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Public Services in Hungary

The scope of public services and related legislation

In Hungary, the term *local public services* is connected to several types of deliverable services to the public. These services include social welfare services, education and health services, environmental protection and local development, transport and public utilities.

Local self-governments have specific functions connected to the delivery of public services. Since Hungary introduced a three-tier governmental system, which is based on local self-governments, county self-governments and the central government, there are different responsibilities divided among these tiers.

The central idea behind the reorganization of the public services delivery, later discussed in detail, was that since the local level has the most accurate knowledge about local needs, it can therefore steer the delivery of services to the most appropriate level.

The right to define the range and scope of service delivery is established in paragraph 8 of the Law on Local Self-Governments passed in 1990. However, on the list of the 27 so-called “particular” duties of local self-governments, the regulation also names those services that are compulsory local responsibilities. These responsibilities include: the provision of kindergartens and primary education; basic health and social services; assuring the rights of minorities; and, in communal areas, the provision of healthy drinking water, public lighting, and the maintenance of local roads and cemeteries.

In the case of the capital and its districts, some further obligatory performances are defined by law. The state assures the completion of its mandatory tasks by allocating financial tools and allowing the local self-governments to impose local taxes and borrow money.

According to paragraph 43 of the Hungarian Constitution, the Law on local Self-Governments is not the only regulation that may prescribe duties that are to be performed on the local level. These are the sector laws and the so-called “Competency Law” that set further obligations, such as the operation of public libraries, or, in other areas, depending on the size and population of the settlement, the different levels of obligatory social service, health and education service, and waste disposal.

This means that the main framework of the definition of public services is the Law on Local Self-Governments; however, the definition of “particular” duties of local governments may be extended and specified by other regulations as well. The situation gets even more complicated considering that local governments may take

over any duties they prefer to perform for their inhabitants, provided that this does not affect the completion of their obligatory services nor violates any legal regulations. Therefore, besides the mandatory duties, the majority of municipalities in Hungary also perform public sanitation, solid and liquid waste disposal and ensure the cleaning of the roads and parks of the settlement. In case a municipality is unable to carry out a “voluntary” task, it may pass it on to the upper tier, namely the county self-government which is obliged to take it over according to the regulation that says that certain services have to be carried out only by a minimum size of settlement or number of inhabitants.

Overview of the reforms related to public services

The transformation of the socialist state raised the question of the new division of public and private services. Decreasing state property (utilities were transferred to the local municipalities along with the flats, roads, and buildings in which administrative work was done), and the lack of resources for financing the previously extended public services, resulted in the decrease in public spending on public services. Consequently, this spending had to be reorganized and, finally, decentralized to the local level.

Additionally, there were several motives for decentralization, such as local accountability, (and the higher public participation and control, that it was designed to achieve) and the local articulation of needs and decisions on services matched (see Hermann, Horváth, Péteri, Ungvári 1998).

As a result of the transition, the assets of the public utilities that were formerly owned by the councils were transferred to the local self-governments. Or, for example, in the case of water companies, the operating parts were kept and reorganized separately or were soon privatized or otherwise refashioned by the municipalities themselves.

The fact that assets were directly given to the municipalities created a completely different set up of required actions and in a few years some changes needed to be introduced to the public service regulations. According to the law, municipalities are not obliged to perform certain tasks (e.g. secondary school education) below a given number of population (secondary school education is only binding for the districts of Budapest and the cities of county rights) and therefore the municipalities gave back the task to the counties they could not finance. However, they did not hand over the necessary assets related to the task, which actually made it impossible to carry out the assignment. Therefore, the regulation was modified and from then on (in the case of educational tasks, since 1993) the municipalities had to transfer to the councils not only the duty, but also the capital, that is connected to the given task in the case that they turn out not to be capable of fulfilling that operation. On the other hand, in the case of some services, which were considered as particularly important for the community (e.g. the existence of secondary schools that were considered an important tool to stopping the emigration of inhabitants), local governments are reluctant to shift this service to the county despite the financial burden it imposes upon them.

Since the responsibility of public service delivery is on the local level, municipalities

have to raise their own resources to cover the costs of services for which they do not receive enough grants or targeted subsidies. One of the most important steps of the reform was that local self-governments may impose local taxes and use the revenues, e.g. from the local business tax, for their own purposes.

Residential consumption prices were kept on a very low level and the cross-subsidizing of services was a common tool for equalizing the low revenues and high costs of services. After the transition, the need to rationalize public services had to be combined with the social implication of reorganization and a price increase as well.

Ownership types (private, public) and the main characteristics of public service companies

The transfer of assets to municipalities immediately launched a change in the ownership and operation types of the services. In the case of water utilities, there was a great fragmentation of the previously quasi-monopolistic water service sector. The provision of public services takes on significantly different forms in the different sectors. While the social services (e.g. education health care and social care) are typically provided through budgetary institutions, housing related services (e.g. water, sewage, and heating) are usually provided by companies.

The property structure of service providers can be categorized as follows:

Budgetary institutions

In the case of municipally owned companies, service companies may take the form of a limited company, a joint-stock company or a non-profit organization. These companies function actually as budgetary institutions, and the supervisory board or organ of these firms are normally composed from the members of the assembly. In the case of public utility provision, all cities with county rights have such companies, as do 66% of larger cities and 33% of settlements.

Some companies have mixed ownership. Local governments choose such joint ventures when they lack the resources for capital investment and they allow private entrepreneurs to obtain a share of ownership to cover such investments. This alternative normally is accomplished with a majority stake held by the municipality and a special voting share, which is separately defined in most cases resulting in more control by the municipality than its share would represent. In the report of the State Audit Office of Hungary in 2002, from 480 explored settlements 4,1% of the municipalities had an ownership rate of more than 75%, 6,2% had more than 50% and 7,2% had more than 25% ownership in public utility companies.

Some municipalities have established concessions whereas their control on services is kept to a maximum.

There are also private companies and NGOs that are contracted for the provision of certain services.

According to a sample-survey conducted in the period of 1996-1998, service providers in public sanitation, water, and sewage treatment operated in the following

ownership-types:

Table 1: Distribution of public service companies according to ownership type

OWNERSHIP TYPE	%
Budgetary institution	37,8%
Joint-stock company	11,42%
Limited company	30,31%
Private undertaker	11,02%
Limited or unlimited partnership	1,97%
Non-profit organization	4,33%
Other	3,15%
Total	100%

Source: Horváth, Kristóf, Valentiny 2001

The above scheme of the variety of operation alternatives demonstrates the permanent conflict that municipalities must face: the clash of interests between the regulators, owners and institutions that politically depend on inhabitants' support and the municipalities' statutory responsibility to deliver services.

Financing public services on the local level

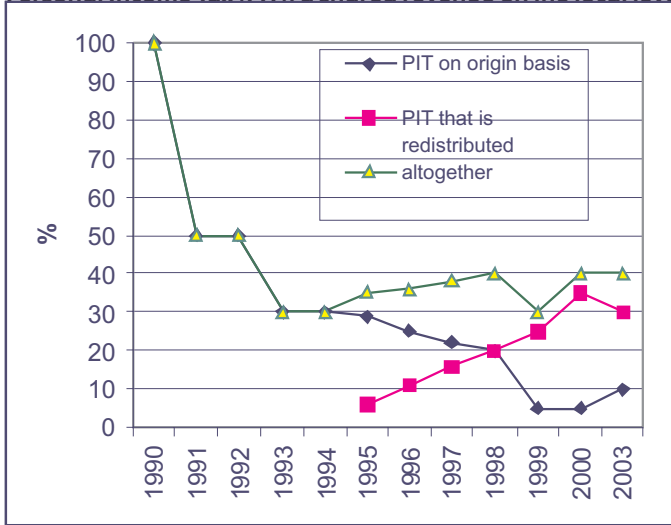
According to the Budget Law of Hungary, local governments receive normative grants for a variety of tasks related to social, educational and health services. For the tasks defined, the central budget allocates targeted grants mostly for infrastructure developments and waste disposal improvements. Targeted normative subsidies can be received for liquid waste treatment purposes as well (8-10% of all central subsidies, 26,6% of the local revenues). Municipalities with resource deficits (in 2000 more than one third - 1227 - of the municipalities), receive additional subsidies.

Local governments receive 40% of the collected personal income tax altogether for the abovementioned purposes, of which 10% is allocated on the basis of origin and the rest, 30% is used for financing grants and targeted grants (however, the actual amount always refers to the numbers of 2 years prior). In 2000, 70% of all central funds were used to support mandatory services, and normally it is not taken into account how much the performance of the given task would cost when defining the sum of the subsidy.

Additional resources are 50% of all collected duties. This amount should provide for the operation of the related administrative agency (1-2% in the local budget). 100% of all local vehicle taxes remain on the local level (0,5% of the local budget). Personal income tax related to land borrowing also stays on the local level. Penalties from environmental violations remain at 30% in the municipality. 100% of penalties related to infractions that belong to local competencies also make up the local budget's

revenue source (1,5% of the local budget in 2001).

Figure 1: Personal Income Tax (PIT), a shared revenue on the local level



Source: Balás, Hegedüs 2001, Budget Law 2003

Local governments also have their own resources: local taxes (the local business tax, communal taxes, tourism tax and property tax, amounted to 14,3% of the total revenue in 2001), operation charges (1,8%), and the profits of operation and capital.

The charges for local utility services are defined in two stages: the official price setting and the local statute have different areas of relevancy. Setting the charges for communal solid and liquid waste removal is a local competency, whereas the supply's price of drinking water is set centrally in the case of regional providers.

The size of expenditures related to public services varies to a great extent. The largest amount of spending is related to actual costs (including personal wages) and to approximately 25% of the local budget capital expenditures. When we take a look at the distribution of expenditures by different sectors in 1999, it is education (33%) and health care (19%) that are on the top of the list. Administration is in third place (13%), social welfare is fourth (with app. 7%), and housing, water, transportation and communication represent altogether only 7%.

This means that due to the organizational set-up of public utility provisions, the spending of local governments remains very moderate. However, subsidies may be steered toward companies that provide service.

Monitoring the public services sector

According to a survey conducted in 1998, local self-governments only rarely monitor

provided services, according to indicators. Instead, they mostly rely on written reports and public opinion, and 15% of them do not collect any data concerning service delivery at all. The improvement of public service delivery due to the outsourcing and out-contracting of services is therefore not proven, although anecdotal resources may state it (Zupkó 2001).

Normally there are different commissions that oversee the operation of services that are provided by a company of the municipality or the municipality itself. When service delivery is supplied by a joint venture, representatives of the municipality have control of the price setting and management of the companies.

The State Audit Office of Hungary also prepares the monitoring of Hungarian local self-governments. However, there rarely is reliable data on the expenditure side according to sector. The revenue collected from different resources for voluntary tasks are often not programmed and therefore there is no reliable data available about the efficiency of the grants of public services and their operation.

The sector laws prescribe the minimum level of deliverable services and establish an administrative body as supervisor.

There is another issue related to the control of service provision on the local level. As mentioned above, local governments may provide additional financial assistance to companies that take over duties. According to the Competition Rules of the European Union, this means that there is an influential behavior upon the distribution of public funds to firms. The role of regulator, owner, and maintainer often leads to cross-subsidizing of different public services, which is not going to be possible after EU accession.

Case study of the water sector transformation in Hungary

Before the transition, the water sector was operated in a centralized, state owned system: there were 33 regional state-owned companies under the control of the Central Water Agency and the fee for water and sewage was determined centrally. As a part of the decentralization process of the early nineties the ownership of water utilities was transferred to the municipalities. Additionally, water supply became a mandatory responsibility of the municipalities and the municipalities have the authority to define water and sewage fees. The Ministry of Water and Environment Protection operates a subsidy system for those water companies that have higher expenses. Current regulation specifies that the revenue that originates from these fees must cover the justified expenses. At present, however, no central price-setting formula has been defined.

As a result of the decentralization, the water sector became fragmented: 377 water companies operated in 2001 of which five regional companies are still state owned. The sizes of the water companies vary significantly, which is represented by the fact that 92 companies provided 96% of the total amount of water supply in 1998.

The new owners have the right to choose among different service provision forms including different forms of privatization.

Only in the case of larger cities did commercialization and/or privatization occur.

The reasons for commercialization are political and organizational. From the side of the municipalities there was big pressure not to raise water fees significantly. Therefore the companies were forced to rationalize their operation in order to avoid producing losses. However, only big companies had the experts and knowledge to meet the new requirements and adopt such mechanism as would assure efficient operation. As a result of restructuring and the introduction of modern management techniques these companies could reach greater autonomy. In the case of smaller companies, one of the biggest problems is the lack of competent experts that (aside from the more direct political influences) prevent such companies from getting engaged in the commercialization process.

Debrecen, the second largest city in Hungary, is a good example of successful commercialization without privatization.

Water companies were privatized in six large cities and in one smaller region. However, the privatized sector covers about 20-25% of the water supply of the Hungarian population. The main privatizing actors were mostly foreign professional investors who established concession contracts for 15-25 years. The water utilities as such remain in municipal ownership and the foreign companies obtained a share in the operating companies. Under the current regulation the municipality must retain the majority ownership of water companies. Nevertheless, generally the representatives of the foreign companies dominate the management boards.

There is no central policy for water privatization, the municipalities themselves have to decide on the form by which water companies are operated.

The revenue from privatization was not spent on sector improvement. However, significant developments are needed to meet EU requirements.

In the case of some privatized water companies, problems emerged that raised the question of the transparency of the privatization process and the negotiating ability of municipalities.

Regarding the structure of the sector, it seems that the smaller water companies will be integrated, as there is large professional pressure towards this direction. The EU requirements will push more and more companies towards more professional and efficient operations that also could result in forward privatization. Future privatization will not necessarily be completed by foreign investors as some positive examples of domestic investors (e.g. the Szolnok case) can foster domestic investments into the sector as well.

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