



Inter-Municipal Cooperation in the Czech Republic: A Public Finance Perspective

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Abstract

Inter-municipal cooperation (IMC) in the Czech Republic is common and flexible and is generally viewed as a means to reduce problems related to the highly fragmented local government structure. The paper utilizes financial and accounting data of public entities to evaluate the character and magnitude of inter-municipal cooperation in the Czech Republic. It concludes that the extent of public services provided based on the service contracts or through institutionalized forms of IMC is quite limited and that the majority of the IMC is somewhat informal and soft, e.g. exchange of experience and ad-hoc projects.

Keywords:

inter-municipal cooperation, financial management, local government, Czech Republic

Introduction

Inter-municipal cooperation (IMC) in the Czech Republic is common and flexible (Lewis and Fall 2017, 25), which is not surprising as there are 6,254 municipalities with a median size of 430 inhabitants and an average size of 1,692 inhabitants (Czech Statistical Office 2018). IMC is a way how to deal with pressures on local government resulting from increasing technical scale of production, growing scale of social and economic processes and pressures of the market (Hulst and van Montfort 2007). It may be an alternative to compulsory, top-down territorial amalgamation (Hertzog 2010 and Obec a finance 2016) or a tool to increase administrative capacity of small municipalities (Union of Towns and Municipalities of the Czech Republic 2018a). Successful IMC generates collective benefits by producing

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efficiencies and economies of scale in provision and production of services and by internalizing spillover problems (Feiock 2007).

Inter-municipal cooperation takes many different forms, ranging from informal and voluntary to institutionalized and mandated. The full variability and extent of IMC in the Czech Republic are not fully researched yet. The existing research relies mostly on surveys and single or multiple case studies and favors one form of IMC, namely the voluntary associations of municipalities (VAM) (e.g. Vajdová et al. 2006, Jetmar et al. 2015 or Ježek et al. 2015).

The paper aims to explore the forms of inter-municipal cooperation in the Czech Republic and to evaluate its role in the provision of public services and joint investment. It utilizes the data on public finances, i.e. information available in the accounting records of the involved municipalities and voluntary associations of municipalities.

The first part of the paper presents the various forms of IMC in the Czech Republic using the taxonomy of collaborative institutions proposed by Dowding and Feiock (2012). The second section describes the data and methods utilized. The third part presents the results, and the final part discusses the results and their implications.

1. Modes of inter-municipal cooperation

Decentralization brings governments closer to the people with the aim to improve allocative efficiency and increase accountability (Lockwood 2005). Unfortunately, the existing structure of local governments often fails to internalize tax and expenditure externalities and to exploit economies of scale (Oates 1999). Small local governments may also lack the executive capacity for effective management of public services or exercise of regulatory duties (Davey 2004).

These problems can be solved or limited by a variety of collaborative mechanisms which involve different levels of negotiations and ease of exit (Dowding and Feiock 2012). Figure 1 presents their taxonomy of collaborative arrangements, which result either from the initiative of higher-level government, when its decisions bind all the actors (upper row) or from voluntary choices of two or more local governments, which decide on the rules themselves (bottom row).

The horizontal dimension captures the nature of the coordination mechanism (collective centralized and negotiated). Forms on the left rely on the resources and authority of other governments. In the middle, municipalities voluntarily enter into organizations or contracts that bind them but depend on mutual consent. To the right side, the relationships are informal.

Figure 1
Taxonomy of collaborative arrangements

Extent negotiated	Collective centralized	Centralized regional authorities A	Regional organizations C	Partnerships E
	Negotiated	Mandated networks or agreements B	Interlocal agreements and service contracts D	Informal groups and policy networks F
		Governmental authority	Contracts	Informal
			Ease of Exit	

Source: Dowding and Feiock (2012, 41), adjusted

In the Czech context, IMC is generally understood as voluntary (middle and right column) and negotiated (bottom line), i.e. fields D and F in Figure 1. Close scrutiny, however, reveals that all types of collaborative arrangements are present there to some extent and that mandated networks and agreements (field B) play a more prominent role in providing public services than interlocal agreements and service contracts (field D).

Czech municipalities exercise two types of competences at the same time: independent competencies (self-government) and delegated powers (public administration). In the execution of the independent competencies, municipalities enjoy a high degree of autonomy. For delegated powers, the municipalities are in a legal sense the executors of central government policy and have limited autonomy (Hemmings 2006). While the Law on Municipalities (128/2000 Coll.) states that municipalities can cooperate in case of independent competencies, cooperation, as understood by Dowding and Feiock (2012), takes place in both types of competences.

Cooperation among municipalities in the area of delegated power takes two forms: First, bigger municipalities provide some of the administrative services for a specified catchment area which covers other municipalities, as well. There are seven different categories of municipalities according to the extent of delegated power they exercise. The most important are the 207 so-called municipalities with extended power. The range of services and the catchment area are defined by the central government, which also contributes to the financing of these services through grants. This type of cooperation fits under the mandated networks (field B).

In the area of delegated powers municipalities can cooperate through public contracts when one municipality provides some of the administrative services for an-

other one. These contracts are common in the area of offenses or child protective services. This type of cooperation is voluntary and fits under service contracts (field D).

In the case of IMC in the area of own competencies, the Law on Municipalities clearly prefers the form of voluntary association of municipalities (VAM) as it does not specify any other form of IMC (Jetmar et al. 2015). Despite this, three primary forms of IMC are possible: (1) contracts, (2) formation of a voluntary association of municipalities, and (3) foundation of another type of legal person based on the appropriate legislation. All of these forms of cooperation fall under interlocal agreements and service contracts (field D).

Currently 185 local action groups (LAG) operate in the Czech Republic, created and funded in the framework of EU program LEADER (Vrabková and Šaradín 2017). The Union of Towns and Municipalities of the Czech Republic is a strong advocate of IMC in the Czech Republic. In the framework of a project funded by the EU funds 83 involved VAM operate so-called Centers of joint services which aim to increase the administrative capacity of municipalities (Union of Towns and Municipalities of the Czech Republic 2018b). According to Dowding and Feiock's (2012) taxonomy both LAG and Centers of joint services stay on the border between the regional organization and interlocal agreements (field C), as they strongly rely on external funding, which comes hand in hand with stringent rules.

A unique form of cooperation takes place in the case of preschool and elementary education. Municipalities which do not operate own schools guarantee the availability of education through contracts with other municipalities. Municipalities compensated each other for the provision of education until 2012 (Figure 2). Since 2013 education is financed through the shared taxes when municipalities which operate a school receive a higher share based on the number of enrolled pupils. This arrangement incorporates voluntariness and central government funding again (field C).

Informal cooperation (field F) is extremely popular. It includes the exchange of information and experience using informal networks, such as working groups or meetings of mayors. 30 % of mayors surveyed by Jetmar et al. (2015) deemed it the most suitable form of IMC, and more than half of the officials surveyed by Ježek et al. (2015) prefer this form of IMC.

Hulst and van Montfort (2011) add one more dimension to classify inter-municipal cooperation: the tasks involved in cooperation. They distinguish between service delivery, i.e. joint production, and policy coordination and planning. A prerequisite for the provision and production of many public services is the existence of particular infrastructures, such as a drinking water and sewer network or a school building. IMC can be particularly useful when building such an infrastructure.

Our analysis of the IMC in the Czech Republic is based on the fact that both the provision of services and building necessary infrastructure incurs costs, and these costs, together with the revenues which finance them, must be recorded in the

accounting books of either the municipalities or the jointly created organizations. This allows us to track cooperation in service delivery and joint investment in the form of interlocal agreements and service contracts (field D). Policy coordination and planning and any type of informal cooperation, on the other hand, is very hard to track in accounting books.

2. Data and methods

In our analysis, we combine a longitudinal approach (1997–2017) with an in-depth cross-sectional analysis in 2014. The year 2014 was chosen as it is the only year for which the complete data on the VAM membership and population is available.

To map the IMC, we use and combine various resources:

Information on public finances come from the budget and accounting reports of individual municipalities and VAM provided by the Ministry of Finance (2018a) through its database Monitor. Budget reports include data on revenue and expenditure recorded using the cash principle and classified using the Budget classification (323/2002 Coll.) based on their economic type and function. These data are available for the period 1997 to 2017. Accounting data include data from the individual balance sheets and profit and loss statements for the period 2010–2017. It is possible to aggregate the data for individual entities and get the total volume of any particular indicator.

Data on the VAM, including their founding and termination date, if applicable, and seat, come from the Registry of Economic Subjects run by the Czech Statistical Office (2017). Data on their member municipalities and total population come from the Union of Towns and Municipalities of the Czech Republic (2014).

Data on public companies come from the list provided by the Ministry of Finance (2014) and are accompanied by information on their seat and owners from database Albertina.

In order to analyze the economic activity of the VAM four main indicators are used:

- Fixed assets per capita = netto fixed assets as of 31 December 2014 divided by the sum of inhabitants in the member municipalities;
- Per capita costs from own activity = average costs from own activity in 2012–2014 divided by the sum of inhabitants in the member municipalities;
- Per capita expenditure = average total expenditure in 2012–2014 divided by the sum of inhabitants in the member municipalities;
- Share of own resources = difference between total revenues and the sum of transfers received from other subjects than municipalities divided by total revenues in 2012–2014.

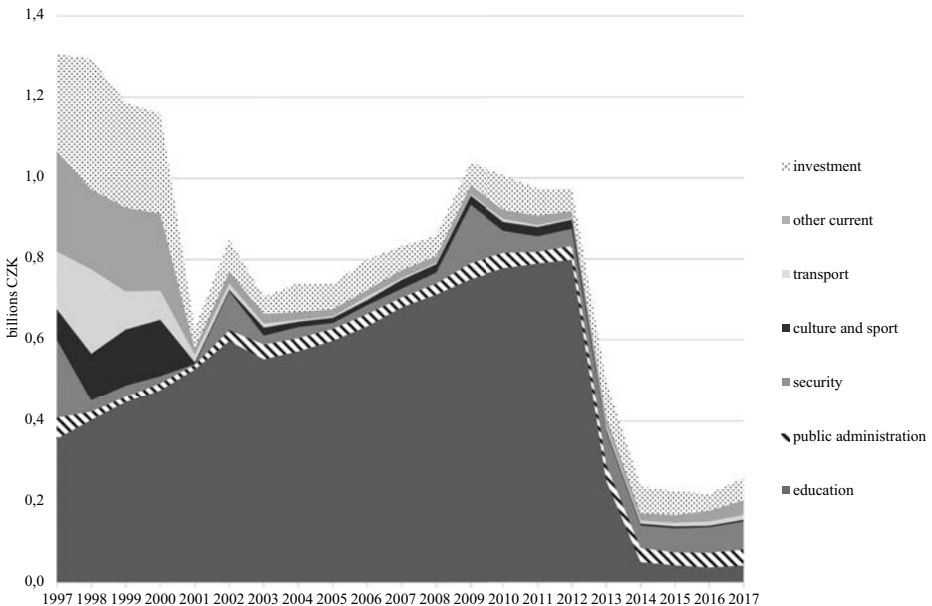
The data were analyzed using descriptive statistics and difference of the means test and visualized in MS Excel.

3. Results

3.1 Contracts signed for the fulfillment of particular tasks

Municipalities can close contracts with another municipality in the case of both independent and delegated competencies. The related financial compensation is displayed in municipal budgets as current or investment transfers to another municipality. Figure 2 shows its development over the last two decades. The volume of inter-municipal transfers was always low, and its share in total municipal expenditure fell further from 1 % in 1997 to 0.1 % in 2017. The significant change since 2001 is related to the public administration reform and the introduction of a new system of tax revenue sharing. Financing preschool and elementary education through the tax revenue sharing since 2013 replaced the previous system of mutual compensations between municipalities.

Figure 2
Inter-municipal transfers (billions CZK)



Source: Ministry of Finance (2018a), own elaboration

Unfortunately, we are not able to track one type of cooperation in the accounting books, namely joint out-sourcing of service delivery to private companies, as both individual and joint out-sourcing is displayed together.

3.2 Joint registered companies

Municipalities can jointly establish various types of legal entities based on the relevant legislation, such as joint stock company, limited company, limited partnership, co-partnership, cooperative, not-for-profit organization, and foundation (Vedral et al. 2008).

Our analysis deals only with joint stock companies and limited companies. In total there were 292 public joint stock companies in 2014 and 658 public limited companies (Ministry of Finance 2014). The published list provides the name of the company and its identification number, but not the public entity which is the owner of the company. Database Albertina includes data on registered companies provided by the business registry, but the data is unfortunately not complete, so that we were able to identify owners for only 75 % of public companies. Based on the available data municipalities own at least 167 joint stock companies and 541 limited companies.

Joint municipal ownership of registered companies is quite rare. The above-described search led to the identification of 1 joint stock company and 25 joint limited companies owned by at least two municipalities. The number of owners ranges from two to 17, and the companies operate in the area of public transportation, water, forest management and waste management.

This finding is in line with Ježek (2016), who surveyed municipal officials and found out that cooperation in the form of joint registered companies is the least preferred form of inter-municipal cooperation.

3.3 Voluntary associations of municipalities

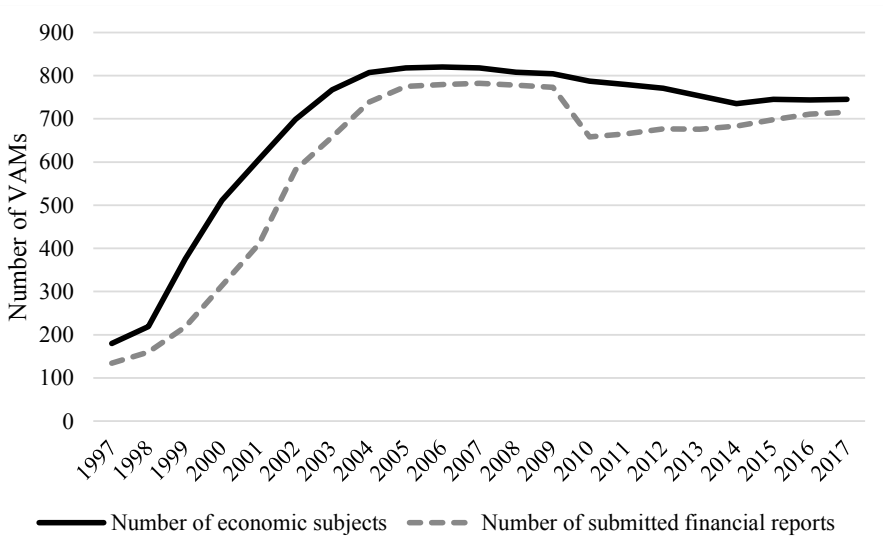
The voluntary association of municipalities (VAM) is a particular type of legal entity intended for inter-municipal cooperation. A VAM can be founded by two or more municipalities that need not be neighbors. One municipality can be a member of multiple VAMs. The VAM is established based on a contract that must be approved by the municipal councils of all participating municipalities. Its status declaration guides the activity of a VAM.

The VAM legally comes into being when the regional office registers it, and it ends its existence based on an agreement, lapse of the designated period, or fulfillment of the task defined in the founding contract.

The number of active VAM grew steadily since 1990 with the peak in 2006 with 820 active VAMs (Figure 3). The significant growth around 2000 is related to the adoption of a new Law on Municipalities (128/2000 Coll.), which banned the

utilization of some other legal forms for IMC. Out of 1,024 VAMs founded until the end of 2017, 280 already terminated their activity. On average nine VAMs were founded annually since 2010.

Figure 3
Number of active VAMs (1997–2017)



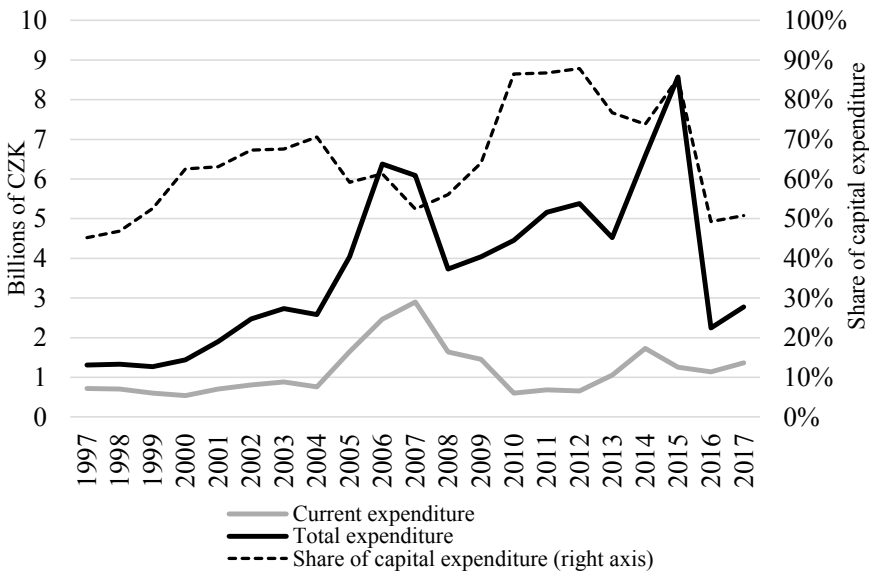
Source: Czech Statistical Office (2017) and Ministry of Finance (2018a), own elaboration

VAM formation and activity are regulated by the Law on Municipalities (128/2000 Coll.) and its management by the Law on Budgetary Rules of Local Governments (250/2000 Coll.). In case a particular issue is not regulated in these two laws the Civil Code (89/2012 Coll.) is applied.

The financial management of VAMs is regulated similarly to that of local governments: VAMs prepare and approve an annual budget which uses the Budget classification (323/2002 Coll.), compile the regular budget reporting and accounting documents, and their management is subject to an annual audit. Unfortunately not all registered VAMs submit their financial documents properly, and their data are not included in the database Monitor (Figure 3 shows the extent of the missing documents).

Total VAM expenditure was quite volatile over the last two decades (Figure 4), but its share in total municipal revenues remained low (3 %) even at its peak in 2015. The volume and structure are strongly influenced by the availability of external financing, for instance the EU funds.

Figure 4
VAM expenditure (1997–2017, Billions of CZK)



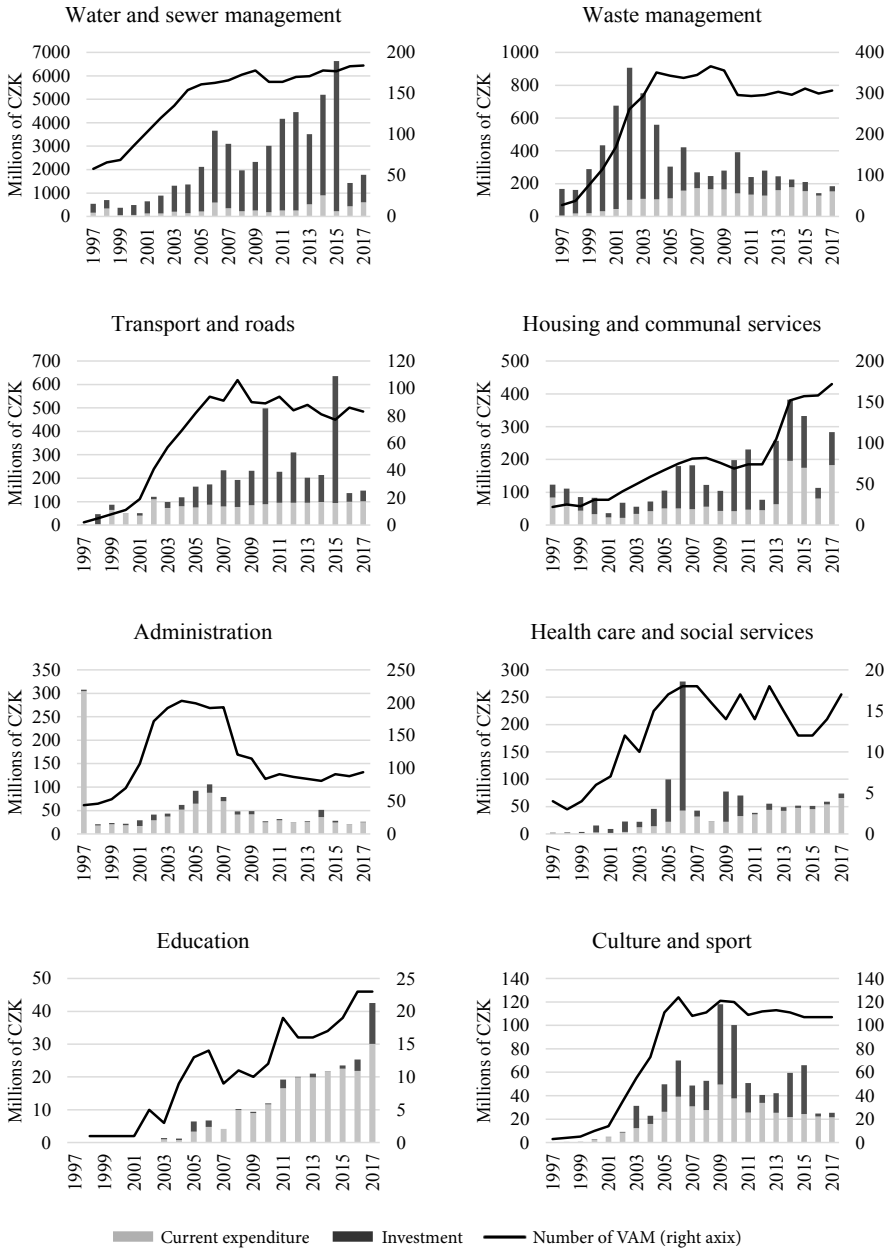
Source: Ministry of Finance (2018a), own elaboration

VAMs have three main financial sources: member contributions, non-tax revenues resulting from their operations, and external resources, such as grants (Gavlasová et al. 2007, 62). Member contributions (contributions from the member municipalities) usually include annual and entrance fees. The annual fee is mostly given as a per-capita amount (approved by all participating municipalities), while the entrance fee is a lump sum per municipality. These fees are usually quite symbolic. In case of the realization of an investment project, contributions are often calculated based on the cost principle.

The share of external recourses available to VAM declines. The average share of external resources fell steadily from 35% in 2010 to 21% in 2017. At the same time, the share of VAM without external resources grew from 40% in 2010 to 48% in 2017.

The disaggregation of VAM expenditure gives a more detailed picture of their role and activity (Figure 5). The individual functions are based on the functional budget classification, when individual paragraphs are grouped into broader categories. The division on current expenditure and investment follows the economic budget classification. The number of VAM indicates the number of VAM with any expenditure in the given area; hence in some cases, the extent of their activity can be extremely limited.

Figure 5
 VAM expenditure for key functional areas (Millions of CZK and number of VAMs, 1997–2017)



Source: Ministry of Finance (2018a), own elaboration

The primary area of activity of VAMs is water and sewer management. The investment in this area comprises the vast majority of total VAM expenditure. Current expenditure is significant, as well. Much investment in the area of waste management took place at the beginning of the century, followed by stable current expenditure needed for the operation of the existing facilities. Current expenditure in the area of transport and roads is very stable over time, and there were a few one-time significant investments.

Expenditure in the remaining areas is significantly lower. We can observe the growth of current expenditure in the area of housing and communal services, health care and social services and recently in the area of education. The number of involved VAMs is growing in these areas, as well. However, generally, the role of VAMs in these areas is minimal.

These data contradict the preferences of the mayors surveyed by Jetmar et al. (2015). About a third of them claimed that their preferred activity of VAM is waste management, social services, and education. These preferences are met only in the area of waste management. Our analysis based on the financial and accounting records showed that cooperation in the area of education or social services realized through VAM is sporadic.

3.4 Voluntary associations of municipalities in 2014

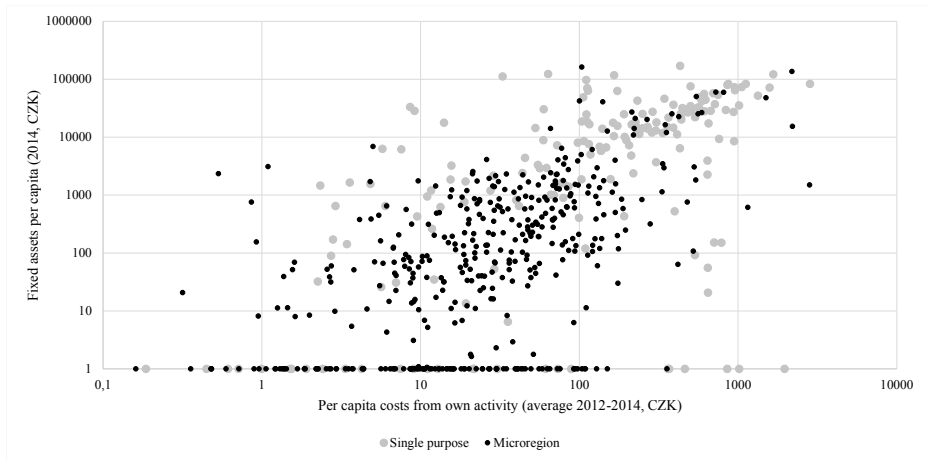
According to the registry of economic subjects for the whole year 2014, 731 VAMs existed. Database Monitor does not include any financial and accounting reports in the case of 22 VAMs (Ministry of Finance 2018a), and the database of audit results in 2014 does not contain information about 27 VAMs (Ministry of Finance 2018b). These deficiencies raise questions regarding the real functionality of these VAMs, as they do not comply with legal obligations, and generally regarding the comprehensiveness of the financial and accounting data regarding VAMs.

The final sample of analyzed VAMs includes 615 units for which data on membership municipalities were available in Union of Towns and Municipalities (2014). Two types of VAMs are distinguished: single-purpose VAMs (182 units) and microregions (433 units). Single-purpose VAMs are most often active in the area of water and sewer management or waste management. Microregions, on the other hand, realize a broader range of activities in their territories, usually with a developmental aim. The division is based on Union of Towns and Municipalities (2014).

Many VAMs (15 % single-purpose and 26 % microregions) did not own any long-term fixed assets in 2014, and the average costs from own activity between 2012 and 2014 were often meager. Half of the microregions operated annually with less than 27 CZK (app. 1 EUR) per inhabitant. The median per-capita costs in single-purpose VAMs were 137 CZK (app. 5 EUR). Both fixed assets per capita and annual per capita costs from own activity were significantly higher in single-

purpose VAMs, but we can find extraordinarily high and low values in both types of VAM (Figure 6).

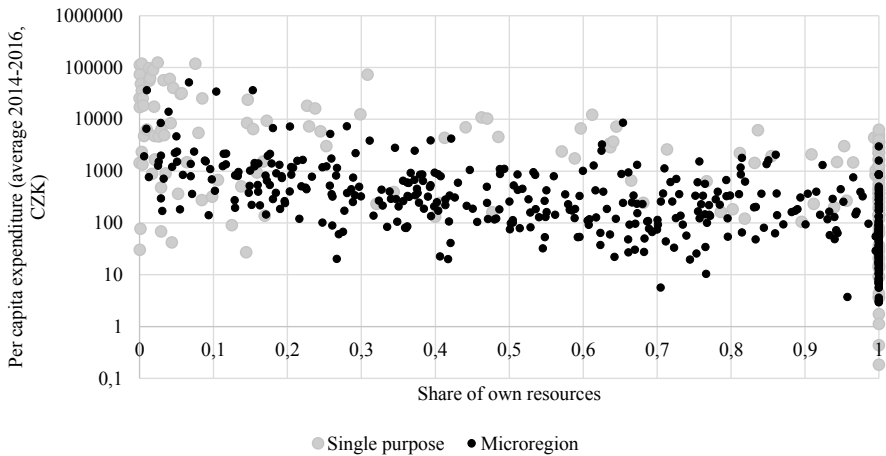
Figure 6
Fixed assets per capita and annual per capita costs from own activity
(CZK, N=615)



Source: Ministry of Finance (2018a), Union of Towns and Municipalities of the Czech Republic (2014), own elaboration

The share of own resources, i.e. municipal contributions and revenues from own activity, ranges from almost zero to one. 43% of single-purpose VAMs and 26% of microregions operated in the period 2012 to 2014 without external resources. There is no clear relationship between the share of own resources, and per capita expenditure; however, very high expenditure is always related with a high share of external resources, i.e. grants (Figure 7).

Figure 7
Average per capita expenditure and share of own resources
(CZK, N=615)



Source: Ministry of Finance (2018a), Union of Towns and Municipalities of the Czech Republic (2014), own elaboration

The analysis of chosen financial indicators showed enormous heterogeneity among the existing VAMs. Almost a third of VAMs operate without external funding, and another third rely more on own than external funding. On the other hand, the volume of their expenditure or costs of own activity is often so low that it questions its real impact beyond the informal exchange of experience.

4. Discussion

From the point of view of a single municipality, IMC is one of the possible ways how to provide public services (Bel and Warner 2016). Our analysis, based on financial and accounting information provided by public entities, confirmed that interlocal agreements in service delivery and building infrastructure is less significant than expected, based on opinions of local officials (e.g. Ježek et al. 2015 or Jetmar et al. 2015). However, is it really a surprising result?

Small-scale local government and sizeable local policy domain are likely to result in intense IMC in service delivery (Hulst and van Montfort 2011). While Czech municipalities comply with the small-scale requirement, they have a relatively small policy domain. Municipalities have quite a limited number of public services they lawfully must provide (e.g. waste management, elementary education, basic administrative services). Regarding many public services (e.g. social services or leisure

activities) they are free to take up new tasks and services, but small municipalities rarely do (Sedmíradská and Kábelová 2018). Reforms of the tax sharing formulas favoring small municipalities since 2008 and providing funding of elementary education since 2013 softened the budget constraint of mostly small municipalities and further limited the already weak pressure to search for more efficient forms of public service provision.

Functional areas of IMC, when the VAMs are most active in the areas of water and sewer management and waste management, comply with the expectation that municipalities are inclined to collaborate in services which require substantial financial investment and offer substantial efficiencies of scale (Hulst and van Montfort 2011).

The dominance of the VAMs compared to service agreements is entirely in line with the experience in other European countries: if the legal requirements to found an organization are not prohibitive and if there are (potential) financial incentives from central government, “informal or contract like forms of co-operation are replaced by co-operation through service organizations” (Hulst and van Montfort 2011, 135). Current legislation only mentioning VAM as a form of IMC clearly expresses the intents of the central government.

5. Conclusions

Financial and accounting information about public entities is a rich source of information about their activity. This paper utilized this data source to explore the extent and character of inter-municipal cooperation (IMC) in the Czech Republic and presents new findings which complement the existing research based predominantly on public officials’ surveys.

Czech municipalities cooperate to a great extent, and we can find numerous examples of very successful IMC either in the form of VAM or others.

The key form of IMC are without any doubt voluntary associations of municipalities (VAM), as also suggested by Jetmar et al. (2015) and Ježek et al. (2015). The magnitude of the cooperation is hugely varied across functional areas and individual VAMs. The most widespread is cooperation in the area of waste management (300 VAMs), with a current annual expenditure above 150 million CZK. The highest share of expenditure, both current and capital, is dedicated to water and sewer management (26% of current expenditure and 79% of capital expenditure over the period 1997–2017). Surprisingly, the significant impact of IMC in this area is not indeed reflected in the above-cited research, and unlike cooperation in the area waste management (e.g. Soukopová and Klimovský 2016) is not a subject of academic research, either. VAMs play only a minimal role in the case of education (23 VAMs) and healthcare and social services (17 VAMs), which is quite contrary

to the findings of both Ježek (2016) and Jetmar et al. (2015), who found out that municipalities want to cooperate in these areas and do.

Municipalities often cooperate based on mutual contracts, but the resulting financial compensations are extremely low (less than 0.1 % of total municipal expenditure in 2017). This suggests that municipalities rely less on purely voluntary cooperation and more on mandated networks or agreements when the provider of the service is not compensated by the receiver of the service but by a higher level of government through another mechanism, e.g. grants or tax sharing. At the same time, it is likely that much cooperation has a more informal and soft character than the joint provision of services or joint investment.

Our findings thus suggest that a significant share of IMC takes the form of mandated networks and agreements (field B in Figure 1) rather than interlocal agreements and service contracts (field D in Figure 1). Hence IMC may often be a result of higher-level government stimuli and financial support rather than bottom-up voluntary initiative (see also Swianiewicz 2010).

These findings are important in the current debate about the capacity of IMC and VAM in particular to solve (some) problems of the fragmented municipal structure and of the many small municipalities (Obec a finance 2016). Czech municipalities strongly oppose any changes in the mandated networks but at the same time call for higher financial support of voluntary IMC. So far the central government plays along – municipal amalgamation is an absolute taboo in political discussion, and sizable projects supporting IMC are funded. Their real impact needs yet to be evaluated.

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