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Phillip J. Bryson
phil_bryson@byu.edu

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User Fees in Local Finance: Performance and Potential in the Czech and Slovak Republics

I. Introduction

The attempts of the Czech and Slovak Republics to transition to market economics began before their separation via the Velvet Divorce in 1993. The central governments of both countries have been inclined at times to retain their centralist traditions. As a result, the public sector transition may have been even more difficult than that of the private sector. The basic institutions of municipal finance were established after the disappearance of communism in late 1989, but *before* the Czechoslovak union ended in 1993. Public Finance institutions remained quite similar in the twin republics until Slovakia began to prepare for accession to the EU by developing some widely-publicized financial innovations as a part of a “Reform of Public Administration” in the early 2000s. The two countries are just now beginning to diverge noticeably.

Because of their common origins, both republics face similar transition problems with similar institutions and traditions. The same can doubtless be said of other central and east European countries of transition. A single paper cannot have the scope to address several of such countries without becoming too general and superficial. Nor should a single paper address either the Czech or Slovak Republic alone, denying itself of the economies of scale possible in investigating both of the fraternal-twin republics simultaneously. Regarding local user fees in general, what can be said of one of these countries can usually be said of the other. Where there is a substantive difference or potential for growing difference, it will be mentioned.

In both republics, the reforms of public administration were intended to devolve power from the center to the municipalities and the recently organized regions, but the effort to achieve fiscal decentralization has been difficult in the face of insufficient flows of funds from the center to the cities and towns. The Czech Republic has been far more generous toward its municipalities than has been the case in Slovakia, but the Czech central government has been more inclined to micromanage the use of funds granted and transferred.

The budgetary viability and fiscal independence of both Czech and Slovak municipalities would benefit greatly if independent financial sources (*e.g.*, property tax and local user fees) produced more robust revenue yields. This paper considers local user fees and their potential for providing some financial relief for Czech and Slovak municipalities. Those revenues currently represent only a miniscule share of the receipts of local budgets. The

OECD (1997, p. 11), for example, laments that Czech “own tax revenues” derived from the real property tax and a number of “low yield taxes” are “very limited.”

In transitional states trying to cope with a backlog of needs for local and national infrastructure and for ongoing public services, one must ask whether such revenues could not be increased. Underlying this question is the more philosophical one about what role user fees should play in the Czech and Slovak republics. It is a common view that the acceptable rationale for the prices of public goods and services is cost recovery (Oum and Zhang, 1990; Griffin, 1987). Policy may justify charging less than full cost recovery in some instances, but sometimes it may also seek more than the recovery of the full cost (Kaiser, 1988; Lee and Wilson, 1991). In transition countries user fees are frequently administered in the hope of providing a contribution to general revenue, and this is of significance for the Czech and Slovak Republics (Bryson and Cornia, 2003; Sedmihradská, 2005).

Some public services, *e.g.*, permitting the use of public spaces for parking or other purposes or granting licenses to establish casinos or gambling, are provided to citizens for the payment of fees. Because the provision of such services or licenses yields revenues for municipalities, they will be discussed at length below. We will be interested in revenue generation in practice and in its potential for far greater yields.

The focus of this investigation is the set of “*poplatky*” currently in use in both the Czech and Slovak Republics. These might well be translated as “fees,” but in a more technical sense they would be better referred to as “charges.” The list of *poplatky* is reasonably short and it does include actual user fees. The list also includes, however, some local taxes as well and the Czech Ministry of Finance proposed a few years ago that “fees” be classified as taxes. The Czech parliament did not grant permission for that, and where such charges represent payment for public services as such, it seems appropriate that the term “fees” (*poplatky*) still applies.

Because of the properties of user fees, which will be discussed below, they represent an important source of autonomous revenues for local governments. Such revenues make possible enhanced and extended goods and services for the public and they provide other desirable possibilities for scarce public funds. Where a clear service is provided, those receiving the service are usually happier about paying for it than taxpayers simply obeying the tax code. This is an opportunity for subnational governments to provide positive services and, through appropriate pricing, produce revenues for the general good. So user fees are the issue. At the same time, the Czech and Slovak Republics already have on the books some local taxes,

likewise classified as *poplatky*, that have become a part of the commercial culture. As long as they are on the books, they too should be considered as potential revenue sources. Where the local government does not provide a service, there is generally little more to say for a tax than that that it generates revenue. Naturally, the tax may be designed to affect resource allocation, but the function of revenue generation is in any case a significant one. Where appropriate, local taxes should likewise be considered from that perspective, which is complementary to the focus of this paper.

In the course of the transition to market orientation, services that are sometimes publicly provided have been turned over to the private sector in both republics, *e.g.*, water, sewage, electricity and heat. The consumer/citizen renders payment to the providing private firm directly. Those firms are subject to the same industrial regulations, provided in the one case by the Czech Ministry of Industry and Trade, as other private firms. Since those services provided privately are not the focus of this paper, neither their regulation nor their revenues will require further discussion.

The provision of public services is seen both as a duty of public administration and, appropriately, as a source of public revenue. Generally, privately provided services have characteristics that suggest the use of prices, while publicly provided services have characteristics that suggest the use of fees. The Czech and Slovak Republics have yet seriously to address a menu of public services which have some of the characteristics of private ones and for which fees would reasonably be charged and revenues produced.

This paper will review the current budgetary contribution of user fees as well as their potential for greater future revenue in both the Czech and Slovak Republics. The use of local fees was originally affirmed in Czechoslovak legislation, both in Prague and Bratislava in 1990, well before the federation was abandoned. The same law, therefore, remained the basis for user fees in both Slovakia and the Czech Republic after the transition began, so the two countries separated from an identical initial situation. They make an interesting comparative study, especially as their approaches to national and local finance now begin to diverge. Divergence was hardly noticeable until the Slovak Republic undertook a complete overhaul of public finance and a comprehensive tax reform prior to its accession to the EU in May of 2004. This included the adoption of a “flat tax” (rate) of 19 per cent for the VAT, for the corporate and the personal income tax.

These Slovak reforms are of particular relevance for this paper, because they also extended to the realm of intergovernmental finance. The key change was that local

governments were formally granted the right, beginning January 1, 2005, to set their own “tax rates.” This term was applied, interestingly, not only to the real estate tax, but apparently also to the limited number of local user fees and taxes already extant. But they were also authorized to introduce new “taxes.” The municipalities were empowered to adjust rates and apply exemptions to the traditional fees according to their own preferences. To this point, the Slovak municipalities have not perceived the new legislation as an invitation to begin making immediate changes. None are expected which would affect municipal tax and user fee revenues immediately, but the invitation to pursue independent action is a huge opportunity and it can be expected that Slovak municipalities will not remain idle indefinitely.

No such action has been taken by the Czech Republic. It is true that the Czechs also undertook a Reform of Public Administration prior to EU accession, but their effort was basically focused on organizational changes rather than fiscal innovation, and it primarily created the new regions and transferred the functions of the former districts to selected larger towns and cities and to the new regions. These changes were sufficient to get the Czech Republic into the European Union, but the Czech Republic has been more focused on central financial problems than inter-governmental fiscal relations.

This paper focuses on the need to apply user fees much more liberally and much more independently of central direction. The review begins with the fiscal parameters prevailing during the transition period prior to the adoption of reforms of public administration and the accession by the twin republics to the EU, showing why that period produced very little in terms of user fees revenues. And the situation regarding user fees in the Czech Republic remains unchanged, as will be described below. In the Slovak Republic, announced changes already mentioned have made significant change possible, and it can be expected.

Section II reviews the services for which fees are imposed in the twin republics, as well as the small number of local taxes applied beyond the property tax. Section III reviews the revenue implications of such public services for local budgets. Section IV reviews the potential and the growing significance of user fees globally, suggesting the possibility for heavier reliance on them in the twin republics. Section V addresses the key question of charging user fees not only as a means of cost recovery but as a technique for providing budgetary relief for hard-pressed local authorities in the economic transition of the Czech and Slovak Republics. Conclusions are presented in section VI.

II. User Fees in the Czech and Slovak Republics

There are charges for only nine general service and levy categories in the Czech Republic (Jiráskova and Šneberková, 2002, p. 7). The list is short when compared to the large menu of services provided for fees where local governments have become serious about charging directly those who benefit from provided services. For the Czech Republic, modest receipts reflect both the limited list of services for which fees are charged and the extremely modest (basically symbolic) fees charged for them, as well as the (likewise modest) local taxes. That menu includes:

- 1 fees on the utilization of public properties for parking and other uses,
- 2 permits to drive in the city center,
- 3 garbage collection,
- 4 value-added fees for lands where water and sewage hookups have been made available by the municipality,
- 5 dog licenses,
- 6 fees on casino gambling and slot machines.
- 7 recreation and spa fees,
- 8 fees on local housing accommodations, and
- 9 fees on admissions to ticketed entertainment,

The first four of these are genuine user fees, since the municipality provides some service for the charge assessed. The fifth and sixth could be classified as quasi-fees, since the municipality is providing at least the service of managing externalities involved in the activities of owning dogs and gambling apparatus and activities. The charges for items 7 through 9 represent local taxes, although some might perceive a nominal element of externality management in these “services” as well. The same basic list is provided by the Law of the Slovak National Council on Local Fees of April 29, 1992 (Zakon, 1992). Although there have been a small number of changes in these municipal fees stemming from 1990 in both the Czech and Slovak Republics, they remain very similar to the present. The right to apply user fees in both republics, which precedes their division in 1993, was granted by the national parliament through law. Individual municipalities, however, have no prerogative to adopt new fees or alter those currently in use according to their own preferences. They can implement only those fees specified by central legislation and only within the specified parameters. If Czech or Slovak municipal authorities decide to charge an approved fee at a particular (approved) rate, they will post a notice on the municipal bulletin board announcing when it will be implemented.

Fee for use of a public area. This fee has a “regulative and educative” function intended to maintain public order. It is paid for private use of public space, particularly for the

placement of facilities offering services or for the use of sales or advertisement facilities, *e.g.*, for circuses, carnivals and other attractions, for cultural or sports activities, or for film or TV work. No fee is paid for activities that charge no admission fee or for activities providing proceeds only for charities. Public space can be utilized, in other words, only for activities of social worth, and educational activities are especially favoured. If such activities are profit-making, the municipality may share the profits for sharing its land and desirable locations.

Unfortunately for the revenue-seeking municipality, law stipulates that the fee for use of public space cannot exceed \$0.4075 (10 CZK) for each square meter of public area used per day (*Ibid.*, p. 36), making it apparent that the legislators did not view this fee as an appropriate means of revenue generation. It is at best a diffident measure to screen out frivolous applications for the use of public space.

Motor vehicle fee for restricted areas. Fees levied on vehicles entering into restricted places in the municipality are limited to \$0.815 (20 CZK) per day. The legislative purpose of this fee is to preserve the tranquillity of historical parts of towns, or to improve the environment in such places. The fee is not paid by property owners or residents in such areas; nor is it paid by their close relatives or by handicapped persons.

Fee for communal waste. The fee for gathering, collection, transport, separation, or removal of communal waste is paid by any corporate body which has permanent residence in the municipality, or by a household's owner or the owner's agent.

Fee for enhanced construction property. A fee can be levied for the enhancement of construction property when the municipality connects it to water and sewage. The purpose of this local fee is to permit the supplying municipality to recover at least a part of the cost of the provided service. It is paid by the owner of the construction property and can be collected only for the first connection to water and sewage (*ibid.*, p. 61).

Fees for dog licenses. Review of specific provisions pertaining to user fees makes the legislative intent apparent. For the dog license fee, one intent is to regulate external effects. When citizens in a large apartment building own a dog, those effects are usually negative and are ostensibly discouraged through the imposition of the fee. When fees are exempted for specially trained dogs for the blind, helpless, or handicapped persons, another intent is apparent (Jiráskova and Šneberková, 2002, p. 21). Since handicapped individuals' elasticity of demand for canine assistance would be low and the willingness to pay greater, if higher than normal license fees applied, we are not talking about normal price discrimination. Whether or not it may be necessary, the Czech or Slovak municipality is invited by federal legislation to

subsidize the handicapped. The Municipality can also extend the exemption for dogs to other owners of dogs with special qualifications, *e.g.*, for guard dogs or hunting dogs.

Fee for slot machines. The municipality is not required to offer exemptions from this fee, which must be paid for each machine in use (*ibid.*, p. 45). The fee is paid by the machine's permit holder, a Czech corporation without property participation of non-citizens (*ibid.*, p. 48). The tariff for each machine ranges from \$40.75 (1,000 CZK) to \$203.74 (5,000 CZK) for a three month period; it can be set differentially, depending *inter alia* on the machine's physical location.

Fees for visiting a spa or recreation facility are not paid by the blind, helpless, or handicapped, nor by any assisting person accompanying them. Nor is this fee paid by persons younger than 18 or older than 70, by child support recipients, or by soldiers on active duty. Since the tariff may not exceed \$0.61¹ (15 CZK) per person per day of the stay, this fee is rather minimal. These exemptions reflect the intent to avoid creating hardships rather than to apply a price discrimination scheme targeting higher municipal revenues.

Fees for lodging are levied in spa towns or at facilities serving as temporary residences. The fee, obviously just a local tax, can even be collected from owners of family homes if even a part of the house is used for paid lodgings. The fee may not be levied on lodging for students of any age.

Fees on entrance charges for public events. The purpose of this fee extends beyond revenue generation. It also gives municipalities the opportunity to influence what cultural, sport, and other ticketed activities are held within the municipality. As we saw earlier, the law indicates that fees shall not be paid for admission to activities whose entire proceeds are intended for a charity or public service (*Ibid.*, p. 38). When it is charged, the fee may not exceed 20 per cent of the total amount of the entrance charge, but this amount would permit the municipality to enjoy a reasonable share of the net revenues.

The breakdown of actual fees receipts from 1997 to 2002, as well as the aggregate of these fees for those years is reported in Table 1. Initially, fees for the use of public space yielded the largest revenues, while that on resorts and recreation was rather substantially behind, but in second place, followed closely by the fee for dog licenses. With the introduction of the fee on gambling machines in 1999, revenues exceeded those of all other

¹ For easier reference, all values are presented in terms of U.S. dollars at the rate prevailing January 2, 2006 of \$1 U.S. dollar = 24.54 Czech crowns and \$1 to 32.00 Slovak Crowns respectively.

fees by the year 2000. The total amount of revenue from fees is a source of considerable importance for the municipalities, but of course it could be much larger.

Table 1
Revenues from Czech Local Fees: 1997-2002

	1997	1998	1999	2000	2001	2002
Dog fee						
Resort and Recreation Fees	6,876	7,273	7,773	8,146	8,419	8,777
Fee on public space use	8,157	8,671	9,019	9,918	10,707	10,184
Fee on entry tickets	34,422	31,558	30,595	27,574	26,335	26,250
Fee on recreational units	2,830	2,775	2,978	2,797	2,836	2,660
Motor vehicle entry fee	2,970	2,800	2,872	2,945	3,019	2,999
Fee on gambling machines	1,016	1,233	1,331	1,366	1,363	1,489
Cancelled local fees	0	0	28,173	30,838	33,978	35,574
Total	1,853	32,465	3,299	13,094	4,478	6,964
	58,125	86,775	86,040	96,678	91,135	94,896

In U.S. Dollars (1 USD = 24.54 CZK) as of January, 2006.

Source: Czech Ministry of Finance and own calculations.

2000. The total amount of revenue from fees is a source of considerable importance for the municipalities, but of course it could be much larger.

Fees in the Republic of Slovakia

The fees applied in Slovakia are quite similar to those already discussed; Table 2 shows those implemented. Local fees were established by law 544/1990, which came into effect on January 1, 1991. The law has been modified in minor ways on ten occasions since. Revenues from these fees (not including revenues from the fee for collection of communal waste and the fee on placement of nuclear facilities) reached \$32 million in 2001.

The fee for the sale of alcoholic beverages and tobacco products accounted at one time for about 50 per cent of the total revenues derived from local charges in Slovakia. However, the European Union prohibits the establishment of duplicative taxes (federal and local, for example) on alcohol and tobacco, an offence for which the Slovak (but not the Czech) Republic was in violation. Before its accession to the EU, the Slovaks realigned their national VAT tax to conform to EU specifications, repealing this particular charge.

The fee for usage of public space yields the second largest share of total receipts, the top revenue gains being generated by the fee for collection of communal waste, which yields 20 per cent of total municipal revenues. **The fee on placement of entertainment machines** has had a strong tendency to yield declining revenues, largely because they are subject to vandalism and the municipalities are often unwilling to have them available.

Table 2
Local Fees in the Slovak Republic

	Fee	Subject of the fee	Maximum tariff
1.	For usage of public space	Space	\$0.34/m ² (10 SKK/m ²)
2.	For an apartment or part of one used for purposes other than dwelling	Rent	500%
3.	For lodging	Bed	\$0.07/day
4.	For a spa town or tourist site	Person	\$0.50/day
5.	For a dog	Dog	\$34/year
6.	Entrance fee	Entrance fee	20%
7.	Sale of alcohol or tobacco	Retail value	10%
8.	Motor vehicle access to restricted areas	Motor vehicle	\$0.34/day
9.	Advertising in public area	Advertisement	5% of ad price, \$0.17/m ²
10.	For entertainment machines	Machine	\$673/year
11.	For vending machines (500% extra for alcohol or tobacco)	Vending machine	\$34/year ≤ 10 kinds of merchandise, \$673/year ≥ 10
12.	For placement of nuclear facility	Nuclear facility	Mochovce \$1.25 million Jasl. Bohunice \$2.33 mil
13.	For collection, transport and processing of communal and small construction waste	Amount of waste	80-1200 \$2.7-\$123 per person/year

Source: Ministry of Finance, Slovak Republic, *Koncepcia daňovej reformy v rokoch 2004 B 2006*, Available at the web site of the ministry, [http://www.finance.gov.sk/mfsr/mfsr.nsf/0/308A707A1FC47662C1256D4A00429DBD?OpenDocument#Miestne per cent20poplatky](http://www.finance.gov.sk/mfsr/mfsr.nsf/0/308A707A1FC47662C1256D4A00429DBD?OpenDocument#Miestne%20per%20cent20poplatky).

Some fees are perceived as being inequitable. The fee on lodging, for example, has the character of a property tax, but restaurant capacity is not taxed. Until the recent adoption of the “single tax” in Slovakia, the gain from the principal seven national taxes was 400 times larger than the gain from Slovakia’s ten local fees. So there is some question as to whether from a strictly financial point of view it would not be better to repeal them. The significance of local fees, however, lies in the fact that the municipality independently decides which it will impose and how the revenues they yield will be utilized. They represent a small, but important part of the independence of Slovak local governments.

Recent Legislative Change on Fees in the Czech Republic

The first major revision of the original Czech law on local user fees, Law Number 565/1990, was the enactment on July 31, 2003 of Law Number 229/2003 Coll (*Místní poplatky*, 2004). Changes in the law were allegedly motivated, at least in part, by the desire to increase local charges. A glance at the changes suggests it was necessitated more by the creation of the new regional governments, which will also require revenues to perform their assigned tasks. The new law will have no impact at all on 1) fees for driving in restricted municipal areas, 2) fees for the use of slot machines, 3) fees for use of the communal waste system, and 4) fees on constructions sites enhanced by water and sewer connections. The new law stipulates that tardy fee payments or for the late remaining payment of fees only partially paid previously may be increased by municipalities up to three hundred per cent. In the past they could be increased only up to 50 per cent.

Perhaps the most significant thing about these legislative changes is that the parliament took the time to revisit the question of fees apparently without any recognition of the real problem involved – that of a lost opportunity. The number of user fees remains extremely small and the opportunity for greater local independence overlooked.

The most significant legislative change pertains to dog licenses. This law might almost have been entitled “Closing the Loophole on Dog Licenses.” Apparently, too many Czechs had minimized their obligation by asking a friend or relative residing in a low-fee dog-license area to declare themselves the “owner” of the animal. The new law will no longer permit this to occur. The “owner” will no longer pay the fee for the license, but the individual in possession of the animal, which must be licensed where it resides. After the first of January, 2004, licensing fees were to be paid each three months (rather than the former six months) and the fee was increased from \$427 to \$640 per year for the first dog. For the second and any additional dogs, municipalities may increase the annual fee another 50 per cent. Dogs kept for other “non-recreational” purposes pay significantly lower rates or may be exempted. Dog licenses are relatively expensive because the revenue-starved municipalities have too few revenue sources and too little latitude in developing their own user fees.

Fees for a stay at a recreational or spa site were increased from \$.08 per day to \$0.16 and fees for the use of public space were discussed and clarified, so that applications of and exemptions for the fees would be more uniform. These very low fees are relics surviving from the communist period when prices were held at artificially low levels for the few goods and services the system made available. Pricing in the transition period in both republics has been

a patchwork of the low prices surviving from the past and the cost-covering, substantially higher market prices necessitated by the new conditions of the transition. It is also an unfortunate reality that the incomes of a large share of the population have not kept pace with the rising costs of imported and new products and services. While members of parliament would like to provide more abundant revenues to municipalities, they must remain cognizant of the situation of the taxpayers. Although it was their intent that the new law provide some financial advantages for the municipalities, the low fees generated by the legislative changes on user fees provide little relief. Still, municipalities may now increase the rates of several of the fees they implement and extend the period in which fees are due under the old system. These changes will enhance municipal budgets and rationalize the fees system somewhat, but are only a small instalment on the kinds of revenue increases that would be necessary to alleviate municipal financial problems.

III. Revenues from User Fees in Czech and Slovak Municipal Budgets

In this section the revenue implications of user fees will be considered for the two republics. It will be shown that revenues from “charges,” only a part of which are user fees, are important in spite of the fact that they are really miniscule, regardless of the source that reports them. They are important because they are “own revenues,” providing the possibility of independent action on the part of subnational governments. They are also important because they have the potential to become much more significant revenue sources than they are at present.

Especially for the Slovak Republic, data on municipal revenues derived from user fees are not readily found. They are not reported on line by the Slovak Finance Ministry. An officer of the Finance Ministry in Bratislava suggested to the author that user fees represent only 5.6 per cent of the total budget revenues of the municipalities.²

Information on Czech municipal finance is provided in Table 3, which indicates that tax revenues provide the greatest share of total revenues. Although Czech municipalities collect fees, they do not collect the property tax. Most Czech municipal tax revenues are centrally-provided, “shared” revenues. Non-tax revenues, representing about 15% of total local revenues, would include the revenues from local charges, the latter being only slightly

² Email from Ms. Krkanová on August 11, 2003. In an earlier interview she had estimated that user fees represented 10% of municipal budget revenues.

over one per cent of total revenues. This amount and the fact that the cost of collecting this revenue is not insignificant have prompted some to consider these charges simply a “nuisance tax.”

Reported data from different sources are not always consistent in either republic. According to the non-official data reported in Table 4, Czech Republic revenues from user fees in 2001 and 2002 were actually larger than property tax receipts. That does not mean,

TABLE 3
Czech Municipal Revenues*: 1997-2002

	1997	1998	1999	2000	2001	2002
Tax revenues	2,813,014	2,017,518	3,234,114	3,571,964	3,796,169	4,254,085
As % of total	51.28%	52.51%	44.88%	51.74%	48.61%	48.31%
Non-tax revenues	902,145	977,722	1,022,266	1,041,380	967,946	1,002,057
As % of total	16.44%	16.66%	14.19%	15.08%	12.39%	11.38%
Capital revenues	411,289	562,681	1,567,678	697,154	449,445	490,068
As % of total	7.50%	9.59%	21.76%	10.10%	5.76%	5.56%
Transfers	1,359,504	1,245,751	1,381,571	1,593,550	2,596,037	3,060,490
As % of total	24.78%	21.23%	19.17%	23.08%	33.24%	34.75%
Local fees revenues	58,125	86,775	86,040	96,678	91,135	94,896
As % of total	1.06%	1.48%	1.19%	1.40%	1.17%	1.08%
Total	5,544,077	4,890,447	7,291,669	7,000,726	7,900,733	8,901,596

Source: Czech Ministry of Finance and own calculations.

unfortunately, that such fees represented a significant amount of revenue; rather, it is a comment on the insignificant property tax yield. Local fees for the years reported here represented only 2.9 per cent and 3.8 per cent of total municipal receipts. We observe likewise that property tax receipts for the two years as a share of total receipts amounted to only 2.5 and 2.2 per cent respectively. The combination of both local fees and property tax are appropriately considered together because they are normally the most important sources of a municipality’s “own” revenues and represent a proxy measure of a municipality’s fiscal autonomy.

In an email of Dec 23, 2003 Dr. Zdenka Jiraskova of the Czech Finance Ministry reports local fees revenues for 2002 to be a much smaller, \$94 million (2.306 billion CZK), but also indicates that the gains for local fees for communal waste, which are recorded separately, were another \$85.5 million (2.1 billion CZK) for 2002, the sum of the two being only around 20 million below that reported in Table 4.

Table 4
Municipal Revenues, Czech Republic, 2001 and 2002
(Millions of USD)

Revenue Source	2001	2002
Property Tax	195	195
As % of Total Revenues	2.50%	2.20%
User fees + Property Tax (as % of TR)	5.40%	6.00%
Non-tax Revenue	984	1,017
Capital Revenues	452	495
Own Revenues	5,232	5,767
Grants	2,641	3,131
Current	2,017	2,386
Capital	624	744
Total Revenues	7,873	8,898

Source: "Hospodaření územních samosprava," *Obec a Finance*, March, 2003. Accessed on line. August 8, 2003. See <http://denik.obce.cz/go/clanek.asp?id=5521879> and my own calculations. Exchange rate calculated as 1 USD: 24.54 CZK, Jan., 2006.

With respect to revenues from local charges, as is also the case for property tax receipts in the Czech Republic, municipalities have had no pronounced sense of fiscal autonomy in the transition to democracy and market economics. The process of fiscal decentralization has not been successful in terms of providing independent financial resources for subnational governments (Bryson and Cornia, 2003), nor have user fees contributed significantly to fiscal autonomy.

IV. The Potential Contribution of User Fees in the Twin Republics

When one discusses Czech and Slovak user fees with Finance Ministry officials, the impression gained is that the two republics are doing what can be done to permit municipalities to raise badly needed revenues through their use. One notes, of course, that next to nothing is published about such fees in these countries, except for an occasional mention that it would be sensible to utilize them more extensively, especially in health care and pension reform (OECD, 2004). Numerous online OECD papers suggest their use in other areas as well.

When one considers the growing reliance on user fees internationally and the scholarly literature on user fees, it becomes apparent that much more could be done with them in the twin republics. Doing so would enhance efficiency, promote social justice, and enable more generous provision of public services through the increased municipal budget revenues that could be realized (Besley, 1991; Bird and Tsiopoulos, 2004; Downing, 1992).

When the IMF became concerned about the Czech Republic's deficit spending recently, it observed that deficit reduction would have to be pursued mostly through restraint on the expenditure side of the budget. Taxes, it was argued, should be kept within the levels required for harmonization with the EU. The IMF team felt, however, that the use of small user fees for some public services could enhance the efficiency of the public sector and reduce the need for tax financing (IMF, 2002).

The use of user fees has become much greater globally, implying greater potential use in the Czech and Slovak Republics. Increased reliance on user fees has come about in the United States as State and local governments experienced severe fiscal problems in the recent recession. With constricted revenue sources and the increased exigencies of homeland security, local governments increasingly turned to user fees to enhance budgetary revenues. California had actually discovered the redeeming potential of user fees after the passage of Proposition 13 in 1978 seriously impacted local budget revenues. The California case reminds us that the use of fees is not a new phenomenon, although it has been increasing rapidly in recent decades.

Downing (1992) defined a measure of user-charge reliance (UCR), as current charges divided by general revenue from own sources, and determined that the UCR for the average US city increased by 48 per cent from 1967 to 1987. There was at that time considerable potential for further expansion of the role of user charges in municipal finance. Downing estimated that if cities were uniformly to adopt charges for water services as well as for other services not typically provided on a fee basis, and if such charges were to cover full marginal costs, that the prevailing UCR of 20 per cent at that time could increase to 60 per cent or more.

It is difficult to imagine any such dramatic development for the Czech and Slovak Republics. They could clearly enhance their revenues through greater use of fees, but the conceptual possibility would take time to realize. Political attitudes and institutions would have to be modified, which would require considerable education. Public perceptions of the potential benefits would have to be altered, along with the belief that such change is politically unrealistic. The scope of general economic change over the past 15 years of the transition has been considerable, but basic institutions generally change slowly.

Despite the objection heard frequently in the Czech and Slovak Republics that user fees are just taxes in disguise and that the poor can't afford them, they offer relief to local officials desperate for revenues but anxious to avoid increasing property taxes, downsizing the

public-sector workforce, or eliminating popular public services. And fees are more readily accepted than additional taxes, since they are paid by those who directly benefit from the attached service.

The objective of improving the lot of those with low incomes generally seems to recommend the redistribution of income; that same objective also recommends the application of user fees. Besley (1991) argues that free provision of publicly provided goods or services is rarely optimal. If governments do not have optimal lump-sum transfers available as a policy option for increasing welfare, they will certainly be interested in all reasonable possibilities for politically acceptable redistribution of incomes. An important possibility is through publicly provided goods and services. If fees are attached to their use, the scarce resources involved can be rationed, leaving more for the disadvantaged. Efficient use would then suggest that the poor be given subsidies with which to pay the fees rather than providing the scarce services to all comers on a gratis basis.

Canada is one of a number of countries that would be an example to the Czech and Slovak Republics of user fee utilization. It has also increased its application of user fees, which are seen (Bird and Tsiopoulos, 1997 and Montreal Economic Institute, 2004) as an alternative to privatization. If privatization of government services occurs, the industry's supply will be rationalized by private companies who will charge scarcity prices. Where privatization, however, does not occur, and the government chooses to charge fees for public services, there is the possibility that nearly the same efficiency can be achieved. Where governments neither privatize nor charge fees, a variety of inefficient and wasteful outcomes must be anticipated. The upshot is that Czech and Slovak taxpayers will always pay more for the same menu of services and products than private consumers would.

Charging user fees is also beneficial because users are persuaded to consider the value of the product or service at the specific point in time they choose to use it. It is for this reason that telecommunications companies have adjusted their rates according to the time of use and that hotels set varying rates for high- and low-season reservations. It is of great advantage to encourage some users to select off-peak periods to enjoy lower rates and save money. Vernon Smith's work (2002) on the energy crisis in California suggests that simple peak-load pricing could go a long way toward solving the problem.

The way users react to fees for public services, as in other countries, could signal local Czech and Slovak governments about the value those users place on such services. It could do so more effectively and objectively than the noise emanating from lobby groups. For these

and other reasons, the imposition of fees supports the process of channeling public resources to activities in the greatest demand while moving public choice away from activities that may be of ostensible value, but which people choose to forgo. Bird and Tsiopoulos (1997) discuss the need to make user charges more transparent, more clearly articulated and better understood by the public. Their first challenge is to overcome the misperception of vocal groups who view user fees as just another tax having no benefits attached. The second is to overcome the managerial concern that the imposition of a user fee will alienate clients from public providers who fear that the loss of clients will lead to budget cuts. The third challenge is the technical one of setting the precise fees to be charged (*Ibid.*, p. 3). A bottom line consideration expressed by Bird and Tsiopoulos is that “whenever possible and desirable, public services should be charged for rather than given away” (p. 4). The use of user fees assures more efficient use of scarce, public sector resources, which is highly desirable when budget revenues are tight. User charges can reveal the real value of public services, creating a market test in which public managers must respond more directly to their citizen-clients and use budgeted resources as efficiently as possible (p. 4). Slovaks and Czechs have spent over a decade adjusting to the post-communist notions that taxation is natural and legitimate, that public services are not “free” goods provided by a communist party wishing to secure legitimacy, and that everyone will enjoy certain free services because some are not sufficiently well off to pay for them. The transition to the user fee mentality should not be far behind the transition of perceptions that has already been occurring.

Questions sometimes arise regarding the equity of user fees. These may reflect a failure to consider carefully the benefit/cost differences between the use of fees and normal taxation, which is implicitly a zero-price policy. Many are not aware that upper-income households usually enjoy disproportionately large benefits from the consumption of public services provided either gratis or at low cost. Bird and Tsiopoulos (p. 9) provide the apt example of low storage and landing fees supplied at local airports and docks, which benefit disproportionately the relatively small number of households that own private airplanes and yachts. Subsidized higher education benefits are likewise enjoyed mostly by upper-income families. The common assumption that zero-priced services are the best way to redistribute wealth is not well founded.

User fees are likewise shown to be beneficial (Deweese, 2002) by holding demand in check in times when it proves difficult and expensive to expand the supply of a public service. User fees are of particular benefit to an agency that is not in a position to meet vociferous

public demands for more services. Or they can help to cope with demand that is strongly variable over time, since the pay requirement can temper those variations.

Policy analysts are strongly supportive of user fees, but with the caveat that they be applied to goods and services with characteristics similar to those of the goods and services suited for private markets. User fees are appropriate where services provide specific benefits for a clearly identifiable consumer who can be asked to pay the fee and who can choose to respond to a price by purchasing less or by completely forgoing the service. Strictly public goods and services with the standard characteristic of non-excludability or those which have external effects for which private markets do not tend to produce optimal outcomes still need to be provided by public agencies. The classic example of this is education, a service for which there are obvious and important externalities, which leads us generally to support substantial public subsidization of the activity. To be supportive of user fees is not to support user charges for all public services. Thus, Czech and Slovak policymakers may rest assured: a public sector will always be needed and all public services cannot be provided for a fee.

There are numerous classic examples of the growing use of fees in recent economic history which clarify their general utility as a part of the public sector's economic toolkit. Newbery (1988 and 1988a) and Vickrey (1969) contributed heavily to the literature on the use of road user charges. The former conducted analyses commissioned by the United States Federal Highway Administration and its state counterparts just as the interstate highway system was reaching a ripe age and in need of major upgrading. His studies were designed to measure road use costs and to design a system of road user charges. The World Bank also completed a comprehensive study of highway design and maintenance and of road user charging. The use of toll roads can be considered, at least in part, a result of the effectiveness of these and many other scholarly studies. The continuing use of toll-free highways, however, reflects to some measure the remaining sentiment that highways still bear important public goods characteristics.

In transition countries such as the Czech and Slovak Republics, relatively few citizens have traditionally had the opportunity to use their own vehicles on the public highways. As the more favored come to appreciate the privilege, especially as they observe the use of toll highways in more affluent neighboring countries, they will be more prepared to accept the notion of user fees in transportation. Adopting changes of this sort can also be facilitated by entry into the EU with the more widespread and growing perception that fees are a part of life in other countries.

It has been demonstrated that user fees can improve efficiency in the use of public health care facilities and of the entire health care system (Gertler and Hammer, 1997). Nevertheless, potential gains should be weighed against evidence that unwarranted increases in fees could compromise the goal of improving health care for low-income groups in the Slovak and Czech Republics. The literature has tended to emphasize the possibility of increasing the public health system's revenues, but a more important effect is likely to be the guidance of resources. Gertler and Hammer (p. 2) conclude that user fees applied at the point of service can indeed serve an important role in co-financing health care, but insist that they should not be the primary means of finance. They stress user fees for the public health field, because that area currently claims a large share of the total of public resources and its claims will continue to grow. The Czech and Slovak Republics have already experienced public health care as an item that has put tremendous pressure on the public budgets. They are now grappling with the fact that the level of care they have aspired to provide is beyond their fiscal capacity. Fees will be essential both to help finance and to ration the scarce resources available for health care. The classic approach to resource mobilization is to increase user fees for a public service to generate revenues for improvements in the quality of that service or other needed services. Thus, charging user fees for public medical services has spread throughout much of the world (Griffin, 1987; Nolan and Turbut, 1995; Jimenez, 1996).

The notion of health care as a public sector prerogative is not a new one for the former east European countries, but the notion of *quality* health care is. In the next few years, Czechs and Slovaks will be coping with the historically recent notion that health care is a primary responsibility of and challenge for governments (rather than subscribing to the notion gradually becoming archaic that health care is a private market service for which citizens bear individual responsibility). Now is the time to introduce them to the more timely notion that fees coexisting with public health care combine social justice with improved revenue generation and can help fund enhanced health care services.

V. Pricing to Achieve Increased Budget Revenues

One encounters policymakers in both the Czech and Slovak Republics who are concerned about the feasibility and practicability of user fees. If they are properly designed and administered and if they are set at the appropriate level, fees will indeed be both feasible and practicable. As we saw above, the function of pricing is a key element of success. Actual

user charges on government facilities are often set at inefficient levels. Local officials need assistance or training in the establishment of fees, since the principles are not always intuitive. A part of the huge literature on pricing in general pertains to this specific area. Lee and Wilson (1991), for example, examine efficient user charges on governmentally provided facilities in the presence of rent seeking.

When properly applied, the potential of user fees is great. Vickrey (1999) shows in a clever paper how user charges can be applied to solve parking problems, to achieve effective use of the highways, to ameliorate types of pollution problems, to achieve more optimal airport use, and to reduce noise, congestion and pollution while increasing highway speeds as congestion in large city centers increases. The key to these desirable outcomes is the use of price discrimination in transportation activities and pricing according to marginal social cost considerations. All of the issues Vickrey analyzed are of relevance to the Czech and Slovak Republics, just as they are to other transitioning countries. As external effects increase with the growth, urbanization and modernization of these countries, the need will increase proportionately to alleviate them with techniques such as those considered here.

Although the first concern for public prices is cost recovery, policy and circumstances may also permit a municipality to charge less than the full cost of service provision or to seek the recovery of more than the full cost. Czech and Slovak municipalities should at least consider pricing that offers maximum potential contribution to general revenues. On occasion, traditional taxation considerations will prohibit their use of utilizing revenue-maximizing fees. But where appropriate, they should certainly pursue greater revenues through appropriate pricing techniques.

Likewise, pricing techniques should reflect not only differing demand elasticities in separable markets, but also 1) whether the service provided meets an essential human need and 2) whether cost differentials in diverse market segments reflect choices responsive to higher incomes. It is not necessary here to review the broad array of pricing considerations developed in the literature (see Timothy, 1991; Bird and Tsiopoulos, 1997; Dewees, 2002; Downing, 1992, etc.), but it would seem helpful briefly to discuss pricing of a type appropriate for the fees systems of the twin republics, demonstrating the potential for revenue generation where this is acceptable for public purposes.

There are two basic situations in which appropriate pricing techniques should be a part of user fee applications. In the first case, the municipality itself is the sole provider of a service and at one extreme could price as a monopolist would. There are instances in which, for social

and political considerations, the municipality would wish to provide an essential service *inter alia* to low income groups whose consumption it wishes to subsidize. Here, it would be wise to subsidize where appropriate, while also charging revenue-generating, optimal prices. The kinds of services municipal officials of the Slovak and Czech Republics could provide with revenue optimization in mind include some of the fees (*qua* taxes) currently implemented, *viz.*, those charged for dog licenses, for garbage collection, parking, and rents for public housing. In these cases the Slovak or Czech municipality acts as a monopolistic provider of services.

In the second instance, the municipality becomes a silent but important partner of a private firm providing, for example, entertainment or lodging. In the case of entertainment, the municipality may be providing the site for the activity (*e.g.*, public land for a travelling circus). It may simply be providing oversight to quasi-private activities. They are not completely private because of the potential external effects monitored and, if necessary, regulated or prohibited by the municipality. In any situation of partnering with a private firm, a municipality essentially taxes the revenues generated by attaching a fee to them. Examples are some of the specific kinds of fees utilized in both the Czech and Slovak Republics, *e.g.*, recreation and spa fees, the fees on local housing accommodations, fees on admissions to ticketed entertainment, and those on gambling and slot machines.

Fees Attached to Partnering or Quasi-Private Activities.

Consider the case of an *ad valorem* fee. If it is too low, such a fee's yield will fall short of what could have been realized. If it is excessive, it can drive away the entertainment or other activity it would tax; if the municipality's revenue yield is so great that it removes from the private activity the revenues that would have represented profit or even have covered cost, the fee will prove destructive. Even if these kinds of fees are less extreme, they will distort resource allocation.

The fee should incorporate characteristics of a lump-sum tax. The firm providing gambling or slot machine revenues, or selling tickets to a concert or other form of entertainment, may be assumed to establish ticket prices which maximize net revenues. The municipality then simply lays claim to its share of the take without causing the firm to change its optimal price and quantity results. If the firm were to try to "pass the fee on" to the consumer, raising ticket prices would merely reduce sales and generate a smaller, pre-fee profit

pool, from which the pre-determined amount would still have to be turned over to the municipality.³

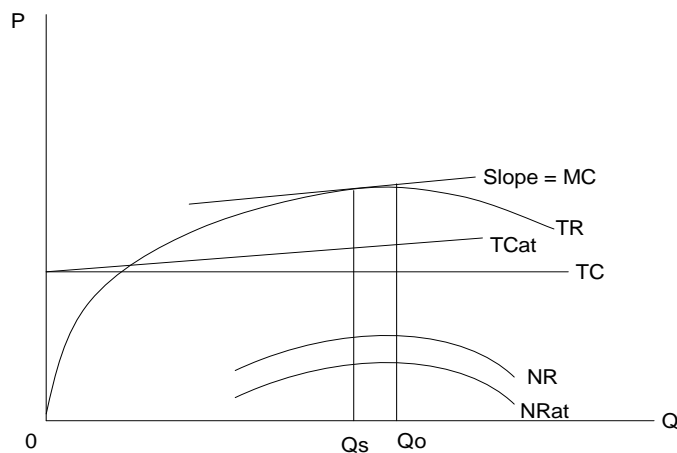
Conceptually, the municipality will estimate the potential net revenues an event held on public property could generate, then decide what share of the net revenues it will appropriate for the public coffers as a lump-sum tax. It would levy the fee as a lump sum tax in the form, say, of a license to perform. If the municipality felt constrained to use the more traditional per-ticket fee, it should divide the total revenue anticipated by the number of tickets sold *ex post*, and collect an average revenue per ticket. In any case, the private firm should know a revenue total that it will have to turn over from the ticket sales and not think of it as a per ticket amount that must be attached to each ticket sold. If the fee is incorrectly treated as an excise or unit tax, a higher ticket price would result in sub-optimal sales.

Where the objective of such action is fee-maximization, pricing should follow this strategy. Assume that local authorities needed to calculate potential revenues for a circus requesting permission to perform in the city. Figure 1 shows the maximum potential net revenue for a given performance. In this instance, the otherwise variable costs for an evening's single performance can for the sake of simplicity be treated here as fixed. If the principles explained above are applied, the municipal entertainment fee will simply appropriate revenues by shifting downward the net revenue function from NR to NR_{at}, the net revenue after tax. It will do so without changing the price of a ticket or the number of tickets sold. It will simply confiscate a share of the profit at Q₀ through the lump-sum fee described. On the same diagram we can consider an "excise" fee that would cause the new, after-tax TC function, TC_{at}, to slope up to the right, showing that increased sales imply increased costs when the tax is added. In this case, the firm would optimize its returns by operating where MC = MR, where the slope of the TR curve is the same as the slope of the TC_{at} curve as it still slopes upward (implying that it cannot have obtained its maximum point where its slope is zero).

³ This is easily seen in the standard way. The firm's demand function is the usual $P = a + bQ$. The total revenue function is $TR = P(Q)$, or $TR = (a + bQ)Q = aQ + bQ^2$. Marginal Revenue, or $MR = dTR/dQ = a + 2bQ$. On the cost side, Average Cost, $AC = c + dQ$. Here we add the fee, ζ , to the fixed cost, so $AC = c + \zeta + dQ$. Total cost, $TC = AC(Q) = (c + \zeta + dQ)Q = cQ + \zeta + dQ^2$, so $MC = dTC/dQ = c + 2dQ$. Note that the differentiation yielding MC does not change by adding the fee. As a part of fixed cost, the fee cannot be passed on through a higher price and the optimal outcome cannot be reached by selling a different quantity.

This will result also in suboptimal ticket sales, Q_s , with smaller net revenues, smaller tax take, and smaller profits.

Figure 1
Optimal Fees on Private Activities



There is no reason a municipality supplying a service or selling a license, for example, cannot utilize pricing techniques that will permit it to maximize its receipts. As reforms allow individual Czech and Slovak cities and towns to establish their own fees, licenses could still retain their regulatory function, but they could also maximize revenues. For a linear demand curve extended from axis to axis, they would do so for an essentially no-cost activity by producing at the mid-point between the vertical axis and the demand curve's interception of the horizontal axis so that $MC = MR = 0$.

A somewhat more sophisticated and productive revenue effort would incorporate price discrimination, charging somewhat smaller fees for senior citizens, low-income groups, etc. It is only reasonable that in the application of local user fees Czech and Slovak municipalities apply methodologies that will help to generate the greater revenues needed.

The case is simple, but compelling. In the appropriate instances, those who receive services are the ones who should pay for them. Where social considerations suggest that low-income groups should not be deprived of particular public services, it would be better to subsidize their participation while retaining the fees that will provide not only social justice, but also revenues for the community. This realization has not come as yet to the Czech and Slovak governments, national or subnational, but fiscal decentralization suggests it is overdue.

VI. Conclusions

The Czech and Slovak Republics have made only the most tenuous beginnings in the area of user fees. As we saw above, those fees already in place were established by fiscally-timid transition governments fifteen years ago. The municipalities of both republics do not have the actual independence to adopt user fees on their own, as all such fees as are allowed are stipulated in federal regulation. But the Slovak subnational governments have been promised the opportunity to develop “new taxes” independently.

In small countries such as those examined here, where regions and municipalities are centrally monitored and managed with much greater ease than would be possible in the United States or Russia, the temptation to manage centrally is much greater and local officials become accustomed to managing in a much different environment from that of a large city in a remote state or region of a very large republic. Local managers in such environments do not have the luxury of leaving to central officials the question of what fees may be applied and what kinds of taxes may be implemented.

To this point, Czech and Slovak municipalities can only adjust fees modestly within centrally prescribed limits. The tentative steps taken toward power devolution, most recently through “reforms of public administration” have been insufficient to acquaint the municipalities with genuine fiscal independence. Nor can it be intimated that the local governments have the resources they need to provide public services elsewhere regarded as desirable or even essential.

The not-for-profit sectors developing in the twin republics will help generate a climate in which user fees could prosper. As early as 1996, Slovakia’s not-for-profit sector (excluding religious organizations) had operating expenditures of \$256 million (7.6 billion Slovak crowns). That represented only 1.3 percent of the country’s GDP, but was not an insignificant amount. Behind these expenditures lies a sizable workforce that included more than 16,000 full-time equivalent paid workers representing 0.9 percent of all nonagricultural workers in the country, The 16,000 full-time workers involved represented 1.4 percent of service employment, and two percent of all federal, provincial and municipal government workers (Woleková *et al.*, 1999, p. 356). The nonprofit sector derives most of its revenues neither from private philanthropy nor from the government, but from fees and charges for the services these organizations provide. This revenue source accounts for 55 percent of all nonprofit revenues.

Development of the nonprofit sector in the Czech Republic was also very respectable after the Velvet Revolution in 1989, especially in the areas of recreation and culture. By 1995 it had operating expenditures of \$800 million, involving a workforce of 74,200 full-time equivalent paid workers (not including another 4,000 workers from religious organizations) representing 1.7 percent of all nonagricultural workers in the Republic, 3.4 percent of service workers, and 6 percent of the total of all federal, provincial and municipal government workers (Frič *et al.*, 1999, p. 289). The not-for-profit sector of the Czech Republic, like that of Slovakia, derives a large share (47 per cent) of its revenues from fees and charges. Unlike its counterpart in Slovakia, the sector enjoys solid support from the government. Payments from the public sector amount to 39.4 percent of Czech nonprofit revenue, which represents a high degree of support relative to central Europe as well as other areas of the world as well.

Frič *et al* describe the public financial system taken over from the Communist era as excessively centralized and lacking a clear plan for the development of the nonprofit sector. In the fields of health, social, and civic services, the Czech government retains the dominant role in financing nonprofit action, generating in excess of half of the total revenues in those fields. As not-for-profit fees become more customary in both the Czech and Slovak Republics, citizens are becoming accustomed to paying for public services.

Like citizens elsewhere, Slovaks and Czechs could become supportive of far greater reliance on user fees in the public sector at all levels. With proper educational efforts and appropriate pricing techniques, the subnational governments of the fraternal twin republics would be prepared to provide more of the public services of contemporary cities and towns. Moreover, they could do so in a manner beneficial for citizens and productive of revenues for the public coffers.

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