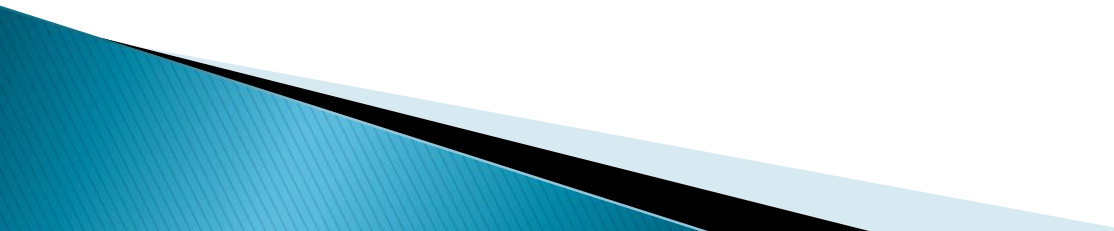


Municipal Accountability in Eastern European Countries with a Focus on the Hungarian Experience

Izabella Barati-Stec
Department of Public Policy
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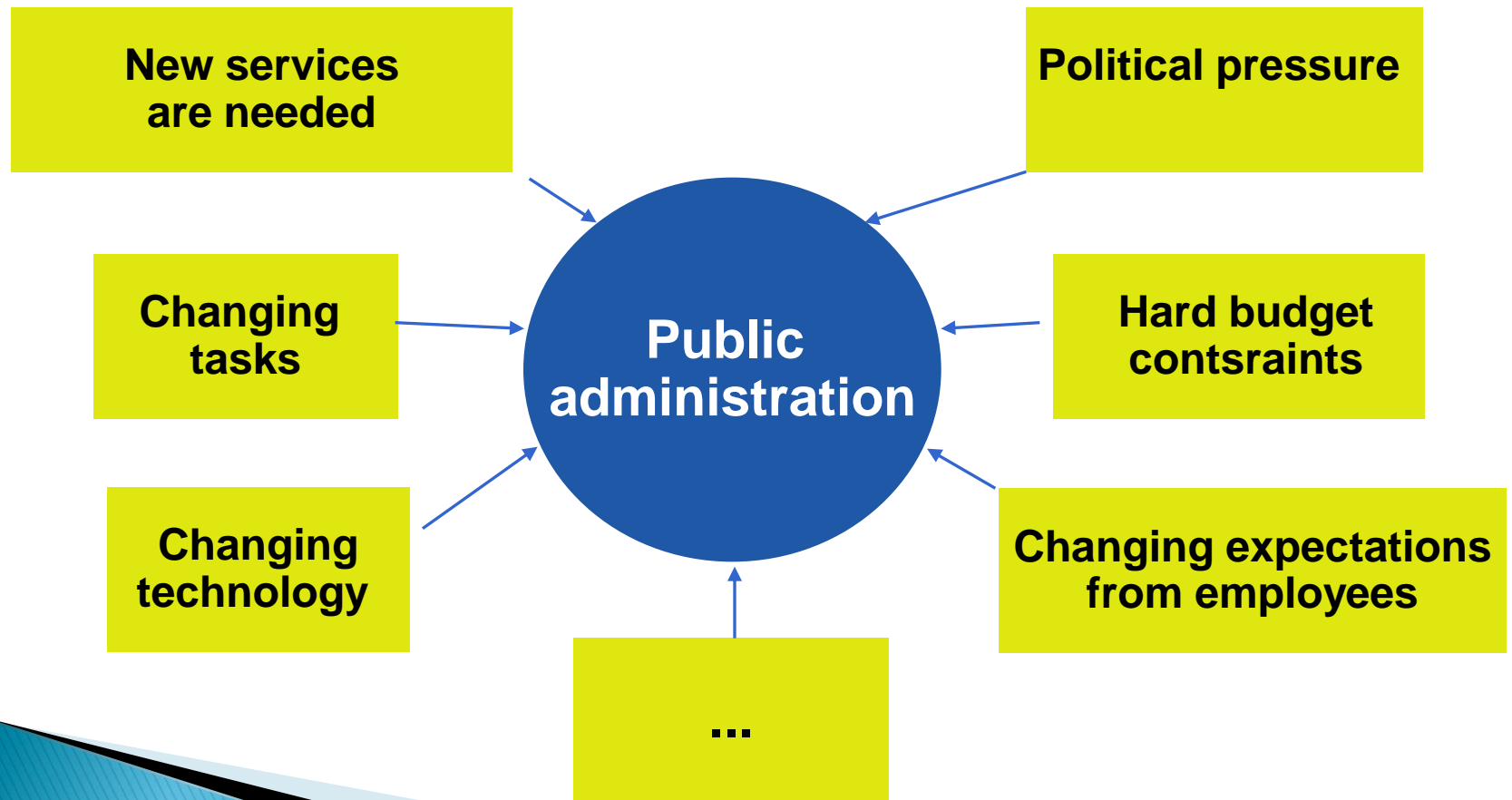
Public Implementation in Subnational Level, Cases and Institutional Design
University of Chile, Public Systems Centre, Santiago, Chile
November 15–16, 2010

Outline of the presentation

- ▶ Decentralization, shift of power and accountability – How accountability can be ensured through economic measures?
 - ▶ Introduction of the Hungarian municipal system
- 

I. Decentralization, shift of power and accountability

Challenges for Public Administration



Answers for challenges

West OECD countries

1. Contracting out, rethinking state tasks, liberalisation, informatics, performance measurement)
2. Business methods, market oriented
3. NPM as a framework
4. Minimum level of services

Hungary

–same as the western countries

1. New laws
2. Government decrees
3. Two and five year programs
4. Decentralization

Aspects of decentralization

- ▶ Vertical (how many tiers in the government)
- ▶ Decision-making (who decides?)
 - SUBSIDIARITY PRINCIPLE
- ▶ Fiscal decentralization
 - Independent decisions on revenues and expenditures
 - Revenues: what taxes and fees the municipality wants to collect
 - Expenditures: What it wants to spend that revenue on
 - Shifting borrowing power

Local revenues

- ▶ Own-source revenues
 - Fees and taxes
 - Two reasons for increasing own revenues
 - “Fiscal” argument (see Hungarian PIT example)
 - “Accountability” argument. (Bahl, [2000])
- ▶ Central subsidies
- ▶ Borrowing

TABLE 3: DISTRIBUTION OF MUNICIPAL REVENUES, SELECTED OECD COUNTRIES, 2006 (%)

	Taxes								Social contributions	Grants	Other revenue	Total revenues
	Individual income	Corporate income	Payroll	Property	Goods and services	Excise	Other	Total taxes				
Australia	0	0	0	38.6	0	0	0	38.6	0	13.5	47.9	100
Austria	14.6	3.7	10.3	5.5	12.1	4.4	4.8	55.3	4.6	13.9	26.2	100
Canada	0	0	0	37.8	0	0	2.1	39.9	0	41.8	18.3	100
Czech Republic	13.2	13.5	0	1.4	18.8	0	1.3	48.2	0	39.9	11.9	100
Denmark	46.4	1.1	0	3.4	0	0	0	50.9	1.6	39.1	8.4	100
Finland	40.8	3.8	0	2.4	0	0	0	47.1	0.1	28.6	24.2	100
France	0	0	3.1	33.7	0	3.7	4.1	44.6	0.2	29.1	26.1	100
Germany	15.8	0.2	0	5.4	1.8	0	18.8	42	1.3	33.8	23	100
Hungary	15.8	0	0	4.5	13.1	0	2	35.5	0.2	48.4	15.9	100
Iceland	53.1	0	0	10.5	0	0	9.4	72.9	0	8.8	18.3	100
Ireland	0	0	0	9.4	0	0	0	9.4	3.5	59.6	27.6	100
Italy	7.9	0.7	0	5.7	2.2	2.7	25.3	44.5	0.6	43.4	11.5	100
Luxembourg	0	28.6	0	2.2	0	0	0.7	31.4	0.2	46.6	21.7	100
New Zealand	0	0	0	54.5	0	0.5	0	55	0	11.2	33.8	100
Norway	40.1	0	0	4.1	0	0	0.9	45.1	0	36.1	18.8	100
Poland	14.7	4.3	0	9.4	0	0	3.9	32.5	0	50.6	16.9	100
Slovak Republic	38.5	0	0	6.4	0	0	6.8	51.8	0.6	35.1	12.6	100
Spain	7.5	2.3	0	16	13.3	3.1	10	52.2	0.5	34.5	12.8	100
Switzerland	33.8	5.2	0	7.1	0	0	0.1	46.3	0	16.3	37.4	100

Notes: Social contributions are actual or imputed receipts from either employers on behalf of their employees or from employees, self-employed, or non-employed persons on their own behalf that secure entitlement to social benefits for the contributors, their dependents, or their survivors. The contributions may be compulsory or voluntary. Grants are non-compulsory transfers received by government units from other government units or international organizations. Grants may be classified as capital or current and can be received in cash or in kind.

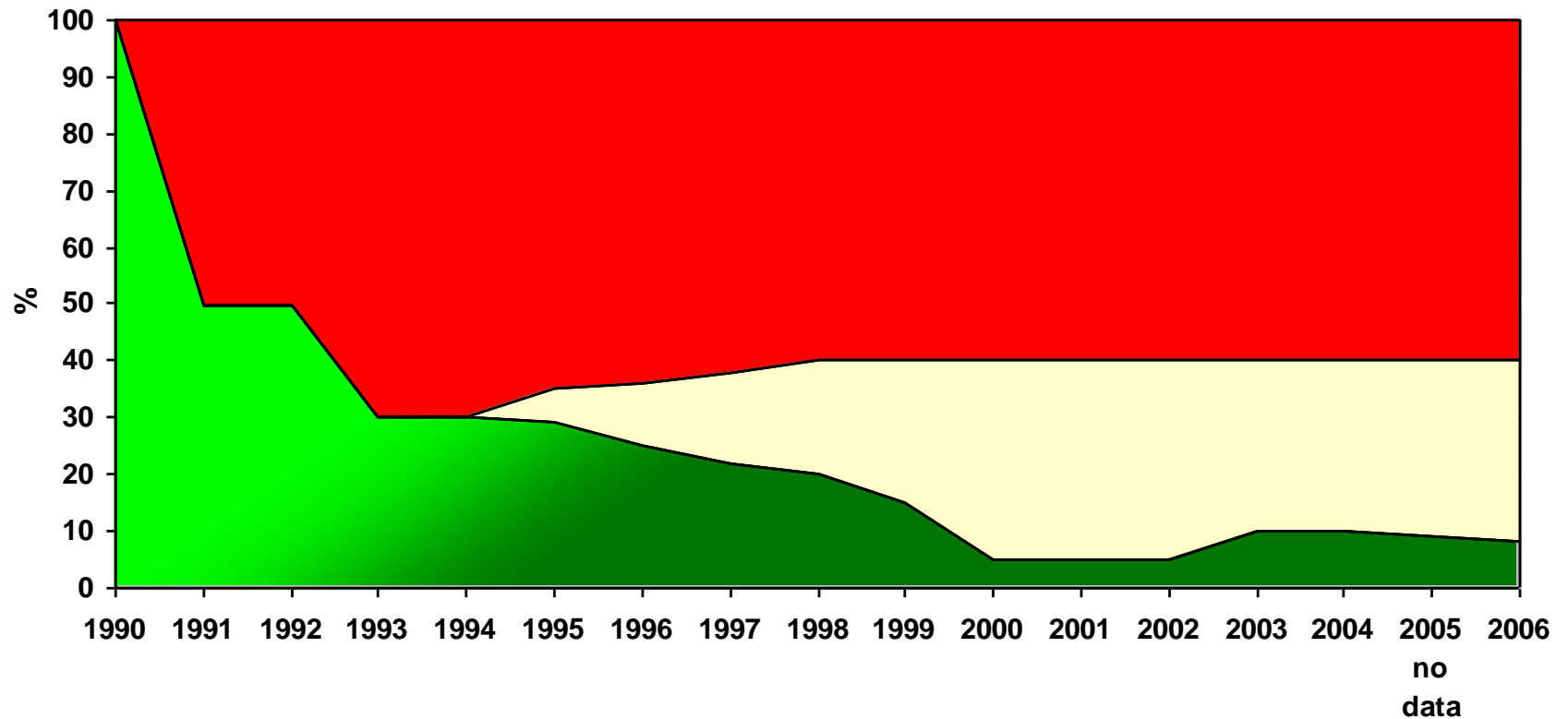
Information for Canada, Czech Republic, Denmark, Finland, Ireland, New Zealand, Norway, and Slovak Republic are preliminary for 2006. Information for Spain is for 2004 and for Switzerland 2005. Source: International Monetary Fund, Government Finance Statistics, Yearbook, 2007, Table 1 and IMF Statistics Department, Government Finance Statistics Manual, 2001.

TABLE 4: DISTRIBUTION OF MUNICIPAL REVENUES, SELECTED COUNTRIES IN CENTRAL AND EASTERN EUROPE, ASIA, AFRICA, AND LATIN AMERICA, 2006 (%)

	Taxes								Social contributions	Grants	Other revenue	Total revenues
	Individual income	Corporate income	Payroll	Property	Goods and services	Excise	Other	Total taxes				
Central and Eastern Europe:												
Belarus	17.9	10.5	0	9.2	21.4	1.1	7.2	67.3	0	30.2	2.5	100
Bulgaria	0	0	0	20.1	0	0	0.1	20.3	0	69.9	9.9	100
Croatia	39.5	15.5	0	3.5	0.4	0	2.3	61.2	0	12.3	26.5	100
Georgia	50	2.1	0	11.1	0	0	3.7	66.9	0	28	5	100
Kazakhstan	17.2	0	24.6	5.9	0	3.3	5.3	56.3	0	43	0.6	100
Kyrgyz Republic	9.2	7.5	0	7.8	11.1	2.4	1.7	39.8	0	45.8	14.4	100
Latvia	48.4	0	0	6.5	0	0	0.8	55.6	0	31.3	13.1	100
Lithuania	30.2	0	0	4.1	0	0	0.9	35.3	0	57.9	6.8	100
Moldova	23.4	13.8	0	4.9	0.8	0.1	4.9	47.9	0	45.2	6.9	100
Romania	38.6	0.2	0	7.8	31.4	0	3.7	81.7	0	8.4	10	100
Russian Federation	19.2	4.2	0	3.6	0	0	3.7	30.7	0	58.2	11.1	100
Slovenia	24	0	0	7.2	0	0	2.8	34.1	0	47.5	18.5	100
Ukraine	32.9	1.4	0.2	2.3	0	0.1	5	41.8	0	47.9	10.3	100
Asia, Africa and Latin America:												
China, PR	2	5	0	2.4	18.4	0	2.2	30	13.3	28.9	27.9	100
Kenya	0	0	0	15.6	0	0	5.9	21.4	0	32.8	45.8	100
Mauritius	0	0	0	11.9	0	0	13.9	25.8	0	67.1	7.2	100
South Africa	0	0	0	16.8	0	0	2.8	19.7	0	24.9	55.4	100
Uganda	1.2	0	0	2.8	0	0	0.9	4.9	0	91.3	3.8	100
Bolivia	0	8.2	0	18.6	18	24.5	3.1	72.3	0	17.6	10	100

Notes and Sources: See Table 3. Information for South Africa and Uganda are preliminary for 2006. Information for China and Kenya is for 2005. Information for Romania is for 2004.

PIT „returned” to the point of origin and through compensation mechanisms, 1990-2006



Returned Redistributed Central Government

Local tax system

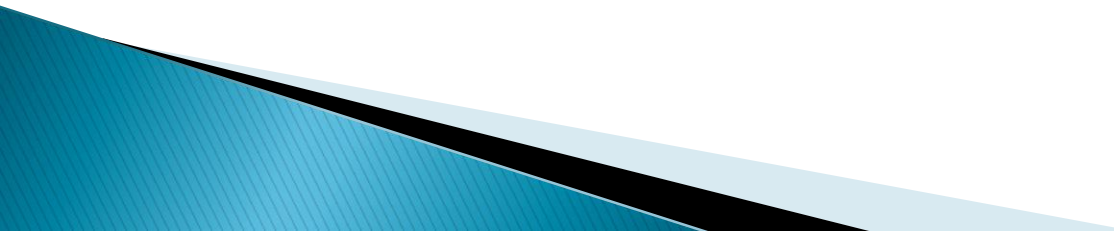
- ▶ The parameters for evaluating the local tax system
 - Efficiency
 - Fairness
 - The cost of tax administration – audits, accounting, record-keeping, billing, collection, enforcement, etc.
 - The possibility of tax competition – “catch 22”
 - The possibility of exporting the tax

Fees for services vs taxes

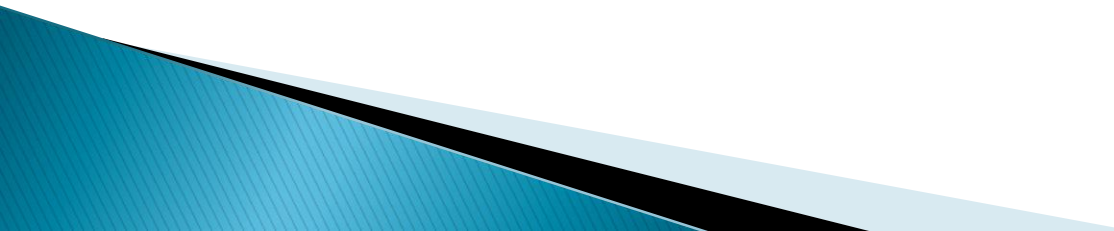
▶ Taxes

- mandatory levies
- are not directly linked to specific services
- serve redistributive purposes

▶ User fees

- are linked to specific services
 - they are charges levied on consumers of goods and services
 - their use has some practical constraints
- 

Grants and normatives

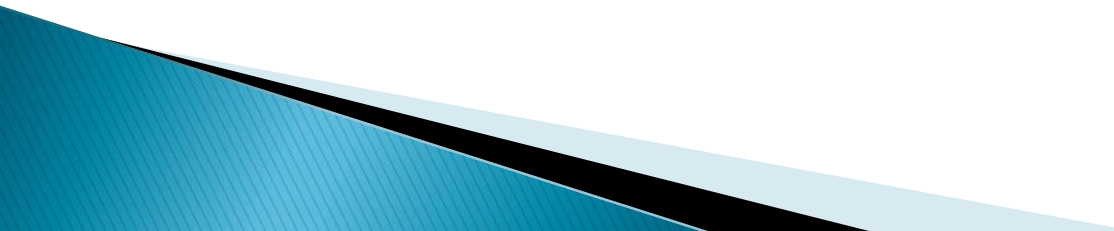
- ▶ Their purpose is to create a balance between the different regions, settlements.
 - ▶ Main forms
 - unconditional (general) grants (autonomy, European Charter of Local Self-Govts),
 - conditional non-matching grants – earmarked grant, not efficient
 - matching grants – + „own part”
- 

Grant types and their objectives (back to slide n.8)

Grant Objective	Grant Design	Better Practices	Practices to avoid
Bridge fiscal gap	Reassign responsibilities Tax abatement Tax base sharing	Tax abatement in Canada and tax base sharing in Canada, Brazil and Pakistan	Deficit grants, Tax by tax sharing as In India
Reduce regional fiscal disparities	General Non-matching Fiscal capacity equalisation transfers	Fiscal equalisation programs of Australia, Canada and Germany	General revenue sharing with multiple factors
Compensate for benefit spillovers	Open-ended matching transfers with matching rate consistent with spillout of benefits	RSA grant for teaching hospitals	
Setting national minimum standards	Conditional non-matching block transfers with conditions on standards of service and access	Indonesia roads and primary education grants, Colombia and Chile education transfers	Conditional transfers with conditions on spending alone Ad hoc grants
Influencing local priorities in areas of high national but low local priority	Open-ended matching transfers (with preferably matching rate to vary inversely with fiscal capacity)	Matching transfers for social assistance as in Canada	Ad hoc grants
Stabilisation	capital grants provided maintenance possible	Limit use of capital grants and encourage private sector participation by providing political and policy risk guarantee	Stabilisation grants with no future upkeep requirements

Source: Shah [1994], Shah [1998], Boadway, Roberts and Shah [1994 pp. 11–24.]

Problems with Transfers

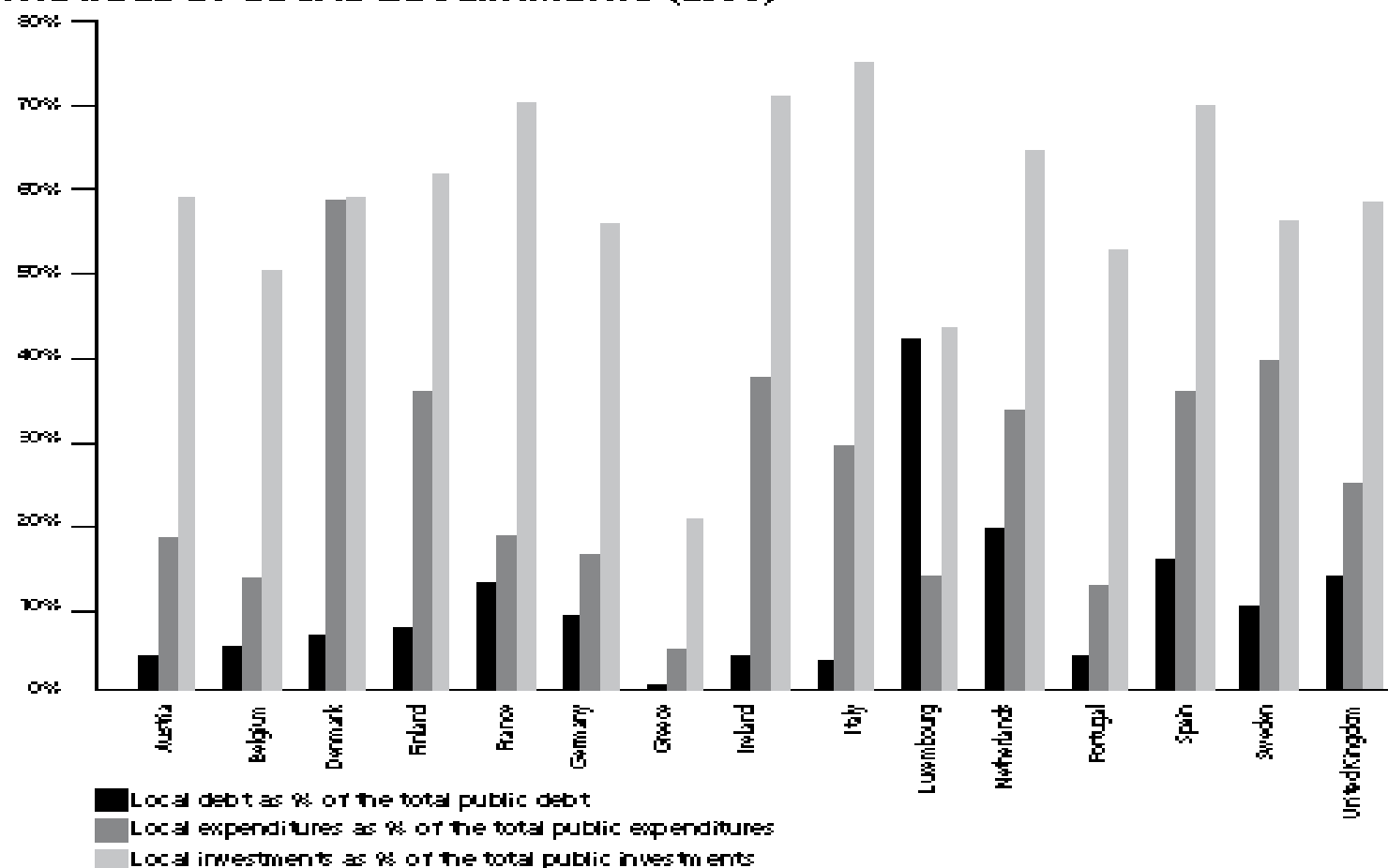
- ▶ Soften the budget constraint (undermine fiscal discipline)
 - ▶ Discourage municipalities from “getting the prices right”
 - ▶ Distort local decisions
 - ▶ Reduce accountability
 - ▶ Not stable and predictable
- 

Loan raising

- Most states support local borrowing
 - Accountability
 - Less stress on central budget
 - Good investment possibility for local funds
- Requires
 - Good working credit market
 - State rules on borrowing (avoiding moral hazard)
 - Creditworthy municipalities

◦

**FIGURE 1: PUBLIC DEBT, SPENDING AND INVESTMENTS –
THE ROLE OF LOCAL GOVERNMENTS (2000)**

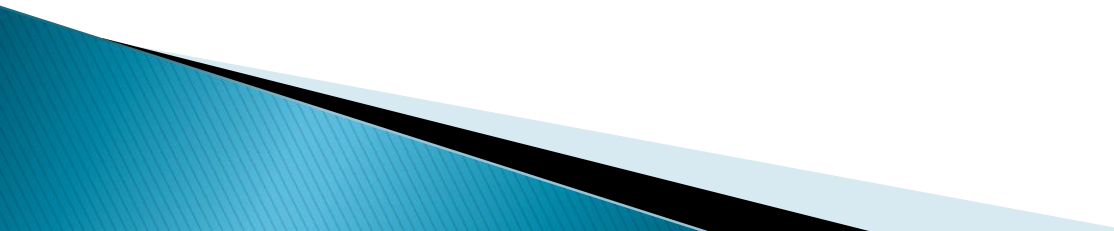


Source: *Deia (2000) Local Finance in Seven Countries of Central, Eastern and Baltic Europe (Paris)* as reproduced in *Swianiewicz, P. (ed.) (2004) Local Government Borrowing Risks and Reward, A Report on Central and Eastern Europe, Budapest: Open Society Institute, p. 17.*

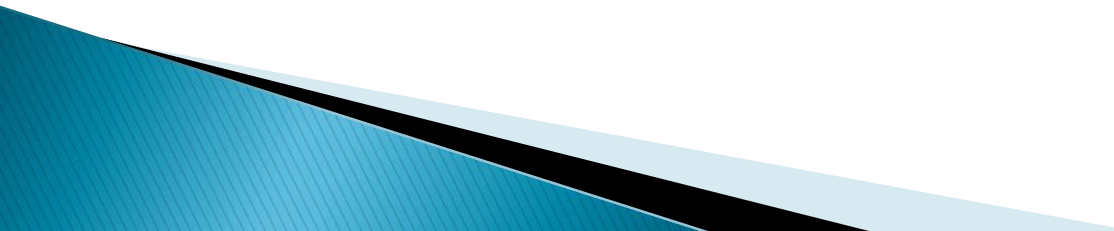
The regulation of municipal credit market participation

- ▶ In certain states there is no special limitation on sub-national borrowing – fiscal conservatism.
- ▶ Ter-Minassian (1996)
 - The markets should be free and open and the intermediaries should not place local governments in a privileged position in the market.
 - Information about the borrower's debt and repayment capacity should be accessible.
 - The borrower should be forced to act responsibly in the marketplace.
 - The central government should not guarantee sub-national borrowings.
- ▶ Bird and Tassonyi (2001)
 - freedom of information
 - the responsible behaviour of borrowers on the market

The prerequisites of municipal creditworthiness at the local level

- ▶ Stable revenue (own-source revenues)
 - ▶ Good management skills and an efficient decision making system
 - ▶ Local politicians who are able to make decisions
 - ▶ Local citizens who are creditworthy as well, and are supporting their politicians
 - ▶ Good cash-management, an efficient tax-collection system, and effective actions against non-payers
 - ▶ Trust of the lenders (public opinion) in the specific municipality.
- 

The prerequisites of municipal creditworthiness at the national level

- Political stability
 - Legal stability, property rights
 - Accounting and audit
 - Low inflation rate
 - The state itself is creditworthy
- 

Moral hazard

- ▶ The market often assumes the existence of central guarantees of local debt even where not explicit, which might seriously undermine the creditworthiness of the state



- ▶ Regulation

Tools of control of the central level

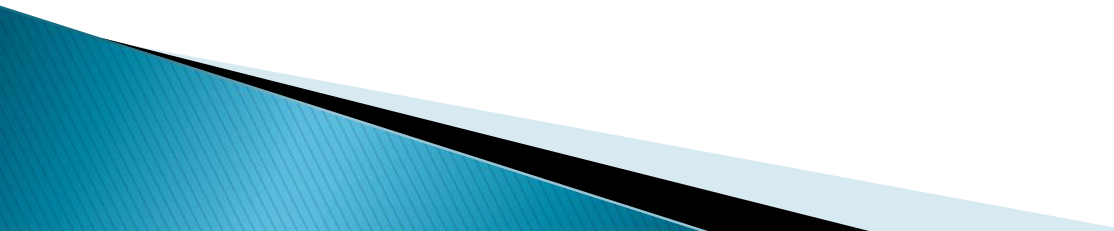
- ▶ Passive tools (when the limits laid down in different laws prohibit over-spending)
 - ▶ Active tools (when the higher levels of government prescribe an approval process before borrowing).
 - ▶ (Like in Chile)
- 

TABLE 1: DISTRIBUTION OF MUNICIPAL EXPENDITURES, SELECTED OECD COUNTRIES, 2006 (%)

	General Public Services		Public Order, Safety, Defense	Economic Affairs Transport	Total	Environmental Protection	Housing & community amenities	Health	Recreation, culture and religion	Education	Social protection	Total expenditures
	Public debt transactions	Total										
Australia	1.6	24.4	2.6	21.5	26.7	9.5	13.7	1.2	15.7	0.4	5.8	100
Austria	0.5	16.9	2.1	n.a.	14.2	2.6	2.8	16.3	7.1	16.7	21.3	100
Canada	2.7	8.7	9.2	11.6	13.2	5.9	7.8	1.5	6.9	41.2	5.5	100
Czech Republic	0.7	14.5	1.8	18.9	21.4	7.3	9.1	2.2	7.5	27.5	8.7	100
Denmark	0.5	6.1	0.3	2.8	4.7	0.9	0.4	20.4	2.7	12.9	51.5	100
Finland	0.6	14	2.1	4.1	6.1	0.7	0.4	28.4	4.6	20.5	23.3	100
France	1.4	19.2	2.8	n.a.	13.1	6.9	15.2	0.6	10.2	16.2	15.8	100
Germany	3.2	17.4	5.4	n.a.	13.5	6.8	7.7	2.3	n.a.	7.2	39.7	100
Hungary	0.5	19.3	1.2	n.a.	5.7	3.9	6.9	15.4	4.8	29.9	12.8	100
Iceland	3.1	10	0.9	11	11.7	2.4	4.5	0.8	17.3	37.2	15	100
Ireland	0.9	11.4	3.2	n.a.	23.8	8.7	22.7	0	4.1	20.7	5.4	100
Italy	1.6	14.6	1.5	n.a.	14.8	4.6	4.7	43.9	3	8.3	4.5	100
Luxembourg	1.3	20.9	1.7	n.a.	15.9	12.1	7.6	0.3	13.1	24.6	3.9	100
New Zealand	2.9	18.3	0.5	29.7	35	21.3	7.3	0	12.1	0	5.5	100
Norway	2.7	10.7	1	4.9	6.5	3.6	4.2	15.2	4.8	28.4	25.6	100
Poland	0.8	9.4	1.8	13	14.8	4	5.6	15.3	5.2	29.6	14.2	100
Slovak Republic	0.7	17.5	1	11.3	15.9	6.2	9.9	0.3	7.1	35.4	6.6	100
Spain	1.3	33.4	7.8	9.8	14.5	10	9.6	1.2	10.9	4.5	8.1	100
Switzerland	3.3	14.3	5.2	7.3	8.7	5.3	2.5	20.5	5.6	21.7	16.2	100

Notes: Sub-categories of general public services include public debt transactions and general transfers between levels of government. Sub-categories of economic affairs include agriculture, forestry, fishing, and hunting; fuel and energy; mining, manufacturing and construction; transport and communications. Sub-categories of health include outpatient services, hospital services, and public health services. Public debt transactions include interest payments and outlays for underwriting and floating government loans. Sub-categories of education include pre-primary and primary education; secondary education; and tertiary education. Information for Canada, Czech Republic, Denmark, New Zealand, Norway, and Slovak Republic are preliminary estimates for 2006. Information for France, Hungary, Ireland, Italy and Switzerland are for 2005. Information for Finland and Spain are preliminary estimates for 2005.

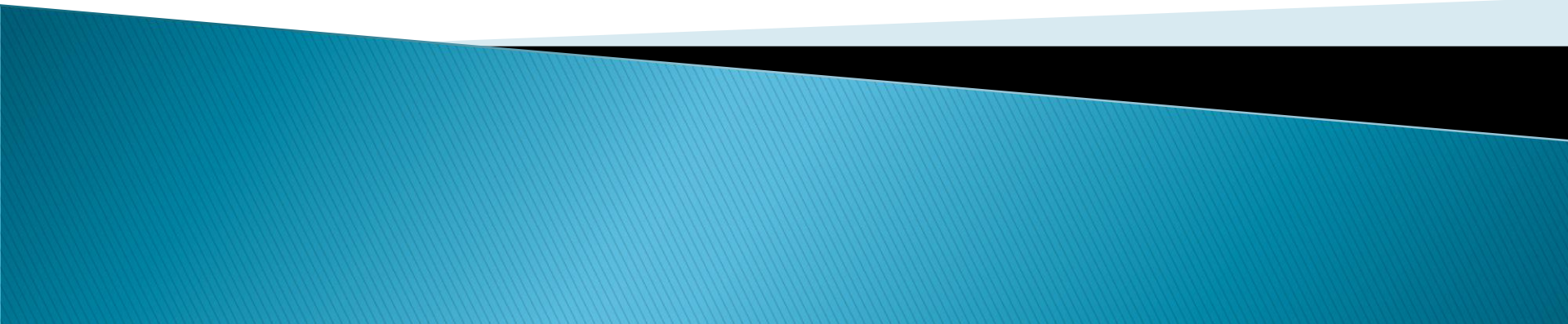
Source: International Monetary Fund, Government Finance Statistics, Yearbook, 2007, Table 7 and IMF Statistics Department, Government Finance Statistics Manual, 2001.

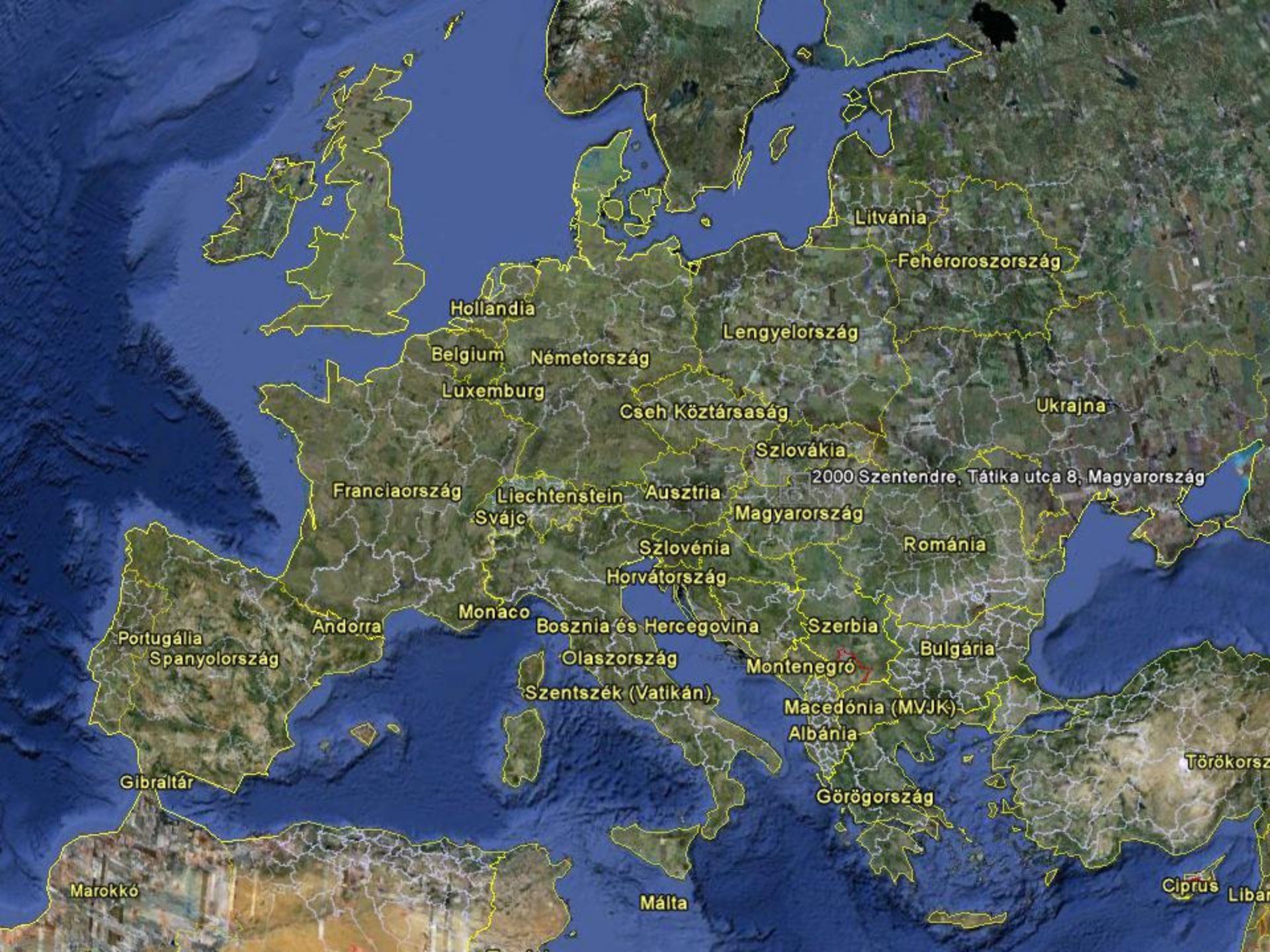
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	General Public Services		Public Order, Safety, Defense	Economic Affairs		Environmental Protection	Housing & community amenities	Health	Recreation, culture and religion	Education	Social protection	Total expenditures.
	Public debt transactions	Total		Transport	Total							
Central and Eastern Europe:												
Belarus	0.2	7.1	2	5.2	13.3	0	16.8	21.3	5.1	28.5	5.9	100
Bulgaria	0.3	11.5	3.1	9.5	12.1	-6.7	26.3	4.7	5.3	35.7	8	100
Croatia	0.5	16.8	2.6	9.8	13.4	3.5	18.6	4.6	13.2	20.1	7.2	100
Georgia	0.6	9.2	2.1	0.1	-0.3	0	59.7	2.7	8.9	8.7	9	100
Kazakhstan	0.1	16.6	3.9	7.7	12.9	0.4	13.5	18.6	4.4	26	3.8	100
Kyrgyz Republic	0	13.3	1.9	0.6	1.7	0	10.6	5.2	4.3	58.4	4.7	100
Latvia	0.8	13.5	1.4	7.5	8.1	n.a.	14.6	2.8	7.8	44.1	7.8	100
Lithuania	0.2	5	0.7	1.8	7.1	2.3	5.9	21.9	5.4	40.5	11.2	100
Moldova	0.5	12.7	3.1	2.8	9.6	0	17.7	1.7	5.1	45.9	4.1	100
Romania	0.4	10.7	1	14.6	16.7	2.8	18.9	0.7	5.6	30.9	12.8	100
Russian Fed.	0.4	10.7	1.7	2.7	3.4	0.2	19	14.1	4.2	38	8.7	100
Slovenia	0.1	9.5	1.4	8.4	13.2	4.5	5.1	11.8	8	42.5	4	100
Ukraine	0.4	9.9	0.2	4	10.6	0.6	10.3	20.9	4	28.7	14.9	100
Asia, Africa and Latin America:												
China, PR	0.1	21.3	6.0	1.3	39.7	4.4	0.4	3.4	1.6	12.4	10.8	100
Kenya	0.2	32.7	0.0	9.4	45.6	0.0	6.3	6.6	0.0	6.7	2.1	100
Mauritius	0.2	30.9	0	22.4	30.2	0	17.7	1.7	5.1	45.9	10.2	100
South Africa	0	4.9	0.7	4.5	7.1	0.5	3.1	20.8	0.9	34.9	27	100
Uganda	0	24.4	0.8	n.a.	10.8	0.4	3.2	14.1	0.3	44.6	1.3	100
Bolivia	2.1	12.9	1	14.5	21.5	7.3	20.4	11.5	6.9	16.3	2.1	100

Notes and Sources: See Table 1. Also, information for Uganda is preliminary for 2006. Information for Romania, China, and Kenya is for 2005. Information for South Africa is for 2004.

II. Introduction of the Hungarian municipal system





Litvánia

Fehéroroszország

Hollandia

Lengyelország

Belgium

Németország

Luxemburg

Cseh Köztársaság

Ukrajna

Szlovákia

2000 Szentendre, Tátika utca 8, Magyarország

Franciaország

Liechtenstein

Ausztria

Svájc

Magyarország

Románia

Szlovénia

Horvátország

Monaco

Bosznia és Hercegovina

Szerbia

Bulgária

Portugália

Spanyolország

Andorra

Olaszország

Montenegró

Szentszék (Vatikan)

Macedónia (MVJK)

Albánia

Gibráltár

Görögország

Törökország

Marokkó

Málta


Ciprus

Libanon

Types of municipal systems

	Size	Tasks	Financial capacity
North	Large	Large	Large
South	Small	Small	Small
Hungarian	Small	Large	??

Hungarian specialities

- ▶ Two-tier system
 - Local / Municipal level (3154) – Small municipalities
 - Regional / County – Territorial level (19+1)
 - Lack of middle level
 - Municipal associations – financial incentives
 - ▶ Tasks
 - Too many obligatory tasks
 - No difference between small and big municipalities (two exceptions: Budapest, cities with county rights, over 50000 population)
 - ▶ Financial background for operating the system
 - Not symmetrical (local taxes, municipal assets, equalization mechanisms)
 - ▶ Quality of services
- 

Municipal Finance Background Data I.

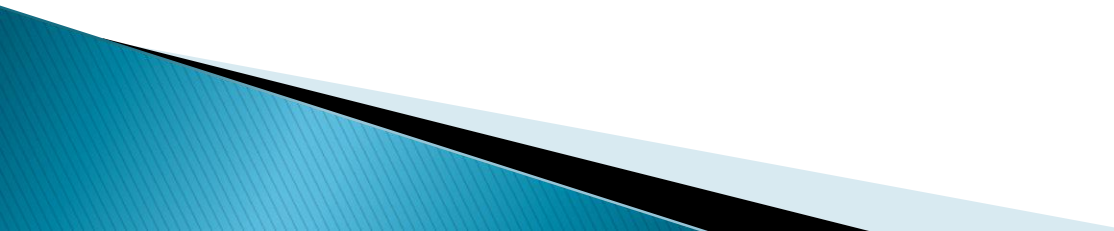
- ▶ Municipal spending 13% of GDP in 2004
- ▶ In 1990, more than two thirds of a local government's revenues came directly from the central budget and other central funds like the social security fund.
- ▶ By 2004, this share of direct central participation in local finance decreased to about 50 per cent.
- ▶ (Karoly Jokay)

Municipal Finance Background Data II.

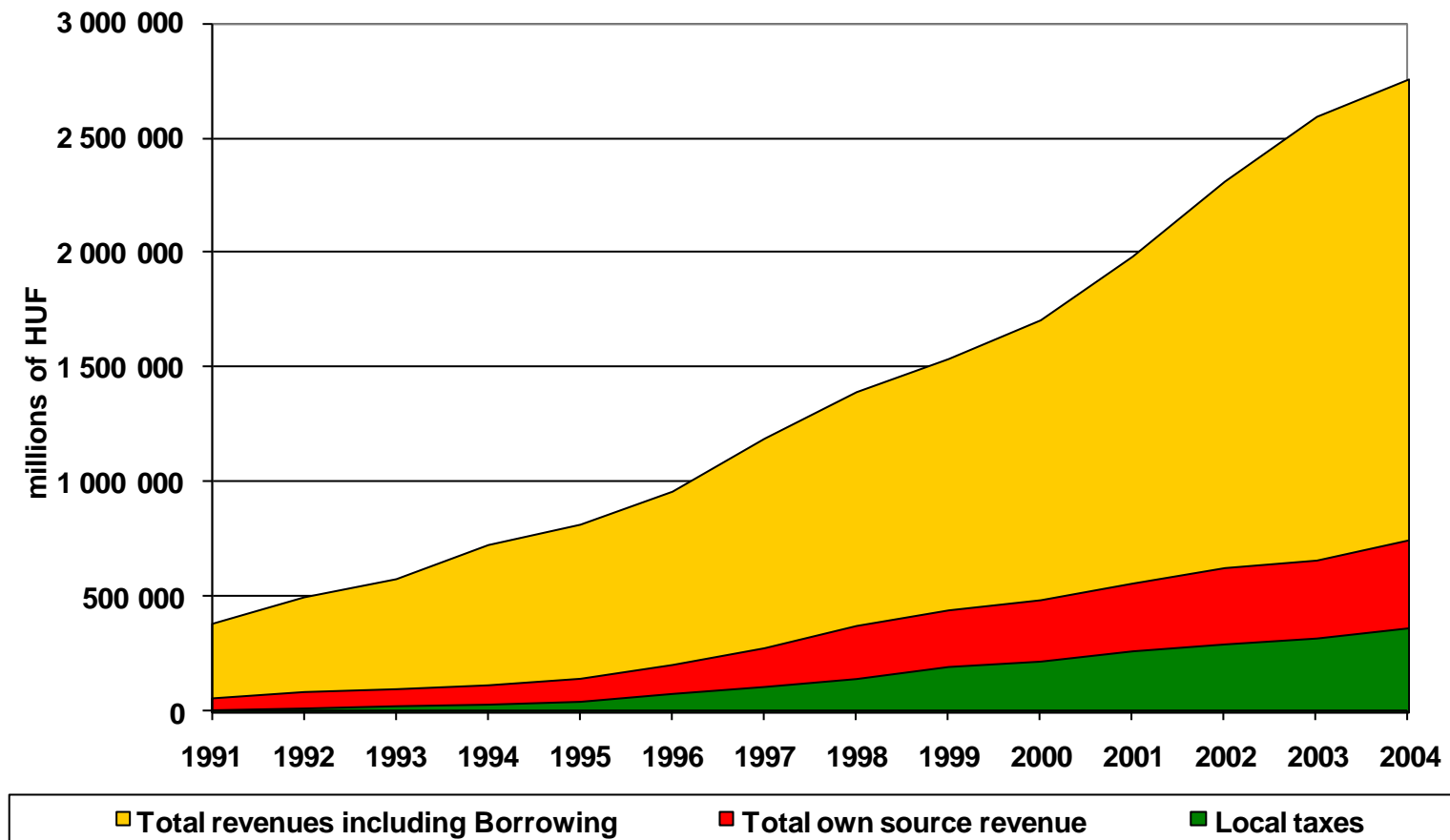
- ▶ Local taxes account for 14% of municipal revenues (with the business turnover accounting for 90% of that, or 12% of municipal revenues).
- ▶ All other local taxes make up only 2% of local revenues on a national average.
- ▶ In Budapest, local taxes take over a 30% share, while in most villages, this number is below 5%.
- ▶ On average, PIT is only 17% of municipal revenue

Local Taxes

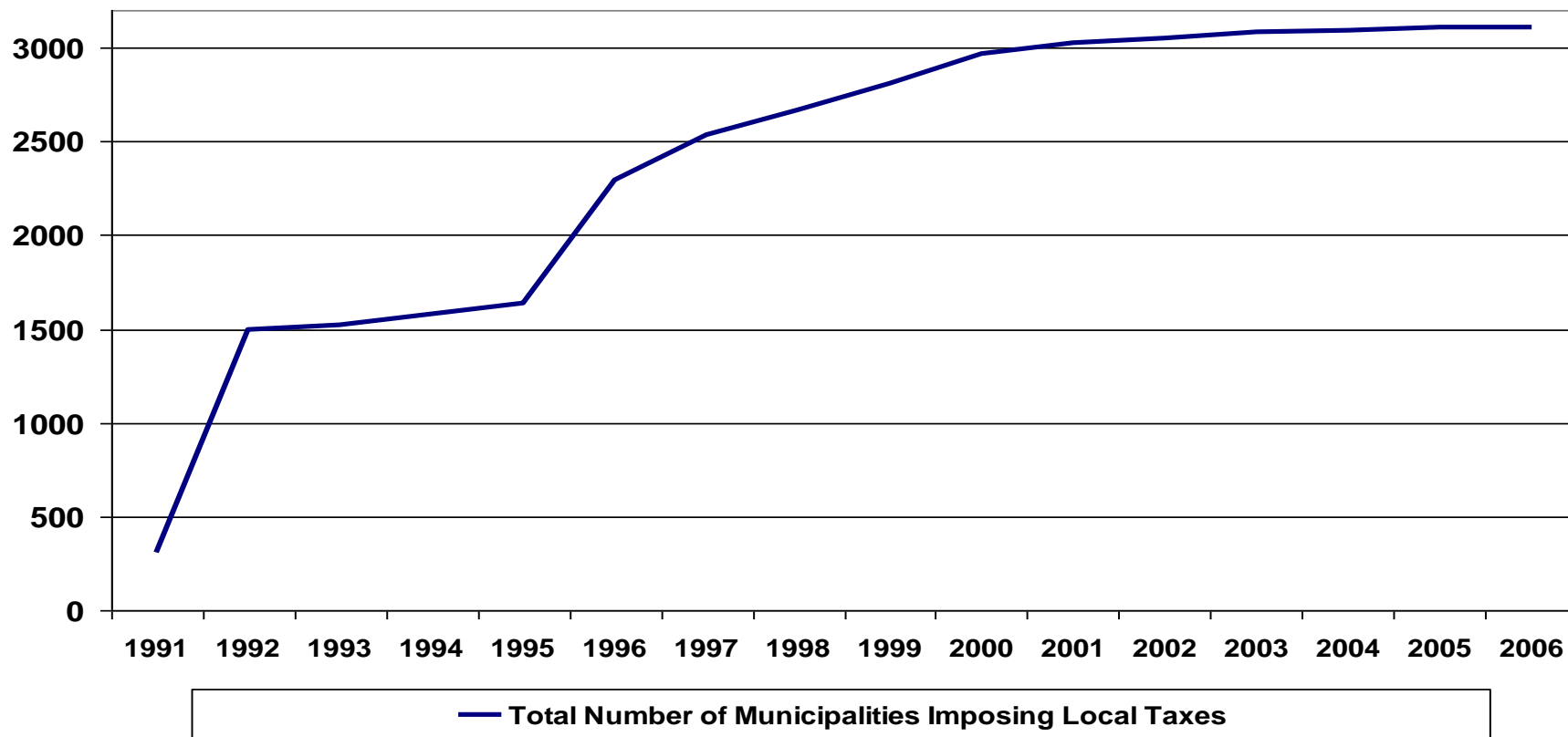
- ▶ There are numerous local taxes
 - Communal tax
 - Business turnover tax
 - Tax on tourism
 - Property tax

 - ▶ These are genuine local taxes.
- 

Share of the Total Own Revenues and Local Taxes in the Total Revenues of the Municipalities, 1991-2004



Total Number of Municipalities Imposing Local Tax, 1991-2006



Source: Jókay, 2007

Borrowing in Hungarian Municipalities

- ▶ Central control over borrowing
- ▶ Short term borrowing is possible
- ▶ Bank loans fall under the law, bonds do not

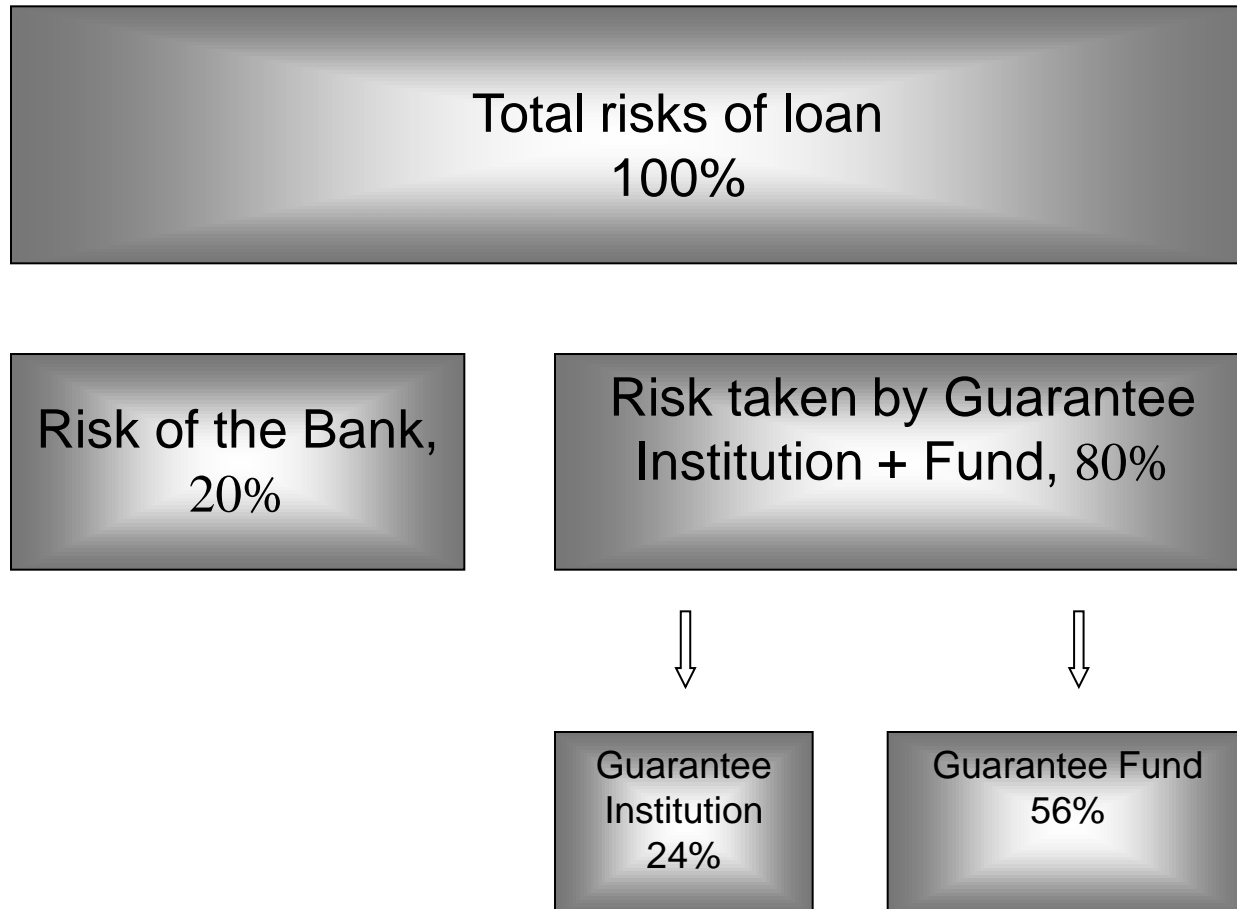


- ▶ Moral hazard

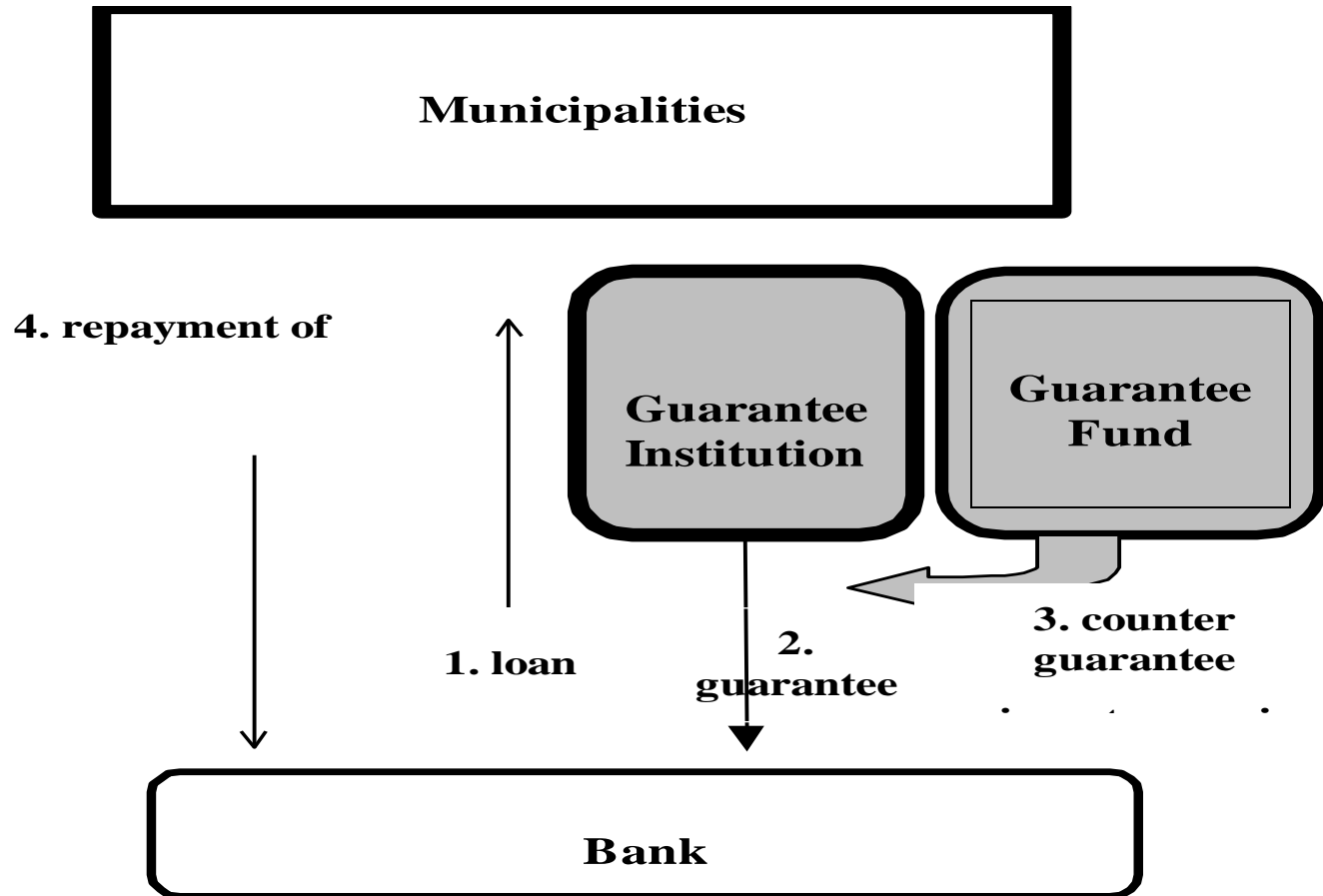


- ▶ Studies about guarantee system

Risk sharing in the guarantee system




The process of risk allocation in the Municipal Guarantee System



The services offered by the guarantee institutions

- ▶ **Guarantee institutions**
 - Guarantees
 - Consulting
 - Credit rating
 - International loans
 - Offering loans and issuing bonds
 - Fees for services
- ▶ **State guarantee fund**
 - Only services

Lessons learnt

- ▶ Municipal responsibilities should meet financial capacities
 - ▶ Controlled local borrowing, avoid moral hazard
 - ▶ Local tax mix, independent income sources
 - ▶ Murphy's law: If anything can go wrong, it will!
 - If the state has the chance to interfere with local income, it will!
 - ▶ Municipal service provision is not equal to producing a service (involvement of the private sector)
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2010 survey results

