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A Systemic Approach to the Local Government System

SUMMARY: The Hungarian system of local governments is an important part of the public finance system. The share of the local government system within general government spending was around 20% in 2010 and is still 11–12% following the recent reallocation of responsibilities. From 2012 to date, fundamental changes have been made to the system of local governments operating since 1990. This paper does not seek either to evaluate the changes or to make comparisons of any kind between the new system of local governments and the former system. Although a vast majority of the changes have been implemented on the basis of recommendations over which there was consensus among experts, the time that has elapsed since the adoption of the new Local Government Act is not sufficient for a comprehensive evaluation. In this paper, I am making an attempt to outline a framework that could be suitable for an analysis of the changes. I will be highlighting four of the components constituting the local government system: the responsibilities of local governments, the funding system, the regulatory environment setting out the operating framework of the system, and the organisational system. My experience suggests these components to be the most relevant in discussing the system of local governments as a public finance system. These system components are highly interdependent, and their movements are aligned. Consequently, any proposal for change will only be meaningful with this interdependence in mind. I will be elaborating on the matter at hand primarily in a public finance approach, merely touching upon the legal context of the system.

KEYWORDS: local government system, public finance system

JEL CODE: H30, H70, H72

RESPONSIBILITIES

In modern market economies, state functions are generally performed at two or more levels of government. The level of local government plays a significant role in the provision and prioritisation of collective assets, and in the organisation of public services. Self-government is manifested in local governments' autonomy to make decisions, subject to constitutional arrangements, on organising the performance of their responsibilities.

Local governments' weight carried in the

performance of public functions within public finances may be described from two aspects:

- the weight of local governments within public finances, and
- the nature of the responsibilities performed by local governments.

In practice, two indicators are used to measure the weight of local governments within public finances. One indicator looks at the share of each subsystem within public finances as a percentage of total revenues or expenditures. The other indicator to judge the weight of state engagement may be one describing the internal structure of local government responsibilities.

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The weight of local governments within public finances, decentralisation of responsibilities

The weight carried by local governments within public finances varies considerably across modern market economies, expressing the level of decentralisation in each country. Fiscal decentralisation means that in respect of certain responsibilities, the state imposes a service obligation and confers decision-making powers on lower levels of government, while providing those levels with the required resources. The rest of this section presents an overview of the decentralisation of responsibilities, and the decentralisation of resources is described in the section on funding. The decentralisation of responsibilities and resources is generally the result of political deliberation and political decisions, which reflect the mechanism of the state and the ways of state participation.

In arrangements for fiscal decentralisation¹, consideration should be given to the benefits from the delegation of the given responsibility to a lower level of government, as well as any drawbacks this may involve.

The benefits of fiscal decentralisation discussed in the literature include the following:

- access to information available at the sub-central level enables maximum alignment of the intensity of service needs, and to a certain degree, of their quality requirements. This possibility may guarantee that the resources (public funds) delegated to the performance of responsibilities are utilised as efficiently as possible;
- the utilisation of limited funding resources may facilitate the requirement of efficiency, i.e. access to the widest range and best quality of services against scarce resources. Incentives are also provided for taking the opportunities for the expansion of resources available at the sub-central level;
- as regards the performance of responsibilities

and the provision of public services, processes become directly appreciable by and accountable to the citizens using the services, while the liability and performance of local decision-makers also become directly appreciable.

At the same time, there are drawbacks to decentralisation that should be considered in the allocation of responsibilities to various levels of government:

- there is a risk that in the performance of delegated responsibilities, the autonomous decisions made at the sub-central level are not necessarily aligned with the intentions previously expressed by the central level of government;
- the delegation of resources (subsidies and taxes) and responsibilities to the sub-central level may result in over-funding in certain cases, and a permanent shortage of resources in others, which, in the former case, will lead to wasteful financial management in the absence of prudence and, in the latter, to deteriorating service quality;
- the performance of responsibilities at the sub-central level does not always meet the requirement for economies of scale, which will obviously cause cost conditions to deteriorate and lead to unjustified extra costs;
- there is a serious hazard in cases where either under pressure or as a result of inefficient financial management, the sub-central level enters the path to indebtedness through credit options, with the consequences of risk taking borne by creditors (banks and suppliers) or by the central budget.

Decentralisation is still a core issue in judgments over the functioning of local government systems and in reforms of the systems already in place. There have also been unrealistic expectations relating to the wave of decentralisation emerging in welfare states in the 1970s and 1980s. Based on the lessons learned, perhaps today we have more solid grounds than

previously to judge its significance in the performance of state responsibilities. In particular, experience shows that the benefits of decentralisation are not realised automatically, and that the combination of benefits and drawbacks varies greatly across countries. This diversity is reflected in the fact that in modern economies, the allocation of responsibilities to various levels of government involves alternating decentralisation and centralisation processes according to the state policy on how responsibilities should be allocated.

The OECD has produced a number of analyses and studies to evaluate the lessons learned from the decentralisation processes that took place in member countries, which could make useful and valuable contributions to studies on the decentralisation of responsibilities in Hungary. As fiscal decentralisation involves the simultaneous decentralisation of responsibilities and resources, decentralisation is usually measured by taking both into account. Although literature has not defined exact indicators to measure the degree of decentralisation, a number of practical indicators that offer a good approximation have been recommended for the purposes of judging the processes and comparing specific countries through their application.

In the OECD's practice, the following indicators are applied (OECD, 2013c):

- the ratio of sub-central to general government spending (spending decentralisation or decentralisation of responsibilities);
- the ratio of sub-central own revenue to general government revenue (revenue decentralisation);
- the ratio of sub-central tax revenue to general government tax revenue (tax revenue decentralisation);
- the ratio of local taxes (subject to sub-central decision-making) to general government tax revenue (tax autonomy).

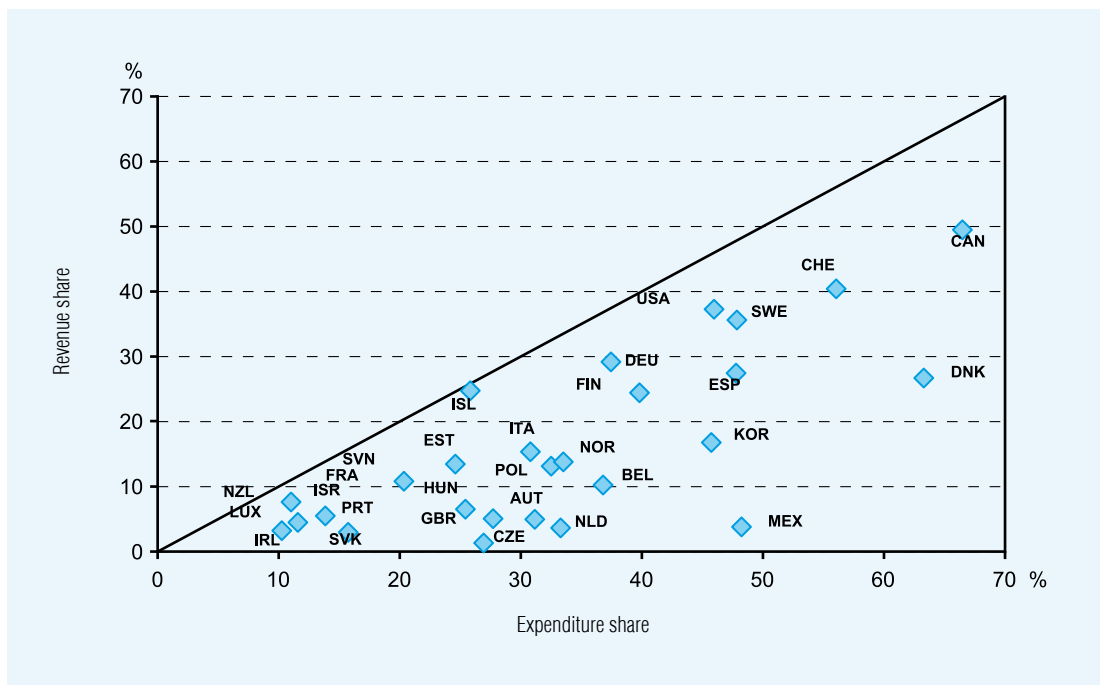
In connection with these indicators, it should

be noted that analysis should take into account their limits as they are suitable to represent tendencies only. Let us consider the indicator of spending decentralisation, for example. Indeed, a higher value of the indicator does suggest greater participation of the sub-central level in the performance of public functions, and as such, it also implies a great degree of local autonomy. However, the diversity in the distribution of tasks among various levels of government allows, for instance, the responsibilities performed at the sub-central level to be determined centrally through a variety of regulations. Consequently, in such a case the high degree of decentralisation represented by the indicator will not imply a corresponding autonomy in sub-central decision-making. Similarly, a high value of the tax autonomy indicator, while significantly affecting autonomy at the sub-central level, will not be accompanied by strong sub-central autonomy where limits are imposed centrally on the base or rates of local taxes.

Over the past 15 years, the trend of decentralisation has been apparent in all OECD countries, but the extent of decentralisation varies considerably. *Table 1* shows data for some countries on the extent of decentralisation described as the ratio of sub-central spending to general government spending. The horizontal axis represents the ratio of spending to general government expenditure (decentralisation of responsibilities), whereas the vertical axis represents the share in general government revenues of the revenues decentralised to local governments, primarily taxes (revenue decentralisation). Apparently, in all countries the extent of decentralisation is greater for spending than revenues. The resulting vertical imbalance is corrected by public grants – in an “ideal” case, the countries would be positioned on the 45-degree straight line (*see Chart 1*).

OECD-wide, the sub-central spending share averaged around 31% in 2010 (OECD, 2013c). The average represents a variety of val-

DECENTRALISATION IN OECD COUNTRIES, 2011



Source: OECD, 2013c

ues ranging from Ireland’s lowest at 11% to Canada’s highest at 66%. Also taking the process into account, it may be argued that in nearly all countries, responsibilities have increasingly been delegated to the sub-central level, or more generally, to lower government levels. Based on the evaluation of findings, research by the OECD has also concluded that the impact of decentralisation, expressed for example by service quality or consumer satisfaction, cannot be judged solely against the degree of decentralisation, only by taking into account the funding principles accompanying it. In most OECD countries, the decentralisation of educational responsibilities is a matter of priority. The role of the local government level is important as 58% of all public education spending is absorbed at that level. On a related note, in a remarkable analysis using mathematical and statistical methodology, OECD experts have

demonstrated that the decentralisation of public education responsibilities tends to be more beneficial if the effectiveness of decentralisation is viewed from the perspective of PISA² performance (OECD, 2013c).

The role of local governments in the performance of public functions may be examined at the macro level according to the structure of the responsibilities performed locally. Arguably, in view of the functional classification of government responsibilities, in OECD countries the sub-central level plays a key role in the performance of public functions. This is primarily shown by the fact that core public services (education, healthcare and social services) make up approximately 50% of sub-central spending. In 2010, based on the average composition of spending, the following responsibilities were performed by lower government levels in OECD countries.

Table 1

COMPOSITION OF SUB-CENTRAL SPENDING IN OECD COUNTRIES, 2010

Denomination	%
Education	24
Healthcare	10
Social services	16
Economic affairs	14
Other (environment, housing, public order, recreation)	36
Total	100

Source:OECD

The decentralisation of educational responsibilities varies considerably. In 2010, the share of lower government levels in public education spending was close to 60%. Hidden behind the average, one extreme is Belgium, where 100% of educational spending is decentralised to regional government. The opposite solution has been adopted for example in Greece and New Zealand, where education is fully centralised. There are a number of countries where the share of lower government levels in educational spending approximates 90% (Spain, Germany, Canada, Switzerland, United States) (OECD, 2013b).

Similar variations are observed in the performance of healthcare responsibilities. The lower government levels have a 30% share in healthcare spending. In the United Kingdom and New Zealand, healthcare is fully centralised, while in Spain, Italy, Sweden and Switzerland, the lower government levels have shares of approximately 90%.

Changing responsibilities in the Hungarian system of local governments

The Local Government Act³ of 2011 introduced one of the most significant changes to the Hungarian system of local governments with respect to responsibilities. In accordance

with the classification introduced above, one change is a fundamental shift in state and local government participation in performing the responsibilities of education (primary and secondary education) and healthcare (services excluding the maintenance of clinics requiring specialist care). Previously being local governments’ mandatory responsibilities and amounting to a large part of their expenditures, the responsibilities of education and healthcare have been re-centralised. In terms of public finance, the change at the macro-economic level is most prominently shown by the fact that centralisation has brought about a change in the weight of the local government system within public finances, i.e. there has been a shift (in this case, a reduction) in the degree of decentralisation, which has narrowed the scope of local governments’ mandatory responsibilities.

The change in macro-economic weight of local governments is illustrated by the two tables below. *Table 2* shows the changes in the macro-structure of revenues and *Table 3* in that of expenditures, highlighting the changes brought about by the enactment of the new Local Government Act.

At the macro level, changes in the responsibilities of local governments can be described by the changes in their spending composition as shown in *Table 4*.

Table 2

THE WEIGHT OF LOCAL GOVERNMENTS WITHIN PUBLIC FINANCES						
(macro-structure of revenues, %)						
	2009	2010	2011	2012	2013	2014, plan
Total revenues in the central subsystem of public finances	80.5	80.2	79.9	83.7	87.1	86.8
Total revenues in the subsystem of local governments within public finances	19.5	19.8	20.1	16.3	12.9	13.2
Public finances total	100	100	1000	100	100	100

Source: Ministry for National Economy of Hungary

Table 3

THE WEIGHT OF LOCAL GOVERNMENTS WITHIN PUBLIC FINANCES						
(macro-structure of expenditures, %)						
	2009	2010	2011	2012	2013	2014, plan
Total expenditures in the central subsystem of public finances	81.2	80.5	82.4	84.7	88.2	87.6
Total expenditures in the subsystem of local governments within public finances	18.8	19.5	17.6	15.3	11.8	12.4
Public finances total	100	1000	100	100	100	100

Source: Ministry for National Economy of Hungary

Table 4

COMPOSITION OF LOCAL GOVERNMENT EXPENDITURES					
(by function, %)					
	2009	2011	2012	2013	2014, plan
Public operating expenditures	18.1	14.5	13.8	17.3	16.9
Welfare functions	68.9	67.8	65.8	56.1	59.3
• education	27.8	26.8	28.6	13.6	18.0
• healthcare	12.5	12.1	3.5	2.6	4.5
• social security and social services	13.0	14.6	16.2	23.2	17.3
• housing and community amenities	10.8	8.7	11.8	14.6	12.3
• culture, recreation and religion	5.0	5.6	5.7	7.1	7.2
Economic functions	11.1	15.4	16.9	24.2	22.1
Items not elsewhere classified	1.9	2.3	3.5	2.4	1.7
Total consolidated functional expenditures	100	100	100	100	100

Source: Ministry for National Economy of Hungary

Table 5

COMPOSITION OF WELFARE SERVICES, %					
	2009	2011	2012	2013	2014, plan
Education	40.3	39.5	43.5	24.3	30.3
Healthcare	18.0	17.9	5.3	4.7	7.7
Social security and social services	18.9	21.6	24.6	32.2	29.2
Housing and community amenities	15.6	12.8	17.9	26.1	20.6
Culture, recreation and religion	7.2	8.2	8.7	12.7	12.2
Total	100	100	100	100	100

Source: Ministry for National Economy of Hungary

Further details of the changes are shown in *Table 5*, which illustrates rearrangements within welfare services, amounting to about two-thirds of local government spending. Clearly, spending on education and healthcare has been reduced significantly, coupled with an increased share of spending on social services and economic affairs.

In addition to the structural changes observed at the macro level, the enactment of the new Local Government Act has introduced further amendments to the local government system in terms of responsibilities:

- a vast majority of the responsibilities previously performed by county governments are being withdrawn, and in the future, county governments will be primarily responsible for regional development;
- the regulatory environment of voluntary engagement is becoming tighter;
- the introduction of a differentiated allocation of responsibilities is a logical answer to previous technical recommendations.

FUNDING SYSTEM

In a systemic approach, the decentralisation of responsibilities should be followed by the decentralisation of funding resources. Two

key questions concerning the allocation of resources among government levels are the following:

- What resources should be decentralised to a lower government level, in this case to local governments?
- What logic (principles) should be followed in channelling public grants to local governments?

Modern economies are generally comprised of multiple levels where responsibilities and resources are decentralised. The funding system is determined by the following:

- What are the financial means of decentralisation?
- What degree of autonomy is granted for sub-central decision-making on resources?
- What budgetary restrictions are imposed?
- What links exist with money and capital markets?

The answers to these questions could be the subject of a textbook. This paper only addresses the means of funding and the principles of allocation in order to relate to international trends and the changes taking place in Hungary.

In most countries, sub-central funding resources include the following:

- *Tax financing*, comprising the local taxes that may be imposed and collected sub-

centrally, and the allocation of central taxes between the central and sub-central levels.

- *Public grants and contributions.* This support is provided to ensure vertical and horizontal balance. Vertical balance is achieved essentially by contributions to the performance of delegated mandatory responsibilities, while horizontal balance is achieved by adjusting the differences between local governments in terms of revenues and capacities. Contributions are also used to facilitate development.

- *Credit funds.*

As regards the allocation of public contributions, two principles have evolved. One is expenditure-oriented regulation, which assumes public contributions and the expenditure needs of the local government to be given, and allocates grants to these. In this case, grants are normally earmarked. The local government has a vested interest in being awarded the highest grant amount possible, but has no incentive for tight cost management.

In the resource-oriented system of the other principle, public grants are non-earmarked, the revenues available are regulated by the local government itself, which determines its expenditures by taking into account its own local revenues as well.

In any given country, the funding system of local governments is determined by a combination of instruments, the logic of allocating public grants, the system of responsibilities to be performed, and the method of state participation. There are no clean models.

Funding trends in OECD countries

In OECD countries, the impact of the 2007–2008 crisis was also felt sub-nationally, although papers suggest that the impact was less severe than on central government. In the

Public Finance Quarterly, *Péter Halmosi* published a very thorough analysis of the effect of the economic crisis on local governments in OECD countries (Halmosi, 2013). In accordance with the subject of that article, below I am attempting to provide a summary of the responses given by OECD countries in the area of local government funding in the period of crisis and consolidation.

Overall, it may be argued that the funding system of local governments in OECD countries is relatively stable, and that funding instruments have been in place for years. The processes induced by the crisis aim for two distinct objectives. One is the implementation of reforms that refine the funding system (local taxes, grant system), while reinforcing fiscal sustainability (fiscal rules, regulation of borrowing).

Local taxes play a significant role in most OECD countries. The extended application of property taxes and a wider scope of user charges are virtually permanent items on the local taxation agenda. One question of local tax reforms is how to improve the relationship between specific local tax categories and the services used. The harmonisation of local and central taxes is considered a similar reform measure.

Grants are key instruments in funding lower government levels as OECD-wide an average 50% of revenues at those levels come from grants. Over the past two decades, the size of grants has increased steadily. This is because although the decentralisation of responsibilities has been continuous, it has not been followed by the decentralisation of resources such as taxes. As regards grants, the ratio of earmarked and non-earmarked grants to the total volume of grants is a constantly debated issue. OECD countries have shifted towards an increased ratio of non-earmarked grants. In the United Kingdom, for example, local governments have been given unprecedented free-

doms and flexibilities over budgets (OECD, 2013b). Earmarking was abandoned, except for school grants and protected public health grants, and the number of grants has also been reduced from more than 90 to less than 10, and streamlined into general-purpose grants.

At the lower government levels, including local governments, the application of fiscal rules has been part of budgeting since the early 2000s as fiscal discipline gained prominence in OECD countries. The rules have been applied in pursuit of well-known objectives:

- ensuring financial sustainability in the long term;
- achieving stability in financial management;
- improving efficiency at the level of local governments.

Most OECD countries apply at least one of the fiscal rules. The rules that have evolved over the past years fall into the following main types:⁴

- *Budget balance rule* – as it generally requires a balanced budget for current spending, it is commonly referred to as the balanced budget rule and often as the “golden rule” of fiscal policy.
- *Borrowing and debt rule* – a rule concerning borrowing and restrictions on total debt. The regulation of borrowing will be explained in more detail below.

- *Tax limit* – it is used to regulate the maximum tax rate applied and the tax base taken into account for the purpose of sub-national tax assignment.

- *Spending limit* – limits imposed explicitly on specific items of spending, or linked to a single or a combination of indicators.

Table 6 illustrates the types of fiscal rules applied by local governments in some countries.

As can be seen from the table, budgetary restrictions are applied by all of the countries, which reflects the need for stronger fiscal discipline and the requirement of tighter restrictions. Obviously, every rule is worth as much as it is observed in practice. During the 2008 economic crisis and subsequent consolidation, OECD countries displayed a marked tendency to enforce compliance with fiscal rules and to align the rules to local conditions, predominantly on strict terms. There was a general tendency to impose sanctions in the event of non-compliance with the rules (Italy, Spain) (OECD, 2013b). Let us consider the example of Austria. In Austria, a new law passed in 2012, stipulating that all levels of government must reach a balanced budget in 2016, then from 2017 onwards a structural balance rule must be implemented. The new rules also include a debt criterion, according to which all levels of government must reduce their level of

Table 6

FISCAL RULES APPLIED IN SOME COUNTRIES (2011)

Country	Budget	Spending	Taxation	Borrowing
Czech Republic	x		x	
Denmark	x	x	x	x
Poland	x			x
Slovakia	x			x
Slovenia	x		x	x
Finland	x		x	

Source: OECD, 2013d

debt, and Austria's debt should pass from 75% of GDP in 2013 to 60% in 2016.

In the regulation of lending, the rules that may be applied to restrict borrowing had previously been established. The models of borrowing restrictions are summarised in an excellent article by *Gábor Kecő* (Kecő, 2013b). In order to relate to Hungarian regulation, below is a list of the model types known in literature:

- model based on market discipline;
- model based on cooperation;
- model based on normative rules;
- model based on government approval.

Each is used in the practice of OECD countries. Their use attracted more attention following the accumulation of huge debts during the crisis. Today, the rules are applied to prevent another wave of indebtedness.

Changes in Hungarian local government funding

The following highlights are included here to illustrate the changes in the funding principles of the Hungarian local government system.

① In parallel with the reallocation of responsibilities, the composition of local governments' resources also changed. The most significant changes are the withdrawal of the personal income tax from the resources, and the reduction in public contributions and grants. In 2013, public contributions were reduced to 68% of the 2012 amount. At the same time, local tax revenues continued to rise in line with the tendency of previous years. Another change in funding is that the law requires public contributions to be implemented based on the principle of task financing. The size of public contributions is determined by taking into account the fiscal capacity of the municipality concerned, and contributions have become earmarked. In terms of its

approach, this funding principle is more akin to expenditure-oriented funding. Changes in the composition of local governments' resources are illustrated by *Table 7*.

② Two strong features in the changes to the funding system are tighter budgetary restrictions and new regulations on borrowing to control indebtedness.

Tighter budgetary restrictions are imposed to replace the previously experienced loose fiscal discipline with responsible fiscal management in the local government system as well. With a view to tightening budgetary restrictions, the Local Government Act very clearly stipulates that no operating deficit may be provided for in any budget decree.⁵ Additionally, the Local Government Act provides that a local government is responsible for its own financial management. The consequences of losses incurred from a local government's financial management are borne by the local government concerned, without any central budget coverage for its liabilities. In all probability, the preclusion of bailouts will compel both local governments and their creditors and suppliers to make responsible financial management decisions.

In financial terms, changes to the funding system are aimed at curbing indebtedness and controlling debt. Rather than the third group of borrowing models (normative regulation) mentioned previously, the new regulations on local government borrowing use a solution belonging to the fourth model, that is based on government approval.⁶ Effective as of 1 January 2012, the Act requires that, except as provided for in the Act, local governments obtain prior government approval on entering commitments that give rise to debt. Definitely stricter than previous regulations, this requirement was probably introduced with the intention to enable the government to adopt specific decisions based on past experience that influence local government debt, which is a

Table 7

BUDGET BALANCE OF LOCAL GOVERNMENTS						
REVENUES	2008	2009	2010	2011	2012	2013
	satisfaction	satisfaction	satisfaction	satisfaction	satisfaction	satisfaction
Own current revenues	1,018,262.7	1,058,056.7	1,027,285.7	1,035,219.0	999,133.7	986,953.6
<i>Of which: Local taxes</i>	<i>553,341.6</i>	<i>566,251.5</i>	<i>542,585.8</i>	<i>566,625.2</i>	<i>605,761.1</i>	<i>644,589.5</i>
<i>Excise</i>	<i>67,314.0</i>	<i>58,370.5</i>	<i>39,247.9</i>	<i>35,026.2</i>	<i>12,146.1</i>	<i>0.0</i>
Assigned revenues	180,252.5	193,759.7	207,145.0	198,645.7	183,893.0	28,144.1
<i>Of which: Personal income tax</i>	<i>114,215.7</i>	<i>129,870.0</i>	<i>135,888.5</i>	<i>126,426.2</i>	<i>113,117.4</i>	<i>0.0</i>
Operating grants received	430,592.2	389,751.3	426,595.6	440,358.2	198,596.6	206,946.5
<i>Of which: Funds transferred from the Health Insurance Fund</i>	<i>366,641.3</i>	<i>317,445.7</i>	<i>330,647.7</i>	<i>317,470.0</i>	<i>64,168.6</i>	<i>42,581.4</i>
Own non-operating and capital revenues	136,706.5	75,929.9	57,177.3	60,195.7	48,091.6	81,144.8
Non-operating grants received including EU grants	140,041.2	160,211.4	250,023.4	286,329.1	260,020.2	379,163.8
Non-operating revenues outside public finances	28,509.5	40,674.6	48,667.3	75,194.3	34,035.7	25,788.3
Public contributions and grants	1,307,500.3	1,178,581.9	1,123,498.0	1,203,905.9	1,035,737.9	711,106.7
Operating revenues outside public finances, recovery on loans, temporary funds, settlement of core and business operations	26,847.0	29,389.3	33,096.8	32,122.3	38,445.3	29,038.6
Total revenues excluding credit and security transactions	3,268,711.9	3,126,354.8	3,173,489.1	3,331,970.2	2,797,954.0	2,448,286.4
Revenues from credit and security transactions	763,984.4	562,287.9	557,088.6	461,345.9	427,182.7	355,994.7
Total revenues in current year	4,032,696.3	3,688,642.7	3,730,577.7	3,793,316.1	3,225,136.7	2,804,281.1
Public grants and personal income tax joint total:	1,421,716.0	1,308,451.9	1,259,386.5	1,330,332.1	1,148,855.3	711,106.7

Source: Ministry for National Economy of Hungary

part of the government sector. For such commitments, the government requires joint satisfaction of a set of predefined criteria:

- the development creates or increases the capacity required for the performance of a mandatory responsibility provided for by law;
- payment obligations are restricted by the local government's own revenues so that

in any year during its term, the obligation is capped at 50% of own revenues for the year concerned;

- the local government introduces the local business tax, or some type of property tax, or the communal tax on individuals;
- even with the approval granted, the debt of the subsystem of local governments as specified in the Budget Act remains viable.

REGULATORY ENVIRONMENT

The regulatory environment is included among the system components for the sake of completeness, but is not discussed in detail. In this context, the environment is comprised of the regulations setting out the framework of the system, usually at a high level. Among these, the following are of particular importance:

- Fundamental Law;
- Local Government Act;
- Act on Public Finances.

ORGANISATIONAL SYSTEM

In organisational terms, local government systems are commonly described by taking into account the number of local governments, the number of residents per local government, and the institutional system in which responsibilities are performed. These features are extremely varied across OECD countries and EU Member States. The configuration of local government systems and the structure of government levels evolved as a result of a great number of factors, most prominently including the historical development of the country concerned, the type of state (centralised or federal), and regulations on government participation.

Based on joint assessments against a variety of criteria, literature commonly distinguishes different local government models. Accordingly, we have the Rhenish model, the Mediterranean model, the Scandinavian model and the Anglo-Saxon model. Since an explanation of these models is beyond the scope of this paper, the reader is referred to their excellent description and evaluation in Vigvári (2011). As regards organisational matters, suffice it to point out that whatever model is considered, there is great diversity in terms of both the number and size of local governments. Arguably, countries belonging to the Mediterranean model typical-

ly have fragmented local government systems, while the countries of the Scandinavian model are characterised by large units of local government. To illustrate this point, *Table 8* presents data on a few countries representing each model of local government, highlighting the major differences in local government sizes.

A systemic approach to the analysis of local government systems should capture the integration of local governments as a general tendency in developed countries from the 1960s onwards. Integration has taken place in various ways ranging from the promotion of associations (France) through municipal mergers (Germany) to increasing the size of local government units (Denmark). Attention should also be paid to contemporary processes. Consolidation following the economic crisis also involved further integration. In Greece, for example, the 1,034 local governments shown in the table were reduced to 325 in 2010. Ireland has also announced municipal mergers starting in 2014. Launched in 2010, the scope of France's territorial reform includes the local government system (OECD, 2013b).

In terms of the number of local governments (see *Table 9*), the organisational structure of the Hungarian local government system had long been the subject of a debate on the efficiency deficit resulting from a fragmented organisational form accompanied by broad autonomy in the performance of responsibilities. As opposed to the changes introduced in the field of funding, no material changes were made by the new Local Government Act to the organisational system of local governments.

A reference is appropriate to the point made in the introduction that the movements of the system components need to be aligned. At this point, it is difficult to judge the risks inherent in the co-existence of an unchanged organisational system and a modified system of responsibilities and funding. Nevertheless, the

Table 8

NUMBER AND AVERAGE POPULATION OF LOCAL GOVERNMENTS (2010)		
Country	Number of local governments	Residents per local government
France	36,683	1,720
Hungary	3,175	3,170
Greece	1,034	10,750
Poland	2,478	15,390
Denmark	98	55,840
Great Britain	434	139,480

Source: Vigvári, 2011

Table 9

ENTITIES OF THE HUNGARIAN LOCAL GOVERNMENT SYSTEM UNDER THE LOCAL GOVERNMENT ACT IN 2013	
Type	Number
Municipality of Budapest	1
Capital district	23
Town with county rank	23
County government	19
Borough seat	175
Town	129
Large village	119
Village	2,707
Total	3,196

Source: Sivák – Szemlér – Vigvári (2013), p. 161.

risk is mitigated by the fact that a significantly smaller number of responsibilities need to be performed within the same “plant size”, that responsibilities are assigned in a differentiated manner by taking into account the specificities of the various types of local government, and that local governments have been placed under pressure to form associations in order to perform their responsibilities.

An international outlook also presents a varied picture in terms of the institutional systems maintained by local government systems. The Mediterranean and Rhenish mod-

els are generally characterised by an extensive network of institutions. In the spirit of new public management, local governments of the Anglo-Saxon type tend to outsource responsibilities and perform them in a market approach, as a result of which their network of institutions is relatively small.

Table 10 shows the institutional system established following the enactment of the new Local Government Act.

The institutional system is very frequently judged by the number of institutions. In themselves, the figures shown in the table reveal lit-

Table 10

NUMBER OF BUDGETARY INSTITUTIONS IN THE LOCAL GOVERNMENT SYSTEM		
Type of budgetary institution	End of 2010	End of 2013
Independent local government offices	1,130	545
<i>Of which: County local government offices</i>	19	19
Number of regional clerk's offices	768	
Number of joint local government offices		749
Local budgetary institution*	6,146	4,469
Budgetary institution of a legal entity	18	737
Budgetary institution of a multi-purpose micro-regional association		94
Local minority budgetary institution		9
Total	8,062	6,603

*Note: In 2013 (as of 2012), mayor's offices/local government offices would feature here as budgetary institutions 'separately' from the local governments, but for the sake of comparability, independent offices and joint offices are featured in separate lines; and in 2010 (up until 2011), minority local government institutions and institutions of multi-purpose micro-regional associations are found in the data of this line.

Source: NGM

tle about the chances that the quality of local public services will improve in the face of an essentially unchanged institutional system of local governments. In addressing operational efficiency and service quality, it should be remembered that everything is decided within the institutions. In essence, the recent reform on local governments has brought no changes in the part of the institutional system that remained with local governments with the existing capacities. In my view, the long-term success of the reform will largely depend on how local governments can utilise institutional capacities, and how they can involve local NGOs and businesses in funding and in capacity building and utilisation.

SUMMARY

Reforms on our local government system were launched only three years ago. It is a commonly held view among experts and researchers working in the field of local government that reforms on the system should be conceived of as a process that requires the most thorough analyses possible to make progress. The systemic approach proposed in this paper argues that in further refining the local government system, account should be taken of the aligned movements of responsibilities, the funding system, the organisational system and the regulatory environment.

NOTES

¹ There's an extensive body of literature on the theoretical background of fiscal decentralisation. For a brief summary of its substance, see Sivák – Vigvári (2012), pp. 171–176.

² Program for International Student Assessment. An international program initiated and conducted by the OECD to assess the skills of 15-year-old students every three years.

³ Act CLXXXIX of 2011 on the Local Governments of Hungary

⁴ For a detailed discussion of fiscal rules, see Sivák – Szemlér – Vigvári (2013), Chapter 6.

⁵ Local Government Act, Article 111(4)

⁶ Act CXCIV of 2011 on the Economic Stability of Hungary, Article 10.

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