</li> </ul>		

Source: OECD (2018c).

Health status of the population varies across regions. Life expectancy compares favourably with other Central and Eastern European (CEE) countries (Figure 20). It has risen in all regions over the last decade, but large disparities remain (Figure 21). There are also marked differences across regions in age-adjusted mortality rates (Figure 22). Disparities in health outcomes persist, despite the fact that gaps in physician density between urban and rural areas are not particularly large by international standards (Figure 23), and there is a wide network of hospitals across the country. Evidence nevertheless shows, that while health outcomes are closely associated with socio-economic factors (Figure 24) and behavioural risk factors that vary across regions, they also reflect variations in the access (Figure 25) and the quality of health care services (OECD, 2018d).

Figure 20. Life expectancy compares favourably with other CEE countries

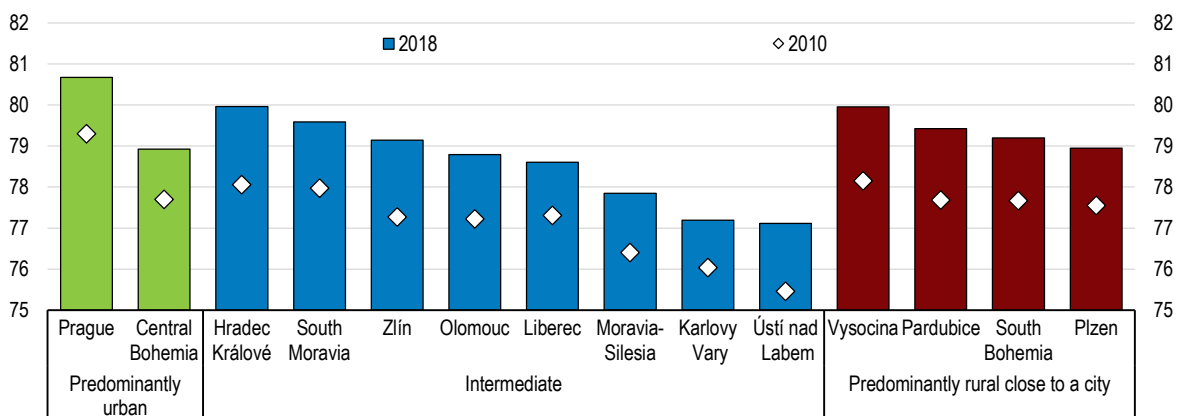


1. The indicator Healthy Life Years (HLY) at age 65 measures the number of years that a person at age 65 is still expected to live in a healthy condition.

Source: OECD Health Statistics; Eurostat database.

Figure 21. Life expectancy has increased in all regions but disparities remain

Life expectancy at birth, total population, years



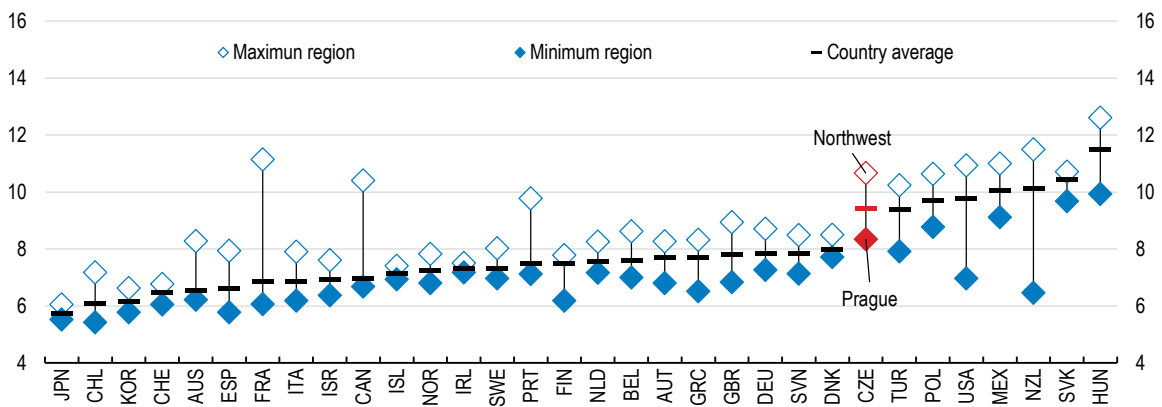
Note: The OECD has classified TL3 regions as predominantly urban (PU), intermediate (IN), or predominantly rural (PR) regions. This typology is based on the percentage of regional population living in rural communities, combined with the existence of urban centres where at least one-quarter of the regional population reside. An extended regional typology has been adopted to distinguish between rural regions that are located

close to larger urban centres and those that are not. See (OECD, 2016b) for more details.

Source: OECD Regional Database.

**Figure 22. Differences in mortality rates across regions are high in international comparison**

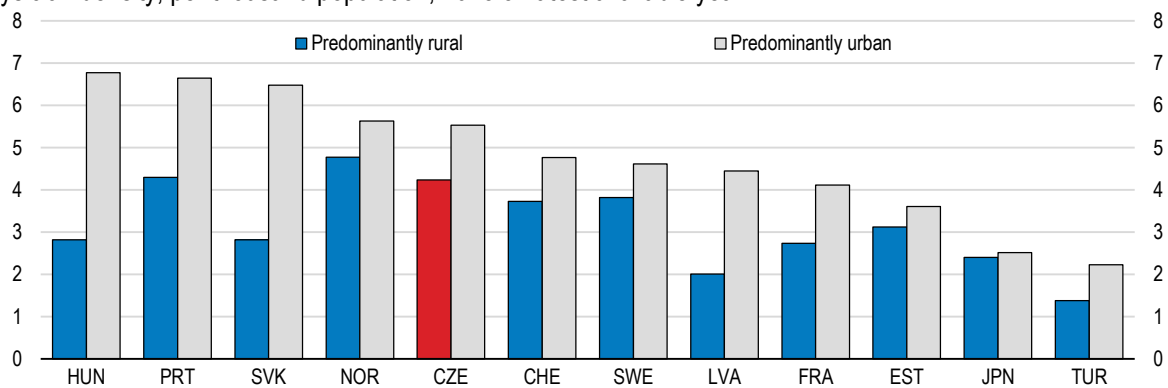
Age-adjusted mortality rate, by large region (TL2), deaths for 1000 population, 2017 or latest available year



Source: OECD Regional database.

**Figure 23. The gap in physician density between urban and rural areas is not large**

Physician density, per thousand population, 2018 or latest available year

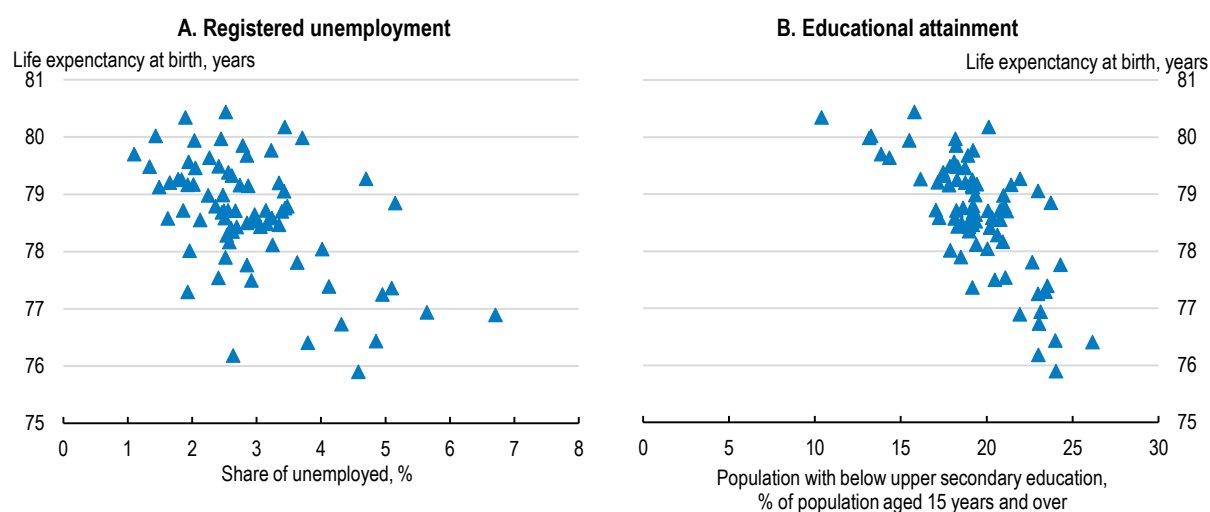


Note: The OECD has classified TL3 regions as predominantly urban (PU), intermediate (IN), or predominantly rural (PR) regions. This typology is based on the percentage of regional population living in rural communities, combined with the existence of urban centres where at least one-quarter of the regional population reside. See (OECD, 2016b) for more details.

Source: OECD Regional Statistics database.

The number of hospital beds per capita is above the OECD average. There are 4.1 acute care hospital beds in the Czech Republic per 1000 population, compared to 3.6 in the OECD on average (OECD, 2019f). A high number of beds - and appropriate equipment - can be helpful in the event of a health crisis such as an infectious virus outbreak, but this should not preclude an assessment of potential inefficiencies in the use of hospital resources (OECD, 2018d). In 2017, the occupancy rate was lower than the OECD average and it had been on a downward trend (OECD, 2019f). Where possible, shifting towards day-care, instead of inpatient care, can help save resources (OECD, 2018d). Better co-ordination of neighbouring municipalities and regional hospitals by merging and regrouping some services could enhance the efficiency of the hospital sector. However, to ensure that relying more on same-day surgeries reduces costs – and does not jeopardise health outcomes - it should go hand in hand with improvements to post-acute care and strengthened primary health care at the local level, to ensure uncompromised recovery. This requires coordination between the hospital sector and primary care.

**Figure 24. Life expectancy is lower in disadvantaged districts**



Note: Data refer to 2018 for life expectancy, to December 2019 for unemployment and to 2011 for educational attainment.

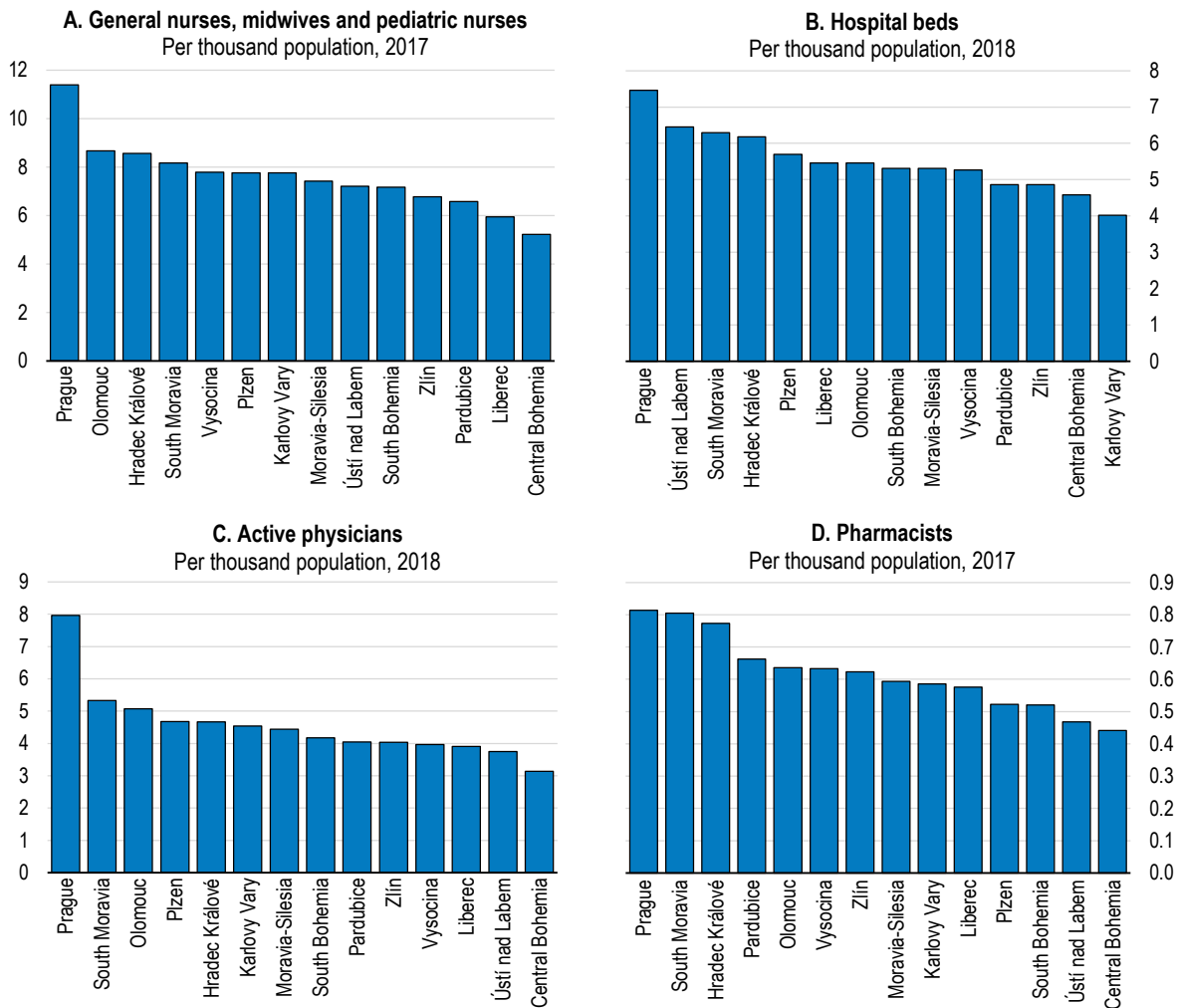
Source: OECD calculations based on data from Czech Statistical Office.

The hospital network could be reorganised to improve efficiency and raise quality of care. This could be facilitated by a simultaneous overall reorganisation of the fragmented subnational government. In Denmark, a 2007 reform of public administration and push for a reduction in the number of municipalities (see Box 3) included reforms to the hospital sector. The reform centralised specialised care in fewer hospitals and reduced the number of acute care hospitals, by merging some of them. The reform was successful in that hospital productivity increased while costs were kept stable (Christiansen and Vrangbaek, 2018).

Sharing activities and consolidation of hospital facilities could help raise the overall quality of services and address the needs of remote areas. Co-operation and consolidation already happen in some regions where different hospitals focus on different specialisation areas. Meanwhile, highly specialised care could be concentrated in designated centres. On the other hand, the reform should be accompanied by a reorganisation of the emergency services as planned in the Strategic Framework for Health 2030 (Ministry of Health, 2019), to ensure continued provision of emergency services close to the population, even in the remote areas. The Strategic Framework for Health 2030 aims at reforming primary care and building an even network of emergency services across the country. The authorities also plan to convert some small municipal and regional hospitals to long-term care (LTC) centres, addressing the relative lack of beds in residential LTC facilities (Figure 26).

Quality of care in remote areas should be monitored more systematically. The lack of comparable data at the local level makes it difficult to assess the quality of primary care. The same applies to small local hospitals. Currently, as funding is weakly linked to performance, there is no incentive for hospitals to provide information that would allow benchmarking. With the greater shift to the use of diagnosis related groups (DRG) system to measure hospital activity planned for 2020 and 2021, benchmarking will be possible. The DRG system can also be used for setting the prices of hospital services but also to provide incentives to underperforming hospitals based on best-performing hospitals.

Figure 25. Health resources vary across regions



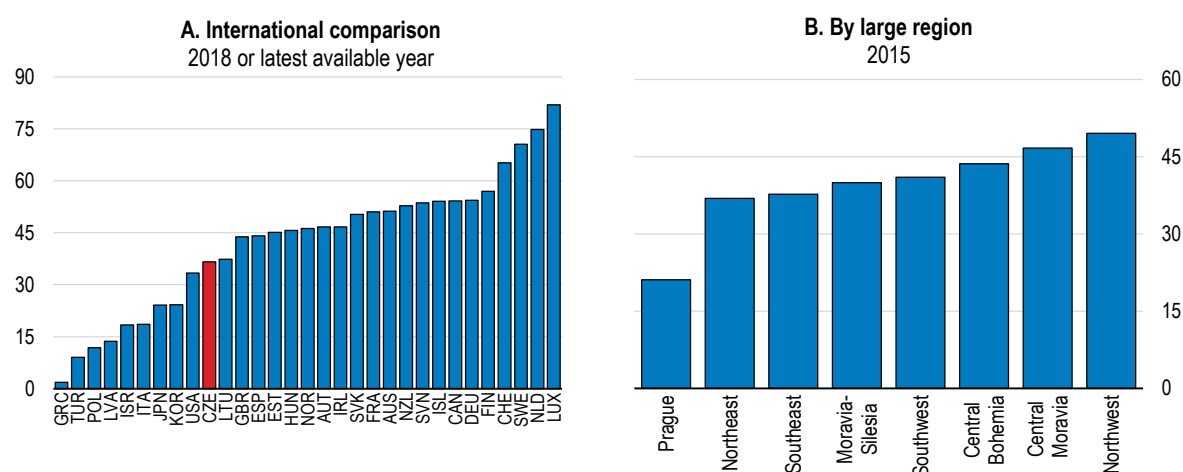
Source: OECD Regional database; Czech Statistical Office; Czech Health Statistics 2017.

Access to General Practitioners (GPs) varies less across regions than in many other OECD countries, but policies could reduce the variation further, notably to improve access in remote areas. The lack of GPs in remote areas has led to high use of emergency services. In 2011-2013, 52% of patients went to an emergency service because primary care was not available, the second highest share in the EU (OECD/EU, 2016). A subsidy programme has been designed that covers the cost of setting up a new medical clinic. In addition, in certain rural or remote areas, GPs may be compensated with a higher capitation if the number of registered patients is significantly below the national average (more than 30% below). These programmes should be closely monitored and regularly evaluated to adjust to emerging needs (OECD, 2018d). Better coordination of primary care between GPs, specialists and outpatient hospital care, with a greater role for GPs, would help release some burden from hospitals and support their refocussing on complex and intense treatments.



**Figure 26. There are few beds in long-term care facilities**

Beds in residential long-term care facilities, per 1 000 population aged 65 years old and over



Source: OECD Health Statistics; Eurostat database [hlth\_rs\_bdsns].

### ***Improving access to long-term care services***

Different levels of government share the responsibilities for the provision and financing of LTC. Financing is provided by the health insurance (for healthcare facilities providing long-term inpatient care), under the supervision of the Health Ministry. Social services and residential LTC facilities are financed by the central, regional or municipal budgets, under the supervision of the Ministry of Labour and Social Affairs. Recipients of social services receive a care allowance, and clients' fees represent a major funding resource for social services, accounting for nearly half of total costs (European Commission, 2018). Co-operation across levels of government and between the two ministries is important to avoid perverse incentives in the use of hospital facilities, where people who need social care are hospitalised. Local authorities should be incentivised to ensure that enough long-term care institutions exist within their borders, taking into account future needs.

Home care should be developed further at the local level. With high quality support at home, either through family and other informal care, professional care workers, or a combination, older people can enjoy a higher quality of life than in a traditional care facility (OECD, 2019e). Furthermore, for persons with less intensive care needs, home care can also be more cost-efficient than institutional care (OECD, 2017d). However, quality assurance, a trained workforce and support for informal workers are lacking in many areas. The European Commission (2018) reports that in the Czech Republic, in some regions, there is an absence of support services for families caring for their members. Moreover, the quality of care is difficult to assess. There is no systematic monitoring and the quality assurance system could be improved.

International experience shows that local governments, social care centres and primary care have important roles in developing effective home care for the elderly. In Japan, an Integrated Community Care System, organised at the municipal level, has been a pillar of the government's strategy to improve support for older populations. Most importantly, the system provides close coordination between medical treatment and long-term care, but also provides prevention services and other support (OECD, 2019e, Morikawa, 2014). In Sweden, reforms introduced in 2018 attempted to better integrate primary care into care planning processes, to raise the quality of care at home. To smooth the transition between hospital and home, hospitals are required to notify the patient's municipality and primary care clinic within one day of admission, to ensure that community services have enough time to prepare for any transition and care co-ordination needs (OECD, 2019e).

**Table 8. Recommendations on enhancing administrative and fiscal decentralisation**

Main findings	Recommendations (key recommendations bolded)
<b>Streamlining and enhancing the effectiveness of local administration</b>	
Czech municipalities are the smallest in the OECD. High fragmentation poses challenges to efficiency and the quality of services. Inter-municipal co-operation is common, but lacks stability and often relies on external, temporary sources of financing.	<p><b>Introduce financial and non-financial incentives for municipal mergers.</b></p> <p><b>Make inter-municipal co-operation mandatory and multi-purpose at the level of micro-regions with clearly specified tasks. Encourage self-funding of inter-municipal co-operation (from own tax sources and by member municipalities).</b></p>
	Increase the role of municipalities with extended powers by transferring to them selected independent competencies and giving them more taxing power.
	Transfer all delegated competencies (public administration services) to larger municipalities with sufficient personnel and financial capacity (type II and type III municipalities).
<b>Upgrading capacity and the quality of public services at the local level</b>	
Indicators about the cost and quality of public service provision across municipalities and regions are missing.	<b>Gather information on the quality of services provided at the local level to increase understanding of best practices and allow the use of benchmarking.</b>
Capacity at the local level is low and maintaining the quality of public services can be a challenge, particularly in remote and sparsely populated areas.	Continue the rolling out of eGovernment and offer training to local public officials.
<b>Improving fiscal efficiency</b>	
The tax-sharing system tends to favour small municipalities.	Adjust the tax sharing formula so that it does not encourage very small municipalities to stay small, by reducing the weight of the cadastral area.
Fiscal autonomy is low and the link between received tax revenues and the tax base is weak, reducing incentives to grow local economies. Having said that, most Czech municipalities are not optimal taxing units due to their small size.	Encourage municipalities, of appropriate size or once merged, to develop their tax base, by raising the weight of factors linked to economic activity in the tax sharing formula. Make fiscal equalisation flows explicit.
Grants are generally earmarked and do not require matched funding, reducing efficiency	Favour non-earmarked grants with required co-financing by SNGs to raise cost efficiency.
<b>Raising equity in education across the country</b>	
The new funding system is fairer but does not correct for economic disparities across regions.	<b>Introduce explicit and objective criteria in the funding formula of schools to further address inequities and disadvantage.</b>
<p>The number of small schools is high and many of them are not of an efficient size, lowering quality.</p> <p>Municipalities often do not have sufficient capacity to run schools effectively.</p>	<p><b>Consolidate the school network to ensure quality of education in all schools and encourage small schools to cooperate and share administrative resources.</b></p> <p>Introduce legal requirements for provision of transportation to schools.</p> <p>Shift education competencies – and the flow of education grants – to the municipalities with extended powers.</p>
Disadvantaged schools are more likely to have staff shortages and they employ the least experienced teachers. This is even more pronounced in remote and rural settings.	Offer better career paths to teachers and increase incentives for high quality teachers to work in remote areas.
<b>Improving the delivery of health and long-term care services at the local level</b>	
The number of small hospitals is high reducing efficiency in health care delivery	Spatially redistribute healthcare services. Concentrate highly specialised care in fewer centres. Extend the network of primary care provision and emergency centres.
Provision and financing of LTC is fragmented and under pressure from population ageing	Facilitate provision of long-term care services at home, by integrating social and health care services at the local level. Strengthen quality assurance and support and training for LTC workers, including for those providing care at home.

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## Annex 1.A. Average tax revenue per capita is higher in small municipalities, 2018

Table A.1. Average tax revenue per capita is higher in small municipalities, 2018

	Total population	Number of municipalities	Average population per municipalities	Number of pupils in municipal schools	Share of tax revenue	Average tax revenue per inhabitant (thousands CZK)	Aprox. cadastral area (ha)	Average share of area per inhabitant (ha)
1-50	2 922	71	41	0	0.0%	19.3	21 008	7.2
51-100	29 340	376	78	444	0.2%	18.4	156 771	5.3
101-200	147 265	987	149	1 046	1.1%	17.1	573 543	3.9
201-500	652 060	1 991	328	24 033	4.6%	16.2	1 717 451	2.6
501-1000	975 337	1 377	708	91 230	6.9%	16.1	1 718 246	1.8
1001-2000	1 053 794	754	1 398	139 493	7.5%	16.2	1 318 423	1.3
2001-5000	1 284 242	425	3 022	178 533	9.2%	16.3	1 034 287	0.8
5001-10000	979 575	143	6 850	140 675	7.3%	16.8	460 769	0.5
10001-20000	957 946	68	14 087	135 690	7.2%	17.0	234 011	0.2
20001-30000	609 580	26	23 445	78 795	4.5%	16.6	109 992	0.2
30001-50000	707 564	18	39 309	92 688	5.4%	17.2	105 611	0.1
50001-100000	870 531	12	72 544	107 747	6.8%	17.6	88 423	0.1
100001 and more	204 473	2	102 237	25 131	1.7%	18.6	20 942	0.1
Brno, Ostrava, Plzeň	840 913	3	280 304	92 281	10.5%	28.3	58 208	0.1
Prague	1 294 513	1	1 294 513	137 257	27.0%	47.2	49 621	0.0

Source: Ministry of Finance.