

*LOCAL GOVERNMENT KNOW HOW PROGRAMME*

**Local autonomy and responsibility**

*Development of government actions in a plural public service system*

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**Issues, Conflicts, Solutions**

## **LOCAL AUTONOMY AND RESPONSIBILITY**

### *Development of government actions in a plural public service system*

#### **EXECUTIVE SUMMARY**

##### **Introduction**

1. This is the Executive Summary of a Report by the Know How Fund Local Government Project on the first phase of a study of local government competencies requested by the Prime Minister's Office as a contribution to its Public Administration Review. This report is our contribution to section "II. Development of regional and municipal public administration", item 3.a on revision of local government functions and competencies. This is the first stage of our work, when the approach and direction of future tasks was defined. There are eight background papers on Hungary and two international examples attached to this report.

##### **The Challenge**

2. There is a fundamental gap between the aspirations of the 1990 Local Government Act and practical reality. The Act recognises the freedom of communities of any size to constitute municipalities and confers equal responsibility upon them all. The reality is a huge disparity in ability to perform those responsibilities, largely based on size, but also influenced by geographical region. How can this contradiction - and its practical implications for the quality of public services - be resolved? This is the basic challenge to Government and this Report.
3. Local government has achieved great improvements in the environment and in the provision of many services over the last decade despite a severe fiscal squeeze. Territorial fragmentation is a fundamental weakness, however. Small municipalities are unable to provide necessary economies of scale for their services and there is a widespread mismatch between the catchment areas of service institutions and the jurisdictions of their owners.
4. The Local Government Act anticipated these problems in two ways. Firstly, it vested responsibility for certain large catchment area institutions in county governments; this was undermined, however, by the failure to provide counties with independent revenue sources and by allowing municipalities to claim ownership of institutions on their soil.
5. Secondly, it permitted municipalities to provide joint services. In practice - and in line with international experience - this intermunicipal cooperation has only occurred where there has been a high degree of legal, technical or financial pressure.

##### **Restructuring**

6. It is natural to see solutions in terms of structural reorganisation. Possible models take two forms. The first is a *reorganisation of local government* itself. This might involve the wholesale amalgamation of small municipalities to achieve a minimum viable size. Alternatively it might leave village municipalities in place but create an intermediate tier of district authorities each serving a town and its surrounding villages and providing all services with economies of scale. At the higher level it might substitute the region for the county as a self government level, partly again for scale economy in specialised services, but also for consistency with development planning in relation to EU Accession.
7. The second reform model leaves the existing municipal structure intact, but *redistributes competences*. Favoured by sectoral specialists, this approach would concentrate responsibility for particular services in the county governments, larger towns or mandatory intermunicipal associations.
8. Both of these models have an internal logic. They raise three basic questions, however. The first is the cost of reorganisation - of redundancy, rehousing, dislocation, dissatisfaction.
9. The second question is the possible loss of the benefits of the current system and, in particular, the degree of local initiative and self-reliance which has been evident over the last decade, particularly in response to economic shocks.
10. Finally restructuring solutions run up against the constitutional entrenchment of the 1990 Act. The chances of obtaining a two thirds parliamentary majority for any substantial change in local government structure and competences are subject to serious doubt.

### **An Incentive Based Strategy**

11. There is an alternative strategy which would seek to bring local government services up to nationally acceptable levels by *incentives*: a combination of enablement and compulsion, stick and carrot. The smaller municipalities would be under far greater pressure to cooperate if they could not meet these standards on their own. This approach is already in practice, but not in a coherent or systematic form, and vital instruments are lacking.
12. This strategy would depend upon looking at each sector from a comprehensive standpoint including legal requirements, supervision, financing, organisation and management, professional and performance control. It would comprise five areas of reform:
  - (1) *Enforcement of Standards*: strengthening enforcement of acceptable performance standards of services of national interest through a mixture of measures including
    - . developing inspectorates for education and social services
    - . more rigorous registration procedures for institutions
    - . reinforcing the audit system, with concerns for efficiency as well as legality

- . making specific normative grants for schools, social welfare etc and Health Insurance Fund financing of hospitals conditional on achievement of prescribed standards
- (2) *Facilitating Cooperation*: legal, employment and financial changes needed to make intermunicipal cooperation easier:
- . making intermunicipal bodies eligible for direct receipt of grants
  - . through modification of sectoral legislation options for co-operation should be increased (e.g. joint employment of specialised teachers, social workers)
  - . giving intermunicipal bodies power to levy municipal taxes and to set user charges
  - . further development of regulations on utility services to improve client positions and to protect customer rights
  - . in the case of public administration functions creation of district authorities should be in compliance with characteristics of functions.
- (3) *Operation in a Market Environment, Development of Partnership Arrangements*:
- . improvements in tendering, contracting and regulatory procedures should be based on unified rules, with a strong emphasis on consumer protection
  - . incentives to cooperation with the private and voluntary sectors
  - . unification of user charge setting rules
  - . compulsory contracting with service organisations
  - . amendment of public procurement and concession regulation in the case of local utilities.
- (4) *Improving Transparency* through legal reforms and by using ethical codes
- . enforcing disclosure of interest
  - . restricting participation of service providers in municipal decision making
  - . written ethical codes of conduct for councillors and local officials.
- (5) *Financial Resources and Equalisation*: reforms to the system of local government finance to
- . increase accountability by greater capacity to levy revenue sources
  - . enhance stability and predictability by guaranteeing levels of state budget support
  - . move towards normative grants, based on indicators related to local needs
  - . eliminating or withholding grants which enable uneconomic and substandard units to survive
  - . provide firmer funding for inter-municipal bodies
  - . own source or shared revenues for county local governments
  - . link equalisation to spending need as well as revenue capacity.

13. Implementation would require a host of separate legal, institutional, procedural and financial reforms which are detailed in Part III of the Report. But there is a strong complementarity and together they offer a coherent strategy. Indeed their effectiveness will depend upon their being seen as instruments of a concerted policy of reform.

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## **PART I: THE ISSUES**

### **Introduction**

1. The 1990 Local Government Act created a remarkable degree of local *autonomy*. This is reflected in the right given to individual settlements to claim municipal status, their equality in powers and duties, and the relative freedom of local governments from external controls.
2. The Act also gave local government an exceptionally wide range of *responsibilities*, both mandatory and discretionary.
3. Finally, both of these characteristics were enshrined in fundamental legislation which can only be amended by a two thirds majority in Parliament, i.e. with a degree of political consensus which is hard to achieve in respect of any substantial change.
4. These radical reforms were an understandable reaction against the centralisation of the Communist era which was basically political and economic, but also territorial insofar as it stifled the development of the smaller settlements. Decentralisation became part of a wider process prompted by inefficient provision of public services and an economic crisis. Severe fiscal austerity in the public sector as a whole led to continuing devolution of public functions but also to reductions in the real value of central budget transfers.
5. Local government has achieved much over the past nine years, both in the development and repair of infrastructure and in keeping basic services going despite a severe fiscal squeeze. From large cities to tiny villages determination and imagination have been shown in responding to economic shocks and promoting new forms of employment and enterprise.
6. There are, nevertheless, serious weaknesses in the operation of individual services, particularly by the smaller municipalities, which are a matter of public concern and are highlighted in the sectoral studies attached to this report. Many of these demonstrate flaws in the underlying concepts of local autonomy and responsibility and inherent conflicts between the two. These can only be resolved by a reappraisal of the dynamics of *central-local relations*.

### **Autonomy**

#### ***Resource Dependence***

7. The concept of local autonomy enshrined in the 1990 Act has several flaws. Firstly it overestimates the capacity for independent action. In practice to fulfil its responsibilities local government is extremely *dependent on external resources*. All local governments



depend substantially on government grants; even if Government were willing to transfer more taxing power to local government, it would still - for both technical and equity reasons - fall short of local expenditure needs. Small local governments are also very dependent on external resources for technical and human capacity.

### **Local Accountability**

8. Secondly, the argument for local autonomy is based upon assumptions about local accountability - about the role of local elections in guaranteeing the integrity, efficiency and responsiveness of local leaders. This is a genuine feature of local government and one can see many examples of its impact on local government operations. The vigour of municipal responses to employment losses shows the pressure on elected leaders to confront the problems of their communities even when they have no mandatory duty.
9. Local accountability is not by itself an absolute guarantee of the quality of municipal governance, however. In practice its impact is diluted by two other characteristics of local government. The first is the prevalence of *conflicts of interest*, such as widespread membership of councils by teachers, doctors and municipal company directors who are *de facto* employees, or the abuse of urban planning powers to allow inappropriate developments of municipal real estate.
10. The second is the *fragmentation of power* within municipalities between mayors, deputy mayors, council factions, officers and directors of institutions and companies which can impede clear, consistent and courageous decision making.
11. The ballot box does not necessarily ensure responsible use of power at any level of government. Democratic accountability can be undermined by public apathy and, particularly in small communities, by the dominance of elites. Use of discretion can be characterised by prejudice against minorities, indifference to deprivation, hostility to neighbouring communities and preoccupation with the short term. Both national and local politicians can be at fault in these respects; salvation often lies in a creative tension between levels of government, each acting as a brake on the irresponsibility of the other.

### **The Autonomy of Providers**

12. Thirdly, local services are mostly delivered by institutions and companies which have their own degree of autonomy. This has at least three dimensions:
  - (1) *legal*: institutions and companies have legal rights over revenues, expenditures, employment and operations; these should be exercised within a contractual and supervisory framework which ensures the public interest, but is often too weak for this purpose;
  - (2) *technical*: town halls often lack the technical expertise to supervise the operations of the institutions and companies; for example, only 20% of municipalities owning schools have an Education Officer; few heads of municipal health

departments have the real stature and experience to supervise management of a hospital;

- (3) *political*: municipal supervision is often compromised by political factors such as membership of councils by institutional/company directors and employees, or their personal relationship to key politicians.
13. As a result the capacity to guarantee the quality and integrity of their service providers varies widely between municipalities, even though these are their subordinates and municipalities are legally responsible for what they do. Control and management of urban service companies requires highly technical knowledge which many municipal administrations lack. The extreme case concerns hospitals. Recent SAO investigations of medical equipment and outpatient services have confirmed widespread mismanagement and abuse in hospitals, some of which have incurred large debts. The municipal owners are legally responsible for the hospitals and their liabilities but have little capacity to control them effectively.

### ***The Market***

14. The relationship between local government and its service providers introduces another major dimension. Local public services are increasingly operating in a market environment. Parents can choose a school for their children. Hospitals compete for the county quota of beds funded by the Insurance Fund, while GPs can choose to which hospital to refer their patients. Town based technical service companies are competing for village contracts; their ownership is diversifying. And already crossing the horizon are the big international companies interested in running anything from a landfill to an old peoples' home - and with the right to compete in these markets once Hungary signs the Treaty of Rome.
15. Market competition can be just as good for the supply of public as private goods. But it has its obvious weaknesses. Families do not have equal opportunities to send their children to the better but more distant schools, or to attend the best hospitals. It depends on income and mobility. The more local schools and hospitals on which the poorer and less mobile are forced to depend may decline in quality because of reduced patronage. Company takeovers can effectively eliminate choice of waste disposal contractor or water supply manager. The role of local government in guaranteeing the availability of a quality service at affordable prices (either for the consumer or the municipal budget) may become easier or progressively harder. There are both major opportunities and risks.

### ***The National Role***

16. The emphasis of the Local Government Act on local autonomy does not adequately recognise the responsibility of the State to ensure equality of access to those services which are a basic human right, or to regulate those local activities which have serious implications beyond the local jurisdiction. On the other hand the operation and behaviour of ministries and other national agencies has not fully adapted to the concept of devolution. We return to these points later.

### ***Public and Private Partnership***

17. Finally, it has to be recognised that many of the challenges facing local communities - unemployment, social deviance, family breakdown, drugs, criminality - cannot be addressed exclusively by the public sector. They require *partnerships* across society as a whole: the State, local government, business, the voluntary sector. The emerging non-profit organisations already provide a good basis for joint provision of local human services. In providing urban technical infrastructure external resources can be attracted and higher efficiency achieved through public-private partnerships. Cooperation is far more relevant as a guiding concept than autonomy in contemporary circumstances.

### **Responsibility**

18. As mentioned already, the scope of local government responsibility under the 1990 Act is exceptionally wide. It is only comparable with that in Scandinavian countries and, after recent changes, in Poland. But again there are factors which compromise the exercise of these responsibilities in practice.

### ***Ambiguity***

19. The word "competence" is usually used to describe the powers and duties of local government, rather than "responsibility" or "function". This seems to indicate an ambiguity of attitude. A "competence" can be seen as a responsibility or duty to provide a service, or as a property right - something which embellishes the power of the holder.
20. This could be just a quibble about words. But a deeper significance is apparent. Local governments do seem to see their competences in terms of power and property, and this can conflict with real responsibility to the public. In particular, their interests as owners and employers often conflict with their duty to provide the most effective and efficient service. A small municipality may well prefer to maintain its own institution despite its inadequacy, rather than join with neighbours in a common facility which can be properly staffed and equipped; it may persist with the services of its own company when contracting an external provider would be more cost effective. This is not unique to Hungary but that does not lessen the problem. The most conspicuous example again concerns hospitals which tend to be retained in municipal hands even where there is no capacity to improve them.

### ***Territorial Fragmentation***

21. The geographic/urban structure of the country and the administrative boundaries of the county local governments raise several problems for local service delivery. Fragmentation is reflected not only in the high number of relatively small municipalities, but also in the mismatch of administrative powers and service management. For geographical, economic and historical reasons the catchment areas of local public services do not fit with administrative boundaries.

22. Human services at regional level do not fall neatly within county borders and county and municipal services in large cities overlap. In the field of communal and utility services existing networks, physical limits to service areas and business ambitions are incompatible with clear cut jurisdictions.
23. Fragmentation causes problems for the planning and financing of investment and physical development. The size of public utilities is frequently below a financial optimum, and utilities are sometimes constructed with unused capacity. The authority for territorial planning does not always cover appropriate regions and conurbations.

### **Unreality**

24. The biggest problem is the gap between the legal responsibility for services and actual capacity to exercise it. This is compromised by a number of factors.
25. The biggest problem is the inability of small municipalities to provide necessary *economies of scale*. For example, statistics show that the performance of pupils from small rural schools is below national norms and deteriorating because of the lack of specialised teaching and equipment needed in grades 5 to 8. Although child protection services are now legally supervised by town based professionals, they are still inadequate in rural areas because of the absence of field social workers capable of supplying case information before a legal decision and supervising its implementation.
26. A second problem is the constraints on *supervision of service providers* already mentioned. This is coupled with the fact that in some sectors the real involvement of local government is secondary; the classic example is hospital management where the bulk of resources come directly from the Health Insurance Fund.
27. The third problem is the mismatch between *service catchment areas* and municipal jurisdictions which has already been mentioned. The specific normatives partially overcome this by routing state funding to the authority which actually provides the service, but these do not cover the full cost.
28. The Local Government Act anticipated these problems in two ways. Firstly, it vested responsibility for certain large catchment area institutions in county governments; this was undermined, however, by the failure to provide counties with independent revenue sources and by allowing municipalities to claim ownership of institutions on their soil.
29. Secondly, it permitted municipalities to provide *joint services* and various incentives have been provided for this, both legal (in the case of public administration) and financial. Many joint arrangements including associations have been formed. A high proportion of these have responded to legal requirements and pressures; these particularly concern public administration duties, but the prospect of EU standards is promoting much subregional cooperation in waste disposal. There are also many cooperative arrangements for somewhat peripheral operations such as weekend cover for medical practices. There are some 400 water suppliers managing municipally and commercially

owned networks collectively because of their physical integration.

30. Cooperation is hardest to achieve in the management of schools. More than half of local governments (58%) operate eight grade primary schools and one fifth of these have populations below 1,000. There are numerous examples of failure: a group of villages in Tolna recognises that only one school can viably offer grade 5 to 8 teaching but none will surrender it. Kaposvar has an agreement to take pupils from 50 surrounding villages into its schools but only 10% actually pay their agreed contribution.
31. International experience suggests that intermunicipal cooperation does not thrive in a voluntarist environment. Hungarian law does not provide sufficient compulsion, facilitation or incentive.

### ***Fragmentation of Responsibility***

32. The current fragmentation of responsibility for services leads to both overlaps and gaps, as well as perverse incentives. For example, municipalities encourage old people to enter residential homes run by county governments to avoid the cost to their own budgets of domiciliary care which might be cheaper or more acceptable to the client. Split responsibilities for health services between county medical officers, the Health Insurance Fund, county governments and municipalities mean that no one takes an overall lead in the promotion of public health. In the case of hospitals it also leads to purchases of expensive equipment which cannot be repaired or maintained.

### ***Fiscal Squeeze***

33. Finally ability to exercise responsibility has been severely constrained by fiscal squeeze. State budget support for local government declined by 25% in real terms during the last parliamentary term, and the trend has continued under the current Government. The underfunding of the 1999 teachers salary award is a well known example.
34. This has been a reflection of national budget deficits, from whose effects local public services cannot be expected to escape. It is also true that local government could absorb some reductions without detriment to services by eliminating inefficiency and excess capacity. However, it is very questionable whether the cuts in grants have been distributed according to real capacity to absorb them and have encouraged greater efficiency. The whole issue of increasing local revenue sources is also in abeyance, since it arouses ambivalent attitudes in both central and local government. This report will return to this issue later.

### **Central Local Relations**

35. Where does the analysis lead? A purely centralised approach to Government was discredited by the experience of Communist rule, and a return to that direction has been deliberately obstructed by the Constitution and the fundamental status of the 1990 Act. Real power is in any case fragmented by the influence of international bureaucratic and

commercial structures.

36. Nor is local autonomy a complete answer. By itself it can guarantee neither complete accountability nor adequate provision of local public services.
37. "Cooperative federalism" more nearly describes the necessary approach. This recognises the interdependence of national and local government, and the role of creative tension in mitigating each other's inadequacies and irresponsibility.
38. This approach recognises the legitimate role of the State in
  - (1) safeguarding the public against the abuse of power by local officials
  - (2) setting policy goals and standards for services which constitute a basic human right for all citizens regardless of location
  - (3) ensuring the firm application of rules which prevent local business and people doing damage to others outside the locality.
39. But "cooperative federalism" also means that the State should
  - (1) act responsibly in ensuring that the tasks and standards it sets for local government are achievable; this means a constant regard for local resource constraints and opinions
  - (2) recognise the value of local discretion in implementing policy in locally appropriate ways and coopting public support and contribution
  - (3) recognise the value of local initiative in pioneering new approaches to public service
  - (4) acknowledge the existence of fields of local responsibility and interest where no national interest is at stake and local autonomy should be unfettered.

This means developing new functions and operational rules to suit a decentralised legal and financial environment through advisory and professional development activities, providing access to information and supporting local innovation.

40. "Cooperative federalism" demands constant dialogue between politicians and professionals active in particular fields of policy development at all levels. National interventions in local government operations need to be conducted in as positive a spirit as possible, encouraging and disseminating good practice, suggesting improvements rather than censoring failure. Interventions need to be normative rather than arbitrary, based on transparent and predictable rules of the game.
41. Finally, central local relations should promote a spirit of partnership, not only between central and local government, but also with private enterprise, the third sector and the

community as a whole.

## Strategies for Reform

### *The Challenge*

42. There is a fundamental gap between the aspirations of the 1990 Local Government Act and practical reality. The Act recognises the freedom of communities of any size to constitute municipalities and confers equal responsibility upon them all. The reality is a huge disparity in ability to perform those responsibilities, largely based on size, but also influenced by geographical region. How can this contradiction - and its practical implications for the quality of public services - be resolved? This is the basic challenge to Government and this Report.

### *Restructuring*

43. It is natural to see solutions in terms of structural reorganisation. Possible models will be discussed in Part II. They take two forms. The first is a *reorganisation of local government* itself. This might involve the wholesale amalgamation of small municipalities to achieve a minimum viable size. Alternatively it might leave village municipalities in place but create an intermediate tier of district authorities each serving a town and its surrounding villages and providing all services with economies of scale. At the higher level it might substitute the region for the county as a self government level, partly again for scale economy in specialised services, but also for consistency with development planning in relation to EU Accession.
44. The second reform model leaves the existing municipal structure intact, but *redistributes competences*. Favoured by sectoral specialists, this approach would concentrate responsibility for particular services in the county governments, larger towns or mandatory intermunicipal associations.
45. Both of these models have an internal logic. They raise three basic questions, however. The first is the cost of reorganisation - of redundancy, rehousing, dislocation, dissatisfaction.
46. The second question is the possible loss of the benefits of the current system and, in particular, the degree of local initiative and self-reliance which has been evident over the last decade.
47. Finally restructuring solutions run up against the constitutional entrenchment of the 1990 Act. The chances of obtaining a two thirds parliamentary majority for any substantial change in local government structure and competences is subject to serious doubt.

### *An Incentive Based Strategy*

48. There is an alternative strategy which would seek to bring local government services up to nationally acceptable levels by incentives: a combination of enablement and



compulsion, stick and carrot. The smaller municipalities would be under far greater pressure to cooperate if they could not meet these standards on their own. This approach is already in practice, but not in a coherent or systematic form, and vital instruments are lacking.

49. This strategy would depend upon looking at each sector from a comprehensive standpoint including legal requirements, supervision, financing, organisation and management, professional and performance control. It would comprise five areas of reform:
- (1) *Enforcement of Standards*: strengthening enforcement of acceptable performance standards of services of national interest through a mixture of measures including inspection, registration, audit and conditionality for financial support.
  - (2) *Facilitating Cooperation and Partnership*: legal, employment and financial changes needed to make intermunicipal cooperation easier and promote public/private partnership.
  - (3) *Operation in a Market Environment*: improvements in tendering, contracting and regulatory procedures with a strong emphasis on consumer protection; incentives to cooperation with the private and voluntary sectors.
  - (4) *Conflicts of Interest*: legal reforms concerning disclosure of interest and participation of service providers in municipal decision making.
  - (5) *Financial Resources and Equalisation*: reforms to the system of local government finance to increase accountability by greater capacity to levy revenue sources, enhance stability, eliminate subsidies to inefficiency, provide firmer funding for inter-municipal bodies, and link equalisation to spending need as well as revenue capacity.
50. These reforms will be outlined in greater detail in Part III. Implementation would require a host of separate legal, institutional, procedural and financial reforms. But there is a strong complementarity and together they offer a coherent strategy. Indeed their effectiveness will depend upon their being seen as instruments of a concerted policy of reform.

## **PART II: RESTRUCTURING**

### **Introduction**

51. This Part discusses possible reforms of local government involving *reorganisation*. As mentioned in paragraph 43 these are of two kinds
- (1) changes in the structure of local government
  - (2) redistributions of responsibility between local governments.

These will be discussed in turn.

## **Reorganisation**

### *Amalgamations*

52. This Report has already referred to the wide range of responsibility conferred on local government by the 1990 Act, comparable only to Scandinavian countries and Poland. In western European countries where local government has a similar range of competence, there have been reorganisations, particularly during the 1960s and 1970s, aimed to match the size of individual municipalities to the scale economies relevant to their tasks.
53. Most of these reorganisations concentrated on the amalgamation of small municipalities. The most common target was a minimum size of 5,000 population, but with an average closer to 25,000 (100,000 in Britain). Numbers of local authorities declined by 87% in Sweden, 80% in Denmark, 78% in Belgium, 76% in Britain and 67% in Germany (Western).
54. Amalgamations were less radical or effective in the southern European countries where in the Napoleonic tradition the State maintains a major local presence through prefectorial administration and field technical services, so that public services are not as dependent upon the executive capacity of local government.

### *Semi-amalgamation*

55. Amalgamations on this or any scale would obviously meet great political resistance in Hungary. However, there have also been *semi-amalgamation* models which combine small municipalities into larger units for administration and service provision but leave some form of representative body in existence in the original settlements. Examples are the British rural system of districts and parishes, and the *verbandsgemeinde* in some German Lander.
56. The British reorganisation in 1974 merged local authorities into districts with large populations (25,000 being the smallest). All mandatory tasks and all the normal financial resources (grants, taxes etc) were allocated to the districts or county authorities. The districts became in practice the basic level of local executive authority. However, smaller communities within districts can constitute and elect *parish councils* with the right to levy a small surcharge on the local district tax. Parish councils have no mandatory tasks but they can provide supplementary services if they wish, have the right to be consulted on all planning issues (plans and planning/building permissions) and generally represent local opinion to other bodies, public or private. (*Insert reference to Beechey Paper*)
57. This example could provide one option for Hungary. Larger territorial units could be created at subregional/district level, with elected officials, taxing power etc to manage all

local competences which required substantial resources of finance and manpower. But villages might retain the right to elect mayors and councils, with minor ceremonial and administrative *duties* (performing weddings, civil registration, for example), *rights* to voice local opinion and to be consulted on sensitive issues like planning, and *discretion* to raise a small amount of revenue and provide extra, non-obligatory services. They might even be given a definitive role in determining planning/building applications, but with expert advice being provided by the subregional authority.

58. *Verbandsgemeinde* in the German Land of Rhine Palatinate (and new equivalents in Brandenburg and Lower Saxony) provide another model of semi-amalgamation. They provide a common administration for groups of small *gemeinde*. The latter continue to elect mayors and councils, to levy taxes and make budgets, but employ no staff or administrative apparatus. Budgets and services are administered on their behalf by the *verbände* which also has an elected mayor and council. Competences are divided between the two levels. This is also a possible model for Hungary with a single administration at subregional level serving a group of municipalities. (*Insert reference to Banner Paper*)

### ***Enforced Cooperation***

59. France, which has 36,000 basic communes, has many agencies for inter-municipal cooperation, both single and multi-purpose. Whilst voluntary cooperation remains the ideal, there is a heavy degree of State coercion involved. Some inter-municipal bodies have been established by law such as the *communautes urbaines* which undertake functions like planning, transportation, economic development, fire protection, water supply and waste management in large conurbations. There are rules which allow an intermunicipal body to be imposed on a group of communes providing the majority of the communes or their combined population agree. State officials often regulate the financial obligations of individual communes to intermunicipal agencies. Access to investment grants and loans has often been made conditional on intermunicipal cooperation in executing and managing the works concerned. (*Insert reference to Marcou Paper*).
60. Britain, too, has some mandatory joint authorities for services like structure planning, fire protection, trading standards and waste disposal. These either combine municipal authorities in metropolitan areas, or counties and the equivalent of county-rights towns.

### ***Regions and Counties***

61. Whether the region or the county is the appropriate level for deconcentrated state agencies or development planning and programming lies outside the scope of this Report. There are obvious costs and dysfunctions in trying to sustain planning and administrative mechanisms at both.
62. There would be advantages in locating the upper tier of self government at the level with prime responsibility for development planning. This would strengthen the representative voice in this process and provide a clear link to at least some of the local government

services. A regional self government would have even greater scale economy in running what are now county services. Some of the current regions, however, lack the ease of access and natural identity which are important to self government at all levels.

63. The subregional development associations have clearly assumed a critical role in developing investment proposals for funding through both the regional and county development channels. However, they are very dependent on the limited technical capacity of their chairmen's own offices; it is understood that ISPA applications have suffered from inadequate preparation at the subregional level. Greater state or donor technical assistance may be needed if the subregions are to reach their full potential for inter-municipal planning.

### **Redistribution of Competences**

64. An alternative approach would involve the redistribution of competences between levels and types of local government within the present structure.
65. This is already being attempted in the case of public administration functions, notably in the case of building and child protection authorities.
66. The clearest option would be to consolidate the responsibility of county governments for secondary education, social care institutions and hospitals by making the transfer to them of ownership and management mandatory. This would overcome the current uncertainties over responsibility and the mismatch between municipal funding and catchment areas, (although not in the case of services crossing county boundaries). It would also reduce the incentive to keep uneconomically small units running.
67. A second and complementary strategy would be to develop a network of district notaries based on traditional subregions, fulfilling a number of functions on behalf of the constituent municipalities acting together through subregional associations. These might include
- (1) joint negotiation of technical service and waste disposal contracts
  - (2) joint employment of an education officer or of teachers working on a retainer basis
  - (3) joint employment of qualified social workers to support the child protection officers and advise municipalities in their social welfare tasks
  - (4) providing administrative and technical support to the subregional development associations in their investment design and bidding roles.

### **Risks and Constraints**

68. Each of these solutions has an internal logic based on economy of scale and clarification of responsibility. They are confronted, however, by a number of risks and constraints. These vary from disadvantages to potentially insuperable obstacles.

### ***Costs of Reorganisation***

69. International experience (not least in Britain) highlights the costs of reorganisation. There are the *financial* costs including staff redundancy and the construction and equipment of new offices, (usually more lavish than they should be). Adding an intermediate tier may also add to costs since villages will not necessarily reduce their own political and administrative apparatus to match the reduction of duties.
70. There are *human* costs in morale, disappointment and uncertainty. And there are the costs of disruption with politicians and staff distracted from the real business of service to the public.

### ***Loss of Local Identity***

71. The more radical forms of reorganisation have hidden costs in the loss of local initiative, knowledge and identity. The smaller Hungarian settlements may struggle to provide efficient and effective services. But they have also showed a remarkable capacity for economic survival and social solidarity as well as much innovation through avenues such as horticulture, industrial outsourcing, or village tourism.
72. It is also easy to underrate their administrative capacity. Mayor's offices tend to be staffed by local housewives and mothers whose lack of qualification is substantially compensated by their experience, commitment and local knowledge. Shared notaries and building authority officials are in practice heavily dependent on the way they deal with initial public inquiries and process business. "Rationalisations" which dispense with this local familiarity and experience may yield no real improvement in public service.

### ***Political and Legal Obstacles***

73. Finally, any attempts to impose major changes in local government structure or competence face formidable political and legislative hurdles. This was evident in the 1998 reform of the system of building authorities. The Ministry of Environment's intention was to restrict the power to award building permissions to 150 professionally staffed offices. In the event the political sensitivity was so great that nearly 1,500 offices still have these powers. This failure to achieve rationalisation occurred in making legislation which only required a simple majority. It showed how much risk surrounds any attempt to mobilise a two thirds majority to amend the Local Government Act.

### **Conclusion**

74. There is a very well worn joke about the Irishman asked the way to Dublin. "I would not start from here", he replied.

75. It is easy to design local government structures and distributions of functions which would be far more appropriate than those currently in force in Hungary. But the point of departure would not be the 1990 Local Government Act. Unfortunately that is the starting point for reform; we have to recognise the difficulties it places in the way of any fundamental restructuring.
76. For this reason we have to consider alternative strategies which rely more on incremental incentives to change than radical, imposed solutions. These are discussed in Part III.

### **PART III: INCREMENTAL SOLUTIONS**

77. The incentive based strategy focuses functions instead of the local government structure. The starting point is that functions are not (only) legal scopes and duties, but provision of public services. Local governments and the government in general do not have overall responsibilities for provision of public services, but they do have definitely system-specific public roles in managing provision in the environment of existing different sectors.
78. In the Hungarian practice of public provision and also in the regulation as a whole a lot of new elements have been working since the transition in different extent and different intensity. That is necessary now to prefer a *consequent regulatory strategy* to develop these elements and fit them to an anticipated coherent system of public functions. In this sense, problems of insufficiency are not solved by the typical deregulation. Now a specific, policy based strategy should be encouraged as *re-regulation*.
79. The coherent policy program of re-regulation of public role in provision of public services in an intergovernmental context consists of (i) the philosophy of *co-operative federalism* (described generally in the Part I); a *package* of particular issues which can be regulated in different ways and instruments.
80. A strategy of induced reform through a stick and carrot approach within the "cooperative federalism" approach. This requires a significant change in the anticipated methods of public administration reform: moving from reallocation of competencies and functions towards new areas of legislation, organisational and management methods.
81. Public administration reform in the local government sector requires changes at both levels of government. Functions and operation of central government is a condition of improved local government system. Our proposals on incremental solutions will focus on those reform areas, which affect the entire public administration.
82. In our work we concentrate on two aspects of public service delivery: (i) what are the functions of government and how successfully are they implemented (ii) what are the specific sectoral characteristics of services. Government functions are separated along

five dimensions:

- legislative,
- financing rules and techniques,
- legal supervision,
- professional and performance control,
- organisational forms and management techniques.

83. Local public services were grouped into four broader categories:
- human services (education, welfare health care),
  - public utility and communal services,
  - public administration functions,
  - regional development.
84. Our proposal is, that the future public administration reform should deal with *basic principles* of re-regulation. These are as follows:
- a) *a coherent approach* (in the field of public utilities), i. e. codifying rules on provision of public utility services making a consistent framework instead of present dispersed regulation, and collection of different appearances of public influence;
  - b) *generalisation* (in human services), i. e. on the basis of practically having developed principles generalising about public policy preferences and instruments, neglecting unacceptable and unreasonable differences among particular fields of provision; in a way making a new policy orientation on the public role in human services;
  - c) *differentiation* (in administration), i. e. making difference between state administrative authoritative duties, using capacity of bureaucracy in an optimal and effective way, creation of administrative districts should be based on special features of the administrative work in particular types of duties.
85. The main areas of re-regulation cover the five major functions of government. Designing the role of the government in those five areas the public administration reform programme should take into consideration the different characteristics of the four service groups: the emphasis of the reform will be different by sectors. In the following sections major areas of “stick and carrot” approach based reforms will be discussed.

## 1. Enforcement of standards

### *Objectives*

86. The enforcement of standards is the key "stick" in the "sticks and carrots" approach. Exercise of local government competences should be subject to the achievement of acceptable standards. These should be defined and enforced so that an individual municipality which is unable to meet those standards by itself, will be compelled to cooperate with others in joint provision or, where appropriate under the Local Government Act, hand over the responsibility and the related assets to the county self government.





## **Methods**

### *Definition of Standards*

87. Minimum standards are likely to be prescribed by national sectoral legislation, where national policies are at stake or where the performance of a municipality will have impacts on its neighbours. However, standards may also be defined by contracts with public service providers such as utility companies. Municipal assemblies may also set standards for their own institutions and officials.

### *Enforcement of Standards*

88. Where standards are prescribed, there should be an adequate system of monitoring and inspection to check whether they are being achieved. Where national interests and policies are involved, this should require the existence of some form of inspectorate, with the task of promoting improved performance as well as identifying failure. This usually requires a professional base, although auditors and public administration offices may also have a role to play.
89. Sanctions for failure to meet required standards may include:
- (1) a court order requiring observance of a legal duty
  - (2) refusal of registration for a municipal institution
  - (3) loss or reduction of any specific state funding; (there are currently a number of extra normative grants for inter-municipal cooperation; however, these are inadequate incentives since the standard specific normatives are not withheld if a service fails to achieve an acceptable standard)
  - (4) publicity leading to hostile criticism.

## **Sectoral Applications**

### *Education*

90. Responsibility for education is as highly devolved in Hungary as in any other European country. This is nevertheless a field in which national interests are clearly at stake and where equality of access is demanded by modern concepts of social justice.
91. Background study on education, annexed to this Report refers to a decline in the standards of educational attainment by eighth graders. It shows this has been most marked in villages, but that performance within each category of municipality has correlated with the personal income tax base.
92. To some extent these results may simply reflect differences in social backgrounds and the stimulus given to a child's progress by family circumstances. However, there is also evidence that performance is related to inputs, to differences in the quality of school staffing and equipment, particularly in the more specialised areas of the curriculum. Unit costs are likely to be higher in the case of small schools and the smaller villages may be

least able to afford them.

93. School inputs are covered by national standards which prescribe minimum hours of subject teaching, teaching qualifications, levels of remuneration and equipment. There is, however, no mandatory system of inspection to verify their observance or sanctions in the case of failure.
94. We are aware of the importance given by settlements to the existence of their own school. However, much of the value conferred by schools on village society can be achieved by provision of the first four grades, and joint provision of grades five to eight should be compelled wherever necessary to sufficient scale economies.
95. The establishment of a National Appraisal and Examination Centre and the educational ombudsman, appointed by the minister provide the first steps in creating machinery for both improving and enforcing standards. The aim should be to progress over time to a situation where a school cannot obtain state registration or normative grant support unless it complies with the minimum required standards for each of the grades it offers. At present, normatives are increased as an incentive to cooperation; strict principle suggests that even the standard normative should not be paid to a substandard school.

#### *Social Welfare*

96. Child protection services have been reorganised to vest legal powers in qualified officials serving a group of municipalities. According to the background study on social services this work is still hampered by the absence of qualified social workers, who should be preparing information necessary for case decisions and then supervising the care provided under protection orders.
97. The discretion given to municipalities to determine their own criteria for payment of social benefits and levels of payment has resulted in a degree of disparity, which is unusual by international standards. We appreciate that this was a conscious policy decision and a reflection of economic necessity. It is assumed that national policy will want to promote convergence as soon as fiscal conditions permit.
98. Both of these problems demonstrate the need for an inspectorate capable of vetting the adequacy of local regulations and social welfare staffing, as well as advising municipalities on their improvement. The recent reforms in joint provision of child protection officers may need extension to ensure also an adequate network of field support.
99. As in the case of education, municipal social welfare services are supported by specific normative grants. Once an adequate system of inspection is in place, payment of this grant should become dependent on local services reaching the legally prescribed level.

#### *Medical Services*

100. The main shortcomings in the standards of local government provision relate to hospitals. Many buildings are in a poor state of repair, and a State Audit Office investigation has highlighted major disparities in standards of equipment.
101. The 1995 Report by the former Ministry of Welfare demonstrated major regional disparities in overall standards of health and the incidence of disease. These correlated with the provision of medical services. Although the latter are primarily financed by the Health Insurance Fund on a national basis, the actual allocation system responds to the size and specialisation of medical units, which is derived in turn from the scale and direction of local government investment.
102. There are state grants towards buildings and equipment but their scale and allocation appear to be ad hoc. There is no national system for ensuring adequate expenditure on buildings and equipment or correcting regional disparities. Reliance is placed basically on the ability of local governments to provide funds and the priority given to this subject in municipal budgets. Both factors vary considerably in practice. There is evidence that towns give high priority to the retention of hospitals (which they have shown least willingness to transfer to county governments) but less to their upkeep and supervision.
103. The division of responsibility for hospital services between local government and the Health Insurance Fund has a number of unfortunate consequences, particularly the lack of consistency between capital and maintenance funding. However, we accept that national resources for medical services may already be overstretched and a contribution from local revenue bases essential.
104. In such circumstances, more could be done to ensure that local government meets its obligations and that hospitals are not retained in municipal hands unless they have the capacity to fund them adequately. At present the Health Insurance Fund allocates its annual purchases of beds through a county system of negotiation which resembles an auction. The Fund could surely use its purchasing power in a more discriminatory way. It could restrict its negotiations to hospitals (or departments within them) which comply with maintenance and equipment standards. Alternatively standards could be enforced through the licencing system with the involvement of county medical officers.
105. Background paper on health care, annexed to this Report argues that local governments are concerned with many specific aspects of health care but give inadequate attention to the overall promotion of public health, a role which they are in a uniquely strong position to play. This is not a case of failing to achieve standards since their obligations in this respect are not clearly defined. However, it highlights a gap in the current understanding of municipal responsibilities and deserves much further exploration between Government and the local government associations.

### *Territorial Planning*

106. Territorial planning is a battleground between levels of government in every country. Local communities naturally want control over their built and natural environments, a desire reinforced in Hungary by reaction against the centralised planning regimes of the

Communist era. But the developments they promote may well have damaging consequences for their neighbours, as demonstrated in the background study annexed to this Report.

107. Territorial planning is almost universally an exception to the general rule that relations between tiers of local government should be non-hierarchical. In Britain, as elsewhere, local plans are required to comply with the policies of county structure plans. These govern such aspects as the location of major industrial, residential and commercial growth, the preservation of open land for agriculture, landscape and recreation, the preservation of historical monuments and architectural heritage, the development of trunk infrastructure, the regulation of traffic and the development of public transport. Restrictions are being increasingly applied to the freedom of local governments to sanction large retail parks which may lead to traffic congestion and damage the trade of neighbouring settlements.
108. The 1997 Act on Built Environment does require conformity between local plans and a hierarchy of national, regional and county plans. The problems are two fold. Firstly, the existing higher level plans are generally ignored as of pre-1990 origin, and have not yet been replaced. Secondly, there are no effective sanctions against local planning decisions which do not comply with the county plan framework.
109. The first problem can only be solved by greater urgency in the preparation and adoption of higher level plans. Methods for ensuring compliance of local planning decisions need consideration. One suggested in the background paper is that the 1997 Act should be amended to make joint employment of chief architects at a subcounty level mandatory.

#### *Technical Services and Utilities*

110. National interests in this field are largely environmental and much attention has already been paid both to defining standards and enforcing them. Waste disposal to some extent illustrates the potential success of the "stick and carrot" approach. The impending application of stricter environmental standards plus the possibility of national capital funding has forced many municipalities to plan joint landfill arrangements, usually on a subcounty basis.
111. We are more concerned about the protection of consumer interests; several of these services are funded at least partially by user charges. Municipalities are responsible for the adequacy and quality of the service provided and the equity of the charges imposed. These should be governed by the contractual relationship between the municipality and the provider, usually a company.
112. Standards of service should be defined and enforced by these contractual relationships. This is a matter of procurement law and procedure and discussed further in the relevant section below.

## 2. Extension of the possibilities of co-operation

113. Since the change of the transformation of the political/economic system , according to the Hungarian professional way of thinking the subject of co-operation relates to the problems of associations formed by the local governments. There have been so far two waves of regulations related to the establishment of the institutional framework. The act on local governments defined the types and, within the framework of the independent settlement of local government associations, the legal forms of agreements have been set.
114. Accordingly - while retaining complete freedom in forming associations and in choosing the form of association, the following legislative *types* are available: official administrative association, institutional association, associated assemblies of delegates, regional notary offices, association of small regions. In addition there are certain types of (target) associations which are not specified by law as well as civil law based associations established to implement joint objectives.
115. *According to the contractual forms* we can differentiate among the following forms: association based on contracted tasks, transfer of performing tasks by joint decision and proportionate sharing of costs, and, finally, transfer of the tasks to an association council , a decision making board established jointly for performing tasks.
116. As it became obvious that the local governments are reluctant to establish co-operation among themselves, along with certain development of the institutional framework, the government, correctly, reacted also with the introduction of incentive tools. During the period of political changes examples to that were the central budgetary subsidy supplementing the salary of district notaries and higher norms allocated to local governments ready to perform the given task in the form of association.
117. The policy of motivating co-operation has always remained limited both in extension and in its instruments. The reason may have been that conflicts of interests survived.
118. The failure however must have had another, an even more important reason. The *conditions for establishing links in the organisation of services* in areas most affected by the range of local government operations are still not available. This is what needs to be changed, primarily on the level of government policy. The development of the various sectors in that direction should be implemented on the basis of a uniform and target oriented programme. It is good that the own, encompassing reforms of some major public service areas have achieved such changes in services and public consumption which can accept the key institutional developments suggested below.
119. Finally, when the conditions are available for making the association regulations more specific, it can be considered to transfer further competence to associations which are legal entities even from among issues which can currently not be transferred. Issues of such type may include the establishment of fees, which could be exercised by the members only jointly to make it rational and target oriented.

120. The relaxation of the rigid school system in *public education* could be more inspiring than any formal incentives for the establishment of a relationship among the maintaining authorities so that small settlements should not strive to retain the schools at all cost, when they can meet the minimum professional and other suitability conditions only with the greatest efforts.
121. Such an objective is in complete conformity with the objectives of the reform of public education, namely that the schooling system should become transparent to the greatest possible extent. A successful move could help the promotion of co-operation among the local governments supporting the schools. Thus it would be worth giving priority to a programme of such type with the help of the policy of the sector and of the central government.
122. Similar is the situation with the improvement of access to the services of public education. Education policy and settlement policy both have reasons for that. It would thus be practical to identify the possible and realistically available instruments , starting with subsidy to commuting, or the supply of school buses, through access to internet up to the rational access to vocational training courses.
123. The significance of access is perhaps even more important in *social supply*. Here again government policy should make it unambiguous that the reforms in the sector which try to open the channels as well as the various suppliers , the forms of services trying to increasingly meet requirements and demands are directly related to the motivation of co-operation among the settlements.
124. Only a uniform government guideline can guarantee that the subsidy policy of local government financing and the development of the conditions for access should act in the same direction and operate in a co-ordinated way.
125. Compared to the subjects discussed above the situation is somewhat more difficult in health care in view of the unfortunate delay of a comprehensive reform. It is however certain that it is a basic task to separate more clearly the contents of the tasks to be performed by the local governments and those which are the responsibilities of the health insurance facility (facilities ) and businesses, institutions operating in the given areas.
126. The government policy could initiate the distribution of the tasks. But only on the basis of principles, that is in relation to the re-arrangement of the tasks and the comprehensive clarification of the roles the local governments should play.
127. The conditions of co-operation among local governments in the area of *public utility services* should be arranged primarily through the operation of the companies supplying public utility services. It is through them that the settlements - which are in different positions as clients ordering the public services- can establish links among themselves.

128. The range is very wide, it includes companies which are fully owned by local governments, others may operate as budgetary institutions, while in still other cases the local governments are simply clients, without any ownership right. In that latter case the service supplier may have much greater capacity, and it may happen, that a service supplier in monopolistic position faces a small local government. The local governments as owners and/or clients may have effect on each others' service conditions, although currently , under current conditions they have no institutional possibility for that. Another question is the realisation of consumers' consideration, which is currently totally cut off from the local government position.
129. It is suggested to survey the institutions of public utility services partly to develop the adequate frameworks of these public services and partly to express the actual service links of the local government.
130. The significance of partnership between the public and the private sectors in *regional development* must be determining. For this reason such elements of the political guideline should be concentrated upon which favour less incentives by the state budget but rather the attraction of prospective private resources. For this purpose it is suggested to promote the already existing good examples. It seems at present that one can observe mainly in the development of micro-regions initiatives which meet relevant expectations.
131. In the area of *public administration services* a regional structure has been introduced in recent years. In building administration it can be seen in the so called key construction issues, then in the area of guardianship administration several regional tasks have been transferred to offices which have the professional conditions available for administration. As from 1<sup>st</sup> January 2000 "Certification Offices" will be established on the basis of similar principles.
132. It is worthwhile to regularly monitor the practice of regional organisation. Our studies show a rather mixed picture. We can draw the conclusion that the practice of organisation in regions should be continued most carefully, analysing on the case by case basis the individual issues.

### **3. Development of the institutions of service organisations which fit into the market environment**

133. The organisation of services in order to make them fit into market environment means the continuation of the professional- political guideline based *on partnership* to extend the range of facilities engaged in performing tasks which are to be performed jointly by the society.
134. That means that outside the public sector( meaning state administration, regional local governments and other state organs) the private and the non-profit sectors can also participate in the organisation and supply of public services. These latter facilities can do it without giving up anything from their own features, such as profit orientation -

- for market players- or non-profit operation when serving the public.
135. The public sector must change its role in order to perform tasks of several dimensions. Compared to the past it must occupy different positions, and to the extent possible the mechanisms of keeping in contact and management must flow in a uniform channel. In this sense partnership presumes joint development by the players guided by different motivations.
  136. To manage the procedures which already exist here also and to achieve further benefits from the advanced state achieved the following programmes are worth dealing with in relation to the conditions under which local public services are supplied:
  137. We have to revise on the basis of joint principles- in the area of *public utility supplies* - the systems of links arising from the performance of tasks on public assignments by market players, in the course of which special attention is to be paid on the realisation of the considerations of consumers.
  138. Uniform principles are needed in the areas where it is mandatory to consume services, from the perspectives of material and procedural rights. The clarification of contracts is also not simply a technical issue when determining operations and performance which are not easy to quantify.
  139. Directions of this and similar types will help the rational utilisation of budgetary and private resources- which are to increase in volume-, the improvement of public services and their differentiation in conformity to demands, As a result of the programme program several improvements can be made in the area of public utility services supplied to settlements.
  140. *Comprehensive codification on the conditions of the supply of public utility services to settlements.* The competitive conditions between private companies and firms partly or fully community owned require joint settlement only and exclusively from the aspect that they operate on community order and there are the consumers' considerations which cannot be separated from the totality of local interests.
  141. The regulations in effect- which have been developed in different details for the various types of services- already show the need for legal regulations (on funeral services, district heating supply, public services mandatory to be used, etc.) It would be useful to define legally also timely generalities. These include the issuance of uniform guidelines for the establishment of fees - which is currently most diversified - from the aspects of material rights and procedures. It should also be made mandatory for the local governments - as public client- to conclude contract with the service company, specifying the guarantee elements and conditions. The continuous control in public interest of the contracts is to be institutionalised.
  142. As the citizens are greatly affected by these objectives, it is most justified for the government to determine the relevant policies.



143. *Comprehensive modification package for the development of the public utility services for the settlements.* It is of primary importance to conceptionally manage existing regulations, to supplement the norms in effect.
144. There is a need for instance to modify the regulations on public procurement which favours the purchase of goods rather than services. It does not deal to the necessary extent with the contents of public contracts either. The fact that the act does not cover procurements below a certain limit is also not permissible from the aspects of the future.
145. It would be justified to specialise in certain way the concession rules in relation to public services. In relation to most of the affected services there are rules for the determination of fees, the settlement of which would be realistic by legislation.
146. It would be useful to promote good practices for the *public services and for the possibilities of consumers' control*, apart from legislation. For such purpose further training would be needed and it would also be useful to schedule the formation of public opinion.
147. Partnership between the public sector and the private sphere *in the area of human services in the settlement* has become an accepted practice. Non-profit organisations, institutions and private businesses have become active in public education, in social and cultural supply , and, to a lesser extent, in health care. Naturally the role of the public sphere is not negligible in carious areas. It has been rather early recognised that there was a need to identify and influence relationship between the state sector and other sectors in order to perform community tasks on a higher standard.
148. In the present development phase it has become a problem that regulations differ from one type of service to another one on the frameworks and conditions of the supply by facilities other than the state of various community tasks, especially when it comes to the entitlement to budgetary subsidy and the ratio of such subsidy. For instance the rules on public education differ from those related to social or cultural spheres. Because of the delay of the reform on health care the interpretation of the multi-sector arrangement from the legal and financial aspects is completely missing.
149. The Government level should take steps to unify the system and to set the principles. Moreover as the interests of the various industries are in conflict or inter-related, comprehensive sector-policy priorities must be set on the Government level.
150. There is a need to define in a comprehensive way the possibilities and -recognised-responsibilities in relation to the public tasks of the service suppliers of the different sectors in the areas of public education, culture and the social sphere, on the basis of existing and already implemented reforms. The declared Government policy principles can act as guideline for the existing and coming reforms affecting the human sphere.

151. The defined instruments of community influence should be employed in every sector, on the basis of shared principles. These include the determination of the minimum conditions for the operation of service providers, regardless of the sector to which it belongs; the license of operation based on legal control, the definition of professional standard of actual operation, budgetary financing - regardless of the sector- up to the recognised level, the realisation of the control by the community consumer.
152. The possible further privatisation programmes of public tasks can also fit into the concept of partnership. Naturally that is the most obvious and extreme form of partnership. Under current conditions, in view also of the developments which had taken place so far in the transformation of the political/economic system in this area, no major campaign would be needed..
153. We must certainly be careful with the use of certain terms. When for instance the only objective of privatisation is to bring an interest group into monopolistic position the arrangement must not be termed as privatisation, even if community instruments are transferred into private hands. In any case there will always be privatisation demand, and should such demand arise in the public service sphere -directly affecting everybody- the applying principles and practical procedures must be clarified.
154. Public administration has to perform “night watchman” functions also in the area of multi-sector public service supply. Although in a modern state these contribute only a portion to the necessary interventions, they are not negligible either. In the range of economic regulatory tasks special care should be taken in this range (in view of community consumption) to supervise the monopolies, to exercise competitive control, to operate price regulations.

#### **4. Assurance of Transparency**

155. It is very important that the operation of decision makers and those who execute those decisions by the local governments should be transparent and possible for the public to control. Current regulations narrow down the problem to the issue of conflict of interests. Accordingly it is claimed that it is sufficient to limit the responsibilities and the scope of responsibilities public officers are permitted to undertake in order to make them avoid from landing into dubious situation. From time to time discussions emerge on the area and extent of such limitations at most.
156. Although regulations in effect have been supplemented several times since the transformation of the political system, one can almost constantly hear about making regulations on public officers stricter. Currently they also urge certain limitations to apply to representatives. It is rather difficult to progress in this area because anything that would make regulations stricter would violate important interests.
157. We need to continue keeping the issue of stricter rules of incompatibility on the agenda of the day. Membership in certain board of local government employees or of people nominated by the local government who may affect the organisation also as

owners may give reason for concern. They have to participate in taking important decisions on their own organisation, on the working conditions of such organisation. The experiences of foreign models prove that one does not have to think necessarily in extremes when it comes to declaring disqualification. It may be possible that such a person should not participate in the decision making in some committees, in taking certain decisions or to issue rationally strict regulations.

158. It is clearly necessary to develop in a systematic way the rules of transparency. At the same time the present approach from the perspectives of *incompatibility* seems to be *insufficient*, regardless of the fact that that by itself needs to be supplemented. Disqualification, or conflict of interests only limit taking concurrent functions, jobs by people in certain position, although that is only one type - albeit the most visible type- of incompatibility. In actual fact a more shaded regulation would be needed to moderate the incompatibility which is to be avoided.
159. In addition to making the rules on incompatibility stricter for officers and representatives the limits of *participation in the decision making procedure of the local governments* should be clarified. That needs to be regulated by legislation and settled clearly in writing, in code of ethics.
160. *Legislation* should first of all extend the institution of exclusion from decision making. Under the current regulations the obligation for disclosing bias arises only in official matters on the consequences of which in relation to participation in the decision making are decided on by the boards by voting.
161. In actual fact bias can arise not only when official decisions are taken, but in a wide range of local government matters, and in matters of major importance at that. It has become almost a regular phenomenon that the decision makers - when passing decisions on settlement policy- vote in ways that bring benefit to their own personal interest. Moreover those who prepare the decisions in the office or as external experts often “take into consideration “ such personal interests.
162. Thus it would be necessary to regulate more exactly the contents and procedures of exclusion from the decision making process. Naturally we know well the argument, that should teachers, physicians not be permitted to participate in decision making in small settlement the range of people who could be elected would be very much limited. For this reason there we do not propose to validate fully the concept of disqualification, but we believe the participation of such representatives should be significantly limited when decision is taken on certain local government issues.
163. Thus the heads and employees of local government budgetary institutions must have no possibilities to exert influence , thus for instance they must not be committee chairmen in the area of their own sector. The heads of the economic organisations of local governments should be considered fully disqualified. They are generally local government representatives in towns where the number of candidates for deputies is not limited. Naturally sanctions should also be set so the regulations can be enforced.

164. Another - concurrently applicable - way for ensuring transparency is a *written code of ethics*. That is necessary because in this area it is not possible to exert proper control by legislative provisions. General principles - which express in all respects the expectations of society- must be set for the behaviour of the representatives and officer.
165. Even if at the beginning it will be difficult to make people meet these norms, in time institutions will emerge which will be capable to enforce them. In any case we must start by defining these so far unusual regulations and make them accepted by political, industrial consensus .
166. Thus the programme of Government policy should be that the following codes of ethics be developed and approved through proper institutions, and measures should be taken to have them realised to the extent it is currently possible.
167. *The code of ethics of representatives*. Starting from the elections, though the decision making by the assembly, up to keeping contact with the electors the code would include all the “unwritten” rules related to the work of representatives. First of all the basic principles on the activities must be clarified then the methods of normal management of typical conflicts.
168. Naturally a code of ethics is needed not only for the local representatives but also for the members of parliament. Although that could also be initiated by the Government, it would be more practical to leave the issue to the political parties. Perhaps that would also serve as motivation for the clarification of the local government standards.
169. *Code of ethics of public servants*. It is becoming increasingly necessary to treat norms related to the operation of public servants also in such a way. It is highly unlikely that every rational rule can or should be codified.
170. In view of the existence of trade/professional organisations in principle the chances of could be qualified as favourable, at least if the procedural guarantees are established. The development could be initiated, motivated and supported by the Government, but should also be the task of trade/professional organisations, representative associations.
171. *Code of ethics of organisations providing public services*. In certain sectors- such as for instance for social workers- the relevant demand has already been raised. The need for the regulations is especially strong for instance in health care. The already existing code of ethics for medical professionals is specifically a set of professional rules which are not focused on public service and do not relate to all professions and groups of trades participating in the health care industry.
172. Similarly there could be a need for some code for those delivering public utility services. Here again we do not need to start out from zero, as the mechanism of complaint management already operates on a certain level.

173. It would be useful to have a Government programme initiating and motivating the trade organisations, representatives of the various public utility services to start and develop their code of ethics.
174. Transparency can be efficiently improved in relation to local government- and other public administration tasks if organised within the frameworks of uniform government actions. The work of the individual sectors, the large number of partial measures must be combined into a policy programme to become public. For this reason the programme should set the objectives in a comprehensive and systematic way.

## 5. Financial resources and equalisation

### *Priorities*

175. Basic principles of local government finance reform in 1990 were validated by the relatively stable operation of municipalities. Local governments under the present structure of intergovernmental finances were able to cope successfully with restrictive fiscal measures. However, based on the experience of the past decade, proportions and some techniques of local finances have to be modified.
176. There are three major areas, where significant changes are needed. Local *revenue raising capacity* should be increased by giving greater discretion to local governments and through support to local revenue administration. *Grant allocation scheme* has to follow both local needs and revenue raising capacity; it should provide fiscal incentives for co-operation. Both of these changes will serve horizontal equalisation purposes, which are the major problems of the present local fiscal structure. Thirdly, municipal *financial management* should be developed for making local governments capable to operate in a market environment. In the field of current budget partnerships arrangements have to be developed. In capital investments new forms of co-operation with private organisations and financial institutions are needed<sup>1</sup>.

### *Revenue raising capacity*

177. Local government own source revenues were increased significantly since the new local taxes were introduced and localities had access to privatisation revenues. By now one-third of local budget revenues are own current and capital revenues. 85% of municipalities already introduced some forms of local taxes. Under these circumstances local government own source revenues have to be increased for achieving two strategic goals: (i) to develop local government autonomy and (ii) to improve local accountability.
178. Higher local revenues are needed to balance vertically local government expenditures.

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<sup>1</sup> These following paragraphs are based on K.Davey-G.Péteri: *Local government finances: options for reform*. Local Government Know How Programme, 1998.

- Municipalities with more extended public service functions and with inherited regional service functions should have access to higher local revenues. The present efforts to follow differences in service needs with specific normative grants often do not support revenue raising efforts and efficient service provision. This is proved by examples in the field of education and social services.
179. Dependence on own source revenues will motive local decision makers to search for improved service delivery arrangements and service performance. Better accountability can be guaranteed through higher proportion of municipal revenues under local discretion.
  180. Two types of local government own revenues can be increased in the future. Property tax, based on the value of the property might be a new source of municipalities, primarily in urban areas. The vehicle tax is a shared revenue, but getting closer the base rate to the European average, with the local surcharging capacity municipalities could have access to higher revenues.
  181. Recognising the present high general tax burden in Hungary, local autonomy and accountability goals should be achieved through revenue-neutral reforms. Shifting partially the shared Personal Income Taxes towards a surcharging system would have several positive outcomes. Local discretion to levy a limited local surcharge on a nationally set tax base would make the municipal budgets more predictable. This component of local taxes would be connected to the actual position of the economy, unlike the present sharing practices, which follow the changes with a two-year-long delay. As PIT is mostly raised in urban areas, the local surcharge might cover the higher expenditure needs of regional services. Last, but not least the local government's authority to tap this significant tax revenue would increase local accountability.
  182. There are two other problems of local own source revenue system. Local governments gradually transfer more and more regional service functions to county local governments. Counties without own current and capital revenues are not able to run these service institutions under the present normative grant system.
  183. By increasing their revenue base, the counties would be less dependent on the central budget, which would decrease their over-politicised character and would place them to a position similar to municipalities. County own revenues might be taxes shared with municipalities in the territory of the county (e.g. business tax); surcharging PIT within a limited range of tax rates; sharing national taxes with counties (e.g. centralised portion of vehicle tax, VAT).
  184. In the fragmented urban structure local governments have to co-operate for efficient provision of public services. Municipal associations would be frequently established, if they had the authority to levy or surcharge taxes. In France, for example, certain types of inter-municipal body are able to levy taxes, provided that the members of their governing councils are nominated by municipal councils and are themselves elected councillors. When these joint service delivery arrangements are governed by elected bodies and their functions are separated from their members, then they should have access to own revenues. The best candidate for surcharging is the business tax, which is usually produced in a micro-region, regardless of the company centre's location.

***Grant allocation schemes***

185. Intergovernmental transfers are needed to finance mandatory local public services at a similar (average) level and to provide additional grants to manage spillovers (vertically balancing local budgets); to guarantee equal services (managing horizontal /regional/ imbalances). Grant allocation schemes also have to put incentives on local governments to raise their own revenues and to efficiently manage their services.
186. Recent trend in intergovernmental fiscal transfers is characterised by moving towards a sectoral (block) grant system. Proportion of specific normative grants was increased (two-third of normatives are allocated by institutions' capacity based indicators), opposed to the general grants, allocated by need based indicators (e.g. population). Institution capacity based normatives usually finance only two-third of average specific expenditures.
187. At the same time public education is specially treated in the system of intergovernmental transfers, because education normatives are supposed to cover 90% of total education expenditures, two years earlier. Both of these changes (low coverage and special regulations in public education) show for local governments, that normative grants are directly connected to special municipal services.
188. The normative grant for social care homes has been criticised on the basis that it does not discriminate between the ability of residents to contribute to their costs, and provides an incentive for managers to choose the wealthier applicants for vacancies. Since most of these institutions are run by counties, there is also an incentive for municipalities to encourage people to enter these homes to avoid the provision of domiciliary care. Possibilities of reform are worthy of further consideration. These would include converting the normative into a means based subsidy to individual municipality.
189. Through the specific normative grants the basic problems of Hungarian intergovernmental transfer system (spillovers, fragmentation, inequalities in own revenue base) cannot be solved. Financing local governments, which run human services for a larger region require major restructuring in intergovernmental finances. These local governments with regional functions need more own source revenues and the specific grant to cost ration should be higher to provide sufficient funds for financing the services used by non-residents.
190. Fragmentation has to be managed through joint forms of service delivery. Financial incentives are needed to support co-operation among local governments in two ways: (i) to increase the proportion of the measurable need based general grants and (ii) to force local government co-operation through financial incentives and by making grants conditional. General grants will not force municipalities to run specific service institutions, but encourage them to use alternative forms of service delivery. Financial incentives can be connected to larger service capacity or population size, as they are used for capital grants. Conditionality might be used for those services, where minimum (optimal) size of services can be defined. Economies of scale can be justified mostly at physical infrastructure services.
191. Inequalities among local governments are caused by three major factors: (i) lack of

own source revenues, (ii) differences in local needs and (iii) disparities in service costs. Under the present equalisations schemes these three factors and the problems of spillovers are mixed. Recent effort to build the representative revenue capacity component into the deficit grant system was a positive step towards a new model, but did not solve all the problems. Now, when one-fifth of grants (normative and reallocated PIT) are assigned for equalisation purposes the basic rules of transfers should be modified.

192. A new form of general normative grant should be developed. It has to incorporate all the three factors of local government differences: revenue capacity, special municipal demand and unique local service conditions. This grant allocation formula does not intend to achieve a full equalisation. It should be based on standard per capita expenditures and own source revenues, when the grant is calculated as the difference of standardised expenditures and revenues. Specific expenditures and revenues are modified on a unified way, according to variations in revenue raising capacity and expenditure responsibilities (needs and costs). This model would significantly decrease the need for detailed calculations of deficit grant applications.
193. Hungarian local governments are dependent on centrally regulated and allocated revenues. In the period of restrictive fiscal policy actions, central revenue dependence makes local government budgets vulnerable to discretionary decisions and decreases the predictability of local budgets. This problem should be solved by connecting the total amount of grants to some indicators of the national economy. The amount of local government regulated revenues (grants and PIT transfers) should be defined in relation to indicators of economic growth or major national taxes. In the period of economic growth this would make municipal revenue forecasts more reliable. In a declining economy restrictive measures would inflate local revenues proportionally, local governments would take a fair share cutbacks.

### ***Financial management***

194. With the emerging non-profit and commercial organisations in public services local government financial management practices have to adjust to the new environment. Local government as the client of a service organisation has to develop new cost accounting and planning methods. When a municipality makes a decision on the particular sector or service organisation, it has to develop performance and cost information systems: regular collection and evaluation of output measures (both quantity and quality indicators), comparative information are needed. Total costs should be calculated by collecting financial information by activities, at public and private entities, observing current and capital costs.
195. Both types of information will be used for budgeting purposes and for setting the user charges. When public services are financed partially by user charges and need for accountability increases with higher proportion of own source revenues, public participation techniques should be developed. Consumer protection and contacts with the general public is directly related to financial decisions.
196. In the field of capital expenditures local governments as owners of service organisations and contractors to service producers have to invent new capital



financing techniques. Three parties have to co-operate: local government, service organisations and financial institutions, as investors. Local governments control the market, the future revenue flow and they are eligible for grants. Service companies are responsible for the technology and they are also potential investors. Banks and financial institutions provide the capital.

197. Public administration reform should take responsibility for improved financial management techniques in two ways: (i) inventing, developing and disseminating new methods both in the field of current and capital budgets; (ii) supporting those institutions, which have a role in developing innovative financial management techniques (e.g. associations, information centres, advisory, rating organisations).